

EFC BANCORP INC  
Form 10-Q  
November 12, 2004

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

WASHINGTON, D.C. 20549

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended September 30, 2004

or

☐ **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 1-13605

**EFC BANCORP, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of incorporation or organization)

**1695 Larkin Avenue, Elgin, Illinois**  
(Address of principal executive offices)

**36-4193304**  
(I.R.S. Employer Identification No.)

**60123**  
(Zip Code)

**(847) 741-3900**

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(Registrant's telephone number, including area code)

**Not Applicable**

(Former name, former address and former fiscal year, if changed since last report)

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

days. Yes ☒ No ☐

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12(b)-2 of the Exchange

Act). Yes ☐ No ☒

**APPLICABLE ONLY TO CORPORATE ISSUERS:**

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 4,697,703 shares of common stock, par value \$0.01 per share, were outstanding as of November 10, 2004.

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EFC Bancorp, Inc.

Form 10-Q

For the Quarter Ended September 30, 2004

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**PART I. FINANCIAL INFORMATION****EFC BANCORP, INC.**

## Item 1. Financial Statements.

**EFC BANCORP, INC.****AND SUBSIDIARIES**

## Consolidated Balance Sheets (unaudited)

September 30, 2004 and December 31, 2003

|  | September 30,  | December 31, |
|--|----------------|--------------|
| Assets   | 2004           | 2003         |
| Cash and cash equivalents:   |                |              |
| On hand and in banks   | \$ 5,783,274   | 5,449,261    |
| Interest bearing deposits with financial institutions  | 27,841,452     | 16,426,727   |
| Total cash and cash equivalents  | 33,624,726     | 21,875,988   |
| Loans receivable, net  | 794,014,980    | 716,883,910  |
| Mortgage-backed securities available-for-sale, at fair value                                   | 10,877,623     | 10,164,501   |
| Investment securities available-for-sale, at fair value  | 96,176,496     | 90,656,208   |
| Stock in Federal Home Loan Bank of Chicago, at cost  | 11,766,100     | 10,877,600   |
| Accrued interest receivable  | 4,312,539      | 4,009,280    |
| Office properties and equipment, net   | 23,732,431     | 17,672,562   |
| Real estate held for development   | 4,920,696      | 4,189,637    |
| Bank owned life insurance  | 18,967,239     | 17,986,416   |
| Other assets   | 609,464        | 2,776,482    |
| Total assets   | \$ 999,002,294 | 897,092,584  |
| Liabilities and Stockholders' Equity   |                |              |
| Liabilities:   |                |              |
| Deposits   | \$ 672,660,124 | 596,763,807  |
| Borrowed money   | 232,000,000    | 211,788,751  |
| Accrued expenses, income taxes payable and other liabilities                                   | 11,161,190     | 10,294,740   |
| Total liabilities  | 915,821,314    | 818,847,298  |
| Minority interest  |                | (158,666)    |
| Stockholders' Equity:  |                |              |
| Preferred stock, par value \$.01 per share, authorized 2,000,000 shares; no shares issued      |                |              |
| Common stock, par value \$.01 per share, authorized 25,000,000 shares; issued 7,491,434 shares | 74,914         | 74,914       |
| Additional paid-in capital   | 72,886,537     | 72,247,346   |
| Retained earnings, substantially restricted  | 49,451,163     | 46,681,729   |

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|   |                |              |
|---|----------------|--------------|
| Treasury stock, at cost, 2,801,731 and 2,898,763 shares at September 30, 2004 and December 31, 2003, respectively                   | (34,741,252)   | (35,598,664) |
| Unearned employee stock ownership plan (ESOP), 329,624 and 359,590 shares at September 30, 2004 and December 31, 2003, respectively | (4,928,715)    | (5,376,779)  |
| Unearned stock award plan, 3,776 and 6,026 shares at September 30, 2004 and December 31, 2003, respectively                         | (42,008)       | (67,039)     |
| Accumulated other comprehensive income  | 480,341        | 442,445      |
| Total stockholders' equity  | 83,180,980     | 78,403,952   |
| Commitments and contingencies   |                |              |
| Total liabilities and stockholders' equity  | \$ 999,002,294 | 897,092,584  |

See accompanying notes to consolidated financial statements.

**EFC BANCORP, INC.****AND SUBSIDIARIES**

## Consolidated Statements of Income (unaudited)

For the three and nine months ended September 30, 2004 and 2003

|  | Three months ended    |            | Nine months ended     |            |
|--|-----------------------|------------|-----------------------|------------|
|  | September 30,<br>2004 | 2003       | September 30,<br>2004 | 2003       |
| <b>Interest income:</b>  |                       |            |                       |            |
| Loans secured by real estate   | \$ 7,608,786          | 8,258,392  | 23,220,232            | 25,448,767 |
| Other loans  | 2,865,066             | 1,744,170  | 7,311,046             | 4,729,418  |
| Mortgage-backed securities available-for-sale  | 98,318                | 107,310    | 301,435               | 415,612    |
| Investment securities available-for-sale and interest bearing deposits with financial institutions | 1,266,227             | 1,202,610  | 3,685,013             | 3,717,910  |
| Total interest income  | 11,838,397            | 11,312,482 | 34,517,726            | 34,311,707 |
| <b>Interest expense:</b>   |                       |            |                       |            |
| Deposits   | 3,391,593             | 3,017,886  | 9,433,012             | 9,238,516  |
| Borrowed money   | 2,612,469             | 2,372,350  | 7,370,052             | 6,950,759  |
| Total interest expense   | 6,004,062             | 5,390,236  | 16,803,064            | 16,189,275 |
| Net interest income before provision for loan losses   | 5,834,335             | 5,922,246  | 17,714,662            | 18,122,432 |
| Provision for loan losses  | 210,000               | 140,000    | 550,000               | 463,250    |
| Net interest income after provision for loan losses  | 5,624,335             | 5,782,246  | 17,164,662            | 17,659,182 |
| <b>Noninterest income:</b>   |                       |            |                       |            |
| Service fees   | 795,295               | 572,810    | 2,080,527             | 1,555,618  |
| Insurance and brokerage commissions  | 151,396               | 136,292    | 493,325               | 250,322    |
| Information technology sales and service income, net   | 75,519                | 146,628    | 311,048               | 642,882    |
| Gain on sale of foreclosed real estate   |                       |            |                       | 41,315     |
| Gain on sale of office properties and equipment  |                       |            | 149,396               |            |
| Gain on sale of securities   |                       | 290,385    | 249,418               | 816,454    |
| Gain on sale of loans  | 16,348                |            | 277,972               | 156,223    |
| Bank owned life insurance  | 207,735               | 234,543    | 654,061               | 600,675    |
| Other  | 43,944                | 102,626    | 151,449               | 175,855    |
| Total noninterest income   | 1,290,237             | 1,483,284  | 4,367,196             | 4,239,344  |
| <b>Noninterest expense:</b>  |                       |            |                       |            |
| Compensation and benefits  | 2,713,958             | 2,740,615  | 8,336,106             | 8,062,139  |
| Office building, net   | 747,492               | 683,434    | 2,140,727             | 2,058,996  |
| Federal insurance premiums   | 23,125                | 21,669     | 68,528                | 66,055     |
| Advertising  | 250,712               | 160,877    | 761,724               | 594,003    |
| Data processing  | 285,555               | 220,938    | 860,877               | 704,934    |
| NOW/checking account expenses  | 189,290               | 177,093    | 460,247               | 432,866    |
| Other  | 1,125,105             | 561,355    | 2,444,359             | 1,852,196  |
| Total noninterest expense  | 5,335,237             | 4,565,981  | 15,072,568            | 13,771,189 |
| Income before income taxes and minority interest   | 1,579,335             | 2,699,549  | 6,459,290             | 8,127,337  |

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|                                 |              |           |           |           |
|---------------------------------|--------------|-----------|-----------|-----------|
| Income tax expense              | 350,856      | 889,286   | 1,728,192 | 2,766,221 |
| Income before minority interest | 1,228,479    | 1,810,263 | 4,731,098 | 5,361,116 |
| Minority interest               | (10,103)     | 10,615    |           | 81,265    |
| Net income                      | \$ 1,218,376 | 1,820,878 | 4,731,098 | 5,442,381 |
| Earnings per share:             |              |           |           |           |
| Basic                           | \$ 0.28      | 0.43      | 1.10      | 1.29      |
| Diluted                         | 0.27         | 0.41      | 1.04      | 1.22      |

See accompanying notes to consolidated financial statements.

**EFC BANCORP, INC.**
**AND SUBSIDIARIES**

## Consolidated Statements of Cash Flows (unaudited)

For the nine months ended September 30, 2004 and 2003

|  | 2004         | 2003          |
|--|--------------|---------------|
| Cash flows from operating activities:  |              |               |
| Net income   | \$ 4,731,098 | 5,442,381     |
| Adjustment to reconcile net income to net cash provided by operating activities: |              |               |
| Amortization of premiums and discounts, net                                      | 79,945       | 75,318        |
| Provision for loan losses  | 550,000      | 463,250       |
| FHLB of Chicago stock dividends  | (888,500)    | (568,000)     |
| Stock award plan shares allocated  | 25,031       | 381,843       |
| ESOP shares committed to be released   | 448,064      | 448,064       |
| Change in fair value of ESOP shares  | 639,191      | 132,887       |
| Depreciation of office properties and equipment                                  | 933,366      | 855,482       |
| Gain on sale of foreclosed real estate   |              | (41,315)      |
| Gain on sale of securities   | (249,418)    | (816,454)     |
| Gain on sale of loans receivable   | (277,972)    | (156,223)     |
| Change in minority interest in subsidiary  | 158,666      | (81,265)      |
| Increase in bank owned life insurance  | (555,823)    | (534,210)     |
| Decrease in accrued interest receivable and other assets, net                    | 1,837,399    | 40,294        |
| Increase in income taxes payable, accrued expenses and other liabilities, net    | 816,962      | 1,510,496     |
| Net cash provided by operating activities  | 8,248,009    | 7,152,548     |
| Cash flows from investing activities:  |              |               |
| Net increase in loans receivable   | (47,907,447) | (32,964,799)  |
| Purchases of loans receivable  | (70,023,873) | (83,263,883)  |
| Proceeds from the sale of loans receivable                                       | 40,528,222   | 12,894,951    |
| Increase in real estate held for development                                     | (731,059)    | (823,830)     |
| Purchases of mortgage-backed securities available-for-sale                       | (4,035,625)  | (2,549,222)   |
| Principal payments on mortgage-backed securities available-for-sale              | 3,231,485    | 5,738,497     |
| Maturities of investment securities available-for-sale                           | 23,331,922   | 25,465,274    |
| Purchases of investment securities available-for-sale                            | (32,276,933) | (42,909,565)  |
| Proceeds from the sale of investment securities                                  | 3,747,338    | 15,349,744    |
| Purchases of office properties and equipment                                     | (6,993,235)  | (1,334,060)   |
| Investment in bank owned life insurance  | (425,000)    | (5,000,000)   |
| Purchases of stock in the Federal Home Loan Bank of Chicago                      |              | (760,200)     |
| Proceeds from the sale of foreclosed real estate                                 |              | 2,027,057     |
| Net cash used in investing activities  | (91,554,205) | (108,130,036) |
| Cash flows from financing activities:  |              |               |
| Net increase in deposits   | 75,896,317   | 65,965,874    |
| Proceeds from borrowed money   | 119,000,785  | 91,070,325    |
| Repayments on borrowed money   | (98,789,536) | (61,051,470)  |
| Purchase of treasury stock   | (268,963)    | (2,514,270)   |
| Stock options exercised  | 1,126,375    | 545,178       |



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|  |               |             |
|--|---------------|-------------|
| Cash dividends paid  | (1,910,044)   | (1,761,869) |
| Net cash provided by financing activities                                  | 95,054,934    | 92,253,768  |
| Net increase/(decrease) in cash and cash equivalents                       | 11,748,738    | (8,723,720) |
| Cash and cash equivalents at beginning of period                           | 21,875,988    | 32,844,290  |
| Cash and cash equivalents at end of period                                 | \$ 33,624,726 | 24,120,570  |
| Supplemental disclosures of cash flow information:                         |               |             |
| Cash paid during the period for:   |               |             |
| Interest   | \$ 16,680,058 | 16,241,964  |
| Income taxes   | 2,005,000     | 2,340,000   |
| Noncash investing activities - transfer of loans to foreclosed real estate |               | 39,190      |

See accompanying notes to consolidated financial statements.

**EFC BANCORP, INC.**

**Notes to Unaudited Consolidated Financial Statements**

**Note 1: BASIS OF PRESENTATION**

The accompanying unaudited consolidated financial statements include the accounts of EFC Bancorp, Inc. (the Company), its wholly-owned subsidiary, EFS Bank (the Bank) and its wholly-owned subsidiary, EFS Service Corporation of Elgin. The accompanying unaudited consolidated financial statements also include the accounts of Computer Dynamics Group, Inc. (CDGI), the Company's formerly majority-owned subsidiary. The Company was informed in October 2004 of the bankruptcy filing of its minority partner in CDGI. Upon notification of the bankruptcy, as of September 30, 2004, the Company recorded its investment in CDGI as a wholly-owned subsidiary. Certain amounts for the prior period have been reclassified to conform to the current period presentation. The Company operates as a single segment.

In the opinion of the management of the Company, the accompanying consolidated financial statements include all normal recurring adjustments necessary for a fair presentation of the financial position and results of operations for the periods presented. All significant intercompany transactions have been eliminated in consolidation. These interim financial statements have been prepared according to the rules and regulations of the Securities and Exchange Commission and therefore certain information and footnote disclosures normally included in financial statements presented in accordance with U.S. generally accepted accounting principles have been condensed or omitted. The results of operations for the interim periods are not necessarily indicative of the results to be expected for the full year. It is suggested that the accompanying unaudited consolidated financial statements be read in conjunction with the Company's 2003 Annual Report on Form 10-K. Currently, other than investing in various securities, the Company does not directly transact any material business other than through the Bank. Accordingly, the discussion herein addresses the operations of the Company as they are conducted through the Bank.

Note 2: COMPREHENSIVE INCOME

The Company's comprehensive income for the three and nine month periods ended September 30, 2004 and 2003 are as follows:

|  | Three months ended |             | Nine months ended |           |
|--|--------------------|-------------|-------------------|-----------|
|  | September 30,      |             | September 30,     |           |
|  | 2004               | 2003        | 2004              | 2003      |
| Net income   | \$ 1,218,376       | 1,820,878   | \$ 4,731,098      | 5,442,381 |
| Other comprehensive income, net of tax:  |                    |             |                   |           |
| Unrealized holding gains/(losses) on securities arising during the period, net of tax effect       | 2,123,059          | (1,577,044) | 37,896            | (851,953) |
| Reclassification adjustment for net gain on sales of securities realized in net income, net of tax |                    | (182,943)   | (157,133)         | (514,366) |
| Comprehensive income   | \$ 3,341,435       | 60,891      | 4,611,861         | 4,076,062 |

There were no sales of securities for the three months ended September 30, 2004. For the nine month period ended September 30, 2004 the sale of securities resulted in a gain of \$249,418 (\$157,133 net of tax effect). For the three and nine month periods ended September 30, 2003 the sale of securities resulted in gains of \$290,385 and \$816,454, respectively (\$182,943 and \$514,366 net of tax effect).

Note 3: COMPUTATION OF PER SHARE EARNINGS

Basic earnings per share is calculated by dividing net income by the weighted average number of common shares outstanding. Diluted earnings per share is calculated by dividing net income by the weighted average number of common shares outstanding adjusted for the dilutive effect of outstanding stock options. ESOP shares are only considered outstanding for earnings per share calculations when they are released or committed to be released.

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Presented below are the calculations for the basic and diluted earnings per share:

|  | Three months ended    |           | Nine months ended     |           |
|--|-----------------------|-----------|-----------------------|-----------|
|  | September 30,<br>2004 | 2003      | September 30,<br>2004 | 2003      |
| <b>Basic:</b>                                |                       |           |                       |           |
| Net income                                   | \$ 1,218,376          | 1,820,878 | 4,731,098             | 5,442,381 |
| Weighted average shares outstanding          | 4,340,546             | 4,205,803 | 4,287,395             | 4,213,292 |
| Basic earnings per share                     | \$ 0.28               | 0.43      | 1.10                  | 1.29      |
| <b>Diluted:</b>                              |                       |           |                       |           |
| Net income                                   | \$ 1,218,376          | 1,820,878 | 4,731,098             | 5,442,381 |
| Weighted average shares outstanding          | 4,340,546             | 4,205,803 | 4,287,395             | 4,213,292 |
| Effect of dilutive stock options outstanding | 247,455               | 243,877   | 252,164               | 234,472   |
| Diluted weighted average shares outstanding  | 4,588,001             | 4,449,680 | 4,539,559             | 4,447,764 |
| Diluted earnings per share                   | \$ 0.27               | 0.41      | 1.04                  | 1.22      |

Note 4: STOCK OPTION PLANS

The Company accounts for stock-based compensation plans under APB Opinion No. 25. For the stock option program, no compensation cost is recognized in connection with the granting of stock options with an exercise price equal to the fair market value of the stock on the date of the grant. For the stock award plan, the Company uses the fixed method of accounting and records compensation expense, over the vesting period of the grant, based upon the fair market value of the stock at the date of grant. In accordance with the disclosure requirements of SFAS No. 123, as amended by SFAS No. 148, the following table provides the pro forma effect on net income and earnings per share if the fair value method of accounting for stock-based compensation had been used for all awards:

|   | For the Three Months Ended |           | For the Nine Months Ended |           |
|---|----------------------------|-----------|---------------------------|-----------|
|   | September 30,<br>2004      | 2003      | September 30,<br>2004     | 2003      |
| Net income as reported  | \$ 1,218,376               | 1,820,878 | 4,731,098                 | 5,442,381 |
| Add: Stock-based compensation, net of tax, included in the determination of net income, as reported                                       | 8,344                      | 127,281   | 25,032                    | 381,843   |
| Deduct: Stock-based compensation, net of tax, that would have been reported if the fair value based method had been applied to all awards | (27,831)                   | (245,185) | (80,394)                  | (732,202) |
| Pro forma net income  | \$ 1,198,889               | 1,702,974 | 4,675,736                 | 5,092,022 |
| Basic earnings per share  |                            |           |                           |           |
| As reported   | \$ 0.28                    | 0.43      | 1.10                      | 1.29      |
| Pro forma   | 0.28                       | 0.40      | 1.09                      | 1.21      |
| Diluted earnings per share  |                            |           |                           |           |

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|             |    |      |      |      |      |
|-------------|----|------|------|------|------|
| As reported | \$ | 0.27 | 0.41 | 1.04 | 1.22 |
| Pro forma   |    | 0.26 | 0.38 | 1.03 | 1.14 |

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

Set forth below are highlights and significant items for the third quarter of 2004:

A \$424,000 non-recurring charge was recorded related to Computer Dynamics Group, Inc., the Company's majority-owned subsidiary;

The Bank continues to experience margin compression as a result of the recent interest rate environment, which management continues to monitor;

Diluted earnings per share were \$0.27 for the quarter and \$0.41 for the comparable prior year period;

Net income was \$1.2 million for the quarter and \$1.8 million for the comparable prior year period;

Return on average equity was 5.99% for the quarter and 9.45% for the comparable prior year period;

The quarterly dividend was increased to \$0.1550 per share from \$0.1525 for the second quarter of 2004.

The following analysis discusses changes in the financial condition at September 30, 2004 and results of operations for the three and nine months ended September 30, 2004, and should be read in conjunction with the Company's Unaudited Consolidated Financial Statements and the notes thereto, appearing in Part I, Item 1 of this document.

**Critical Accounting Policy**

The allowance for loan and lease losses is considered by management to be a critical accounting policy. The allowance for loan losses is maintained through provisions for loan losses based on management's on-going evaluation of the risks in its loan portfolio in consideration of the trends in its loan portfolio, the national and regional economies and the real estate market in the Bank's primary lending area. The allowance for loan losses is maintained at an amount management considers adequate to cover probable losses in its portfolio, based on information currently known to management. The Bank's loan loss allowance determination also incorporates factors and analyses which consider the probable principal loss associated with the loans, costs of acquiring the property and securing the loan through foreclosure or deed in lieu of foreclosure. While management estimates loan losses using the best available information, no assurance can be given that future additions to the allowance will not be necessary based on changes in economic and real estate market conditions, further information obtained regarding problem loans, identification of additional problem loans and other factors, both within and outside of management's control.

**Forward-Looking Statements**

This report contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. The Company intends such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities



Litigation Reform Act of 1995, and is including this statement for purposes of these safe harbor provisions. Forward-looking statements, which are based on certain assumptions and describe future plans, strategies and expectations of the Company, are generally identified by use of the words believe, expect, intend, anticipate, estimate, project, or similar expressions. The Company's ability to predict results or the actual future plans or strategies is inherently uncertain. Factors which could have a material adverse effect on the operations of the Company and its subsidiaries include, but are not limited to, changes in: interest rates, general economic conditions, legislative/regulatory changes, monetary and fiscal policies of the U.S. Government, including policies of the U.S. Treasury and the Federal Reserve Board, the quality or composition of the loan or investment portfolios, demand for loan products, deposit flows, competition, demand for financial services in the Company's market area and accounting principles and guidelines. These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. Further information concerning the Company and its business, including additional factors that could materially affect the Company's financial results, is included in the Company's filings with the SEC, including its 2003 Annual Report on Form 10-K.

The Company does not undertake - and specifically disclaims any obligation - to publicly release the result of any revisions which may be made to any forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

#### **Comparison of Financial Condition at September 30, 2004 and December 31, 2003**

Total assets at September 30, 2004 were \$999.0 million, which represented an increase of \$101.9 million, or 11.4%, compared to \$897.1 million at December 31, 2003. The increase in total assets was primarily a result of an increase in net loans receivable of \$77.1 million, or 10.8%, to \$794.0 million at September 30, 2004 from \$716.9 million at December 31, 2003. Of this increase, \$69.3 million, or 89.9%, was directly related to commercial loans, which totaled \$183.6 million at September 30, 2004. Commercial loans totaled \$114.3 million at December 31, 2003. This growth is consistent with management's long-term strategy for the Bank, which includes branch expansion and competitive pricing of deposit accounts in its local market area. In addition, cash and cash equivalents increased \$11.7 million, or 53.7%, to \$33.6 million at September 30, 2004 from \$21.9 million at December 31, 2003, investment securities increased \$5.5 million, or 6.1%, to \$96.2 million at September 30, 2004 from \$90.7 million at December 31, 2003 and office properties and equipment increased \$6.0 million, or 34.3%, to \$23.7 million at September 30, 2004 from \$17.7 million at December 31, 2003, which is primarily due to the Company's continued branch expansion efforts. The most recent branch was opened in September 2004. These increases were partially offset by a decrease in other assets of \$2.2 million, or 78.1%, to \$609,000 at September 30, 2004 from \$2.8 million at December 31, 2003. The loan growth was funded by increases in deposits and borrowed money. Deposits increased \$75.9 million, or 12.7%, to \$672.7 million at September 30, 2004 from \$596.8 million at December 31, 2003. Borrowed money, primarily representing FHLB advances, increased \$20.2 million to \$232.0 million at September 30, 2004 from \$211.8 million at December 31, 2003. Stockholders' equity increased \$4.8 million to \$83.2 million at September 30, 2004 from \$78.4 million at December 31, 2003. The increase in stockholders' equity was primarily the result of



the Company's net income for the nine months ended September 30, 2004, which was partially offset by stock repurchases totaling \$269,000 and dividends paid of \$1.9 million.

### **Comparison of Operating Results For the Three Months Ended September 30, 2004 and 2003**

**General.** The Company's net income decreased \$603,000, or 33.1%, to \$1.2 million for the three months ended September 30, 2004 as compared to the prior year period.

**Interest Income.** Interest income increased \$526,000, or 4.7%, to \$11.8 million for the three months ended September 30, 2004, compared to the same period in 2003. This increase resulted from an increase in the average balance of interest-earning assets, partially offset by a decrease in the average rate earned on interest-earning assets. The average yield on interest-earning assets decreased by 40 basis points to 5.17% for the three months ended September 30, 2004 from 5.57% for the three months ended September 30, 2003. The decrease in yield is primarily due to the lower overall level of interest rates. The average balance of interest-earning assets increased by \$105.6 million, or 12.8%, to \$931.4 million for the three months ended September 30, 2004 from \$825.8 million for the comparable period in 2003. This increase resulted primarily from an increase in the average balance of loans receivable of \$105.6 million from \$685.6 million for the three months ended September 30, 2003 to \$791.2 million for the three months ended September 30, 2004.

Mortgage loan interest income decreased by \$650,000 for the three months ended September 30, 2004 compared with the same period in 2003. The average balance of mortgage loans increased \$20.3 million to \$579.5 million, while the mortgage loan yield decreased by 66 basis points from 5.91% to 5.25%. Interest income from other loans increased \$1.1 million for the three months ended September 30, 2004. This increase resulted from a combination of an increase in average balance of \$85.2 million to \$211.6 million, partially offset by a 10 basis point decrease in yield from 5.52% for the three months ended September 30, 2003 to 5.42% for the three months ended September 30, 2004. Of the increase in other loans, \$78.8 million is attributed to commercial loans, which increased 79.6%, to \$177.8 million for the three months ended September 30, 2004 from \$99.0 million for the comparable period in 2003. Interest income from investment securities including stock in the Federal Home Loan Bank of Chicago, mortgage-backed securities and short-term deposits increased \$55,000 to \$1.4 million for the three months ended September 30, 2004, compared with the same period in 2003. The average balance decreased \$22,000 and the yield increased 20 basis points from 4.29% for the three months ended September 30, 2003 to 4.49% for the three months ended September 30, 2004. The average yields are reported on a tax equivalent basis.

**Interest Expense.** Interest expense increased by \$614,000, or 11.4%, to \$6.0 million for the three months ended September 30, 2004, compared to the same period in 2003. This increase resulted from an increase in the average balance of interest-bearing liabilities, offset by a decrease in the average rate paid on those interest-bearing liabilities. The average balance of interest-bearing liabilities increased by \$107.7 million, or 14.6%, to \$844.9 million for the three months ended September 30, 2004 from \$737.2 million for the three months ended September 30, 2003. This change reflects a \$72.7 million increase in deposit accounts, which is attributable

to a \$4.1 million increase in passbook savings accounts, a \$83.0 million increase in certificates of deposit and a \$1.9 million increase in NOW accounts. These increases were partially offset by a decrease of \$16.3 million in money market accounts. In addition, borrowings increased \$34.9 million to \$225.3 million for the three months ended September 30, 2004 from \$190.4 million for the comparable period in 2003. The average rate paid on combined deposits and borrowed money decreased by 8 basis points to 2.84% for the three months ended September 30, 2004 from 2.92% for the three months ended September 30, 2003.

**Net Interest Income Before Provision for Loan Losses.** Net interest income before provision for loan losses decreased \$88,000, or 1.5%, to \$5.8 million for the three months ended September 30, 2004 from \$5.9 million for the comparable period in 2003. The average balance of interest-earning assets increased \$105.6 million for the three months ended September 30, 2004 compared to the comparable prior year period. The increase in interest-earning assets was primarily the result of increases in the average balance of mortgage loans of \$20.3 million, \$8.5 million in investment securities and an \$85.2 million increase in other loans. These increases were partially offset by an \$8.1 million decrease in cash and cash equivalents and a \$1.3 million decrease in mortgage-backed securities. The tax equivalent net interest margin as a percent of interest-earning assets decreased by 36 basis points to 2.60% for the three months ended September 30, 2004 from 2.96% for the comparable period in 2003. The Bank continues to experience margin compression as a result of the recent interest rate environment and efforts to reduce interest rate risk. These efforts included the sale of approximately \$32.7 million of fixed rate mortgage loans in 2004. Increasing the net interest margin is dependent on the Bank's ability to generate higher-yielding assets and lower-cost deposits. Management continues to closely monitor the net interest margin.

**Provision for Loan Losses.** The provision for loan losses increased by \$70,000, to \$210,000 for the three months ended September 30, 2004 from \$140,000 in 2003. The increase in the provision for loan losses is primarily due to the increased risk in the loan portfolio based on a greater emphasis placed on commercial lending, which is generally considered to involve a higher degree of risk. At September 30, 2004, December 31, 2003 and September 30, 2003, non-performing loans totaled \$2.5 million, \$2.8 million and \$2.9 million, respectively. At September 30, 2004, the ratio of the allowance for loan losses to non-performing loans was 168.2% compared to 135.7% at December 31, 2003 and 126.1% at September 30, 2003. The ratio of the allowance to total loans was 0.54%, 0.52% and 0.51%, at September 30, 2004, December 31, 2003 and September 30, 2003, respectively. Charge-offs for the three months ended September 30, 2004 totaled \$3,000. There were no charge-offs for the three months ended September 30, 2003. Management periodically performs an allowance sufficiency analysis based upon the portfolio composition, asset classifications, loan-to-value ratios, probable impairments in the loan portfolio, and other factors.

**Noninterest Income.** Noninterest income totaled \$1.3 million and \$1.5 million for the three months ended September 30, 2004 and 2003, respectively. The decrease in noninterest income is primarily attributable to decreases of \$290,000 in gain on sale of securities and \$71,000 in revenues generated by Computer Dynamics Group, Inc. ( CDGI ). The decrease in income generated by CDGI is largely due to a decrease in sales related to a weaker demand for CDGI's services. These decreases were partially offset by increases of \$222,000 in service fees,

\$15,000 in insurance and brokerage commissions and \$16,000 in gain on sale of loans. Service fees increased primarily due to the growth in the number of deposit accounts.

**Noninterest Expense.** Noninterest expense increased \$779,000, to \$5.3 million for the three months ended September 30, 2004 from \$4.6 million for the comparable period in 2003. Of this increase, \$424,000 was due to a non-recurring charge related to the Company's majority-owned subsidiary CDGI. The Company was informed in October of the bankruptcy filing of its minority partner in CDGI. Accordingly, a receivable from the minority owner totaling \$265,000 was written-off. Additionally, upon notification of the bankruptcy, the Company recorded its investment in CDGI as a wholly-owned subsidiary, which resulted in a \$159,000 charge to expense to eliminate the minority interest. In addition, expenses relating to professional audit and outsourced internal audit fees increased \$59,000, advertising increased \$90,000 and data processing expenses increased \$65,000 from the comparable period in 2003. Management continues to emphasize the importance of expense management and control while continuing to provide expanded banking services to a growing market base.

**Income Tax Expense.** Income tax expense totaled \$351,000 and \$889,000 for the three months ended September 30, 2004 and 2003, respectively. The decrease in income tax expense was primarily the result of a decrease in income before income taxes and minority interest of \$1.1 million to \$1.6 million for three months ended September 30, 2004 from \$2.7 million for the comparable prior year period. The effective tax rate was 22.4% and 32.9% for the three months ended September 30, 2004 and 2003, respectively. The decrease in the effective tax rate is due to tax benefits received from the exercise of nonqualified stock options, increases in bank owned life insurance and municipal securities, for which the related income is non-taxable.

#### **Comparison of Operating Results For the Nine Months Ended September 30, 2004 and 2003**

**General.** The Company's net income decreased \$711,000, or 13.1%, to \$4.7 million for the nine months ended September 30, 2004 as compared to the prior year period.

**Interest Income.** Interest income increased \$206,000, or 1.0%, to \$34.5 million for the nine months ended September 30, 2004, compared to the same period in 2003. This increase resulted from an increase in the average balance of interest-earning assets, partially offset by a decrease in the average rate earned on interest-earning assets. The average balance of interest-earning assets increased by \$101.7 million, or 12.9%, to \$892.6 million for the nine months ended September 30, 2004 from \$790.9 million for the comparable period in 2003. This increase resulted primarily from an increase in the average balance of loans receivable of \$105.6 million from \$650.1 million for the nine months ended September 30, 2003 to \$755.7 million for the nine months ended September 30, 2004. The average yield on interest-earning assets decreased by 67 basis points to 5.22% for the nine months ended September 30, 2004 from 5.89% for the nine months ended September 30, 2003.

Mortgage loan interest income decreased by \$2.2 million for the nine months ended September 30, 2004 compared with the same period in 2003. The average balance of mortgage loans increased \$30.2 million, while the mortgage loan yield decreased by 85 basis points from

6.27% to 5.42%. Interest income from other loans increased \$2.6 million for the nine months ended September 30, 2004. This increase resulted from a combination of an increase in the average balance of \$75.4 million, partially offset by a 50 basis point decrease in yield from 5.78% for the nine months ended September 30, 2003 to 5.28% for the nine months ended September 30, 2004. Of the increase in other loans, \$68.7 million is attributed to commercial loans, which increased 82.4%, to \$152.1 million for the nine months ended September 30, 2004 from \$83.4 million for the comparable period in 2003. Interest income from investment securities including stock in the Federal Home Loan Bank of Chicago, mortgage-backed securities and short-term deposits decreased \$147,000 to \$4.0 million for the nine months ended September 30, 2004, compared with the same period in 2003. The average balance decreased \$3.8 million and the yield decreased 21 basis points from 4.49% for the nine months ended September 30, 2003 to 4.28% for the nine months ended September 30, 2004. The average yields are reported on a tax equivalent basis.

**Interest Expense.** Interest expense increased \$614,000, or 3.8%, to \$16.8 million for the nine months ended June 30, 2004 compared to the same period in 2003. There was an increase in the average balance of interest-bearing liabilities, and a decrease in the average rate paid on those interest-bearing liabilities for the nine months ended September 30, 2004 from the nine months ended September 30, 2003. The average balance of interest-bearing liabilities increased by \$100.9 million, or 14.3%, to \$806.3 million for the nine months ended September 30, 2004 from \$705.4 million for the nine months ended September 30, 2003. This change reflects a \$75.3 million increase in deposit accounts, which is attributable to a \$14.1 million increase in passbook savings accounts, a \$65.3 million increase in certificates of deposit and a \$4.0 million increase in NOW accounts. These increases were partially offset by a decrease of \$8.1 million in money market accounts. In addition, borrowings increased \$25.5 million to \$209.9 million for the nine months ended September 30, 2004 from \$184.4 million for the comparable period in 2003. The average rate paid on combined deposits and borrowed money decreased by 28 basis points to 2.78% for the nine months ended September 30, 2004 from 3.06% for the nine months ended September 30, 2003.

**Net Interest Income Before Provision for Loan Losses.** Net interest income before provision for loan losses decreased \$408,000, or 2.3%, to \$17.7 million for the nine months ended September 30, 2004 from \$18.1 million for the comparable period in 2003. The average balance of interest-earning assets increased \$101.8 million for the nine months ended September 30, 2004 compared to the comparable prior year period. The increase in interest-earning assets was primarily the result of increases in the average balance of mortgage loans of \$30.2 million and a \$75.4 million increase in other loans. These increases were partially offset by a \$3.7 million decrease in mortgage-backed securities. The tax equivalent net interest margin as a percent of interest-earning assets decreased by 45 basis points to 2.71% for the nine months ended September 30, 2004 from 3.16% for the comparable period in 2003. The Bank continues to experience margin compression as a result of the recent interest rate environment and efforts to reduce interest rate risk. These efforts included the sale of approximately \$32.7 million of fixed rate mortgage loans in 2004. Increasing the net interest margin is dependent on the Bank's ability to generate higher-yielding assets and lower-cost deposits. Management continues to closely monitor the net interest margin.

**Provision for Loan Losses.** The provision for loan losses increased by \$87,000, to \$550,000 for the nine months ended September 30, 2004 from \$463,000 in 2003. The increase in the provision for loan losses is primarily due to the increased risk in the loan portfolio based on a greater emphasis placed on commercial lending, which is generally considered to involve a higher degree of risk. At September 30, 2004, December 31, 2003 and September 30, 2003, non-performing loans totaled \$2.5 million, \$2.8 million and \$2.9 million, respectively. At September 30, 2004, the ratio of the allowance for loan losses to non-performing loans was 168.2% compared to 135.7% at December 31, 2003 and 126.1% at September 30, 2003. The ratio of the allowance to total loans was 0.54%, 0.52% and 0.51%, at September 30, 2004, December 31, 2003 and September 30, 2003, respectively. Charge-offs for the nine months ended September 30, 2004 totaled \$18,000. There were no charge-offs for the nine months ended September 30, 2003. Management periodically performs an allowance sufficiency analysis based upon the portfolio composition, asset classifications, loan-to-value ratios, probable impairments in the loan portfolio, and other factors.

**Noninterest Income.** Noninterest income totaled \$4.4 million and \$4.2 million for the nine months ended September 30, 2004 and 2003, respectively. The increase in noninterest income is primarily attributable to increases of \$525,000 in service fees, \$243,000 in insurance and brokerage commissions, \$149,000 in gain on sale of property, which was a building previously occupied by the Bank and \$122,000 in gain on sale of loans. Service fees increased primarily due to the growth in number of deposit accounts. Insurance and brokerage commissions increased primarily due to the hiring of three additional salespeople during the third quarter of 2003. These increases were partially offset by decreases of \$332,000 in revenues generated by CDGI and \$567,000 in gain on sale of securities. The decrease in income generated by CDGI is largely due to a decrease in sales related to a weaker demand for CDGI's services.

**Noninterest Expense.** Noninterest expense increased \$1.3 million, to \$15.1 million for the nine months ended September 30, 2004 from \$13.8 million for the comparable period in 2003. As previously discussed, \$424,000 of the increase is due to a non-recurring charge related to the Company's majority-owned subsidiary CDGI. In addition, \$274,000 was directly related to compensation and benefits, \$156,000 is related to data processing, \$168,000 is related to advertising and \$162,000 is related to professional audit and outsourced internal audit fees. The increase in compensation and benefits is primarily due to a combination of annual salary increases and the addition of staff. Management continues to emphasize the importance of expense management and control while continuing to provide expanded banking services to a growing market base.

**Income Tax Expense.** Income tax expense totaled \$1.7 million and \$2.8 million for the nine months ended September 30, 2004 and 2003, respectively. The decrease in income tax expense was primarily the result of a decrease in income before income taxes and minority interest of \$1.6 million to \$6.5 million for nine months ended September 30, 2004 from \$8.1 million for the comparable prior year period. The effective tax rate was 26.8% and 34.0% for the nine months ended September 30, 2004 and 2003, respectively. The decrease in the effective tax rate is due to tax benefits received from the exercise of nonqualified stock options, increases in bank owned life insurance and municipal securities, for which the related income is non-taxable.

## **Liquidity and Capital Resources**

The Company's primary source of funding for dividends and periodic stock repurchases have been dividends from the Bank. The Bank's ability to pay dividends and other capital distributions to the Company is generally limited by the Office of Thrift Supervision regulations.

The Bank's primary sources of funds are savings deposits, proceeds from the principal and interest payments on loans, proceeds from the maturity of securities and borrowings from the FHLB-Chicago. While maturities and scheduled amortization of loans and securities are predictable sources of funds, deposit outflows and mortgage prepayments are greatly influenced by general interest rates, economic conditions and competition.

The primary investing activities of the Bank are the origination and purchase of primarily residential one-to-four-family loans, the purchase of mortgage-backed securities and, to a lesser extent, multi-family and commercial real estate, construction and land, commercial and consumer loans. In addition, the Bank purchases loans, secured by single-family, multi-family and commercial real estate. Deposit flows are affected by the level of interest rates, the interest rates and products offered by the local competitors and other factors.

In addition to the primary investing activities of the Bank, the Company has repurchased shares of its common stock from time to time in the open market. As of September 30, 2004, the Company repurchased a total of 3,087,081 shares of the Company's common stock at an average price per share of \$12.11 since becoming a public company in 1998. There currently is no formal repurchase plan in place and there were no shares repurchased during the three months ended September 30, 2004.

The Bank's most liquid assets are cash and interest-bearing demand accounts. The levels of these assets are dependent on the Bank's operating, financing, lending and investing activities during any given period. At September 30, 2004, cash and interest-bearing demand accounts totaled \$33.6 million, or 3.4% of total assets.

See the Consolidated Statements of Cash Flows in the Unaudited Consolidated Financial Statements included in this Form 10-Q for the sources and uses of cash flows for operating, investing and financing activities for the nine months ended September 30, 2004 and 2003.

At September 30, 2004, the Bank exceeded all of its regulatory capital requirements. The following is a summary of the Bank's regulatory capital ratios at September 30, 2004:

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|  | Actual        |        |    | For capital adequacy |       | To be well capitalized under       |       |
|--|---------------|--------|----|----------------------|-------|------------------------------------|-------|
|  | Amount        | Ratio  |    | Amount               | Ratio | prompt corrective action<br>Amount | Ratio |
| September 30, 2004:                      |               |        |    |                      |       |                                    |       |
| Total capital (to risk weighted assets)  | \$ 78,126,000 | 10.83% | \$ | 57,704,000           | 8.0%  | \$ 72,130,000                      | 10.0% |
| Tier I capital (to risk weighted assets) | 76,844,000    | 10.65  |    | 28,852,000           | 4.0   | 43,278,000                         | 6.0   |
| Tier I capital (to average assets)       | 76,844,000    | 7.79   |    | 39,470,000           | 4.0   | 49,338,000                         | 5.0   |

At September 30, 2004, the Company had a Total Capital to Total Assets ratio of 8.33%.

On September 15, 2004, the Company announced its third quarter dividend of \$0.1550 per share. The dividend was paid on October 12, 2004 to stockholders of record on September 30, 2004.

## Financial Instruments with Off-Balance Sheet Risk

The Bank is party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. Those financial instruments primarily include commitments to extend credit. Commitments to extend credit are agreements to lend to a customer so long as there is no violation of any condition established in the contract. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained is based on management's credit evaluation of the customer. The Bank's exposure to credit loss in the event of nonperformance by the customer is represented by the contractual amount of those financial instruments. The commitments to originate first mortgage loans represent amounts, which the Bank plans to fund within a period of 30 to 90 days.

The Bank's approved, but unused lines of credit are based on underwriting standards that allow total borrowings, including the equity line of credit to exceed 80% of the current appraised value of the customer's residence. However, the Bank charges a 1% higher interest rate on home equity lines of credit up to 90% of the home's current appraised value.

The Bank's standby letters of credit are conditional commitments issued by the Bank to guarantee performance of a customer to a third party. The credit risk involved in these transactions is essentially the same as that involved in extending a loan to a customer in the normal course of business. Standby letters of credit are collateralized by mortgages, savings accounts or liens on business assets. The fair value of standby letters of credit approximates the amount of recorded related fees, which are not considered material. The maximum risk of accounting loss for these items, which is represented by the total commitment outstanding, totaled \$13.9 million at September 30, 2004.

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At September 30, 2004 and December 31, 2003, the bank had the following commitments to extend credit:

|                           | September 30, | December 31, |
|---------------------------|---------------|--------------|
|                           | 2004          | 2003         |
| First mortgage loans      | \$ 6,208,000  | \$ 7,306,000 |
| Construction loans        | 2,080,000     | 4,210,000    |
| Unused lines of credit    | 34,985,000    | 42,342,000   |
| Standby letters of credit | 13,913,000    | 5,434,000    |

### Contractual Obligations

The Bank has certain obligations and commitments to make future payments under contract. There has been no material change in contractual obligations from December 31, 2003.

### Recent Accounting Pronouncements

In December 2003, the American Institute of Certified Public Accountants ( AICPA ) released Statement of Position 03-3, Accounting for Certain Loans or Debt Securities Acquired in a transfer ( SOP 03-3 ). SOP 03-3 addresses the accounting for differences between contractual cash flows and cash flows expected to be collected from an investors initial investment in loans or debt securities acquired in a transfer if those differences are attributable to credit quality. SOP 03-3 is effective for loans acquired in fiscal years beginning after December 31, 2004. Adoption of this Statement is not expected to have a material impact on the Company s consolidated financial statements.

In March 2004, the FASB reached a consensus on EITF 03-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments ( EITF 03-1 ). EITF 03-1 provides guidance for determining when an investment is impaired and whether the impairment is other than temporary. EITF 03-1 also incorporates into its consensus the required disclosures about unrealized losses on investments announced by the EITF in late 2003 and adds new disclosure requirements relating to cost-method investments. The impairment accounting guidance was to become effective for reporting periods beginning after June 15, 2004. The new disclosure requirements are effective for annual reporting periods after June 15, 2004. In September 2004, the FASB delayed the effective date of EITF 03-1 for measurement and recognition of impairment losses until implementation guidance is issued. We do not expect the adoption of the impairment guidance contained in EITF 03-1 to have a material impact on our financial position or results of operations.



# Average Balance Sheet

The following tables set forth certain information relating to the Bank for the three and nine months ended September 30, 2004 and 2003, respectively. The average yields and costs are derived by dividing income or expense by the average balance of interest-earning assets or interest-bearing liabilities, respectively, for the periods shown and reflect annualized yields and costs. Average balances are derived from average monthly balances. The yields and costs include fees, which are considered adjustments to yields. Tax exempt income has been calculated on a tax equivalent basis using a tax rate of 34% and amounted to \$211,000 and \$195,000 for the three months ended September 30, 2004 and 2003 and \$413,000 and \$610,000 for the nine months ended September 30, 2004 and 2003, respectively.

| (in thousands)   | Three Months Ended |          |            | Three Months Ended |          |            |
|--|--------------------|----------|------------|--------------------|----------|------------|
|  | September 30, 2004 |          |            | September 30, 2003 |          |            |
|  | Average<br>Balance | Interest | Yield/Cost | Average<br>Balance | Interest | Yield/Cost |
| <b>Assets:</b>   |                    |          |            |                    |          |            |
| Interest earning assets:   |                    |          |            |                    |          |            |
| Short-term deposits and FHLB stock                               | \$37,386           | 223      | 2.39%      | 44,510             | 202      | 1.82%      |
| Investment securities  | 91,653             | 1,253    | 5.47%      | 83,181             | 1,195    | 5.75%      |
| Mortgage-backed securities                                       | 11,209             | 98       | 3.50%      | 12,534             | 107      | 3.41%      |
| Mortgage loans   | 579,520            | 7,609    | 5.25%      | 559,186            | 8,259    | 5.91%      |
| Other loans  | 211,637            | 2,866    | 5.42%      | 126,390            | 1,745    | 5.52%      |
| Total interest earning assets                                    | 931,405            | 12,049   | 5.17%      | 825,801            | 11,508   | 5.57%      |
| Noninterest earning assets                                       | 58,224             |          |            | 51,559             |          |            |
| Total assets   | \$989,629          |          |            | 877,360            |          |            |
| <b>Liabilities and stockholders' equity</b>                      |                    |          |            |                    |          |            |
| Interest-bearing liabilities:                                    |                    |          |            |                    |          |            |
| Deposits:  |                    |          |            |                    |          |            |
| Money market accounts  | \$131,786          | 547      | 1.66%      | 148,128            | 642      | 1.73%      |
| Passbook savings accounts  | 129,961            | 467      | 1.44%      | 125,827            | 462      | 1.47%      |
| NOW Accounts   | 38,890             | 48       | 0.49%      | 36,991             | 68       | 0.74%      |
| Certificates of deposit  | 318,903            | 2,330    | 2.92%      | 235,894            | 1,846    | 3.13%      |
| Total deposits   | 619,540            | 3,392    | 2.19%      | 546,840            | 3,018    | 2.21%      |
| FHLB Advances  | 225,333            | 2,612    | 4.64%      | 190,366            | 2,372    | 4.98%      |
| Total interest-bearing liabilities                               | 844,873            | 6,004    | 2.84%      | 737,206            | 5,390    | 2.92%      |
| Noninterest-bearing liabilities                                  | 63,426             |          |            | 63,048             |          |            |
| Total liabilities  | 908,299            |          |            | 800,254            |          |            |
| Total stockholders' equity                                       | 81,330             |          |            | 77,106             |          |            |
| Total liabilities and stockholders' equity                       | \$989,629          |          |            | 877,360            |          |            |
| Net interest income before provision for loan losses             |                    | 6,045    |            |                    | 6,118    |            |
| Interest rate spread   |                    |          | 2.33%      |                    |          | 2.65%      |
| Net interest margin as a percent of interest earning assets      |                    |          | 2.60       |                    |          | 2.96%      |
| Ratio of interest-earning assets to interest-bearing liabilities |                    |          | 110.24%    |                    |          | 112.02%    |

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| (in thousands)   | Nine Months Ended  |          |            | Nine Months Ended  |          |            |
|--|--------------------|----------|------------|--------------------|----------|------------|
|  | September 30, 2004 |          |            | September 30, 2003 |          |            |
|  | Average            |          |            | Average            |          |            |
|  | Balance            | Interest | Yield/Cost | Balance            | Interest | Yield/Cost |
| <b>Assets:</b>   |                    |          |            |                    |          |            |
| Interest earning assets:   |                    |          |            |                    |          |            |
| Short-term deposits and FHLB                                     |                    |          |            |                    |          |            |
| stock  | \$ 38,806          | 633      | 2.17%      | 38,511             | 536      | 1.86%      |
| Investment securities  | 87,121             | 3,463    | 5.30%      | 87,528             | 3,789    | 5.77%      |
| Mortgage-backed securities                                       | 11,001             | 302      | 3.66%      | 14,728             | 415      | 3.76%      |
| Mortgage loans   | 571,123            | 23,220   | 5.42%      | 540,907            | 25,449   | 6.27%      |
| Other loans  | 184,574            | 7,313    | 5.28%      | 109,193            | 4,732    | 5.78%      |
| Total interest earning assets                                    | 892,625            | 34,931   | 5.22%      | 790,867            | 34,921   | 5.89%      |
| Noninterest earning assets                                       | 54,947             |          |            | 46,369             |          |            |
| Total assets   | \$ 947,572         |          |            | 837,236            |          |            |
| <b>Liabilities and stockholders' equity</b>                      |                    |          |            |                    |          |            |
| Interest-bearing liabilities                                     |                    |          |            |                    |          |            |
| Deposits:  |                    |          |            |                    |          |            |
| Money market accounts  | \$ 138,394         | 1,675    | 1.61%      | 146,530            | 2,103    | 1.91%      |
| Passbook savings accounts  | 131,075            | 1,370    | 1.39%      | 116,937            | 1,419    | 1.62%      |
| NOW Accounts   | 39,393             | 145      | 0.49%      | 35,344             | 210      | 0.80%      |
| Certificates of deposit  | 287,563            | 6,243    | 2.89%      | 222,261            | 5,506    | 3.30%      |
| Total deposits   | 596,425            | 9,433    | 2.11%      | 521,072            | 9,238    | 2.36%      |
| FHLB Advances  | 209,900            | 7,370    | 4.68%      | 184,367            | 6,951    | 5.03%      |
| Total interest-bearing liabilities                               | 806,325            | 16,803   | 2.78%      | 705,439            | 16,189   | 3.06%      |
| Noninterest-bearing liabilities                                  | 60,523             |          |            | 55,765             |          |            |
| Total liabilities  | 866,848            |          |            | 761,204            |          |            |
| Total stockholders' equity                                       | 80,724             |          |            | 76,032             |          |            |
| Total liabilities and stockholders' equity                       | \$ 947,572         |          |            | 837,236            |          |            |
| Net interest income before provision for loan losses             |                    | 18,128   |            |                    | 18,732   |            |
| Interest rate spread   |                    |          | 2.44%      |                    |          | 2.83%      |
| Net interest margin as a percent of interest earning assets      |                    |          | 2.71%      |                    |          | 3.16%      |
| Ratio of interest-earning assets to interest-bearing liabilities |                    |          | 110.70%    |                    |          | 112.11%    |

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

The Bank's interest rate sensitivity is monitored by management through the use of a Net Portfolio Value Model which generates estimates of the change in the Bank's net portfolio value ( NPV ) over a range of interest rate scenarios. NPV is the present value of expected cash flows from assets, liabilities, and off-balance sheet contracts. The NPV ratio, under any interest rate scenario, is defined as the NPV in that scenario divided by the market value of assets in the same scenario. The model assumes estimated prepayment rates, reinvestment rates and deposit decay rates. The Sensitivity Measure is the decline in the NPV ratio, in basis points, caused by a 3% increase or 1% decrease in rates, whichever produces a larger decline. The higher the institution's Sensitivity Ratio, the greater its exposure to interest rate risk is considered to be. The following NPV Table sets forth the Bank's NPV as of September 30, 2004.

| Change in                       |        | Interest Rates      |             |          |           | NPV as % of Portfolio |          |
|---------------------------------|--------|---------------------|-------------|----------|-----------|-----------------------|----------|
| in Basis Points<br>(Rate Shock) | Amount | Net Portfolio Value |             | % Change | NPV Ratio | Value of Assets       |          |
|                                 |        | (In thousands)      | \$ Change   |          |           |                       | % Change |
| +300                            | \$     | 47,284              | \$ (32,584) | (40.80)% | 4.85%     |                       | (38.45)% |
| +200                            |        | 59,533              | (20,335)    | (25.46)  | 6.03      |                       | (23.48)  |
| +100                            |        | 73,453              | (6,415)     | (8.03)   | 7.33      |                       | (6.98)   |
| Static                          |        | 79,868              |             |          | 7.88      |                       |          |
| -100                            |        | 77,201              | (2,667)     | (3.34)   | 7.59      |                       | (3.68)   |

Certain shortcomings are inherent in the methodology used in the above interest rate risk measurements. Modeling changes in NPV require the making of certain assumptions which may or may not reflect the manner in which actual yields and costs respond to changes in market interest rates. In this regard, the NPV Table presented assumes that the composition of the Bank's interest sensitive assets and liabilities existing at the beginning of a period remains constant over the period being measured and also assumes that a particular change in interest rates is reflected uniformly across the yield curve regardless of the duration to maturity or repricing of specific assets and liabilities. Accordingly, although the NPV Table provides an indication of the Bank's interest rate risk exposure at a particular point in time, such measurements are not intended to and do not provide a precise forecast of the effect of changes in market interest rates on the Bank's net interest income and may differ from actual results.

Item 4. Controls and Procedures

The Company's management, including the Company's principal executive officer and principal financial officer, have evaluated the effectiveness of the Company's disclosure controls and procedures, as such term is defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended, (the Exchange Act ). Based upon their

evaluation, the principal executive officer and principal financial officer concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures were effective for the purpose of ensuring that the information required to be disclosed in the reports that the Company files or submits under the Exchange Act with the Securities and Exchange Commission (the "SEC") (1) is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and (2) is accumulated and communicated to the Company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. In addition, based on that evaluation, no change in the Company's internal control over financial reporting occurred during the quarter ended September 30, 2004 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

**PART II. OTHER INFORMATION**

Item 1. Legal Proceedings.

The Company is not involved in any pending legal proceedings other than routine legal proceedings occurring in the ordinary course of business. Such routine legal proceedings, in the aggregate, are believed by management to be immaterial to the Company's financial condition, results of operations and cash flows.

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

None.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Submission of Matters to a Vote of Security Holders.

None.

Item 5. Other Information.

None.

Item 6. Exhibits

(a) Exhibits

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- 3.1 Certificate of Incorporation of EFC Bancorp, Inc. \*
  - 3.2 Bylaws of EFC Bancorp, Inc. \*
  - 4.0 Specimen Stock Certificate of EFC Bancorp, Inc. \*
  - 10.1 The EFS Bank Supplemental Executive Retirement Agreement between EFS Bank and Randy C. Blackburn (filed herewith)
  - 10.2 The EFS Bank Supplemental Executive Retirement Agreement between EFS Bank and Eric J. Wedeen (filed herewith)
  - 11.0 Statement re: Computation of Per Share Earnings Incorporated herein by reference to Note 3 to the unaudited consolidated financial statements.
  - 31.1 Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer
  - 31.2 Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer
  - 32.1 Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350
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\* Incorporated herein by reference from the Exhibits filed with the Registration Statement on Form S-1 and any amendments thereto. Initially filed with the Securities and Exchange Commission ( SEC ) on October 24, 1997.

**SIGNATURES**

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

EFC BANCORP, INC.

Dated: November 12, 2004

By: /s/ Barrett J. O Connor  
Barrett J. O Connor

Chief Executive Officer

(Principal executive officer)

Dated: November 12, 2004

By: /s/ Eric J. Wedeen  
Eric J. Wedeen

Senior Vice President and Chief

Financial Officer

(Principal financial and accounting officer)