HOPFED BANCORP INC
Form 10-Q
November 10, 2011
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# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-Q

(Mark One)

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

**For the quarterly period ended September 30, 2011**

**OR**

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

**Commission File Number: 000-23667**

# HOPFED BANCORP, INC.

**(Exact name of registrant as specified in its charter)**

| **Delaware** | **61-1322555** |
|---|---|
| **(State or other jurisdiction of incorporation or organization)** | **(I.R.S. Employer Identification No.)** |

| **4155 Lafayette Road, Hopkinsville, Kentucky** | **42240** |
|---|---|
| **(Address of principal executive offices)** | **(Zip Code)** |

**Registrant s telephone number, including area code: (270) 885-1171**

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 ninety days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Date File required and posted pursuant to Rule 405 of Regulation S-T (subsection 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated file or a non-accelerated filer. See definition of accelerated filer , large accelerated filer and smaller reporting company in Rule12b-2 of the Exchange Act: (Check one)

| Large accelerated filer ¨ | Accelerated filer ¨ |
|---|---|
| Non-accelerated filer ¨ | Smaller reporting company filer x |

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act). Yes ¨ No x.

As of November 10, 2011, the Registrant had outstanding 7,492,420 shares of the Registrant s Common stock.

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## PART I. FINANCIAL INFORMATION

**Item 1. Financial Statements**

### HOPFED BANCORP, INC.

**Consolidated Condensed Statements of Financial Condition**

**(Dollars in Thousands)**

| | September 30, 2011 (Unaudited) | December 31, 2010 |
|---|---|---|
| Assets | | |
| Cash and due from banks | $ 44,220 | 54,042 |
| Interest-earning deposits in Federal Home Loan Bank | 6,828 | 6,942 |
| Cash and cash equivalents | 51,048 | 60,984 |
| Federal Home Loan Bank stock, at cost | 4,428 | 4,378 |
| Securities available for sale | 382,673 | 357,738 |
| Loans receivable, net of allowance for loan losses of $13,541 at September 30, 2011, and $9,830 at December 31, 2010 | 568,027 | 600,215 |
| Accrued interest receivable | 5,929 | 6,670 |
| Real estate and other assets owned | 4,561 | 9,812 |
| Bank owned life insurance | 9,069 | 8,819 |
| Premises and equipment, net | 23,627 | 24,289 |
| Deferred tax assets | 2,239 | 3,788 |
| Intangible asset | 584 | 810 |
| Other assets | 5,100 | 5,088 |
| Total assets | $ 1,057,285 | 1,082,591 |
| Liabilities and Stockholders Equity | | |
| Liabilities: | | |
| Deposits: | | |
| Non-interest-bearing accounts | $ 78,626 | 69,139 |
| Interest-bearing accounts | | |
| NOW accounts | 130,664 | 138,936 |
| Savings and money market accounts | 71,264 | 63,848 |
| Other time deposits | 530,962 | 555,006 |
| Total deposits | 811,516 | 826,929 |
| Advances from Federal Home Loan Bank | 69,197 | 81,905 |
| Repurchase agreements | 43,414 | 45,110 |
| Subordinated debentures | 10,310 | 10,310 |
| Advances from borrowers for taxes and insurance | 623 | 239 |
| Dividends payable | 176 | 613 |
| Accrued expenses and other liabilities | 6,260 | 6,041 |
| Total liabilities | 941,496 | 971,147 |

See accompanying Notes to Unaudited Consolidated Condensed Financial Statements.

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**HOPFED BANCORP, INC.**

**Consolidated Condensed Statements of Financial Condition, Continued**

**(Dollars in Thousands)**

| | September 30, 2011 (Unaudited) | December 31, 2010 |
|---|---|---|
| Stockholders equity | | |
| Preferred stock, par value $0.01 per share; authorized - 500,000 shares; 18,400 shares issued and outstanding with a liquidation preference of $18,400,000 at September 30, 2011, and December 31, 2010 | | |
| Common stock, par value $.01 per share; authorized 15,000,000 shares; 7,895,336 issued and 7,492,420 outstanding at September 30, 2011 and 7,737,879 issued and 7,334,963 outstanding at December 31, 2010 (a) | 79 | 77 |
| Common stock warrants (253,666 issued and outstanding) | 556 | 556 |
| Additional paid-in-capital | 75,912 | 74,920 |
| Retained earnings-substantially restricted | 37,671 | 39,994 |
| Treasury stock (at cost, 402,916 shares at September 30, 2011, and December 31, 2010) | (5,076) | (5,076) |
| Accumulated other comprehensive income, net of taxes | 6,647 | 973 |
| Total stockholders equity | 115,789 | 111,444 |
| Total liabilities and stockholders equity | $ 1,057,285 | 1,082,591 |

(a) Shares have been restated to reflect stock dividend distributed through October 18, 2011

The consolidated condensed statement of financial condition at December 31, 2010, has been derived from the audited financial statements as of that date but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

See accompanying Notes to Unaudited Consolidated Condensed Financial Statements.

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**HOPFED BANCORP, INC.**

**Consolidated Condensed Statements of Income (Loss)**

**(Dollars in Thousands)**

**(Unaudited)**

| | For the Three Month Periods Ended September 30, | | For the Nine Month Periods Ended September 30, | |
|---|---|---|---|---|
| | 2011 | 2010 | 2011 | 2010 |
| Interest and dividend income: | | | | |
| Loans receivable | $ 8,332 | 9,396 | 25,254 | 29,027 |
| Investment in securities, taxable | 2,581 | 3,165 | 8,003 | 9,122 |
| Nontaxable securities available for sale | 532 | 635 | 1,733 | 1,809 |
| Interest-earning deposits | 5 | | 13 | |
| Total interest and dividend income | 11,450 | 13,196 | 35,003 | 39,958 |
| Interest expense: | | | | |
| Deposits | 3,543 | 4,313 | 11,179 | 13,405 |
| Advances from Federal Home Loan Bank | 625 | 818 | 1,946 | 2,500 |
| Repurchase agreements | 238 | 213 | 668 | 619 |
| Subordinated debentures | 186 | 193 | 551 | 557 |
| Total interest expense | 4,592 | 5,537 | 14,344 | 17,081 |
| Net interest income | 6,858 | 7,659 | 20,659 | 22,877 |
| Provision for loan losses | 475 | 1,332 | 5,445 | 2,801 |
| Net interest income after provision for loan losses | 6,383 | 6,327 | 15,214 | 20,076 |
| Non-interest income: | | | | |
| Service charges | 1,020 | 953 | 2,828 | 2,974 |
| Merchant card income | 194 | 180 | 571 | 519 |
| Mortgage origination revenue | 295 | 204 | 425 | 391 |
| Gain on sale of investments | 1,247 | 1,060 | 2,297 | 1,786 |
| Other than temporarily impairment on available for sale securities | | | (14) | |
| Income from bank owned life insurance | 84 | 85 | 249 | 263 |
| Financial services commission | 272 | 293 | 691 | 776 |
| Gain on sale of real estate owned | | 63 | | 356 |
| Other operating income | 169 | 247 | 717 | 785 |
| Total non-interest income | 3,281 | 3,085 | 7,764 | 7,850 |

See accompanying Notes to Unaudited Consolidated Condensed Financial Statements.

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**HOPFED BANCORP, INC.**

**Consolidated Condensed Statements of Income (Loss), Continued**

**(Dollars in Thousands, Except Per Share Amounts)**

**(Unaudited)**

| | For the Three Month Periods Ended September 30, | | For the Nine Month Periods Ended September 30, | |
|---|---|---|---|---|
| | 2011 | 2010 | 2011 | 2010 |
| Non-interest expenses: | | | | |
| Salaries and benefits | $ 3,309 | 3,186 | 9,987 | 9,623 |
| Occupancy expense | 867 | 795 | 2,452 | 2,351 |
| Data processing expense | 653 | 705 | 2,056 | 2,101 |
| State deposit tax | 151 | 162 | 476 | 479 |
| Intangible amortization expense | 65 | 81 | 227 | 276 |
| Professional services expense | 293 | 335 | 986 | 932 |
| Deposit insurance and examination expense | 445 | 759 | 1,604 | 1,547 |
| Advertising expense | 324 | 262 | 931 | 774 |
| Postage and communications expense | 140 | 144 | 421 | 426 |
| Supplies expense | 96 | 95 | 294 | 287 |
| Loss on disposal of equipment | 5 | | 145 | |
| Loss on sale of real estate owned | 570 | | 1,642 | |
| Real estate owned expenses | 16 | 36 | 216 | 218 |
| Other operating expenses | 193 | 296 | 575 | 815 |
| Total non-interest expense | 7,127 | 6,856 | 22,012 | 19,829 |
| Income before income tax expense | 2,537 | 2,556 | 966 | 8,097 |
| Income tax expense | 909 | 788 | 375 | 2,398 |
| Net income | 1,628 | 1,768 | 591 | 5,699 |
| Less: | | | | |
| Dividend on preferred shares | 232 | 232 | 688 | 688 |
| Accretion dividend on preferred shares | 28 | 28 | 83 | 83 |
| Net income (loss) available (attributable) to common shareholders | $ 1,368 | $ 1,508 | ($ 180) | $ 4,928 |
| Net income (loss) available (attributable) to common shareholders | | | | |
| Per share, basic | $ 0.18 | $ 0.20 | ($ 0.02) | $ 0.97 |
| Per share, diluted | $ 0.18 | $ 0.20 | ($ 0.02) | $ 0.97 |
| Dividend per share | $ 0.02 | $ 0.08 | $ 0.18 | $ 0.32 |
| Weighted average shares outstanding - basic (a) | 7,481,448 | 7,416,541 | 7,456,750 | 5,088,374 |

| | | | | |
|---|---|---|---|---|
| Weighted average shares outstanding - diluted (a) | 7,481,448 | 7,416,541 | 7,456,750 | 5,088,374 |

(a) Weighted average shares for the three and nine month periods ended September 30, 2010, have been adjusted to reflect a 2% stock dividend on October 18, 2011

See accompanying Notes to Unaudited Consolidated Condensed Financial Statements.

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**HOPFED BANCORP, INC.**

**Consolidated Condensed Statements of Comprehensive Income**

**(Dollars in Thousands)**

**(Unaudited)**

| | For the Three Month Periods Ended September 30, 2011 | 2010 | For the Nine Month Periods Ended September 30, 2011 | 2010 |
|---|---|---|---|---|
| Net income | $ 1,628 | 1,768 | 591 | 5,699 |
| Other comprehensive income, net of tax: | | | | |
| Unrealized gain on investment securities available for sale, net of tax effect of ($2,218) and ($1,633) for the three months ended September 30, 2011, and September 30, 2010, respectively; and ($3,801) and ($3,777) for the nine months ended September 30, 2011, and September 30, 2010, respectively. | 4,306 | 3,169 | 7,378 | 7,332 |
| Unrealized loss on derivatives, net of tax effect of $77 and $88 for the three month periods ending September 30, 2011 and September 30, 2010, respectively; and $97 and $262 for the nine month periods ended September 30, 2011, and September 30, 2010, respectively. | (149) | (171) | (188) | (509) |
| Reclassification adjustment for gains included in net income, net of tax effect of $424 and $360 for the three month periods ended September 30, 2011 and September 30, 2010, respectively; and $781 and $607 for the nine month periods ended September 30, 2011, and September 30, 2010, respectively. | (823) | (700) | (1,516) | (1,179) |
| Comprehensive income | $ 4,962 | 4,066 | 6,265 | 11,343 |

See accompanying Notes to Unaudited Consolidated Condensed Financial Statements.

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**HOPFED BANCORP, INC.**

**Consolidated Condensed Statement of Stockholders Equity**

**For the Nine Month Period Ended September 30, 2011**

**(Dollars in Thousands, Except Share Amounts)**

**(Unaudited)**

| | Shares | | | | | | | Accumulated | |
|---|---|---|---|---|---|---|---|---|---|
| | Common Stock | Preferred Stock | Common Stock | Common Stock Warrants | Additional Capital Surplus | Retained Earnings | Treasury Stock | Other Comprehensive Income | Total Stockholders Equity |
| Balance at December 31, 2010 | 7,334,963 | 18,400 | $ 77 | 556 | 74,920 | 39,994 | (5,076) | 973 | 111,444 |
| Restricted stock awards | 10,972 | | 1 | | | | | | 1 |
| Consolidated net income | | | | | | 591 | | | 591 |
| Compensation expense, restricted stock awards | | | | | 90 | | | | 90 |
| Net change in unrealized gain on securities available for sale, net of income taxes of $3,020 | | | | | | | | 5,862 | 5,862 |
| Net change in unrealized (loss) on derivatives, net of income tax benefit of $97 | | | | | | | | (188) | (188) |
| Cash dividend to preferred stockholder | | | | | | (690) | | | (690) |
| Accretion of preferred stock discount | | | | | 83 | (83) | | | |
| Cash dividend to common stockholders | | | | | | (1,321) | | | (1,321) |
| Common stock dividend | 146,485 | | 1 | | 819 | (820) | | | |
| Balance September 30, 2011 | 7,492,420 | 18,400 | $ 79 | 556 | 75,912 | 37,671 | (5,076) | 6,647 | 115,789 |

See accompanying Notes to Unaudited Consolidated Condensed Financial Statements

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**HOPFED BANCORP, INC.**

**Consolidated Condensed Statements of Cash Flows**

**(Dollars in Thousands)**

**(Unaudited)**

| | For the Nine Month Period Ended September 30, 2011 | 2010 |
|---|---|---|
| Cash flows from operating activities: | | |
| Net cash provided by operating activities | $ 7,893 | $ 8,674 |
| Cash flows from investing activities | | |
| Proceeds from sales, calls and maturities of securities available for sale | 143,369 | 145,250 |
| Purchase of securities available for sale | (158,954) | (234,394) |
| Net (increase) decrease in loans | 23,228 | 14,448 |
| Purchase of Federal Home Loan Bank stock | (50) | (97) |
| Proceeds from sale of foreclosed assets | 7,124 | 2,961 |
| Purchase of premises and equipment | (665) | (467) |
| Net cash provided by (used in) investing activities | 14,052 | (72,299) |
| Cash flows from financing activities: | | |
| Net increase in demand deposits | 8,631 | 35,393 |
| Net increase (decrease) in time and other deposits | (24,044) | 2,239 |
| Increase in advances from borrowers for taxes and insurance | 384 | 270 |
| Advances from Federal Home Loan Bank | 30,000 | 39,000 |
| Repayment of advances from Federal Home Loan Bank | (42,708) | (43,701) |
| Net increase (decrease) in repurchase agreements | (1,696) | 17,407 |
| Sale of common stock | | 28,952 |
| Sale of treasury stock | | 1,419 |
| Dividend paid on preferred stock | (690) | (690) |
| Dividends paid on common stock | (1,758) | (1,693) |
| Net cash provided by financing activities | (31,881) | 78,596 |
| Increase (decrease) in cash and cash equivalents | (9,936) | 14,971 |
| Cash and cash equivalents, beginning of period | 60,984 | 41,111 |
| Cash and cash equivalents, end of period | $ 51,048 | 56,082 |
| Supplemental disclosures of Cash Flow Information: | | |
| Interest paid | $ 7,447 | 9,026 |
| Income taxes paid | $ 1,445 | 3,250 |
| Supplemental disclosures of non-cash investing and financing activities: | | |
| Loans charged off | $ 2,069 | 2,898 |

| | | | |
|---|---|---|---|
| Foreclosures and in substance foreclosures of loans during period | $ | 3,515 | 3,532 |
| Net unrealized gains on investment securities classified as available for sale | $ | 8,882 | 9,323 |
| Increase (decrease) in deferred tax asset related to unrealized gains on investments | $ | (2,923) | (3,170) |
| Dividends declared and payable | $ | 176 | 613 |
| Issue of unearned restricted stock | $ | 87 | 92 |

See accompanying Notes to Unaudited Consolidated Condensed Financial Statements

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## NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(1) BASIS OF PRESENTATION

HopFed Bancorp, Inc. (the Company ) was formed at the direction of Heritage Bank, formerly Hopkinsville Federal Savings Bank (the Bank ), to become the holding company of the Bank upon the conversion of the Bank from a federally chartered mutual savings bank to a federally chartered stock savings bank. The conversion was consummated on February 6, 1998. The Company s primary assets are the outstanding capital stock of the converted Bank, and its sole business is that of the converted Bank. The Bank owns 100% of the stock of Fall and Fall Insurance Agency ( Fall & Fall ) of Fulton, Kentucky. Fall & Fall sells life and casualty insurance to both individuals and businesses. The majority of Fall & Fall s customer base is within the geographic footprint of the Bank.

The Bank operates a mortgage division, Heritage Mortgage Services, in Clarksville, Tennessee with agents located in several of its markets. The Bank has a financial services division, Heritage Solutions, with offices in Murray, Kentucky, Kingston Springs, Tennessee and Pleasant View, Tennessee. Heritage Solutions agents travel throughout western Kentucky and middle Tennessee offering fixed and variable annuities, mutual funds and brokerage services.

The accompanying unaudited financial statements have been prepared in accordance with accounting principles generally accepted ( GAAP ) in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of only normal recurring accruals) necessary for fair representation have been included. The results of operations and other data for the three and nine month periods ended September 30, 2011, are not necessarily indicative of results that may be expected for the entire fiscal year ending December 31, 2011.

The accompanying unaudited financial statements should be read in conjunction with the Consolidated Financial Statements and the Notes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2010. The accounting policies followed by the Company are set forth in the Summary of Significant Accounting Policies in the Company s December 31, 2010 Consolidated Financial Statements.

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(2) INCOME PER SHARE

The following schedule reconciles the numerators and denominators of the basic and diluted income per share ( IPS ) computations for the three and nine month periods ended September 30, 2011, and September 30, 2010. Diluted common shares arise from the potentially dilutive effect of the Company s stock options and warrants outstanding.

| | Three Month Periods Ended | |
|---|---|---|
| | September 30, 2011 | September 30, 2010 |
| Basic IPS: | | |
| Net income available to common stockholders | $ 1,368,000 | $ 1,508,000 |
| Average common shares outstanding | 7,481,448 | 7,416,541 |
| Net income per share available to common shareholders, basic | $ 0.18 | $ 0.20 |
| Diluted IPS | | |
| Net income available to common stockholders | $ 1,368,000 | $ 1,508,000 |
| Average common shares outstanding | 7,481,448 | 7,416,541 |
| Dilutive effect of stock options | | |
| Average diluted shares outstanding | 7,481,448 | 7,416,541 |
| Net income per share available to common shareholders, diluted | $ 0.18 | $ 0.20 |

| | Nine Month Periods Ended | |
|---|---|---|
| | September 30, 2011 | September 30, 2010 |
| Basic IPS: | | |
| Net income (loss) available (attributable) to common stockholders | ($ 180,000) | $ 4,928,000 |
| Average common shares outstanding | 7,456,750 | 5,088,374 |
| Net income (loss) per share available (attributable) to common shareholders, basic | ($ 0.02) | $ 0.97 |
| Diluted IPS | | |
| Net income (loss) available (attributable) to common stockholders | ($ 180,000) | $ 4,928,000 |
| Average common shares outstanding | 7,456,750 | 5,088,374 |
| Dilutive effect of stock options | | |
| Average diluted shares outstanding | 7,456,750 | 5,088,374 |
| Net income (loss) per share available (attributable) to common shareholders, diluted | ($ 0.02) | $ 0.97 |

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(3) STOCK COMPENSATION

The Company incurred compensation cost related to the HopFed Bancorp, Inc. 2004 Long Term Incentive Plan of $29,000 and $90,000 for the three and nine month periods ended September 30, 2011, and $36,000 and $72,000 for the three and nine month periods ended September 30, 2010, respectively. The Company issued 492 and 10,972 shares of restricted stock during the three and nine month periods ended September 30, 2011, respectively. The table below provides a detail of the Company s future compensation expense related to restricted stock vesting at September 30, 2011:

| Year Ending December 31, | | Future Expense (Dollars in Thousands) |
|---|---|---|
| 2011 | $ | 27,388 |
| 2012 | | 88,080 |
| 2013 | | 55,291 |
| 2014 | | 27,312 |
| 2015 | | 9,127 |
| Total | $ | 207,198 |

The compensation committee may make additional awards of restricted stock, thereby increasing the future expense related to this plan. In addition, award vesting may be accelerated due to certain events as outlined in the restricted stock award agreement. Any acceleration of vesting will change the timing of, but not the aggregate amount of, compensation expense incurred.

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(4) SECURITIES

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluations. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

At September 30, 2011, the Company has 21 securities with unrealized losses. The carrying amount of securities and their estimated fair values at September 30, 2011, were as follows:

| | September 30, 2011 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
| | (Dollars in Thousands) | | | |
| Restricted: | | | | |
| FHLB stock | $ 4,428 | | | 4,428 |
| Unrestricted: | | | | |
| U.S. government and agency securities: | | | | |
| Agency debt securities | $ 164,898 | 3,575 | (225) | 168,248 |
| Taxable municipal bonds | 12,849 | 991 | | 13,840 |
| Tax free municipal bonds | 60,340 | 3,483 | | 63,823 |
| Trust preferred securities | 2,000 | | (954) | 1,046 |
| Mortgage-backed securities: | | | | |
| GNMA | 29,600 | 1,354 | | 30,954 |
| FNMA | 58,865 | 2,082 | (23) | 60,924 |
| FHLMC | 16,850 | 565 | | 17,415 |
| NON-AGENCY CMOs | 2,263 | 8 | (302) | 1,969 |
| AGENCY CMOs | 23,564 | 890 | | 24,454 |
| | $ 371,229 | 12,948 | (1,504) | 382,673 |

The carrying amount of securities and their estimated fair values at December 31, 2010, was as follows:

| | December 31, 2010 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
| | (Dollars in Thousands) | | | |
| Restricted: | | | | |
| FHLB stock | $ 4,378 | | | 4,378 |
| Unrestricted: | | | | |
| U.S. government and agency securities: | | | | |
| Agency debt securities | $ 163,365 | 2,921 | (1,882) | 164,404 |
| Tax free municipal bonds | 64,967 | 481 | (1,055) | 64,393 |
| Taxable municipal bonds | 17,037 | 105 | (350) | 16,792 |
| Trust preferred securities | 2,000 | | (723) | 1,277 |
| Mortgage-backed securities: | | | | |
| GNMA | 30,325 | 873 | (184) | 31,014 |
| FNMA | 27,324 | 1,247 | (23) | 28,548 |
| FHLMC | 19,059 | 413 | (29) | 19,443 |
| NON-AGENCY CMOs | 3,711 | 38 | (205) | 3,544 |
| AGENCY CMOs | 27,388 | 1,039 | (104) | 28,323 |
| | $ 355,176 | 7,117 | (4,555) | 357,738 |

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The scheduled maturities of debt securities available for sale at September 30, 2011, were as follows:

| September 30, 2011 | Amortized Cost | Estimated Fair Value |
|---|---|---|
| | (Dollars in Thousands) | |
| Due within one year | $ 455 | $ 460 |
| Due in one to five years | 9,102 | 9,284 |
| Due in five to ten years | 32,909 | 34,446 |
| Due in more than ten years | 73,624 | 76,343 |
| | 116,090 | 120,533 |
| Amortizing agency bonds | 123,997 | 126,424 |
| Mortgage-backed securities | 131,142 | 135,716 |
| Total debt securities available for sale | $ 371,229 | $ 382,673 |

The scheduled maturities of debt securities available for sale at December 31, 2010, were as follows:

| December 31, 2010 | Amortized Cost | Estimated Fair Value |
|---|---|---|
| | (Dollars in Thousands) | |
| Due within one year | $ 778 | 773 |
| Due in one to five years | 6,699 | 6,772 |
| Due in five to ten years | 21,825 | 22,069 |
| Due after ten years | 88,180 | 86,836 |
| | 117,482 | 116,450 |
| Amortizing agency bonds | 129,887 | 130,416 |
| Mortgage-backed securities | 107,807 | 110,872 |
| Total debt securities available for sale | $ 355,176 | 357,738 |

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The estimated fair value and unrealized loss amounts of temporarily impaired investments as of September 30, 2011, are as follows:

| | Less than 12 months | | 12 months or longer | | Total | |
|---|---|---|---|---|---|---|
| | Estimated Fair Value | Unrealized Losses | Estimated Fair Value | Unrealized Losses | Estimated Fair Value | Unrealized Losses |
| Available for sale | | | | | | |
| U.S. government and agency securities: | | | | | | |
| Agency debt securities | $ 37,802 | (206) | 2,003 | (19) | 39,805 | (225) |
| Taxable municipals | | | | | | |
| Tax free municipals | | | | | | |
| Trust preferred securities | | | 1,046 | (954) | 1,046 | (954) |
| Mortgage-backed securities: | | | | | | |
| GNMA | | | | | | |
| FNMA | 6,029 | (21) | 81 | (2) | 6,110 | (23) |
| FHLMC | | | | | | |
| NON-AGENCY CMOs | | | 1,639 | (302) | 1,639 | (302) |
| AGENCY CMOs | | | | | | |
| Total Available for Sale | $ 43,831 | (227) | 4,769 | (1,277) | 48,600 | (1,504) |

The estimated fair value and unrealized loss amounts of temporarily impaired investments as of December 31, 2010, were as follows:

| | Less than 12 months | | 12 months or longer | | Total | |
|---|---|---|---|---|---|---|
| | Estimated Fair Value | Unrealized Losses | Estimated Fair Value | Unrealized Losses | Estimated Fair Value | Unrealized Losses |
| | | | (Dollars in Thousands) | | | |
| Available for sale | | | | | | |
| U.S. government and agency securities: | | | | | | |
| Agency debt securities | $ 90,716 | (1,882) | | | 90,716 | (1,882) |
| Taxable municipal bonds | 10,207 | (345) | 445 | (5) | 10,652 | (350) |
| Tax free municipal bonds | 31,411 | (885) | 5,225 | (170) | 36,636 | (1,055) |
| Trust preferred securities | | | 1,277 | (723) | 1,277 | (723) |
| Mortgage-backed securities: | | | | | | |
| GNMA | 11,871 | (184) | | | 11,871 | (184) |
| FNMA | 3,104 | (22) | 85 | (1) | 3,189 | (23) |
| FHLMC | 8,316 | (29) | | | 8,316 | (29) |
| NON-AGENCY CMOs | | | 2,149 | (205) | 2,149 | (205) |
| AGENCY CMOs | 5,028 | (104) | | | 5,028 | (104) |
| Total Available for Sale | $ 160,653 | (3,451) | 9,181 | (1,104) | 169,834 | (4,555) |

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At September 30, 2011, securities with a book value of approximately $109.6 million and a market value of approximately $117.8 million were pledged to various municipalities for deposits in excess of FDIC limits as required by law. In addition, securities with a book value of $6.6 million and a market value of $6.9 million are pledged as collateral to the Federal Home Loan Bank of Cincinnati. The Federal Home Loan Bank of Cincinnati has issued letters of credit in the Bank s name totaling $48.0 million secured by the Bank s loan portfolio to secure additional municipal deposits.

At September 30, 2011, securities with a book and market value of approximately $43.4 million were sold under agreements to repurchase from various customers. Furthermore, the Company has two wholesale repurchase agreements with third parties secured by investments with a combined book value of $17.2 million and a market value of $17.5 million. One repurchase agreement is in the amount of $6.0 million and has a maturity of September 18, 2016 and is currently callable on a quarterly basis and has a fixed rate of interest of 4.36%. The second repurchase agreement, in the amount of $10.0 million, has a maturity of September 5, 2014, is currently callable quarterly and has a fixed rate of interest of 4.28%.

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(5) LOANS

Set forth below is selected data relating to the composition of the loan portfolio by type of loan at September 30, 2011 and December 31, 2010. At September 30, 2011 and December 31, 2010, there were no concentrations of loans exceeding 10% of total loans other than as disclosed below:

| | September 30, 2011 Amount | September 30, 2011 Percent | December 31, 2010 Amount | December 31, 2010 Percent |
|---|---|---|---|---|
| | | (Dollars in Thousands) | | |
| Real estate loans: | | | | |
| One-to-four family (closed end) first mortgages | $ 171,343 | 29.5% | $ 182,671 | 30.0% |
| Second mortgages (closed end) | 6,684 | 1.1% | 6,196 | 1.0% |
| Home equity lines of credit | 38,252 | 6.6% | 40,191 | 6.6% |
| Multi-family | 33,501 | 5.8% | 29,416 | 4.8% |
| Construction | 16,413 | 2.8% | 23,361 | 3.8% |
| Land | 52,091 | 9.0% | 60,063 | 9.9% |
| Non-residential real estate | 186,821 | 32.1% | 195,285 | 32.0% |
| Total mortgage loans | 505,105 | 86.9% | 537,183 | 88.1% |
| Consumer loans | 16,286 | 2.8% | 18,060 | 3.0% |
| Commercial loans | 59,892 | 10.3% | 54,439 | 8.9% |
| Total other loans | 76,178 | 13.1% | 72,499 | 11.9% |
| Total loans, gross | 581,283 | 100.0% | 609,682 | 100.0% |
| Deferred loan cost, net of income | 285 | | 363 | |
| Less allowance for loan losses | (13,541) | | (9,830) | |
| Total loans | $ 568,027 | | $ 600,215 | |

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The Bank assigns an industry standard NAICS code to each loan in the Bank s portfolio. By assigning a standard code to each type of loan, management can more readily determine concentrations in risk by industry, location and loan type. This information is most useful when analyzing the Bank s non-residential real estate loan portfolio. At September 30, 2011, and December 31, 2010, the Bank s non-residential real estate loan portfolio was made up of the following loan types:

| | Balance September 30, 2011 | Balance December 31, 2010 |
|---|---|---|
| | (Dollars in Thousands) | |
| Land & development | $ 52,091 | 60,063 |
| Construction | 5,556 | 5,179 |
| Manufacturing | 4,476 | 5,358 |
| Professional and Technical | 2,452 | 2,440 |
| Retail Trade | 12,293 | 12,664 |
| Other Services | 18,046 | 20,200 |
| Finance & Insurance | 136 | 144 |
| Agricultural, Forestry, Fishing & Hunting | 33,762 | 40,655 |
| Real Estate and Rental and Leasing | 49,313 | 49,017 |
| Wholesale Trade | 10,541 | 7,779 |
| Arts, Entertainment & Recreation | 5,489 | 5,981 |
| Accomodations / Food Service | 25,512 | 26,439 |
| Healthcare and Social Assistance | 10,251 | 10,588 |
| Educational Services | 32 | 38 |
| Transportation & Warehousing | 1,661 | 1,771 |
| Information | 2,719 | 3,099 |
| Public Administration | 422 | 119 |
| Non-industry | 2,851 | 3,426 |
| Admin Support / Waste Mgmt | 1,309 | 388 |
| Total | $ 238,912 | 255,348 |

The allowance for loan losses totaled $13.5 million at September 30, 2011, $9.8 million at December 31, 2010, and $8.6 million at September 30, 2010. The ratio of the allowance for loan losses to total loans was 2.33% at September 30, 2011, 1.61% at December 31, 2010, and 1.70% at September 30, 2010. The following table indicates the type and level of non-accrual loans at the periods indicated below:

| | September 30, 2011 | December 31, 2010 | September 30, 2010 |
|---|---|---|---|
| | | (Dollars in Thousands) | |
| One-to-four family mortgages | $ 1,857 | 1,559 | 1,953 |
| Home equity line of credit | 137 | 103 | 6 |
| Multi-family | | 301 | 8,414 |
| Construction | | 1,541 | |
| Land | 1,331 | 363 | 296 |
| Non-residential real estate | 639 | 1,043 | 1,272 |
| Consumer assets owned by bank | 9 | 23 | 9 |
| Commercial loans | 278 | 97 | |
| Total non-accrual loans | $ 4,251 | 5,030 | 11,950 |

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The table below presents past due and non-accrual balances at September 30, 2011, by loan classification allocated between performing and non-performing:

| | Currently Performing | 30 - 89 Days Past Due | Non-accrual Loans | Special Mention | Impaired Loans Currently Performing Substandard | Doubtful | Total |
|---|---|---|---|---|---|---|---|
| | (Dollars in Thousands) | | | | | | |
| One-to-four family mortgages | 153,823 | 443 | 1,757 | 9,012 | 6,046 | 262 | 171,343 |
| Home equity line of credit | 36,146 | 5 | 137 | 1,398 | 336 | 230 | 38,252 |
| Junior liens | 5,335 | | 100 | 114 | 1,135 | | 6,684 |
| Multi-family | 21,644 | | | 5,858 | 5,999 | | 33,501 |
| Construction | 10,747 | 166 | | 3,542 | 1,958 | | 16,413 |
| Land | 15,253 | | 1,331 | 25,136 | 9,372 | 999 | 52,091 |
| Non-residential real estate | 149,414 | | 588 | 15,952 | 20,858 | 9 | 186,821 |
| Consumer loans | 15,607 | 81 | 10 | 230 | 337 | 21 | 16,286 |
| Commercial loans | 51,564 | 192 | 328 | 3,130 | 4,658 | 20 | 59,892 |
| Total | 459,533 | 887 | 4,251 | 64,372 | 50,699 | 1,541 | 581,283 |

All loans listed as 30-89 days past due and non-accrual are not performing as agreed. Loans listed as special mentioned, substandard and doubtful are paying as agreed. However, the customer s financial statements may indicate weaknesses in their current cash flow, the customer s industry may be in decline due to current economic conditions, collateral values used to secure the loan may be declining, or the Company may be concerned about the customer s future business prospects.

The Bank does not originate loans it considers sub-prime and is not aware of any exposure to the additional credit concerns associated with sub-prime lending in either the Company s loan or investment portfolios. The Company does have a significant amount of construction and land development loans. Management reports to the Company s Board of Directors on the status of the Company s specific construction and development loans as well as the market trends in those markets in which the Company actively participates.

The Company s annualized net charge off ratios for three month periods ended September 30, 2011, September 30, 2010, and the year ended December 31, 2010, was 0.39%, 0.55% and 0.78%, respectively. The ratios of allowance for loan losses to non-accrual loans at September 30, 2011, September 30, 2010, and December 31, 2010, were 318.49%, 75.44%, and 195.43% respectively. The following table sets forth an analysis of the Bank s allowance for loan losses for the periods ended:

| | September 30, 2011 | December 31, 2010 | September 30, 2010 |
|---|---|---|---|
| | (Dollars in Thousands, Except Percentages) | | |
| Beginning balance, allowance for loan loss | $ 9,830 | 8,851 | 8,851 |
| Charge offs: | | | |
| One-to-four family mortgages | (441) | (403) | (251) |
| Home equity line of credit | (57) | (61) | (61) |
| Junior liens | | | |
| Multi-family | (89) | (1,605) | (365) |
| Construction | (353) | (751) | (606) |
| Land | (198) | (265) | (265) |
| Non-residential real estate | (572) | (1,252) | (515) |
| Consumer loans | (326) | (472) | (346) |
| Commercial loans | (33) | (481) | (488) |
| Total charge offs | (2,069) | (5,290) | (2,897) |
| Recoveries | | | |
| One-to-four family mortgages | 136 | 10 | 11 |
| Home equity line of credit | | 1 | |
| Junior liens | 1 | 5 | 5 |
| Multi-family | | 85 | 30 |
| Construction | | | |
| Land | 30 | 3 | |
| Non-residential real estate | 84 | | 35 |
| Consumer loans | 82 | 184 | 146 |
| Commercial loans | 2 | 11 | 33 |
| Total recoveries | 335 | 299 | 260 |
| Net Charge offs | (1,734) | (4,991) | (2,637) |
| Provision for loan losses | 5,445 | 5,970 | 2,801 |
| Ending balance | $ 13,541 | 9,830 | 9,015 |
| Average loan balance, gross | $ 592,417 | 638,378 | 639,273 |
| Ratio of net charge offs to average outstanding loans during the period | 0.39% | 0.78% | 0.55% |

The determination of the allowance for loan losses is based on management s analysis, performed on a quarterly basis. Various factors are considered, including the market value of the underlying collateral, growth and composition of the loan portfolio, the relationship of the allowance for loan losses to outstanding loans, historical loss experience, delinquency trends and prevailing economic conditions. Although management believes its allowance for loan losses is adequate, there can be no assurance that additional allowances will not be required or that losses on loans will not be incurred.

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The Company conducts annual reviews on all loan relationships above $1.0 million to ascertain the borrowers continued ability to service their debt as agreed. In addition to the credit relationships mentioned above, management may classify any credit relationship once it becomes aware of adverse credit trends for that customer. Typically, the annual review consists of updated financial statements for borrowers and any guarantors, a review of the borrower s credit history with the Company and other creditors, and current income tax information.

As a result of this review, management will classify loans based on their credit risk. Additionally, the Company provides a risk grade for all loans past due more than sixty days. The Company uses the following risk definitions for risk grades:

**Satisfactory** loans of average strength having some deficiency or vulnerability to changing economic or industry conditions. These customers should have reasonable amount of capital and operating ratios. Secured loans may lack in margin or liquidity. Loans to individuals, perhaps supported in dollars of net worth, but with supporting assets may be difficult to liquidate.

**Watch** loans are acceptable credits: (1) that need continual monitoring, such as out-of territory or asset-based loans (since the Bank does not have an asset-based lending department), or (2) with a marginal risk level to business concerns and individuals that; (a) have exhibited favorable performance in the past, though currently experiencing negative trends; (b) are in an industry that is experiencing volatility or is declining, and their performance is less than industry norms; and (c) are experiencing unfavorable trends in their financial position, such as one-time net losses or declines in asset values. These marginal borrowers may have early warning signs of problems such as occasional overdrafts and minor delinquency. If considered marginal, a loan would be a watch until financial data demonstrated improved performance or further deterioration to a substandard grade usually within a 12-month period. In the table on page 23, Watch loans are included with satisfactory loans and classified as Pass.

**Other Loans Especially Mentioned** are currently protected but are potentially weak. These loans constitute an undue and unwarranted credit risk but not to the point of justifying a substandard classification. The credit risk may be relatively minor yet constitutes an unwarranted risk in light of the circumstances surrounding a specific loan. These credit weaknesses, if not checked or corrected, will weaken the loan or inadequately protect the Bank s credit position at some future date.

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A **Substandard** loan is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. The loans are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. This does not imply ultimate loss of the principal, but may involve burdensome administrative expenses and the accompanying cost to carry the credit. Examples of substandard loans include those to borrowers with insufficient or negative cash flow, negative net worth coupled with inadequate guarantor support, inadequate working capital, and/or significantly past-due loans and overdrafts.

A loan classified **Doubtful** has all the weaknesses inherent in a substandard credit except that the weaknesses make collection or liquidation in full (on the basis of currently existing facts, conditions, and values) highly questionable and improbable. The possibility of loss is extremely high, but because of certain pending factors charge-off is deferred until its more exact status may be determined. Pending factors include proposed merger, acquisition, or liquidation procedures, capital injection, perfecting liens on additional collateral, and refinancing plans. The doubtful classification is applied to that portion of the credit in which the full collection of principal and interest is questionable.

A loan is considered to be impaired when management determines that it is possible that the Company will be unable to collect all principal and interest payments due in accordance with the contractual terms of the loan agreement. The value of individually impaired loans is measured based on the present value of expected payments using the fair value of the collateral if the loan is collateral dependent. Currently, it is management s practice to classify all substandard or doubtful loans as impaired. At September 30, 2011, December 31, 2010 and September 30, 2010, the Company s impaired loans totaled $56.8 million, $58.6 million and $39.2 million, respectively. At September 30, 2011, December 31, 2010, and September 30, 2010, the Company s specific reserve for impaired loans totaled $6.0 million, $4.3 million and $3.1 million, respectively.

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A summary of the Company s impaired loans, including their respective regulatory classification and their respective specific reserve at September 30, 2011, were as follows:

| September 30, 2011 | | | Impaired Loans | | | Specific Reserve for Impairment | Reserve for Performing Loans |
|---|---|---|---|---|---|---|---|
| | Pass | Special Mention | Substandard | Doubful | Total | | |
| | | | **(Dollars in Thousands)** | | | | |
| One-to-four family mortgages | $ 154,053 | 9,057 | 7,864 | 369 | 171,343 | 825 | 1,670 |
| Home equity line of credit | 36,146 | 1,403 | 470 | 233 | 38,252 | 143 | 190 |
| Junior liens | 5,335 | 114 | 1,235 | | 6,684 | 71 | 15 |
| Multi-family | 21,644 | 5,858 | 5,999 | | 33,501 | 258 | 1,984 |
| Construction | 10,912 | 3,543 | 1,958 | | 16,413 | 33 | 257 |
| Land | 15,253 | 25,136 | 10,703 | 999 | 52,091 | 1,248 | 443 |
| Non-residential real estate | 149,414 | 15,952 | 21,334 | 121 | 186,821 | 2,814 | 2,356 |
| Consumer loans | 15,687 | 230 | 347 | 22 | 16,286 | 73 | 96 |
| Commercial loans | 51,564 | 3,164 | 4,936 | 228 | 59,892 | 561 | 504 |
| Total | $ 460,008 | 64,457 | 54,846 | 1,972 | 581,283 | 6,026 | 7,515 |

A summary of the Company s impaired loans and their respective reserve at December 31, 2010, were as follows:

| December 31, 2010 | | | Impaired Loans | | | Specific Reserve for Impairment | Reserve for Performing Loans |
|---|---|---|---|---|---|---|---|
| | Pass | Special Mention | Substandard | Doubful | Gross Loans Total | | |
| | | | (Dollars in Thousands) | | | | |
| One-to-four family mortgages | $ 165,864 | 8,121 | 8,388 | 298 | 182,671 | 350 | 746 |
| Home equity line of credit | 39,129 | 499 | 333 | 230 | 40,191 | 105 | 69 |
| Junior liens | 5,514 | 495 | 187 | | 6,196 | 77 | 107 |
| Multi-family | 26,098 | | 3,017 | 301 | 29,416 | 178 | 1,843 |
| Construction | 16,164 | 3,292 | 3,702 | 203 | 23,361 | 108 | 549 |
| Land | 29,858 | 16,930 | 13,275 | | 60,063 | 588 | 276 |
| Non-residential real estate | 160,995 | 11,089 | 22,780 | 421 | 195,285 | 2,540 | 1,489 |
| Consumer loans | 17,488 | 205 | 367 | | 18,060 | 85 | 22 |
| Commercial loans | 47,016 | 2,314 | 5,092 | 17 | 54,439 | 255 | 443 |
| Total | $ 508,126 | 42,945 | 57,141 | 1,470 | 609,682 | 4,286 | 5,544 |

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Impaired loans by classification type and the related valuation allowance amounts at September 30, 2011, were as follows:

| | At September 30, 2011 | | | Nine month period ended 09/30/11 | |
|---|---|---|---|---|---|
| Impaired loans with no recorded reserve | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized |
| One-to-four family mortgages | 3,344 | 3,344 | | 5,846 | 158 |
| Home equity line of credit | 438 | 438 | | 495 | 13 |
| Junior liens | 511 | 511 | | 313 | 9 |
| Multi-family | 2,743 | 2,743 | | 589 | 122 |
| Construction | 1,543 | 1,543 | | 9,786 | 49 |
| Land | 7,947 | 7,947 | | 11,050 | 408 |
| Non-residential real estate | 10,037 | 10,037 | | 11,473 | 387 |
| Consumer assets owned by bank | 86 | 86 | | 590 | 6 |
| Commercial loans | 935 | 935 | | 3,002 | 25 |
| Total | 27,584 | 27,584 | | 43,144 | 1,177 |

| | At September 30, 2011 | | | Nine month period ended 09/30/11 | |
|---|---|---|---|---|---|
| Impaired loans with recorded reserve | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized |
| One-to-four family mortgages | 4,889 | 4,889 | 825 | 4,779 | 137 |
| Home equity line of credit | 265 | 265 | 143 | 446 | 10 |
| Junior liens | 724 | 724 | 71 | 824 | 22 |
| Multi-family | 3,256 | 3,256 | 258 | 1,643 | 38 |
| Construction | 415 | 415 | 33 | 1,034 | 18 |
| Land | 3,755 | 3,755 | 1,248 | 3,558 | 103 |
| Non-residential real estate | 11,419 | 11,419 | 2,814 | 12,322 | 1,159 |
| Consumer assets owned by bank | 283 | 283 | 73 | 94 | 2 |
| Commercial loans | 4,228 | 4,228 | 561 | 749 | 20 |
| Total | 29,234 | 29,234 | 6,026 | 25,449 | 1,509 |
| Total impaired loans | 56,818 | 56,818 | 6,026 | 68,593 | 2,686 |

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On a periodic basis, the Bank may modify the terms of certain loans. In evaluating whether a restructuring constitutes a troubled debt restructuring (TDR), Financial Accounting Standards Board has issued Accounting Standards Update 310 (ASU 310), *A Creditor s Determination of Whether a Restructuring is a Troubled Debt Restructuring.* In evaluating whether a restructuring constitutes a TDR, the Bank must separately conclude that both of the following exist:

The restructuring constitutes a concession

The debtor is experiencing financial difficulties

ASU 310 provides the following guidance for the Bank s evaluation of whether it has granted a concession as follows:

1. If a debtor does not otherwise have access to funds at a market interest rate for debt with similar risk characteristics as the restructured debt, the restructured debt would be considered a below market rate, which may indicate that the Bank may have granted a concession. In that circumstance, the Bank should consider all aspects of the restructuring in determining whether it has granted a concession, the creditor must make a separate assessment about whether the debtor is experiencing financial difficulties to determine whether the restructuring constitutes a TDR.

2. A temporary or permanent increase in the interest rate on a loan as a result of a restructuring does not eliminate the possibility of the restructuring from being considered a concession if the new interest rate on the loan is below the market interest rate for loans of similar risk characteristics.

3. A restructuring that results in a delay in payment that is insignificant is not a concession. However, the Bank must consider a variety of factors in assessing whether a restructuring resulting in a delay in payment is insignificant.

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A summary of the Company s loans classified as Troubled Debt Restructurings (TDR s) that are reported as performing at September 30, 2011 and December 31, 2010, is below:

| | September 30, 2011 | December 31, 2010 |
|---|---|---|
| | (Dollars in Thousands) | |
| One-to-four family mortgages | $ 3,664 | 3,932 |
| Home equity line of credit | | 114 |
| Multi-family | 243 | 246 |
| Construction | | 1,541 |
| Land | 963 | 512 |
| Non-residential real estate | 3,589 | 3,915 |
| Consumer loans | 35 | 69 |
| Commercial loans | 219 | 700 |
| Total TDR | $ 8,713 | 11,029 |
| Less: | | |
| TDR in non-accrual status | | |
| One-to-four family mortgages | (1,501) | (1,181) |
| Home equity line of credit | | |
| Multi-family | | |
| Construction | | (1,338) |
| Land | | (512) |
| Non-residential real estate | (113) | |
| Consumer loans | | |
| Commercial loans | (208) | |
| Total performing TDR | $ 6,891 | $ 7,998 |

(6) REAL ESTATE AND OTHER ASSETS OWNED

The Company s real estate and other assets owned represent properties and personal collateral acquired through customer loan defaults. The property is recorded at the lower of cost or fair value less estimated cost to sell and carrying cost at the date acquired. Any difference between the book value and estimated market value is recognized as a charge off through the allowance for loan loss account. Additional real estate owned and other asset losses may be determined on individual properties at specific intervals or at the time of disposal. In general, the Company will obtain a new appraisal on all real estate owned with a book balance in excess of $100,000 on an annual basis. Additional losses are recognized as a non-interest expense.

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At September 30, 2011, December 31, 2010, and September 30, 2010, the Company had balances in other real estate and assets owned consisting of the following:

| | September 30, 2011 | December 31, 2010 | September 30, 2010 |
|---|---|---|---|
| | | (Dollars in Thousands) | |
| One-to-four family mortgages | $ 218 | 534 | 326 |
| Multi-family | 2,507 | 7,266 | 575 |
| Construction | 535 | 624 | 702 |
| Land | 665 | 482 | 565 |
| Non-residential real estate | 635 | 900 | 470 |
| Consumer assets owned by bank | 1 | 6 | 8 |
| Total other assets owned | 4,561 | 9,812 | 2,646 |
| Total non-accrual loans | 4,251 | 5,030 | 11,950 |
| Total non-performing assets | $ 8,812 | 14,842 | 14,596 |
| Non-performing asset / Total assets | 0.83% | 1.37% | 1.30% |

The following is a summary of the activity in the Company s real estate and other assets owned for the nine month period ending September 30, 2011:

| | Balance 12/31/2010 | Activity During 2011 Foreclosures | Sales | Reduction in Values | Gain (Loss) on Sale | Balance 9/30/2011 |
|---|---|---|---|---|---|---|
| | | (Dollars in Thousands) | | | | |
| One-to-four family mortgages | $ 534 | 887 | (1,083) | (111) | (9) | 218 |
| Multi-family | 7,266 | | (2,892) | (773) | (1,094) | 2,507 |
| Construction | 624 | 1,144 | (1,282) | (15) | 64 | 535 |
| Land | 482 | 1,070 | (1,325) | (25) | 463 | 665 |
| Non-residential real estate | 900 | 265 | (391) | (117) | (22) | 635 |
| Consumer assets owned by bank | 6 | 149 | (151) | | (3) | 1 |
| Total | $ 9,812 | 3,515 | (7,124) | (1,041) | (601) | 4,561 |

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(7) INVESTMENTS IN AFFILIATED COMPANIES

Investments in affiliated companies accounted for under the equity method consist of 100% of the common stock of HopFed Capital Trust 1 ( Trust ), a wholly-owned statutory business trust. The Trust was formed on September 25, 2003. Summary financial information for the Trust follows (dollars in thousands):

| Summary Statements of Financial Condition | At September 30, 2011 | At December 31, 2010 |
|---|---|---|
| Asset - investment in subordinated debentures issued by HopFed Bancorp, Inc. | $ 10,310 | 10,310 |
| Liabilities | | |
| Stockholder s equity trust preferred securities | 10,000 | 10,000 |
| Common stock (100% Owned by HopFed Bancorp, Inc.) | 310 | 310 |
| Total stockholders equity | $ 10,310 | 10,310 |

| Summary Income Statements | Three Month Periods Ended September 30, | | Nine Month Periods Ended September 30, | |
|---|---|---|---|---|
| | 2011 | 2010 | 2011 | 2010 |
| Income interest income from subordinated debentures issued by HopFed Bancorp, Inc. | $ 91 | 95 | $ 265 | 270 |
| Net income | $ 91 | 95 | $ 265 | 270 |

Summary Statement of Stockholders Equity

| | Trust Preferred Securities | Common Stock | Retained Earnings | Total Stockholders Equity |
|---|---|---|---|---|
| Beginning balances, December 31, 2010 | $ 10,000 | 310 | | 10,310 |
| Net income | | | 265 | 265 |
| Dividends: | | | | |
| Trust preferred securities | | | (257) | (257) |
| Common paid to HopFed Bancorp, Inc. | | | (8) | (8) |
| Ending balances, September 30, 2011 | $ 10,000 | 310 | | 10,310 |

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(8) FAIR VALUE OF ASSETS AND LIABILITIES

In September 2006, the FASB issued ASC 820-10*, Fair Value Measurements.* This Statement defines fair value, establishes a framework for measuring fair value and expands disclosure about fair value. The statement establishes a fair value hierarchy which requires an entity to maximize the use of observable input and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value.

Level 1 is for assets and liabilities that management has obtained quoted prices (unadjusted for transaction cost) or identical assets or liabilities in active markets that the Company has the ability to access as of the measurement date.

Level 2 is for assets and liabilities in which significant unobservable inputs other than Level 1 prices such as quoted prices for similar assets and liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3 is for assets and liabilities in which significant unobservable inputs that reflect a reporting entity s own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The fair values of securities available for sale are determined by a matrix pricing, which is a mathematical technique that is widely used in the industry to value debt securities without exclusively using quoted prices for the individual securities in the Company s portfolio but rather by relying on the securities relationship to other benchmark quoted securities. Impaired loans are valued at the net present value of expected payments using the fair value of any assigned collateral. The values for bank owned life insurance are obtained from stated values from the respective insurance companies. The liability associated with the Company s derivative is obtained from a quoted value supplied by our correspondent banker. The value of real estate owned is obtained from appraisals completed on properties at the time of acquisition and annually thereafter.

Assets and Liabilities Measured on a Recurring Basis

The assets and liabilities measured at fair value on a recurring basis are summarized below:

| September 30, 2011<br>Description | Total carrying value in the consolidated balance sheet at September 30, 2011 | Quoted Prices In Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| Assets | | | | |
| Available for sale securities | $ 382,673 | | 381,627 | 1,046 |
| Bank owned life insurance | 9,069 | | 9,069 | |
| Liabilities | | | | |
| Interest rate swap | 1,373 | | 1,373 | |

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| December 31, 2010<br>Description | Total carrying value in the consolidated condensed Statement of Financial Position at December 31, 2010 | Quoted Prices In Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| Assets | | | | |
| Available for sale securities | $ 357,738 | | 356,461 | $ 1,277 |
| Bank owned life insurance | 8,819 | | 8,819 | |
| Liabilities | | | | |
| Interest rate swap | 1,088 | | 1,088 | |

The assets and liabilities measured at fair value on a non-recurring basis are summarized below for September 30, 2011:

| September 30, 2011<br>Description | Total carrying value in the consolidated balance sheet at September 30, 2011 | Quoted Prices In Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| Assets | | | | |
| Other real estate owned | $ 4,560 | | | $ 4,560 |
| Other assets owned | 1 | | | 1 |
| Impaired loans, net of reserve of $6,026 | 50,792 | | | 50,792 |

The assets and liabilities measured at fair value on a non-recurring basis are summarized below for December 31, 2010:

| December 31, 2010<br>Description | Total carrying value in the consolidated condensed Statement of Financial Condition at December 31, 2010 | Quoted Prices In Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| Assets | | | | |
| Other real estate owned | $ 9,806 | | | $ 9,806 |
| Other assets owned | 6 | | | 6 |
| Impaired loans, net of reserve of $4,286 | 54,325 | | | 54,325 |

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The table below includes a roll-forward of the consolidated condensed statement of financial condition items for the nine-month periods ended September 30, 2011, and September 30, 2010, (including the change in fair value) for assets and liabilities classified by HopFed Bancorp, Inc. within level 3 of the valuation hierarchy for assets and liabilities measured at fair value on a recurring basis. When a determination is made to classify an asset or liability within level 3 of the valuation hierarchy, the determination is based upon the significance of the unobservable factors to the overall fair value measurement. However, since level 3 assets and liabilities typically include, in addition to the unobservable or level 3 components, observable components (that is components that are actively quoted and can be validated to external sources), the gains and losses in the table below include changes in fair value due in part to observable factors that are part of the valuation methodology.

| | 2011 | | 2010 | |
|---|---|---|---|---|
| Nine month period ended September 30, | Other Assets | Other Liabilities | Other Assets | Other Liabilities |
| | (Dollars in Thousands) | | | |
| Fair value, January 1, | $ 1,277 | | 1,426 | |
| Change in unrealized losses included in other comprehensive income for assets and liabilities still held at September 30, | (231) | | (149) | |
| Purchases, issuances and settlements, net | | | | |
| Transfers in and/or out of Level 3 | | | | |
| Fair value, September 30, | $ 1,046 | | 1,277 | |

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The estimated fair values of financial instruments were as follows at September 30, 2011:

| | Carrying Amount | Estimated Fair Value |
|---|---|---|
| | (Dollars in Thousands) | |
| Financial assets: | | |
| Cash and due from banks | $ 44,220 | 44,220 |
| Interest-earning deposits in Federal Home Loan Bank | 6,828 | 6,828 |
| Securities available for sale | 382,673 | 382,673 |
| Federal Home Loan Bank stock | 4,428 | 4,428 |
| Loans receivable | 568,027 | 604,171 |
| Bank owned life insurance | 9,069 | 9,069 |
| Accrued interest receivable | 5,929 | 5,929 |
| Financial liabilities: | | |
| Deposits | 811,516 | 822,160 |
| Advances from borrowers for taxes and insurance | 623 | 623 |
| Advances from Federal Home Loan Bank | 69,197 | 73,110 |
| Repurchase agreements | 43,414 | 48,458 |
| Subordinated debentures | 10,310 | 10,088 |
| Accrued interest payable | 1,306 | 1,306 |
| Market loss on value of interest rate swap | 1,373 | 1,373 |
| Off-balance-sheet liabilities: | | |
| Commitments to extend credit | | |
| Commercial letters of credit | | |

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The estimated fair values of financial instruments were as follows at December 31, 2010:

| | Carrying Amount | Estimated Fair Value |
|---|---|---|
| | (Dollars in Thousands) | |
| Financial assets: | | |
| Cash and due from banks | $ 54,042 | 54,042 |
| Interest-earning deposits in Federal Home Loan Bank | 6,942 | 6,942 |
| Securities available for sale | 357,738 | 357,738 |
| Federal Home Loan Bank stock | 4,378 | 4,378 |
| Loans receivable | 600,215 | 612,694 |
| Bank owned life insurance | 8,819 | 8,819 |
| Accrued interest receivable | 6,670 | 6,670 |
| Financial liabilities: | | |
| Deposits | 826,929 | 835,465 |
| Advances from borrowers for taxes and insurance | 239 | 239 |
| Advances from Federal Home Loan Bank | 81,905 | 85,209 |
| Repurchase agreements | 45,110 | 46,273 |
| Subordinated debentures | 10,310 | 10,092 |
| Accrued interest payable | 1,542 | 1,542 |
| Market loss on value of interest rate swap | 1,088 | 1,088 |
| Off-balance-sheet liabilities: | | |
| Commitments to extend credit | | |
| Commercial letters of credit | | |

(9) ISSUANCE OF PREFERRED SHARES

On December 12, 2008, HopFed Bancorp issued and sold 18,400 shares of preferred stock to the United States Treasury (Treasury) for $18,400,000 pursuant to the Capital Purchase Program. The Company also issued 243,816 common stock warrants to the Treasury as a condition to its participation in the Capital Purchase Program. The warrants have an exercise price of $11.32 each and are immediately exercisable. The warrants expire in ten years from the date of issuance. The preferred stock has no stated maturity and is non-voting, other than having class voting rights on certain matters, and pays cumulative dividends quarterly at a rate of 5% per year for the first five years and 9% thereafter.

On September 22, 2010, and September 21, 2011, the Board of Directors declared a 2% common stock dividend to be paid to shareholders of record on September 30, 2010 and October 3, 2011, respectively. As a result of the common stock dividends, total shares outstanding increased by 143,458 at September 30, 2010, and 146,485 on September 30, 2011. In addition, the Company is obligated to adjust the number and strike price of warrants issued to the United States Treasury under the Capital Purchase Program. At November 10, 2011, the warrant balance is 253,666 shares and the warrant strike price is $10.88.

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(10) STOCK OPTIONS

At September 30, 2011, all stock options outstanding were issued under the HopFed Bancorp, Inc. 1999 Stock Option Plan. At September 30, 2011, the Company can no longer issue options under this plan. The remaining 31,212 options are fully vested and outstanding until their maturity date. At September 30, 2011, the strike price of outstanding options exceeds the current market price of HopFed Bancorp, Inc. stock.

The following is a summary of stock options outstanding at September 30, 2011:

| Exercise Price | Average Remaining Life (Years) | Outstanding Options |
|---|---|---|
| $ 11.85 | 0.9 | 10,404 |
| 16.67 | 2.7 | 20,808 |
| $ 15.06 | 2.1 | 31,212 |

(11) DERIVATIVE INSTRUMENTS

Under guidelines of Financial Accounting Standards Board ( FASB ) ASC 815*, Derivative and Hedging Activities*, as amended, all derivative instruments are required to be carried at fair value on the consolidated statement of financial position. ASC 815 provides special hedge accounting provisions, which permit the change in fair value of the hedge item related to the risk being hedged to be recognized in earnings in the same period and in the same income statement line as the change in the fair value of the derivative.

A derivative instrument designated in a hedge relationship to mitigate exposure to changes in the fair value of an asset, liability or firm commitment attributable to a particular risk, such as interest rate risk, are considered fair value hedges under ASC 815. Derivative instruments designated in a hedge relationship to mitigate exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges. Cash value hedges are accounted for by recording the fair value of the derivative instrument and the fair value related to the risk being hedged of the hedged asset or liability on the consolidated statement of financial position with corresponding offsets recorded in the consolidated statement of financial position.

The adjustment to the hedged asset or liability is included in the basis of the hedged item, while the fair value of the derivative is recorded as a freestanding asset or liability. Actual cash receipts or payments and related amounts accrued during the period on derivatives included in a fair value hedge relationship are recorded as adjustments to the income or expense recorded on the hedged asset or liability.

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Under both the fair value and cash flow hedge methods, derivative gains and losses not effective in hedging the change in fair value or expected cash flows of the hedged item are recognized immediately in the income statement. At the hedge s inception and at least quarterly thereafter, a formal assessment is performed to determine whether changes in the fair values or cash flows of the derivative instrument has been highly effective in offsetting changes in the fair values or cash flows of the hedged items and whether they are expected to be highly effective in the future. If it is determined a derivative instrument has not been, or will not continue to be highly effective as a hedge, hedged accounting is discontinued. ASC 815 basis adjustments recorded on hedged assets and liabilities are amortized over the remaining life of the hedged item beginning no later than when hedge accounting ceases. There were no fair value hedging gains or losses, as a result of hedge ineffectiveness, recognized for the three and nine month periods ended September 30, 2011, or the year ended December 31, 2010.

In October of 2008, the Bank entered into an interest rate swap agreement for a term of seven years and an amount of $10.0 million. The Bank will pay a fixed rate of 7.27% for seven years and receive an amount equal to the three-month London Interbank Lending Rate (LIBOR) plus 3.10%. The interest rate swap is classified as a cash flow hedge by the Bank and will be tested quarterly for effectiveness. At September 30, 2011, and December 31, 2010, the cost of the Bank to terminate the cash flow hedge was approximately $1,372,630 and $1,088,000, respectively.

(12) REGULATORY AGREEMENT

On April 30, 2010, the Company and the Bank, each entered into an informal Memorandum of Understanding (MOU) with its primary regulator at that time, the Office of Thrift Supervision (OTS). The agreement requires the Company to obtain prior written approval prior to the declaration of a common stock dividend or to receive a cash dividend from the Bank. The Company may continue to pay other normal operating expenses, and may pay interest on HopFed Capital Trust 1 and dividends on preferred stock held by the United States Department of Treasury without regulatory approval if the Bank maintains a Tier 1 Capital Ratio of 9.00% and a Total Risk Based Capital Ratio of 12.00%. At September 30, 2011, the Bank s Tier 1 Ratio was 9.75% and its Total Risk Based Capital was 17.10%.

Under the Bank MOU, among other things, the Bank has agreed to the following: (1) the Bank will not declare or pay any dividends or make other capital distributions, or commit to pay dividends or make other capital distributions, without prior regulatory approval; (2) the Bank will adopt a concentration risk reduction plan to reduce the outstanding balance of commercial real estate loans relative to core capital and the allowance for loan losses; and (3) the Bank will not increase brokered deposits without prior regulatory approval.

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In addition, the MOUs identify actions, policies and procedures to be taken and adopted by the Board of Directors and management of the Company and the Bank, as appropriate, to ensure maintenance of adequate liquidity, monitor and report compliance with the MOUs and certain applicable regulations, reduce the level of classified assets, and correct certain deficiencies and weaknesses identified by the regulator. The MOUs will remain in effect until modified or terminated by the regulator.

The Board of Directors and management of each of the Company and the Bank have taken various actions to comply with the terms and conditions of the MOUs, and will continue to take all actions believed to be necessary for compliance. The Board and management will continue to work closely with its regulators in order to comply with the terms and conditions of the MOUs and are committed to addressing and resolving any and all issues presented in the MOUs.

(13) REGULATORY CHANGES

Effective July 21, 2011, pursuant to Section 312 of Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act ) (i) the regulatory functions and rulemaking authority of the OTS with regard to federally chartered savings and loans associations (including the Company s wholly owned bank subsidiary) were transferred to the Office of the Comptroller of the Currency ( OCC ) and the (ii) regulatory functions and rulemaking authority of the OTS in regards to saving and loan companies, including HopFed Bancorp, Inc., were transferred to the Board of Governors of the Federal Reserve System ( FRB ). Beginning on July 21, 2011, the OCC became the primary regulator of the Bank and is vested with the authority to enforce the Bank s MOU. Also beginning July, 21, 2011, the Company became subject to the regulation of the FRB, which is vested with authority to enforce the Company s MOU.

The Bank is subject to various regulatory capital requirements now administered by the Office of the Comptroller of the Currency as successor to the OTS (see discussion above regarding Regulatory Changes ). Failure to meet minimum capital requirements can result in certain mandatory and possible additional discretionary actions by regulators that, if undertaken, could have a direct and material effect on the Bank s financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank s assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Bank s capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors

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(14) EFFECT OF NEW ACCOUNTING PRONOUNCEMENTS

In July 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2010-20, *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*. ASU 2010-20 provides enhanced disclosures related to the credit quality of financing receivables and the allowance for credit losses, and provides that new and existing disclosures should be disaggregated based on how an entity develops its allowance for credit losses and how it manages credit exposures.

Under the provisions of ASU 2010-20, additional disclosures required for financing receivables include information regarding the aging of past due receivables, credit quality indicators, and modifications of financing receivables. The provisions of ASU 2010-20 were effective for periods ending after December 15, 2010, with the exception of the amendments to the roll-forward of the allowance for credit losses which are effective for periods beginning after December 15, 2010. Comparative disclosures are required only for periods ending subsequent to initial adoption. HopFed Bancorp adopted the provisions of ASU 2010-20 and has provided the required disclosures in the consolidated financial statements provided herein.

In 2010, the FASB issued ASU 2010-11, *Scope Exception Related to Embedded Credit Derivatives*. ASU 2010-11 amends ASC 815 to provide clarifying language regarding when embedded credit derivative features are not considered embedded derivatives subject to potential bifurcation and separate accounting. The provisions of ASU 2010-11 are effective for periods beginning after June 15, 2010, and require re-evaluation of certain preexisting contracts to determine whether the accounting for such contracts is consistent with the amended guidance in ASU 2010-11. If the fair value option is elected for an instrument upon adoption of the amendments to ASC 815, re-evaluation of such preexisting contracts is not required. The adoption of this standard did not impact the operating results of the Company.

In January 2011, the FASB issued ASU 2011-01, *Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings in ASU 2010-20* which temporarily delays the effective date of the disclosures about troubled debt restructuring in ASU 2010-20. This delay was intended to allow the FASB time to complete its deliberations on what constitutes a troubled debt restructuring.

In April 2011, the FASB issued ASU 2011-02, *A Creditor s Determination of Whether a Restructuring is a Troubled Debt Restructuring*. The provisions of ASU 2011-02 provide additional guidance related to determining whether a creditor has granted a concession, including factors and examples for creditors to consider in evaluating when a credit restructuring results in a delay in payment that is insignificant, prohibits creditors from using the borrowers interest cost as a factor in determining whether the lender has granted a concession to the borrower, and added factors for creditors to use in determining whether a borrower is experiencing financial difficulties. A provision in ASU 2011-02 ends the FASB s deferral of additional disclosures about troubled debt restructuring as required by ASU 2010-20. The provisions of ASU 2011-02 are effective for the Company s reporting period ending September 30, 2011. The adoption of ASU 2011-02 did not have a material impact on the Company s consolidated financial statements of income, condition and cash flow.

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In September 2011, the FASB issued ASU No. 2011-8, *Intangibles Goodwill and other,* regarding testing goodwill for impairment. The new guidance provides an entity the option to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting until is less than its carrying amount. If an entity determines that this is the case, it is required to perform the currently prescribed two-step goodwill impairment test to identify potential goodwill impairment and measure the amount of goodwill reporting unit is more than its carrying amount, the two-step goodwill impairment test is not required. The new guidance is effective on January 1, 2012. The Company does not anticipate that the implementation of ASU 2011-8 will have a material impact on our consolidated financial statements of income, condition and cash flow.

In June 2011, the FASB issued ASU No. 2011-05, *Comprehensive Income,* new disclosure guidance related to the presentation of the Statement of Comprehensive Income. This guidance eliminates the current option to report other comprehensive income and its components in the statement of changes in equity and requires presentation of reclassification adjustments on the face of the income statement. The effective date of this pronouncement is December 15, 2011. The adoption of this standard will not have a material impact on the Company s consolidated financial statements of income, condition and cash flow.

In May 2011, the FASB issued ASU No. 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in United States of America generally accepted accounting principles (U.S. GAAP) and international Financial Reporting Standards (Topic 820) Fair Value Measurement (ASU 2011-04),* to provide consistent definition of the fair value and ensure that the fair value measurement and disclosure requirements are similar between U.S. GAAP and International Financial Reporting Standards. ASU 2011-04 is effective for reporting periods ending after March 30, 2012, and will be applied prospectively. The Company is currently evaluating the impact of ASU 2011-04.

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

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**Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations**
**Critical Accounting Policies**

The consolidated condensed financial statements as of September 30, 2011, and December 31, 2010, and for the three and nine month periods ended September 30, 2011, and September 30, 2010, included herein have been prepared by the Company, without an audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in interim financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. These financial statements should be read in conjunction with the financial statements and notes thereon included in the Company s 2010 Annual Report to Stockholders on Form 10-K.

Certain of the Company s accounting policies are important to the portrayal of the Company s financial condition, since they require management to make difficult, complex or subjective judgments, some of which may relate to matters that are inherently uncertain. Estimates associated with these policies are susceptible to material changes as a result of changes in facts and circumstances. Facts and circumstances, which could affect these material judgments, include, but without limitation, changes in interest rates, in the performance of the economy or in the financial condition of borrowers. Management believes that its critical accounting policies include determining the allowance for loan losses, determining the fair value of securities and other financial instruments, and assessing other than temporary impairments of securities.

**Comparison of Financial Condition at September 30, 2011, and December 31, 2010**

At September 30, 2011, total assets declined $25.3 million as compared to December 31, 2010 due to lower levels of time deposits. Securities available for sale increased from $357.7 million at December 31, 2010, to $382.7 million at September 30, 2011. At September 30, 2011, and December 31, 2010, securities classified as available for sale had an amortized cost of $371.2 million and $355.2 million, respectively.

The Company s holdings of Federal Home Loan Bank of Cincinnati (FHLB) stock, at cost was $4.4 million at December 31, 2010 and September 30, 2011. Total Federal Home Loan Bank FHLB borrowings declined $12.7 million, from $81.9 million at December 31, 2010, to $69.2 million at September 30, 2011. Total repurchase balances decreased from $45.1 million at December 31, 2010, to $43.4 million at September 30, 2011.

Net loans totaled $568.0 million and $600.2 million at September 30, 2011, and December 31, 2010, respectively. Loan demand is weak for consumer, agricultural and commercial loan products. Given the current weakness in the economy, the Company remains highly selective in both its underwriting standards and types of loans being originated.

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The Company s net loan balances are also adversely affected by the presence of a Memorandum of Understanding and Agreement (MOU) between the Office of Thrift Supervision ( OTS ), the Company and our Bank subsidiary. The MOU remains in effect despite the merger of the OTS by the Office of Comptroller of the current on July 21, 2011.

The Company has made significant increases to its allowance for loan loss account, increasing the allowance to $13.5 million at September 30, 2011, as compared to $9.8 million at December 31, 2010. The provision expense was necessary due to a number of localized factors, including recent flooding and other weather related events that have resulted in poor growing conditions for local farmers, many of whom will lose their crops due to flooded fields. Weather events both here and in Japan have affected local manufacturers, as companies that supply Japanese automakers have been impacted by lower demand in Japan as well as tornadoes locally, which has affected manufacturing production. These factors, as well as a poor economy nationally, have resulted in a higher level of classified loans for the Company.

At September 30, 2011, deposits declined to $811.5 million from $826.9 million at December 31, 2010 as the Company chose not to renew higher costing time deposits. The average cost of all deposits during the three month periods ended September 30, 2011, September 30, 2010, and December 31, 2010, was 1.79%, 2.04% and 1.92%, respectively. Management continually evaluates the investment alternatives available to customers and adjusts the pricing on its deposit products to more actively manage its funding costs while remaining competitive in its market area. Given weak loan demand and poor investment alternatives, the Company has chosen to reduce its balances of higher costing time deposits.

**Comparison of Operating Results for the Nine Month Period Ended September 30, 2011 and 2010**

**Net Income (Loss)**. For the nine months ended September 30, 2011, the Company incurred a net loss attributable to common shareholders of $180,000, compared to net income available to common shareholders of $4,928,000 for the nine months ended September 30, 2010. The net loss attributable to common shareholders for the nine month period ended September 30, 2011, was primarily the result of higher levels of provision for loan loss expenses incurred during the first three months of 2011. The Company s provision for loan loss expense for the nine month period ended September 30, 2011, was $5.4 million as compared to $2.8 million for the nine month period ended September 30, 2010. During the nine month period ended September 30, 2011, the Company incurred $1.9 million in expenses and losses on other real estate owned as compared to a net gain on other real estate of $138,000 for the nine month period ended September 30, 2010.

**Net Interest Income**. Net interest income for the nine month period ended September 30, 2011 was $20.7 million, compared to $22.9 million for the nine month period ended September 30, 2010. The decline in net interest income for the nine months ended September 30, 2011, as compared to September 30, 2010, was largely due to a decline in the average balance of loans outstanding. For the nine month period ended September 30, 2011, the average balance of loans outstanding declined by $55.2 million as compared to the nine month period ended September 30, 2010.

In addition to the decline in average loan balances, the average yield on loans and investments has fallen by 0.29% and 0.78%, respectively. Loan demand remains weak and management anticipates that interest income on loans will continue to decline through the end of 2011. Management s ability to mitigate the decline in loan income is dependent on our ability to reduce the company s interest expenses on deposits.

For the nine month periods ended September 30, 2011 and September 30, 2010, the Company s cost of interest bearing liabilities was 2.17% and 2.50%, respectively. The lower cost of interest bearing liabilities was the result of lower short term interest rates and the re-pricing of retail and brokered time deposits. As outlined on page 51 of this report, the Company s FHLB advances are well diversified by maturity. While this provides a stable level of liquidity and interest rate risk volatility, the Company s ability to quickly reduce our interest expense on FHLB advances is limited by substantial prepayment penalties on these advances.

**Average Balances, Yields and Interest Expenses**. The table below summarizes the overall effect of changes in both interest rates and the average balances of interest earning assets and liabilities for the nine month periods ended September 30, 2011, and September 30, 2010. Yields on assets and cost of liabilities are derived by dividing income or expense by the average daily balances of interest earning assets and liabilities for the appropriate nine-month periods.

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Average balances for loans include loans classified as non-accrual, net of the allowance for loan losses. The table adjusts tax-free investment income by $810,000 for September 30, 2011, and $832,000 for September 30, 2010, for a tax equivalent rate using a cost of funds rate of 2.20% for September 30, 2011, and 2.50% for September 30, 2010. The table adjusts tax-free loan income by $27,000 for September 30, 2011, and $42,000 for September 30, 2010, for a tax equivalent rate using the same cost of funds rate:

| | Average Balance 9/30/2011 | Income and Expense 9/30/2011 | Average Rates 9/30/2011 | Average Balance 9/30/2010 | Income and Expense 9/30/2010 | Average Rates 9/30/2010 |
|---|---|---|---|---|---|---|
| | (Dollars in Thousands, Except Percentages) | | | | | |
| Loans | $ 579,888 | $ 25,281 | 5.81% | $ 635,118 | $ 29,069 | 6.10% |
| Investments AFS taxable | 305,778 | 8,016 | 3.50% | 282,627 | 9,122 | 4.30% |
| Investment AFS tax free | 66,877 | 2,543 | 5.07% | 61,776 | 2,641 | 5.70% |
| Total interest earning assets | 952,543 | 35,840 | 5.02% | 979,521 | 40,832 | 5.56% |
| Other assets | 121,080 | | | 99,898 | | |
| Total assets | $ 1,073,623 | | | $ 1,079,419 | | |
| Retail time deposits | $ 470,894 | 8,608 | 2.44% | $ 492,589 | 10,542 | 2.85% |
| Brokered deposits | 84,139 | 1,222 | 1.94% | 84,415 | 1,564 | 2.47% |
| Now accounts | 137,961 | 1,256 | 1.21% | 123,816 | 1,203 | 1.30% |
| MMDA and savings accounts | 67,369 | 93 | 0.18% | 62,745 | 96 | 0.20% |
| FHLB borrowings | 72,557 | 1,946 | 3.58% | 94,081 | 2,500 | 3.54% |
| Repurchase agreements | 39,676 | 668 | 2.24% | 41,652 | 619 | 1.98% |
| Subordinated debentures | 10,310 | 551 | 7.13% | 10,310 | 557 | 7.20% |
| Total interest bearing liabilities | 882,906 | 14,344 | 2.17% | 909,608 | 17,081 | 2.50% |
| Non-interest bearing deposits | 72,216 | | | 68,434 | | |
| Other liabilities | 4,905 | | | 5,032 | | |
| Shareholders equity | 113,596 | | | 96,345 | | |
| Total liabilities and shareholder equity | $ 1,073,623 | | | $ 1,079,419 | | |
| Net interest income | | $ 21,496 | | | $ 23,751 | |
| Interest rate spread | | | 2.85% | | | 3.06% |
| Net interest margin | | 3.01% | | | 3.23% | |

**Interest Income**. For the nine month period ended September 30, 2011, the Company s total interest income was $35.0 million, as compared to $40.0 million for the nine months ended September 30, 2010. The decline is largely due to a decline in loans outstanding and lower market interest rates. The average balance of loans receivable decreased $55.2 million, from $635.1 million at September 30, 2010 to $579.9 million at September 30, 2011. The decline in the average balance of loans is the result of weak loan demand and management s lessened appetite for construction lending as well as multi-family and commercial real estate. The ratio of average interest-earning assets to average interest-bearing liabilities was 107.69% for the nine months ended September 30, 2010, as compared to 107.89% for the nine months ended September 30, 2011.

**Interest Expense**. Interest expense declined approximately $2.7 million for the nine month period ended September 30, 2011 as compared to the same period in 2010. The decline was attributable to lower market interest rates and lower FHLB borrowing balances. The average cost of interest-bearing retail time deposits declined from 2.85% at September 30, 2010 to 2.44% at September 30, 2011. Over the same period, the average balance of interest bearing retail time deposits declined by $21.7 million, from $492.6 million at September 30, 2010, to $470.9 million at September 30, 2011. The average cost of brokered deposits declined from 2.47% at September 30, 2010 to 1.94% at September 30, 2011. The average cost of all deposits declined from 2.15% at September 30, 2010, to 1.79% at September 30, 2011.

The average balance of funds borrowed from the FHLB declined $21.5 million, from $94.1 million at September 30, 2010, to $72.6 million at September 30, 2011. The average cost funds borrowed from the FHLB increased from 3.54% at September 30, 2010, to 3.58% at September 30, 2011, as shorter term borrowings mature and are not replaced. The average balance of repurchase agreements declined from $41.7 million at September 30, 2010, to $39.7 million at September 30, 2011. The average cost of repurchase agreements increased from 1.98% at September 30, 2010, to 2.24% at September 30, 2011.

**Provision for Loan Losses**. The allowance for loan losses is established through a provision for loan losses based on management s evaluation of the risk inherent in its loan portfolio and the general economy. Such evaluation considers numerous factors including general economic conditions, loan portfolio composition and prior loss experience, the estimated fair value of the underlying collateral and other factors that warrant recognition in providing for an adequate loan loss allowance. The Company determined that an additional $5.4 million in provision for loan loss was required for the nine month period ended September 30, 2011, compared to a $2.8 million in provision for loan loss expense for the nine month period ended September 30, 2010. The increase in the Company s provision expense is largely the result of an increase in loans adversely classified.

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**Non-Interest Income**. There was a $86,000 decline in non-interest income in the nine months ended September 30, 2011 as compared to the same period in 2010. For the nine-month period ended September 30, 2011, service charge income was $2.8 million as compared to $3.0 million during the nine month period ended September 30, 2010. The decline in service charge income is directly related to recent regulatory changes affecting overdraft protection programs on debit card transactions.

For the nine month period ended September 30, 2011, the Company realized gains on the sale of investments totaling $2.3 million, as compared to $1.8 million for the nine month period ended September 30, 2010. For the nine month period ended September 30, 2010, the Company realized gains on the sale of real estate owned totaling $356,000. The Company experienced net losses totaling $1.6 million on other real estate owned during the nine month period ended September 30, 2011. These losses are reported under non-interest expenses on the income statement. The majority of other non-interest income accounts have varied only slightly from prior periods.

**Non-Interest Expenses**. There was a $2.2 million increase in total non-interest expenses in the nine months ended September 30, 2011 compared to the same period in 2010. As mentioned in the prior paragraph, the increase in non-interest expense was significantly influenced by a $1.6 million loss on real estate owned. In the nine month period ended September 30, 2011, salaries and benefits expenses increased by $364,000 as compared to the nine month period ended September 30, 2010 and losses on the disposal of fixed assets were $145,000 for the nine month period ended September 30, 2011, as compared to no losses for the same period in 2010. No other operating expenses increased by more than $100,000 in the comparable periods.

**Income Taxes**. The effective tax rate for the nine months ended September 30, 2011 was 38.8%, compared to 29.6% for the nine month period ended September 30, 2010.

**Comparison of Operating Results for the Three Months Ended September 30, 2011 and 2010**

**Net Income**. The Company s net income available to common shareholders was $1.4 million for the three month period ended September 30, 2011, as compared to net income available to common shareholders of $1.5 million for the three month period ended September 30, 2010. The Company s results for the three month period ended September 30, 2011 were negatively affected by several factors, including $570,000 in losses on other real estate owned and a 10% decline in net interest income for the three month period ended September 30, 2011, as compared to the three month period ended September 30, 2010.

**Net Interest Income**. Net interest income for the three month period ended September 30, 2011, was $6.9 million, compared to $7.7 million for the three month period ended September 30, 2010. The decline in net interest income for the three months ended September 30, 2011, as compared to September 30, 2010, was largely due to a $54.8 million decline in the average balance of loans outstanding. For the three months ended September 30, 2011, the average yield on loans was 5.87%, as compared to 6.04% for the three month period ended September 30, 2010.

For the three month period ended September 30, 2011, income on taxable securities declined to $2.6 million, from $3.2 million for the three month period ended September 30, 2010. For the three month period ended September 30, 2011, the average balance of taxable and tax free securities declined by $4.8 million and $2.4 million, respectively, as compared to the three month period ended September 30, 2010. For the three month period ending September 30, 2011, the tax equivalent yield on tax free securities was 4.84%, compared to 5.53% for the three-month period ended September 30, 2010.

For the three month periods ended September 30, 2011, and September 30, 2010, the Company s cost of interest bearing liabilities was 2.10% and 2.40%, respectively. The lower cost of interest bearing liabilities was the result of lower short term interest rates. However, the decline in yields on interest earnings assets exceeded the decline in the Company s cost of interest bearing liabilities, resulting in a reduced net interest margin. At September 30, 2011, and September 30, 2010, the Company s net interest margin was 3.00% and 3.15%, respectively.

**Average Balances, Yields and Interest Expenses**. The table below summarizes the overall effect of changes in both interest rates and the average balances of interest earning assets and liabilities for the three-month periods ended September 30, 2011, and September 30, 2010. Yields on assets and cost of liabilities are derived by dividing income or expense by the average daily balances of interest earning assets and liabilities for the appropriate three-month periods.

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Average balances for loans include loans classified as non-accrual, net of the allowance for loan losses. The table adjusts tax-free investment income by $250,000 for September 30, 2011, and $292,000 for September 30, 2010, for a tax equivalent rate using a cost of funds rate of 2.00% for September 30, 2011, and 2.40% for September 30, 2010. The table adjusts tax-free loan income by $7,000 for September 30, 2011, and $10,000 for September 30, 2010, for a tax equivalent rate using the same cost of funds rate:

| | Average Balance 9/30/2011 | Income & Expense 9/30/2011 | Average Rates 9/30/2011 | Average Balance 9/30/2010 | Income & Expense 9/30/2010 | Average Rates 9/30/2010 |
|---|---|---|---|---|---|---|
| | (Dollars in Thousands, Except Percentages) | | | | | |
| Loans | $ 568,600 | $ 8,339 | 5.87% | $ 623,398 | $ 9,406 | 6.04% |
| Investments AFS taxable | 316,104 | 2,586 | 3.27% | 320,891 | 3,165 | 3.95% |
| Investment AFS tax free | 64,712 | 782 | 4.84% | 67,111 | 927 | 5.53% |
| Total interest earning assets | 949,416 | 11,707 | 4.93% | 1,011,400 | 13,498 | 5.34% |
| Other assets | 118,896 | | | 104,919 | | |
| Total assets | $ 1,068,312 | | | $ 1,116,319 | | |
| Retail time deposits | $ 475,287 | 2,773 | 2.33% | $ 487,998 | 3,337 | 2.74% |
| Brokered deposits | 76,557 | 374 | 1.95% | 83,632 | 488 | 2.33% |
| Now accounts | 133,022 | 358 | 1.08% | 140,826 | 431 | 1.22% |
| MMDA and savings accounts | 68,913 | 38 | 0.22% | 62,920 | 57 | 0.36% |
| FHLB borrowings | 70,575 | 625 | 3.54% | 89,874 | 818 | 3.64% |
| Repurchase agreements | 39,323 | 238 | 2.42% | 46,459 | 213 | 1.83% |
| Subordinated debentures | 10,310 | 186 | 7.22% | 10,310 | 193 | 7.49% |
| Total interest bearing liabilities | 873,987 | 4,592 | 2.10% | 922,019 | 5,537 | 2.40% |
| Non-interest bearing deposits | 74,077 | | | 69,962 | | |
| Other liabilities | 4,983 | | | 5,503 | | |
| Stockholders equity | 115,265 | | | 118,835 | | |
| Total liabilities and stockholders equity | $ 1,068,312 | | | $ 1,116,319 | | |
| Net interest income | | $ 7,115 | | | $ 7,961 | |
| Interest rate spread | | | 2.83% | | | 2.94% |
| Net yield on interest earning assets | | 3.00% | | | 3.15% | |

**Interest Income**. For the three month periods ended September 30, 2011, and September 30, 2010, the Company s total interest income was $11.5 million and $13.2 million, respectively. As the Company s loan demand has slowed down, we continue to have a greater dependency on investment income. The average balance of loans receivable declined from $623.4 million for the three months ended September 30, 2010, to $568.6 million for the three month period ended September 30, 2011. The ratio of average interest-earning assets to average interest-bearing liabilities decreased from 109.69% for the three months ended September 30, 2010, to 108.63% for the three months ended September 30, 2011.

**Interest Expense**. Interest expense declined approximately $945,000 for the three months ended September 30, 2011, as compared to September 30, 2010. The decline was attributable to lower market interest rates, the re-pricing of higher costing deposits, and a reduction in the average balance of FHLB borrowings. The average cost of interest-bearing retail time deposits declined from 2.74% for the three month period ended September 30, 2010, to 2.33% for the three months ended September 30, 2011. Over the same period, the average balance of interest bearing retail time deposits declined $12.7 million, from $488.0 million for the three months ended September 30, 2010, to $475.3 million for the three months ended September 30, 2011.

The average balance cost of brokered deposits declined from 2.33% for the three months ended September 30, 2010, to 1.95% for the three months ended September 30, 2011. Over the same period, the average balance of brokered deposits declined $7.0 million to $76.6 million for the three month period ended September 30, 2011. For the three month period ended September 30, 2011, the Company s total cost of deposits was 1.71% as compared to 2.04% for the three month period ended September 30, 2010.

The average balance of funds borrowed from the FHLB declined $19.3 million, from $89.9 million for the three months ended September 30, 2010, to $70.6 million for the three month period ended September 30, 2011. The average cost of borrowed funds from the FHLB increased from 3.64% for the three months ended September 30, 2010, to 3.54% for the three months ended September 30, 2011. The average balance of repurchase agreements declined from $46.5 million for the three months ended September 30, 2010, to $39.3 million for the three months ended September 30, 2011. The average cost of repurchase agreements increased from 1.83% for the three months ended September 30, 2010, to 2.42% for the three months ended September 30, 2011.

**Provision for Loan Losses**. The allowance for loan losses is established through a provision for loan losses based on management s evaluation of the risk inherent in its loan portfolio and the general economy. Such evaluation considers numerous factors including general economic conditions, loan portfolio composition and prior loss experience, the estimated fair value of the underlying collateral and other factors that warrant recognition in providing for an adequate loan loss allowance. The Company determined that an additional $1.3 million in provision for loan loss was required for the three months ended September 30, 2010, compared to a $475,000 in provision for loan loss expense for the three months ended September 30, 2011.

**Non-Interest Income**. There was a $200,000 increase in non-interest income in the three months ended September 30, 2011, as compared to the same period in 2010. The increase in non-interest income was largely the result of increases in gains realized on the sale of investments and loans. For the three month period ended September 30, 2011, the Company earned $295,000 in mortgage origination income as compared to $204,000 during the three month period ended September 30, 2010. Likewise, the Company s gains on the sale of investments increased by $187,000 for the three month period ended September 30, 2011, as compared to the three month period ended September 30, 2010. These increases were partially offset by a decline in other income, largely the result of lower fee income associated with loan originations.

**Non-Interest Expenses**. There was a $271,000 increase in total non-interest expenses in the three-month period ended September 30, 2011, as compared to the same period in 2010. The most significant change in non-interest expenses was $570,000 in loss on other real estate owned as compared to a $63,000 gain experienced during the three-month period ended September 30, 2010. New appraised values on several Company owned properties have declined in the last year, requiring the Company to reduce the book value of these properties. During the three month period ended September 30, 2011, the Company reduced its balance in other real estate owned from $10.0 million to $4.6 million. The Company has active contracts to sell an additional $1.8 million in properties during the fourth quarter of 2011. By reducing the portfolio of other real estate owned, we anticipate that we can sharply reduce this expense in future periods.

For the three months ended September 30, 2011, salaries and benefits expense increased by $123,000 over the three month period ended September 30, 2010. For the three month period ended September 30, 2011, no other operating expenses increased by more than $100,000 as compared to the three month period ended September 30, 2011.

**Income Taxes**. The effective tax rate for the three-month periods ending September 30, 2011 and September 30, 2010, was 35.8% and 30.8%, respectively.

**Liquidity and Capital Resources**. The Company has no business other than that of the Bank. Management believes that dividends that may be paid by the Bank to the Company will provide sufficient funds for its current needs. However, no assurance can be given that the Company will not have a need for additional funds in the future. The Bank is subject to certain regulatory limitations with respect to the payment of dividends to the Company. In the past, the Company has been required to seek approval from the Office of Thrift Supervision prior to the declaration of a dividend to common shareholders. Currently , we are required to seek approval for each cash common dividend payment to the Federal Reserve Bank.

As discussed in Note 13 of Notes to Unaudited Consolidated Condensed Financial Statements section of this report, the Bank may not increase the amount of brokered deposits outstanding without prior written approval from the Office of Comptroller of Currency. The Bank uses brokered deposits to supplement its asset liability need for longer term deposits at reasonable prices. In addition to the coupon rate listed below, brokered deposits carry an additional 0.25% that includes the cost of selling and servicing the deposits. The Company includes this cost as interest expense on its income statement.

At September 30, 2011, the Company s brokered deposits consisted of the following:

| Issue Date | Interest Rate | Current Balance | Maturity Date |
|---|---|---|---|
| 10/9/2008 | 4.78% | $ 304,288 | 10/6/2011 |
| 10/23/2009 | 1.65% | 2,020,000 | 10/24/2011 |
| 2/16/2010 | 1.00% | 4,000,000 | 11/16/2011 |
| 2/16/2010 | 1.00% | 2,000,000 | 12/16/2011 |
| 9/22/2009 | 2.00% | 5,077,000 | 3/22/2012 |
| 9/29/2010 | 0.60% | 2,076,000 | 6/30/2012 |
| 7/1/2011 | 0.25% | 4,000,000 | 7/1/2012 |
| 10/16/2009 | 2.30% | 3,011,000 | 10/16/2012 |
| 3/3/2010 | 1.75% | 2,032,000 | 3/4/2013 |
| 1/22/2010 | 2.20% | 3,092,000 | 7/22/2013 |
| 8/19/2010 | 2.12% | 2,037,174 | 8/13/2013 |
| 3/2/2010 | 2.00% | 3,204,000 | 9/2/2013 |
| 10/26/2009 | 2.00% | 5,215,000 | 10/28/2013(1) |
| 9/22/2010 | 1.15% | 2,144,000 | 3/22/2014(1) |
| 7/1/2011 | 1.00% | 3,000,000 | 5/1/2014 |
| 8/11/2009 | 3.00% | 5,095,000 | 8/11/2014(1) |
| 3/9/2010 | 2.00% | 5,078,000 | 3/9/2015 |
| 7/26/2010 | 1.25% | 4,093,000 | 7/26/2015(1) |
| 12/21/2010 | 1.70% | 805,000 | 12/21/2015 |
| 7/1/2011 | 2.00% | 3,052,000 | 1/1/2016 |
| 1/3/2011 | 1.00% | 1,874,000 | 1/3/2016(1) |
| 3/17/2011 | 2.25% | 1,500,000 | 3/17/2016(1) |
| 9/22/2011 | 1.00% | 2,127,000 | 9/22/2017(1) |
| 9/22/2010 | 1.25% | 2,372,000 | 9/22/2020(1) |
| 10/6/2010 | 1.25% | 540,000 | 10/6/2020(1) |
| | | $ 69,748,462 | |

(1) Denotes brokered deposit with rising rate feature in which the Company has a call option.

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The Bank must satisfy three capital standards: a ratio of core capital to adjusted total assets of 4.0%, a tangible capital standard expressed as 1.5% of total adjusted assets, and a combination of core and supplementary capital equal to 8.0% of risk-weighted assets. At September 30, 2011, the Bank exceeded all regulatory capital requirements.

The table below presents certain information relating to the Company s and Bank s capital compliance at September 30, 2011:

| | Company | | Bank | |
|---|---|---|---|---|
| | Amount | Percent | Amount | Percent |
| | **(Dollars in Thousands)** | | | |
| Tangible Capital | $ 119,015 | 11.33% | $ 100,466 | 9.75% |
| Core Capital | $ 119,015 | 11.33% | $ 100,466 | 9.75% |
| Risk Based Capital | $ 126,529 | 19.83% | $ 107,981 | 17.10% |

At September 30, 2011, the Bank had outstanding commitments to originate loans totaling $17.4 million and undisbursed commitments on loans outstanding of $27.3 million. Management believes that the Bank s sources of funds are sufficient to fund all of its outstanding commitments. Certificates of deposits scheduled to mature in one year or less from September 30, 2011, totaled $192.4 million. Management believes that a significant percentage of such deposits will remain with the Bank.

The Bank s FHLB borrowings are secured by a blanket security agreement pledging the Bank s 1-4 family first mortgage loans and non-residential real estate loans. At September 30, 2011, the Bank has pledged all eligible 1-4 family first mortgages, home equity lines of credit and non-residential real estate loans that may be pledged under this agreement.

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At September 30, 2011, the Bank has outstanding borrowings of $69.2 million from the FHLB with maturities two months to seven years. A schedule of FHLB borrowings at September 30, 2011, is provided below:

| Outstanding Balance | Rate | Maturity | Note |
|---|---|---|---|
| | (Dollars in thousands) | | |
| $ 5,000 | 2.56% | 12/09/11 | |
| 5,000 | 1.82% | 12/16/12 | |
| 2,284 | 3.30% | 06/01/13 | Monthly Principal Payments |
| 5,000 | 2.32% | 12/30/13 | |
| 805 | 3.19% | 04/14/14 | Monthly Principal Payments |
| 5,000 | 3.15% | 12/11/14 | |
| 4,000 | 5.34% | 03/17/16 | |
| 7,000 | 4.25% | 05/01/17 | Quarterly callable |
| 10,000 | 4.56% | 06/28/17 | Quarterly callable |
| 10,000 | 4.26% | 08/17/17 | Quarterly callable |
| 15,108 | 3.13% | 01/01/19 | Monthly Principal Payments |
| $ 69,197 | 3.55% | 4.7 years | Weighted average life |

At September 30, 2011, the Bank had $31.7 million in additional borrowing capacity with the FHLB which includes an overnight line of credit and $8 million in overnight borrowing capacity from the Company s correspondent bank.

The Bank s exposure to credit loss in the event of non-performance by the other party to the financial instrument for commitments to extend credit and standby letters of credit and financial guarantees written is represented by the contractual notional amount of those instruments. The Bank uses the same credit policies in making these commitments and conditional obligations as it does for on-balance-sheet instruments.

At September 30, 2011, the Company had the following off-balance sheet commitments (in thousands):

| | |
|---|---|
| Standby letters of credit | $ 1,282 |
| Unused home equity lines of credit | $ 30,978 |
| Unused commercial lines of credit | $ 7,781 |

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**Forward-Looking Statements**

This Quarterly Report on Form 10-Q contains forward-looking statements. Additional written or oral forward-looking statements may be made by the Company from time to time in filings with the Securities and Exchange Commission or otherwise. The words believe, expect, seek, and intend and similar expressions identify forward-looking statements, which speak only as of the date the statement is made. Such forward-looking statements are within the meaning of that term in Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Such statements may include, but are not limited to, projections of income or loss, expenditures, acquisitions, plans for future operations, financing needs or plans relating to services of the Company, as well as assumptions relating to the foregoing.

Forward-looking statements are inherently subject to risks and uncertainties, some of which cannot be predicted or quantified. Future events and actual results could differ materially from those set forth in, contemplated by or underlying the forward-looking statements. The Company does not undertake, and specifically disclaims, any obligation to publicly release the results of revisions, which may be made to forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

The actual results of the Company s asset liability management analysis are highly dependent on the prepayment speed of mortgage backed securities and collateralized mortgage obligations. The United States Treasury s policy of purchasing longer dated Treasury bonds has the result of lowering mortgage loan rates, allowing more consumers to refinance their mortgages and pay-off their current mortgage, resulting in higher prepayment speeds on mortgage investment products.

The effects of rising interest rates are discussed throughout Item 2, Management s Discussion and Analysis of Financial Condition and Results of Operations. Actual results for the year ending December 31, 2011, will differ from simulations due to timing, magnitude, and the frequency or interest rate changes, market conditions, management strategies, and the timing of the Company s cash receipts and disbursements.

The Company s analysis at September 30, 2011, indicates that changes in interest rates are less likely to result in significant changes in the Company s annual net interest income. A summary of the Company s analysis at September 30, 2011, for the twelve month period ending September 30, 2012, is as follows:

| | Down 1.00% | No change | Up 1.00% | Up 2.00% | Up 3.00% |
|---|---|---|---|---|---|
| | | | (Dollars In Thousands) | | |
| Net interest income | $ 27,785 | $ 28,379 | $ 29,025 | $ 29,571 | $ 30,302 |

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**Item 4. Controls and Procedures**

**Evaluation of Disclosure Controls and Procedures.**

In accordance with Rule 13a-15(b) under the Securities Exchange Act of 1934 (the Exchange Act ), an evaluation was carried out with the participation of the Company s management, including the Company s Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company s disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the quarter ended September 30, 2011.

Based upon their evaluation of these disclosure controls and procedures, the Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures were effective as of the end of the three months ended September 30, 2011, to ensure that material information relating to the Company, including its consolidated subsidiaries, was made known to them by others within those entities, particularly during the period in which this quarterly report on Form 10-Q was being prepared.

Any control system, no matter how well conceived and operated, can provide only reasonable assurance that its objectives are achieved. The design of a control system inherently has limitations, including the controls cost relative to their benefits. Additionally, controls can be circumvented. No cost-effective control system can provide absolute assurance that all control issues and instances of fraud will be detected.

The Company is subject to Section 404 of The Sarbanes-Oxley Act of 2002. Section 404 requires management to assess and report on the effectiveness of the Company s internal controls over financial reporting.

**Changes in Internal Control over Financial Reporting**

There were no changes in the Company s internal control over financial reporting during the Company s fiscal quarter ended September 30, 2011, that have materially affected, or are reasonable likely to materially affect, the Company s internal control over financial reporting.

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## PART II. OTHER INFORMATION

**Item 1. Legal Proceedings**

The Company currently has no material pending legal proceedings

**Item 1A. Risk Factors**

Except as set forth below, there have been no material changes to our risk factors as previously disclosed in Part 1, Item 1A of our annual report on Form 10K for the fiscal year ended December 31, 2010, except for the following:

***A failure in our operational systems or infrastructure, or those of third parties, could impair our liquidity, disrupt our businesses, result in the unauthorized disclosure of confidential information, damage our reputation and cause financial losses.***

Our businesses are dependent on their ability to process and monitor, on a daily basis, a large number of transactions, many of which are highly complex, across numerous and diverse markets. These transactions, as well as the information, technology services we provide to clients, often must adhere to client-specific guidelines, as well as legal and regulatory standards. Due to the breadth of our client base and our geographical reach, developing and maintaining our operational systems and infrastructure is challenging, particularly as a result of rapidly evolving legal and regulatory requirements and technological shifts. Our financial, accounting, data processing or other operating systems and facilities may fail to operate properly or become disabled as a result of events that are wholly or partially beyond our control, such as a spike in transaction volume, cyber attack or other unforeseen catastrophic events, which may adversely affect our ability to process these transactions or provide services.

In addition, our operations rely on the secure processing, storage and transmission of confidential and other information on our computer systems and networks. Although we take protective measures to maintain the confidentiality, integrity and availability of our and our clients information across all geographic and product lines, and endeavor to modify these protective measures as circumstances warrant, the nature of the threats continues to evolve. As a result, our computer systems, software and networks may be vulnerable to unauthorized access, loss or destruction of data (including confidential client information), account takeovers, unavailability of service, computer viruses or other malicious code, cyber attacks and other events that could have an adverse security impact. Despite the defensive measures we take to manage our internal technological and operational infrastructure, these threats may originate externally from third parties such as foreign governments, organized crime and other hackers, and outsource or infrastructure-support providers and application developers, or may originate internally from within our organization. Given the increasingly high volume of our transactions, certain errors may be repeated or compounded before they can be discovered and rectified.

We also face the risk of operational disruption, failure, termination or capacity constraints of any of the third parties that facilitate our business activities, including exchanges, clearing agents, clearing houses or other financial intermediaries. Such parties could also be the source of an attack on, or breach of, our operational systems, data or infrastructure. In addition, as interconnectivity with our clients grows, we increasingly face the risk of operational failure with respect to our clients systems.

Although we have not experienced a cyber incident, if one or more of these events occurs, it could potentially jeopardize the confidential, proprietary and other information processed and stored in, and transmitted through, our computer systems and networks, or otherwise cause interruptions or malfunctions in our, as well as our clients or other third parties , operations, which could result in damage to our reputation, substantial costs, regulatory penalties and/or client dissatisfaction or loss. Potential costs of a cyber incident may include, but would not be limited to, remediation costs, increased protection costs, lost revenue from the unauthorized use of proprietary information or the loss of current and/or future customers, and litigation.

We maintain an insurance policy which we believe provides sufficient coverage at a manageable expense for an institution of our size and scope with similar technological systems. However, we cannot assure that this policy would be sufficient to cover all financial losses, damages, penalties, including lost revenues, should we experience any one or more of our or a third party s systems failing or experiencing attack.

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

(a) None

(b) None

(c) None

**Item 3. Defaults Upon Senior Securities**

None

**Item 4. Removed and Reserved**

None

**Item 5. Other Information**

None

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**Item 6. Exhibits**

| | |
|---|---|
| 31.1 | Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 for John E. Peck, Chief Executive Officer. |
| 31.2 | Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 for Billy C. Duvall, Chief Financial Officer. |
| 32.1 | Certification Pursuant to Section 18 U.S.C. Section 1350 for John E. Peck, Chief Executive Officer. |
| 32.2 | Certification Pursuant to Section 18 U.S.C. Section 1350 for Billy C. Duvall, Chief Financial Officer. |
| 101 | The following materials from the Company s quarterly report on Form 10-Q for the three months ended September 30, 2011, formatted in XBRL (eXtensible Business Reporting Language): (i) Condensed Consolidated Statement of Financial Condition of September 30, 2011 and December 31, 2010 (unaudited), (ii) Condensed Consolidated Statements of Income (Loss) for the three and nine months ended September 30, 2011 and 2010 (unaudited), (iii) Condensed Consolidated Statements of Cash Flows, for the nine months ended September 30, 2011 and 2010 (unaudited), and (iv) Notes to Condensed Consolidated Financial Statements (unaudited), tagged as blocks of text. |

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## SIGNATURES

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

| | HOPFED BANCORP, INC. |
|---|---|
| Date: November 10, 2011 | /s/ John E. Peck<br>John E. Peck<br>President and Chief Executive Officer |
| Date: November 10, 2011 | /s/ Billy C. Duvall<br>Billy C. Duvall<br>Senior Vice President, Chief Financial Officer and Treasurer |