

MSB FINANCIAL INC
Form 10QSB
February 13, 2004

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-QSB

QUARTERLY REPORT UNDER SECTION 13 OR 15 (D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended December 31, 2003

OR

TRANSITION REPORT UNDER SECTION 13 OR 15 (D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number **0-24898**

MSB FINANCIAL, INC.

(Exact name of registrant as specified in its charter)

Maryland

38-3203510

(State or other jurisdiction of
incorporation or organization)

(I.R.S. Employer Identification
Number)

**Park and Kalamazoo Avenue, N.E., Marshall,
Michigan**

49068

(ZIP Code)

(Address of principal executive offices)

Registrant's telephone number, including area code: **(269) 781-5103**

As of February 12, 2004, there were 1,306,733 shares of the Registrant's common stock issued and outstanding.

Transitional Small Business Disclosure Format (check one)

Yes No

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MSB FINANCIAL, INC.

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MSB FINANCIAL, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
 December 31, 2003 and June 30, 2003

	December 31, 2003	June 30, 2003
	(Unaudited)	
ASSETS		
Cash and due from financial institutions	\$ 2,575,402	\$ 2,507,954
Interest-bearing deposits in other financial institutions	1,569,325	2,150,108

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See accompanying notes to condensed consolidated financial statements.

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MSB FINANCIAL, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
Six months and three months ended December 31, 2003 and 2002
(Unaudited)

	Six Months		Three Months	
	2003	2002	2003	2002
Interest and dividend income				
Loans receivable, including fees	\$ 2,418,155	\$ 3,074,072	\$ 1,179,144	\$ 1,506,444
Securities available for sale - taxable	127,535	146,355	56,065	62,820
Other interest and dividend income	50,444	67,547	24,717	33,388
	<u>2,596,134</u>	<u>3,287,974</u>	<u>1,259,926</u>	<u>1,602,652</u>
Interest Expense				
Deposits	539,577	765,530	259,334	349,637
Federal Home Loan Bank advances	292,789	402,677	138,950	190,034
Other interest expense	20,348	18,889	10,651	9,686
	<u>852,714</u>	<u>1,187,096</u>	<u>408,935</u>	<u>549,357</u>
Net interest income	<u>1,743,420</u>	<u>2,100,878</u>	<u>850,991</u>	<u>1,053,295</u>
Provision for loan losses	<u>50,000</u>	<u>65,000</u>	<u>20,000</u>	<u>50,000</u>
Net interest income after provision for loan losses	<u>1,693,420</u>	<u>2,035,878</u>	<u>830,991</u>	<u>1,003,295</u>
Noninterest income				
Loan servicing fees, net	10,756	(132,585)	(84,967)	(96,004)
Net gains on sales of loans held for sale	424,221	766,175	82,854	462,083
Service charges on deposit accounts	270,832	262,420	139,532	140,613
Increase in cash surrender value of life insurance	55,159	64,752	22,618	30,424
Debit card/ATM Fees	76,372	85,129	36,041	43,152
Brokerage commission fees	23,750	3,392	12,127	3,391
Net gains (losses) securities available for sale	(30,871)	16,070	(22,796)	4,022

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Other income	95,831	141,837	34,643	62,141
	926,050	1,207,190	389,986	649,822
Noninterest expense				
Salaries and employee benefits	814,037	770,197	408,628	375,998
Occupancy and equipment expense	175,572	197,612	91,015	98,842
Data processing expense	130,569	128,275	67,365	65,448
Federal deposit insurance premiums	22,776	23,840	11,331	13,040
Director fees	51,085	53,370	22,500	26,550
Amortization of intangible assets	35,658	40,886	17,829	20,443
Michigan Single Business tax	40,000	50,000	12,000	27,000
Advertising	71,463	55,463	27,166	24,582
Professional fees	213,039	89,640	147,646	53,135
Other expense	294,594	411,417	149,947	238,733
	<u>1,848,793</u>	<u>1,820,700</u>	<u>955,427</u>	<u>943,771</u>
Income before federal income tax expense	770,677	1,422,368	265,550	709,346
Federal income tax expense	295,000	499,000	121,000	255,000
	<u>\$ 475,677</u>	<u>\$ 923,368</u>	<u>\$ 144,550</u>	<u>\$ 454,346</u>
Comprehensive income	<u>\$ 437,336</u>	<u>\$ 921,294</u>	<u>\$ 158,285</u>	<u>\$ 452,729</u>
Basic earnings per common share	\$ 0.37	\$ 0.75	\$ 0.11	\$ 0.35
Weighted average common shares outstanding	1,297,327	1,233,484	1,299,049	1,281,988
Diluted earnings per common share	\$ 0.36	\$ 0.74	\$ 0.11	\$ 0.35
Weighted average common share and dilutive potential common shares outstanding	1,313,384	1,246,540	1,313,228	1,286,014

See accompanying notes to condensed consolidated financial statements.

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MSB FINANCIAL, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
 Six months ended December 31, 2003
 (Unaudited)

	Common Stock	Additional Paid-In Capital	Retained Earnings	Unearned Employee Stock Ownership Plan Shares	Unearned Recognition and Retention Plan Shares	Treasury Shares	Accumulated Other Comprehensive Income, Net	Total Shareholders' Equity
Balances, July 1, 2003	\$ 16,310	\$ 9,815,648	\$ 9,014,839	\$ (44,328)	\$ (10,853)	\$ (3,567,280)	\$ 5,982	\$ 15,230,318
Comprehensive income								
Net income	-	-	475,677	-	-	-	-	475,677
Other comprehensive income								
Net change in net unrealized gains (losses) on securities available for sale, net of reclassification adjustments and tax effects	-	-	-	-	-	-	(38,341)	(38,341)
Total comprehensive income	-	-	-	-	-	-	-	437,336
Cash dividends declared on common stock, net of dividends on unearned ESOP shares (\$0.23 per share)	-	-	(298,292)	-	-	-	-	(298,292)
4,908 shares committed to be released under the ESOP	-	57,015	-	22,331	-	-	-	79,346
Issuance of 5,942 common shares from treasury stock due to exercise of stock options	-	(9,270)	-	-	-	51,458	-	42,188
Exercise of stock options	-	(22,201)	-	-	-	-	-	(22,201)
Amortization of RRP shares	-	-	-	-	4,080	-	-	4,080
Balances, December 31, 2003	\$ 16,310	\$ 9,841,192	\$ 9,192,224	\$ (21,997)	\$ (6,773)	\$ (3,515,822)	\$ (32,359)	\$ 15,472,775

See accompanying notes to condensed consolidated financial statements.

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MSB FINANCIAL, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
Six months ended December 31, 2002
(Unaudited)

	Common Stock	Additional Paid-In Capital	Retained Earnings	Unearned Employee Stock Ownership Plan Shares	Unearned Recognition and Retention Plan Shares	Treasury Shares	Accumulated Other Comprehensive Income, Net	Total Shareholders' Equity
Balance, July 1, 2002	\$ 16,310	\$ 9,819,238	\$10,330,263	\$ (92,338)	\$ (19,003)	\$(4,011,189)	\$ 14,653	\$16,057,934
Comprehensive Income								
Net income	-	-	923,368	-	-	-	-	923,368
Other comprehensive income								
Net change in net unrealized gains (losses) on securities available for sale, net of reclassification adjustments and tax effects	-	-	-	-	-	-	(2,174)	(2,174)
Total comprehensive income	-	-	-	-	-	-	-	921,194
Cash dividends declared on common stock, net of dividends on unearned ESOP Shares (\$2.22 per share)	-	-	(2,838,136)	-	-	-	-	(2,838,136)
5,400 shares committed to be released under the ESOP	-	43,574	-	24,570	-	-	-	68,144
Issuance of 71,549 common shares from treasury stock due to exercise of stock options	-	(86,441)	-	-	-	606,409	-	519,968
Amortization of RRP Shares	-	-	-	-	4,080	-	-	4,080
Repurchase of 12,500 shares of common stock	-	-	-	-	-	(162,500)	-	(162,500)
Balances, December 31, 2002	\$ 16,310	\$ 9,776,371	\$ 8,415,495	\$ (67,768)	\$ (14,923)	\$(3,567,280)	\$ 12,479	\$14,570,684

See accompanying notes to condensed consolidated financial statements.

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MSB FINANCIAL, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
Six months ended December 31, 2003 and 2002
(Unaudited)

	2003	2002
Cash flows from operating activities		
Net income	\$ 475,677	\$ 923,368
Adjustments to reconcile net income to net cash from operating activities		
Provision for loan losses	50,000	65,000
Mortgage servicing rights valuation adjustment	(70,000)	38,000
Depreciation	82,650	90,693
Amortization of mortgage servicing rights	183,133	197,235
Amortization of intangible assets	35,658	40,886
Net losses (gains) on sales of securities available for sale	30,870	(16,070)
Employee Stock Ownership Plan expense	79,346	68,144
Recognition and Retention Plan expense	4,080	4,080
Originations of loans held for sale	(18,047,686)	(36,436,832)
Proceeds from sales of loans held for sale	19,723,019	36,344,226
Net gains on sales of loans held for sale	(424,221)	(766,175)
Change in assets and liabilities		
Accrued interest receivable	17,510	40,729
Other assets	(3,740)	669,234
Accrued interest payable	(14,431)	(22,851)
Accrued expenses and other liabilities	(2,128,462)	306,044
	(6,597)	1,545,711
Net cash from operating activities		
Cash flows from investing activities		
Proceeds from sales of securities available for sale	7,250,000	7,000,000
Purchases of securities available for sale	(127,535)	(4,646,355)
Principal paydowns on mortgage-backed securities	-	88
Purchase of Federal Home Loan Bank stock	(36,200)	-
Net change in loans	(883,653)	4,668,395
Net purchases of premises and equipment	(10,093)	(10,343)
	6,192,519	7,011,785
Net cash from investing activities		

See accompanying notes to condensed consolidated financial statements.

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MSB FINANCIAL, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
Six months ended December 31, 2003 and 2002
(Unaudited)

Cash flows from financing activities

Net change in deposits	(3,738,574)	(2,843,296)
Repayments on Federal Home Bank advances	(1,974,729)	(2,789,807)
Net change in advance payments by borrowers for taxes and insurance	(707,649)	(598,087)
Cash dividends paid	(298,292)	(2,838,136)
Repurchase of common stock	-	(162,500)
	19,987	519,968
Proceeds from the exercise of stock options	<u>19,987</u>	<u>519,968</u>
Net cash from financing activities	<u>(6,699,257)</u>	<u>(8,711,858)</u>
Net change in cash and cash equivalents	(513,335)	154,362
Cash and cash equivalents at beginning of period	4,658,062	4,673,211
	<u>\$ 4,144,727</u>	<u>\$ 4,518,849</u>
Cash and cash equivalents at end of period	<u>\$ 4,144,727</u>	<u>\$ 4,518,849</u>
Supplemental disclosures of cash flow information		
Cash paid during the period for:		
Interest	\$ 867,145	\$1,209,947
Supplemental disclosures of noncash investing activities		
Transfers from loans receivable to real-estate held in redemption	1,270,589	449,280

See accompanying notes to condensed consolidated financial statements.

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MSB FINANCIAL, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Six months ended December 31, 2003
(Unaudited)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying condensed consolidated financial statements include the accounts of MSB Financial, Inc. and its wholly-owned subsidiary, Marshall Savings Bank, F.S.B. after the elimination of significant intercompany transactions and accounts. The initial capitalization of MSB Financial and its acquisition of Marshall Savings Bank took place on February 6, 1995.

These interim financial statements are prepared in accordance with the Securities and Exchange Commission's rules for quarterly financial information without audit and reflect all adjustments which, in the opinion of management, are necessary to present fairly our financial position at December 31, 2003 and the results of operations and its cash flows for the periods presented. All such adjustments are normal and recurring in nature. The accompanying condensed consolidated financial statements do not purport to contain all the necessary disclosures required by generally accepted accounting principles that might otherwise be necessary in the circumstances and should be read in conjunction with the consolidated financial statements and notes included in the annual report of MSB Financial, Inc. for the year ended June 30, 2003. The results of the periods presented are not necessarily representative of the results of operations and cash flows which may be expected for the entire year.

Goodwill and Other Intangible Assets: Goodwill resulted from our acquisition of a branch on March 15, 2002 and represents the excess of the purchase price over the fair value of acquired tangible assets and liabilities and identifiable intangible assets. Goodwill is assessed at least annually for impairment and any such impairment will be recognized in the period identified.

SFAS No. 148: SFAS No. 123, which became effective for stock-based compensation awarded during fiscal years beginning after December 15, 1995, required annual proforma disclosures for companies that do not adopt its fair value accounting method for stock-based employee compensation for awards granted in the first fiscal year beginning after December 15, 1994. SFAS No. 148 amends SFAS 123 effective the first quarter of 2003 and requires quarterly pro forma disclosures. Accordingly, the following pro forma information presents net income and earnings per share had the fair value method been used to measure compensation cost for stock option plans. The exercise price of options granted is equivalent to the market value of underlying stock at the grant date. Accordingly, compensation cost actually recognized for stock options was \$0 for the six and three month periods ended December 31, 2003 and 2002. No options were granted during the six and three month periods ended December 31, 2003 and 2002. Had compensation cost for stock options been measured using the fair value method, net income and basic and diluted earnings per share would have been the pro forma amounts indicated below. The pro forma effect may increase in the future if more options are granted.

	Six Months		Three Months	
	2003	2002	2003	2002
Net income as reported	\$ 475,677	\$ 923,368	\$ 144,550	\$ 454,346
Proforma net income	\$ 475,511	\$ 922,994	\$ 144,417	\$ 454,159

Reported earnings per common share				
Basic	\$0.37	\$0.75	\$0.11	\$0.35
Diluted	\$0.36	\$0.74	\$0.11	\$0.35
Proforma earnings per common share				
Basic	\$0.37	\$0.75	\$0.11	\$0.35
Diluted	\$0.36	\$0.74	\$0.11	\$0.35

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MSB FINANCIAL, INC.
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
 Six months ended December 31, 2003
 (Unaudited)

NOTE 2 - EARNINGS PER COMMON SHARE

A reconciliation of the numerators and denominators used in the computation of the basic earnings per common share and diluted earnings per common share is presented below for the six and three month periods ended December 31, 2003 and 2002:

	Six Months		Three Months	
	2003	2002	2003	2002
Basic Earnings Per Common Share				
Numerator				
Net Income	\$ 475,677	\$ 923,368	\$ 144,550	\$ 454,346
Denominator				
Weighted average common shares outstanding	1,306,378	1,253,677	1,306,733	1,300,791
Less: Average unallocated ESOP Shares	(7,359)	(17,727)	(6,132)	(16,477)
Less: Average nonvested RRP Shares	(1,692)	(2,466)	(1,552)	(2,326)

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	Six Months		Three Months	
	2003	2002	2003	2002
Weighted average common shares outstanding for basic earnings per common shares	1,297,327	1,233,484	1,299,049	1,281,988
Basic earnings per common share	\$.37	\$.75	\$.11	\$.35
Diluted Earnings Per Common Share				
Numerator				
Net Income	\$ 475,677	\$ 923,368	\$ 144,550	\$ 454,346
Denominator				
Weighted average common shares outstanding for basic earnings per common share	1,297,327	1,233,484	1,299,049	1,281,988
Add: Dilutive effects of average nonvested nonvested RRP shares, net of tax benefits	583	268	761	182
Add: Dilutive effective of assumed exercises of stock options	15,474	12,788	13,418	3,844
Weighted average common shares and dilutive potential common shares outstanding	1,313,384	1,246,540	1,313,228	1,286,014
Diluted earnings per common share	\$.36	\$.74	\$.11	\$.35

Stock options for 67,848 shares of common stock for the three and six month periods ended December 31, 2002 were not considered in computing diluted earnings per common share because they were not dilutive. Zero shares were considered anti-diluted for the 2003 periods.

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MSB FINANCIAL, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Six months ended December 31, 2003
(Unaudited)

NOTE 3 - ALLOWANCE FOR LOAN LOSSES

Activity in the allowance for loan losses is summarized as follows for the six and three month periods ended December 31, 2003 and 2002:

	Six Months		Three Months	
	2003	2002	2003	2002
Balance at beginning of period	\$638,633	\$554,136	\$670,163	512,746
Provision charged to operating expense	50,000	65,000	20,000	50,000
Recoveries credited to allowance	11,450	4,175	9,920	3,823
Less: Loans charged off	(222,985)	(110,175)	(222,985)	(53,433)
Balance at end of period	<u>\$477,098</u>	<u>\$513,136</u>	<u>\$477,098</u>	<u>\$513,136</u>

NOTE 4 - SECONDARY MORTGAGE MARKET ACTIVITIES

The following summarizes our secondary mortgage market activities for the six and three month periods ended December 31, 2003 and 2002:

	Six Months		Three Months	
	2003	2002	2003	2002
Loans originated for resale, net of principal paydowns	\$18,047,686	\$36,436,832	\$3,377,034	\$20,609,456
Proceeds from sales of loans originated for resale	19,723,019	36,344,226	3,565,066	21,811,598
Gain on sales of loans originated for resale	424,221	766,175	82,854	462,083
Portion of gain resulting from costs allocated to mortgage servicing rights	192,988	355,781	34,822	213,496
Loan servicing fees, net	10,756	(132,585)	84,967	(96,004)

Mortgage loans serviced for others are not included in the accompanying condensed consolidated balance sheets. The unpaid principal balances on these loans at December 31, 2003 and June 30, 2003 are summarized as follows:

Loans held for sale balance at September 30, 2003 and June 30, 2003:

December 31, 2003	June 30, 2003
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Mortgage loan portfolios serviced for Freddie Mac	\$ 94,511,000	\$ 92,531,000
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Mortgage loans serviced for others are not included in the accompanying condensed consolidated balance sheets. The unpaid principal balances on these loans at September 30, 2003 and June 30, 2003 are summarized as follows:

	December 31, 2003	June 30, 2003
Mortgage loan portfolios serviced for Freddie Mac	\$ 94,511,000	\$ 92,531,000

Custodial escrow balances maintained in connection with the foregoing serviced loans at December 31, 2003 and June 30, 2003 were \$207,000 and \$598,000, respectively.

NOTE 5 - PENDING MERGER

On September 2, 2003, MSB Financial, Inc. entered into a definitive agreement to be acquired by Monarch Community Bancorp, Inc. for approximately \$18.80 per share. Consideration includes \$15.04 per share in cash and the balance in Monarch Community Bancorp, Inc. common stock. Shareholders at our annual meeting held January 22, 2004 approved the agreement. OTS approval is pending. The transaction is expected to close during the second quarter of calendar 2004.

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Item 2. Management's Discussion and Analysis

The following discussion compares the consolidated financial condition of MSB Financial and Marshall Savings at December 31, 2003 to June 30, 2003 and the results of operations for the three and six month periods ended December 31, 2003 with the same periods ended December 31, 2002. This discussion should be read in conjunction with the condensed consolidated financial statements and footnotes included herein. References in this Form 10-QSB to "we", "us" and "our" refer to MSB Financial and/or Marshall Savings as the context requires.

Forward-Looking Statements Disclosure

This document, including information incorporated by reference, and future filings by MSB Financial, Inc. on Form 10-KSB, Form 10-QSB, and Form 8-K and future oral and written statements by MSB Financial and its management, may contain forward-looking statements about MSB Financial which we believe are within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include, without limitation, statements with respect to anticipated future operating and financial performance, including revenue creation, lending origination, operating efficiencies, loan sales, charge-offs and loan loss provisions, growth opportunities, interest rates, acquisition and divestiture opportunities, and synergies, efficiencies, cost savings and funding advantages expected to be realized from prior acquisitions. These forward-looking statements are based on currently available competitive, financial and economic data and management's views and assumptions regarding future events. These forward-looking statements are inherently uncertain, and investors must recognize that actual results may differ from those expressed or implied in the forward-looking statements. Accordingly, MSB Financial cautions readers not to place undue reliance on any forward-looking statements.

Many of these forward-looking statements appear in this document under Part I, Item 2, "Management's Discussion and Analysis." Words such as may, could, should, would, believe, anticipate, estimate, expect, intend, plan and similar expressions are intended to identify these forward-looking statements. The important factors we discussed below, as well as other factors discussed elsewhere in this document and factors identified in our filings with the SEC and those presented elsewhere by our management from time to time, could cause actual results to differ materially from those indicated by the forward-looking statements made in this document. Among the factors that could cause our actual

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results to differ from these forward-looking statements are:

- the strength of the United States economy in general and the strength of the local economies in which we conduct our operations; general economic conditions, either nationally or regionally, may be less favorable than expected, resulting in, among other things, a deterioration in the credit quality of our loans and other assets;
- the effects of, and changes in, trade, monetary and fiscal policies and laws, including interest rate policies of the Federal Reserve Board;
- financial market, monetary and interest rate fluctuations, particularly the relative relationship of short-term interest rates to long-term interest rates;
- the timely development of and acceptance of our new products and services of MSB Financial and the perceived overall value of these products and services by users, including the features, pricing and quality compared to competitors' products and services;
- the impact of changes in financial services laws and regulations (including laws concerning taxes, accounting standards, banking, securities and insurance); legislative or regulatory changes may adversely affect the business in which we are engaged;
- the impact of technological changes;
- changes in consumer spending and savings habits; and
- our success at managing the risks involved in the foregoing.

MSB Financial disclaims any obligation to update or revise any forward-looking statements based on the occurrence of future events, the receipt of new information, or otherwise.

Financial Condition

Total assets decreased \$8.3 million to \$94.9 million from June 30, 2003 to December 31, 2003. The decrease in assets was primarily the result of a decrease in securities available for sale of \$7.2 million or 45.3%, the result of withdrawals from an adjustable rate mortgage fund. In addition, we also experienced a decrease in cash and cash equivalents of \$513,000 or 11.0%. These proceeds were primarily used to fund scheduled payments on FHLB advances

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totaling \$1.9 million and to fund a \$3.7 million decrease in deposits, due to withdrawals at maturity of customer certificate of deposit accounts during the period.

We also experienced a decrease in net loans, including loans held for sale, of \$1.9 million or 2.5% for the period. This decrease was primarily due to a decrease in loans held for sale of \$1.4 million at December 31, 2003 as compared to June 30, 2003, the result of loan sales during the current period to Freddie Mac. As a result, mortgage loans serviced for others increased from \$92.5 million at June 30, 2003 to \$94.5 million at December 31, 2003, an increase of \$2.0 million, or 2.2%. In addition to the decrease in loans held for sale, we experienced a decrease in net loans of \$437,000, the result of two loans totaling \$1.2 million being transferred to real estate owned.

Total liabilities decreased \$8.6 million to \$79.4 million from June 30, 2003 to December 31, 2003. In addition to the decrease in FHLB advances and deposits discussed above, we experienced a decrease in accrued interest payable and other liabilities of \$2.1 million. The decrease in accrued interest payable and other liabilities was due to a decrease of \$1.4 million in funds due to Freddie Mac on the payoff of serviced loans at December 31, 2003 as compared to June 30, 2003. We also experienced a decrease in advance payments by borrowers for taxes and insurance of \$707,000, the result of the payment of personal property taxes for real estate mortgage loan customers.

Net income, offset by the payment of dividends on common stock, contributed to a net increase in shareholders equity of \$242,000.

Results of Operations

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General. Our results of operations depend primarily upon the level of net interest income, which is the difference between the average yield earned on loans, securities, interest-bearing deposits, and other interest-earning assets, and the average rate paid on deposits and borrowed funds, as well as competitive factors that influence interest rates, loan demand, and deposit flows. Our results of operations are also dependent upon the level of our noninterest income, including fee income and service charges, and the level of our noninterest expense, including general and administrative expenses. We, like other financial institutions, are subject to interest rate risk to the degree that our interest-bearing liabilities mature or reprice at different times, or on a different basis, than our interest-earning assets.

Net Income. Net income for the three months ended December 31, 2003 was \$145,000, a decrease of 68.2% compared to net income of \$454,000 for the same period ended December 31, 2002. Net income for the six month period ended December 31, 2003 was \$476,000, 48.5% lower than net income of \$923,000 for the same period in 2002. Reasons for the decreases in net income are discussed in detail below.

Net Interest Income. Net interest income decreased \$202,000, or 19.2%, to \$851,000 for the three month period ended December 31, 2003, as compared to the same three month period in 2002. For the six month period ended December 31, 2003, net interest income decreased \$357,000, or 17.0%, to \$1.7 million.

The decrease in net interest income during the three and six month periods ended December 31, 2003 was primarily the result of decreases in interest on loans, including fees. Interest on loans, including fees decreased \$327,000, or 21.9%, during the three month period ended December 31, 2003 compared to the three month period ended December 31, 2002. For the six month period ended December 31, 2003 interest on loans, including fees decreased \$656,000, or 21.3%, as compared to the same period in 2002. These decreases were the result of a decrease in net loans receivables, due to high activity on the secondary market, as well as a decrease in mortgage loan interest rates with adjustable rate mortgages repricing at lower rates. The weighted average yield on the loan portfolio for the three month period ended December 31, 2003 decreased 101 basis points to 6.51% from 7.52% for the same period ended December 31, 2002. For the six month period ended December 31, 2003 the weighted average yield on the loan portfolio was 6.64%, compared to 7.55% for the same period ended December 31, 2002, a decrease of 91 basis points.

For the three and six months periods ended December 31, 2003 interest expense decreased \$140,000 and \$334,000, respectively, when compared to the same periods ended December 31, 2002. The decreases in interest expense were primarily a result of a decrease in certificate of deposit accounts, mentioned previously. For the three and six month periods ended December 31, 2003, deposit interest expense decreased \$90,000 and \$226,000, respectively, when compared to the same periods ended December 31, 2002. The other major component of interest expense, interest paid on FHLB advances, also decreased during the 2003 periods primarily due to decreases in the average principal balance. For the three and six month periods ended December 31, 2003, interest on FHLB advances decreased \$51,000 and \$110,000, respectively, when compared the same 2002 periods. The weighted average rate paid on interest-bearing liabilities for the three month period ended December 31, 2003 decreased 51 basis points to 2.20% from 2.71% for the same period ended December 31, 2002. For the six month period ended December 31, 2003 the weighted average rate paid on interest-bearing liabilities was 2.24%, compared to 2.87% for the same period ended December 31, 2002, a decrease of 63 basis points.

Provision for Loan Losses. The provision for loan losses is a result of our periodic analysis of the adequacy of the allowance for loan losses. For the three and six month periods ended December 31, 2003, the provision for loan losses decreased \$30,000 and \$15,000, respectively, as compared to the same periods ended December 31, 2002, due to our

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continuing reassessment of probable losses inherent in the loan portfolio. At December 31, 2003, the allowance for loan losses totaled \$477,000 or 0.63% of net loans receivable and 46.40% of total non-performing loans. At June 30, 2003, our allowance for loan losses totaled \$639,000, or 0.85% of net loans receivable and 69.38% of total non-performing loans.

We established an allowance for loan losses based on an analysis of risk factors in the loan portfolio. This analysis includes the evaluation of concentrations of credit, past loss experience, current economic conditions, amount and composition of the loan portfolio, estimated fair value of

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underlying collateral, delinquencies, and other factors. Accordingly, the calculation of the adequacy of the allowance for loan losses was not based directly on our level of non-performing assets.

Non-performing assets include non-accrual loans, loans 90 days or more delinquent and still accruing interest, restructured, foreclosed real estate and other repossessed assets. Loans greater than 90 days past due, and other designated loans of concern, are placed on non-accrual status, unless it is determined that the loans are well collateralized and in the process of collection. The following table presents non-performing assets for the periods indicated.

	December 31, 2003	June 30, 2003
Non-accrual loans	\$ 15,000	\$ 33,000
Loans past due 90 days or more and still accruing interest	1,125,000	