WAKE FOREST BANCSHARES INC
Form 10QSB
August 13, 2007

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FORM 10-QSB Quarterly or Transitional Report Under Section 13 or 15(d) of the Securities Exchange Act of 1934 Quarterly or Transitional Report

þ **QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2007

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

For the transition period from __________ to __________

Commission file number 000-25999

Wake Forest Bancshares, Inc.

(Exact name of small business issuer as specified in its charter)

United States of America	56-2131079
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

302 South Brooks Street
Wake Forest, North Carolina 27587
(Address of principal executive offices)
(919)-556-5146
(Issuer s telephone number)
N/A
(Former name, former address and former fiscal year, if changed since last report)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

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

State the number of shares outstanding of each of the issuer s classes of common equity, as of the latest practicable date: As of August 1, 2007 there were issued and outstanding 1,160,093 shares of the Issuer s common stock, $.01 par value

Transitional Small Business Disclosure Format: Yes o No þ

WAKE FOREST BANCSHARES, INC.

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WAKE FOREST BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
June 30, 2007 and September 30, 2006

ASSETS	June 30, 2007 (Unaudited)	September 30, 2006 *
Cash and short-term cash investments	$ 26,523,700	$ 23,818,900
Investment securities:		
Available for sale, at estimated market value	1,986,350	540,850
FHLB stock	191,400	197,600
Loans receivable, net of loan loss allowances of $1,152,550 at June 30, 2007 and $1,042,500 at September 30, 2006	75,715,800	76,635,300
Accrued interest receivable	197,950	230,050
Foreclosed assets, net	1,035,650	1,003,800
Property and equipment, net	361,600	401,800
Bank owned life insurance	1,129,800	1,100,050
Deferred income taxes, net	376,150	295,100
Prepaid expenses and other assets	52,550	55,050
Total Assets	$ 107,570,950	$ 104,278,500
LIABILITIES AND STOCKHOLDERS EQUITY		
Deposits	$ 86,198,150	$ 83,977,850
Accrued interest on deposits	45,850	67,950
Accrued expenses and other liabilities	896,500	784,200
Dividends payable	99,750	88,700
Redeemable common stock held by the ESOP net of unearned ESOP shares	480,200	553,650
Total Liabilities	87,720,450	85,472,350
Stockholders equity:		
Preferred stock, authorized 1,000,000 shares, none issued		
Common stock, par value $.01, authorized 5,000,000 shares, issued 1,253,948 shares at June 30, 2007 and 1,247,134 shares at September 30, 2006	12,550	12,450
Additional paid-in capital	5,779,500	5,665,700
Accumulated other comprehensive income	296,600	330,400
Retained earnings, substantially restricted	15,229,200	14,187,400
Less: Common stock in treasury, at cost	(1,467,350)	(1,389,800)
Total stockholders equity	19,850,500	18,806,150
Total liabilities and stockholders equity	$ 107,570,950	$ 104,278,500

See Notes to Consolidated Financial Statements.
* Derived from Audited Consolidated Financial Statements.

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WAKE FOREST BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)
Three Months Ended June 30, 2007 and 2006

	2007	2006
Interest and dividend income:		
Loans	$ 1,632,900	$ 1,549,000
Investment securities	14,200	6,600
Short-term cash investments	332,050	288,100
Total interest income	1,979,150	1,843,700
Interest expense:		
Interest on deposits	937,550	760,100
Total interest expense	937,550	760,100
Net interest income before provision for loan losses	1,041,600	1,083,600
Provision for loan losses	(37,500)	(50,000)
Net interest income after provision for loan losses	1,004,100	1,033,600
Noninterest income:		
Service charges and fees	19,000	11,600
Other	9,950	8,400
	28,950	20,000
Noninterest expense:		
Compensation and benefits	224,150	211,700
Occupancy	10,800	11,700
Federal insurance and operating assessments	12,000	11,350
Data processing	27,500	32,350
REO provisions and expense	28,400	46,300
Other operating expense	70,700	91,750
	373,550	405,150
Income before income taxes	659,500	648,450
Income taxes	234,950	234,550
Net income	$ 424,550	$ 413,900
Basic earnings per share	$ 0.37	$ 0.36

Diluted earnings per share	$	0.37	$	0.36
Dividends per share	$	0.19	$	0.17

See Notes to Consolidated Financial Statements.

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WAKE FOREST BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)
Nine Months Ended June 30, 2007 and 2006

	2007	2006
Interest and dividend income:		
Loans	$ 4,849,300	$ 4,415,200
Investment securities	28,200	18,850
Short-term cash investments	1,000,550	791,000
Total interest income	5,878,050	5,225,050
Interest expense:		
Interest on deposits	2,739,300	2,131,700
Total interest expense	2,739,300	2,131,700
Net interest income before provision for loan losses	3,138,750	3,093,350
Provision for loan losses	(130,000)	(145,000)
Net interest income after provision for loan losses	3,008,750	2,948,350
Noninterest income:		
Service charges and fees	49,700	41,850
Secondary market fee income	6,150	7,950
Other	31,300	29,100
	87,150	78,900
Noninterest expense:		
Compensation and benefits	649,200	630,300
Occupancy	35,600	34,000
Federal insurance and operating assessments	35,400	33,950
Data processing	85,350	111,300
REO provisions and expense	68,600	131,850
Other operating expense	262,450	233,550
	1,136,600	1,174,950
Income before income taxes	1,959,300	1,852,300
Income taxes	691,650	668,900
Net income	$ 1,267,650	$ 1,183,400

Basic earnings per share	$	1.09	$	1.03
Diluted earnings per share	$	1.09	$	1.02
Dividends per share	$	0.57	$	0.51

See Notes to Consolidated Financial Statements.

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WAKE FOREST BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)
Three and Nine Months Ended June 30, 2007 and 2006

	2007	2006
For the Three Months Ended June 30:		
Net income	$ 424,550	$ 413,900
Other comprehensive (loss), net of tax:		
Unrealized gains (losses) on securities:		
Unrealized holding gains (losses) arising during period	800	(20,200)
Less: reclassification adjustments for (losses) included in net income		
Other comprehensive income (loss)	800	(20,200)
Comprehensive income	$ 425,350	$ 393,700

	2007	2006
For the Nine Months Ended June 30:		
Net income	$ 1,267,650	$ 1,183,400
Other comprehensive income (loss), net of tax:		
Unrealized gains (losses) on securities:		
Unrealized holding gains (losses) arising during period	(33,800)	2,750
Less: reclassification adjustments for gains (losses) included in net income		
Other comprehensive income (loss)	(33,800)	2,750
Comprehensive income	$ 1,233,850	$ 1,186,150

See Notes to Consolidated Financial Statements.

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WAKE FOREST BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
Nine Months Ended June 30, 2007 and 2006

	2007	2006
Net income	$ 1,267,650	1,183,400
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	40,200	48,850
Provision for loan losses	130,000	145,000
Deferred income taxes	(60,350)	(38,400)
Loss on sale of foreclosed assets	3,150	
Increase in cash surrender value of life insurance	(29,750)	(24,350)
Changes in assets and liabilities:		
Prepaid expenses and other assets	2,500	(20,700)
Accrued interest receivable	32,100	(68,300)
Accrued interest on deposits	(22,100)	8,700
Accrued expenses and other liabilities	112,300	223,150
Net cash provided by operating activities	1,475,700	1,457,350
Cash Flows From Investing Activities:		
Net (increase) decrease in loans receivable	493,650	(1,160,750)
Purchase of US agency securities	(1,500,000)	
Proceeds from the sale of foreclosed assets	262,500	
Redemption of FHLB stock	6,200	
Purchase of FHLB stock		(15,300)
Purchase of property and equipment		(91,100)
Net cash used in investing activities	(737,650)	(1,267,150)
Cash Flows From Financing Activities:		
Net increase in deposits	2,220,300	2,290,600
Proceeds from exercise of stock options	86,900	68,350
Costs capitalized to acquire foreclosed assets	(1,650)	
Additions to paid-in-capital from tax effect from exercise of of stock options	27,000	18,850
Repurchase of common stock for the Treasury	(77,550)	(119,450)
Dividends paid	(288,250)	(253,850)
Net cash provided by financing activities	1,966,750	2,004,500
Net increase in cash and cash equivalents	2,704,800	2,194,700
Cash and cash equivalents:		
Beginning	23,818,900	22,327,400
Ending	$ 26,523,700	24,522,100
Supplemental Disclosure of Cash Flow Information:		
Cash payments of interest	$ 2,761,400	2,123,000

Cash payment of income taxes	$ 714,000	676,000
Supplemental Disclosure of Noncash transactions:		
Increase (decrease) in ESOP put option charged to retained earnings	$ (73,450)	$ 18,250
Transfer of loans to foreclosed assets	$ 295,850	
Increase (decrease) in unrealized gain on investment securities, net of tax	$ (33,800)	2,750

See Notes to Consolidated Finanical Statements.

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Wake Forest Bancshares, Inc.
Notes to Consolidated Financial Statements

Note 1. Nature of Business

Wake Forest Bancshares, Inc. (the Company) is located in Wake Forest, North Carolina and is the parent stock holding company of Wake Forest Federal Savings and Loan Association (the Association or Wake Forest Federal), its only subsidiary. The Company conducts no business other than holding all of the stock in the Association, investing dividends received from the Association, repurchasing its common stock from time to time, and distributing dividends on its common stock to its shareholders. The Association s principal activities consist of obtaining deposits and providing mortgage credit to customers in its primary market area, the counties of Wake and Franklin, North Carolina. The Company s and the Association s primary regulator is the Office of Thrift Supervision (OTS) and its deposits are insured by the Federal Deposit Insurance Corporation (FDIC).

Note 2. Organizational Structure

The Company is majority owned by the Wake Forest Bancorp, M.H.C., (the MHC) a mutual holding company. Members of the MHC consist of depositors and certain borrowers of the Association, who have the sole authority to elect the board of directors of the MHC for as long as it remains in mutual form. Initially, the MHC s principal assets consisted of 635,000 shares of the Association s common stock (now converted to the Company s common stock) and $100,000 in cash received from the Association as initial capital. Prior to 2003 (see Note 4), the MHC received its proportional share of dividends declared and paid by the Association (now the Company), and such funds are invested in deposits with the Association. The MHC, which by law must own in excess of 50% of the stock of the Company, currently has an ownership interest of 54.7% of the Company. The mutual holding company is registered as a savings and loan holding company and is subject to regulation, examination, and supervision by the OTS.

The Company was formed on May 7, 1999 solely for the purpose of becoming a savings and loan holding company and had no prior operating history. The formation of the Company had no impact on the operations of the Association or the MHC. The Association continues to operate at the same location and is subject to all the rights, obligations and liabilities of the Association which existed immediately prior to the formation of the Company. The Board of Directors of the Association capitalized the Company with $100,000. Future capitalization of the Company will depend upon dividends declared by the Association based on future earnings, or the raising of additional capital by the Company through a future issuance of securities, debt or by other means. The Board of Directors of the Company has no present plans or intentions with respect to any future issuance of securities or debt at this time.

Note 3. Basis of Presentation

The accompanying unaudited consolidated financial statements (except for the consolidated statement of financial condition at September 30, 2006, which is derived from audited consolidated financial statements) have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and Regulation S-B. Accordingly, they do not include all of the information required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (none of which were other than normal recurring accruals) necessary for a fair presentation of the financial position and results of operations for the periods presented have been included. The results of operations for the three and nine month periods ended June 30, 2007 are not necessarily indicative of the results of operations that may be expected for the Company s fiscal year ending September 30, 2007. The accounting policies followed are as set forth in Note 1 of the Notes to Consolidated Financial Statements in the Company s September 30, 2006 Annual Report to Stockholders.

Note 4. Dividends Declared

On June 18, 2007, the Board of Directors of the Company declared a dividend of $0.19 a share for stockholders of record as of June 29, 2007 and payable on July 10, 2007. The dividends declared were accrued and reported as dividends payable in the June 30, 2007 Consolidated Statement of Financial Condition. Wake Forest Bancorp, Inc., the mutual holding company, waived the receipt of the dividend declared by the Company this quarter.

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Wake Forest Bancshares, Inc.
Notes to Consolidated Financial Statements

Note 5. Earnings Per Share

Basic earnings per share amounts are based on the weighted average shares of common stock outstanding. Diluted earnings per share assumes the conversion, exercise or issuance of all potential common stock instruments such as options, warrants and convertible securities, unless the effect is to reduce a loss or increase earnings per share. This presentation has been adopted for all periods presented. There were no adjustments required to net income for any period in the computation of diluted earnings per share. The reconciliation of weighted average shares outstanding for the computation of basic and diluted earnings per share for the three and nine month periods ended June 30, 2007 and 2006 is presented below.

For the Three Months Ended June 30:	2007	2006
Weighted average shares outstanding for Basic EPS	1,161,088	1,152,661
Plus incremental shares from assumed issuances of shares pursuant to stock option and stock award plans		4,621
Weighted average shares outstanding for diluted EPS	1,161,088	1,157,282

For the Nine Months Ended June 30:	2007	2006
Weighted average shares outstanding for Basic EPS	1,160,165	1,152,709
Plus incremental shares from assumed issuances of shares pursuant to stock option and stock award plans	1,145	5,734
Weighted average shares outstanding for diluted EPS	1,161,310	1,158,443

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Wake Forest Bancshares, Inc.
Management s Discussion and Analysis of Financial Condition
and Results of Operations

Forward Looking Statements

Information set forth below contains various forward-looking statements within the meaning of Section 27A of the Securities and Exchange Act of 1933 and Section 21E of the Securities Exchange Act of 1934, which statements represent the Company s judgment concerning the future and are subject to risks and uncertainties that could cause the Company s actual operating results to differ materially. Such forward-looking statements can be identified by the use of forward-looking terminology, such as may , will , expect , anticipate , estimate , believe , or continue , or thereof or other variations thereof or comparable terminology. The Company cautions that such forward-looking statements are further qualified by important factors that could cause the Company s actual operating results to differ materially from those in the forward-looking statements, as well as the factors set forth in the Company s periodic reports and other filings with the SEC.

Comparison of Financial Condition at September 30, 2006 and June 30, 2007

Total assets increased by $3.3 million to $107.6 million at June 30, 2007 from $104.3 million at September 30, 2006. The increase in total assets during the nine month period ended June 30, 2007 was funded primarily from an increase in deposits of approximately $2.2 million and cash generated from internal operating activities during the same period. Due to adequate levels of current liquidity, deposits were priced to meet competition and retain certain accounts but not to aggressively attract additional funds. The Company attempts to maintain a certain level of liquidity to fund loan growth and to provide a cushion for its construction loan commitments. During the current nine month period, cash and short term cash investments increased by approximately $2.7 million.

Net loans receivable decreased by $919,500 to $75.7 million at June 30, 2007 from $76.6 million at September 30, 2006. The decrease occurred primarily because of a decline in commercial lines and other real estate loans tied to Prime which at current rates are deemed less desirable. Due to interest rate risk exposure, the Company generally does not offer commercial or investment loans with long-term fixed rates. The Company s primary lending area continues to expand but home sales have declined slightly in recent months and newly constructed homes remain on the market for longer periods of time. The Company s local real estate market has experienced significant growth over the last five years, primarily due to an influx of newcomers from outside the area. Although the Company s markets have not experienced a drop in home prices like many areas of the country, local real estate markets are impacted by newcomers unable to purchase homes here until they are able to sell residences elsewhere. Population growth and employment expansion across a wide spectrum of the local economic base combined with moderate interest rate levels will ultimately determine whether consistent loan demand can be sustained. Assuming local economic conditions continue to improve, management believes that the long-term fundamentals of its lending markets provide potential for future loan growth. However, there can be no assurances that such loan demand can or will materialize in the future.

Investment securities increased by $1,439,300 to $2,177,750 at June 30, 2007 from $738,450 at September 30, 2006. The increase is attributable to the purchase of $1.5 million in FHLB bonds during the current quarter reduced by unrealized losses in the Company s investment in FHLMC stock and the bonds amounting to $54,500 and a required $6,200 redemption of FHLB stock during the same period. The Company generally maintains higher levels of short term liquidity in order to minimize interest rate risk, to fund construction loan commitments, and due to the relatively minor differential in current investment rates available on extended maturities. As a result, the Company has not previously been actively involved in the buying and selling securities but may continue to ladder the purchase of intermediate term debt securities in the future to protect against downward interest rate risk. At June 30, 2007, the Company s investment portfolio, which consisted of FHLB stock, FHLMC stock, and FHLB bonds had approximately $478,400 in net unrealized gains.

The Company had no borrowings outstanding during the period because its current level of liquidity was sufficient to fund lending and other cash commitments. The Company has recorded a liability of $480,200 at June 30, 2007 for the ESOP put option which represents the potential liability owed to participants based on the current market value of the Company s stock if all participants were to request the balance of their account from the Company in cash instead of stock.

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Comparison of Financial Condition at September 30, 2006 and June 30, 2007 (Continued)

The Company has an ongoing stock repurchase program authorizing management to repurchase shares of its outstanding common stock. The repurchases are made through registered broker-dealers from shareholders in open market purchases at the discretion of management. The Company intends to hold the shares repurchased as treasury shares, and may utilize such shares to fund stock benefit plans or for any other general corporate purposes permitted by applicable law. At June 30, 2007 the Company had repurchased 93,855 shares of its common stock. The program continues until completed or terminated by the Board of Directors.

Retained earnings increased by $1,041,800 to $15.2 million at June 30, 2007 from $14.2 million at September 30, 2006. The increase is primarily attributable to the Company s earnings of $1,267,650 during the nine month period ended June 30, 2007, reduced by $299,300 in dividends declared during the period and a $73,450 recovery of prior charges to retained earnings to reflect the change in the fair value of the ESOP shares subject to the put option. At June 30, 2007 the Company s capital amounted to $19.9 million, which as a percentage of total assets was 18.45%. The Company and the Association are both required to meet certain capital requirements as established by the OTS. At June 30, 2007, all capital requirements were met.

Asset Quality

The Company s level of non-performing loans, consisting of loans past due 90 days or more, amounted to $1,525,100 or 1.98% as a percentage of loans outstanding at June 30, 2007. Non-performing loans amounted to $666,400 or 0.86% as a percentage of loans outstanding at September 30, 2006. At June 30, 2007, non-performing loans consisted of one residential construction loan amounting to $103,050, one lot loan totaling $25,050, and two residential land loans (including second mortgages on both) amounting to $1,397,000. The construction loan and the lot loan are with one builder and the land loans are all from the same developer. The collateral for the land loans includes both undeveloped tracts and residential lots valued at $4.8 million. Foreclosure proceedings have commenced on all of the non-performing loans outstanding at June 30, 2007. We believe that the fair market value of all these properties is higher than the outstanding loan balances and we will not incur a loss on the ultimate disposition of these loans. All of the loans have been placed on non-accrual status.

Non-performing assets also includes real estate acquired through foreclosure. At June 30, 2007, foreclosed real estate included one residential building lot ($31,850) and a foreclosed commercial property ($1,003,800) which consisted of a convenience store and an adjacent tract of land, in total 3.81 acres located on a major highway outside of Wake Forest, North Carolina. While the commercial property s location is considered highly desirable, the Company decided that an environmental assessment was necessary to properly market the tract due to the historical uses of the property. As a result, site assessment reports were filed with various state environmental agencies. Petroleum contamination and other trace elements consistent with operating a gas station and a truck maintenance facility over an extended period of time were found on parts of the property. The Company has obtained brownfields status for the site which should make the tract more attractive to prospective developers of the property. In addition, the Company obtained Trust Fund status for the site which will allow certain environmental cost to be reimbursed. Although the Company does not currently believe the contamination will have a detrimental effect on the potential development of the property, the agencies are expected to be able to assist the Company in determining the extent of any required clean-up and ongoing monitoring steps that will be required. The Company has set aside $150,000 at June 30, 2007 for such testing and clean-up activities. At this time, the Company does not believe that the ongoing environmental costs will materially impact the value of the property and no loss is expected on its ultimate sale. During the current quarter, the Company expensed $18,550 in environmentally related cost for this property. In addition, the Company believes it will be able to dispose of the residential lot without incurring a loss.

The Company had $19,950 in loan charge-offs during the nine months ended June 30, 2007. The Company s loan loss allowance amounted to $1,152,550 at June 30, 2007 and management believes that it has sufficient allowances established to cover losses associated with its loan portfolio. The allowance for loan losses is established based upon probable losses that are estimated to have occurred through a provision for loan losses charged to earnings.

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Wake Forest Bancshares, Inc.
Management s Discussion and Analysis of Financial Condition
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Asset Quality (Continued):

During the past five years, the Association s loan portfolio has gradually trended towards a greater concentration of residential construction and land loans, which generally involve a greater degree of credit risk and collection issues. As a result, the Company has provided relatively higher levels of loan loss provisions and resulting allowances during this period than what has historically been considered necessary. The allowance for loan losses is evaluated on a regular basis by management.

The Company records provisions for loan losses based upon known problem loans and estimated deficiencies in the existing loan portfolio. The Company s methodology for assessing the appropriateness of the allowance for loan losses consists of two key components which are a specific allowance for identified problem or impaired loans under the provisions of Statement of Financial Accounting Standards (SFAS) No. 114, *Accounting by Creditors for Impairment of a Loan"*, and a formula allowance for the remainder of the portfolio under the provisions of SFAS No. 5, *Accounting for Contingencies.* Because the Company only originates loans secured by real estate, specific problem loans are graded using the standard regulatory classifications and are evaluated for impairment under SFAS No. 114 based upon the collateral s fair value less estimated cost of disposal.

All other loans with unidentified impairment issues are pooled and segmented by major loan types (single-family residential properties, construction loans, commercial real estate, land, etc.). Loan loss rates for these categories are then generated by capturing historical loan losses net of recoveries over a five and ten year period, with added weight given to the more recent five year period. Qualitative factors that may affect loan collectibility such as geographical and lending concentrations, local economic conditions, and delinquency trends are also considered in determining the Company s best estimate of the range of credit losses. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. Although management believes it has established and maintained the allowance for loan losses at appropriate levels, future adjustments may be necessary if economic, real estate values and other conditions differ substantially from the current operating environment. In addition, regulatory examiners may require the Association to recognize adjustments to the allowance for loan losses based on their judgments about information available to them at the time of their examination.

Comparison of Operating Results for the Three and Nine Months Ended June 30, 2007 and 2006

General. Net income for the three month period ended June 30, 2007 was $424,550, or $10,650 more than the $413,900 earned during the same quarter in 2006. Net income for the nine month period ended June 30, 2007 was $1,267,650, or $84,250 more than the $1,183,400 earned during the same period in 2006. As discussed below, changes in net interest income between the comparable periods combined with lower data processing expense and costs associated with holding foreclosed properties were primarily responsible for the change in net income during the current quarter and nine month period end June 30, 2007 when compared to the same periods a year earlier. In addition, changes to loan loss provisions, non-interest income, and other operating expenses also impacted operating results during the current quarter and nine months ended June 30, 2007 as compared to the same periods a year earlier.

Interest income. Interest income increased by $135,450 from $1,843,700 for the three months ended June 30, 2006 to $1,979,150 for the three months ended June 30, 2007. The increase in interest income resulted primarily from $5.8 million increase in the average balance of interest-earning assets outstanding between the quarters. Interest income increased by $653,000 from $5,225,050 for the nine months ended June 30, 2006 to $5,878,050 for the nine months ended June 30, 2007. The increase in interest income resulted from both a 53 basis point increase in the average yield on interest earning assets between the nine month periods and an increase of $6.0 million in the average balance of interest-earning assets outstanding between the periods. The Company s yield on interest earning assets was 7.27% and 7.28% for the quarter and nine month period ended June 30, 2007; respectively, and 7.13% and 6.75% for the quarter and nine month period ended June 30, 2006; respectively. The changes in yield occurred primarily due to fluctuations in market rates outstanding during the periods. A significant portion of the Company s assets are able to re-price quickly when market rates influenced by Federal Reserve rate movements change.

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Wake Forest Bancshares, Inc.
Management s Discussion and Analysis of Financial Condition
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Comparison of Operating Results for the Three and Nine Months Ended June 30, 2007 and 2006 (Continued)

Interest Expense. Interest expense increased by $177,450 from $760,100 for the three months ended June 30, 2006 to $937,550 for the three months ended June 30, 2007. Interest expense increased by $607,600 from $2,131,700 for the nine months ended June 30, 2006 to $2,739,300 for the nine months ended June 30, 2007. The increases were the result of both an increase in the Company s cost of funds between the periods and an increase in the average balance of deposits outstanding between the periods. The Company s cost of funds increased by 58 basis points and 75 basis points for the three and nine month periods ended June 30, 2007; respectively, as compared to the same periods a year earlier.

As a result of overall higher market rates, the Company s cost of funds increased from 3.79% and 3.56% for the quarter and nine month period ended June 30, 2006; respectively, to 4.37% and 4.31% for the quarter and nine month period ended June 30, 2007, respectively. The Company s average balance of deposits outstanding increased by $4.5 million and $4.6 million for the three and nine month periods ended June 30, 2007, respectively, as compared to the same periods a year earlier.

Net interest income. Net interest income decreased by $42,000 from $1,083,600 for the three months ended June 30, 2006 to $1,041,600 for the three months ended June 30, 2007. Net interest income increased by $45,400 from $3,093,350 for the nine months ended June 30, 2006 to $3,138,750 for the nine months ended June 30, 2007. As explained above, the changes in net interest income resulted primarily from fluctuations in both the yields on interest-earning assets and the cost of funds on interest-bearing liabilities between the periods as well as changes in the level of interest earning assets and interest-bearing liabilities. The Company s net interest margin was 4.01% and 4.05% for the current quarter and nine months ended June 30, 2007 versus 4.41% and 4.23% for the same quarter and nine month period a year earlier.

Provision for loan losses. The Company provided $37,500 and $130,000 in loan loss provisions during the current quarter and nine month period ended June 30, 2007; respectively, as compared to $50,000 and $145,000 during the three and nine month periods; respectively, a year earlier. Provisions, which are charged to operations, and the resulting loan loss allowances are amounts the Company s management believes will be adequate to absorb losses that are estimated to have occurred in the portfolio. Loans are charged off against the allowance when management believes that uncollectibility is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The Association s loan portfolio has gradually trended towards a greater concentration of builder construction loans, land, and land development loans which generally involve a greater degree of credit risk and collection issues. Also, many of these types of loans involve lending relationships which are larger than what the Company has traditionally maintained. As a result, the Company has provided relatively higher levels of loan loss provisions and resulting allowances during the last five years than what has historically been considered necessary. In addition, the Company has experienced an increased level of delinquent loans during more recent periods as compared to prior years. None of the provisions provided during the reported periods occurred due to the impairment of specific loans as required by SFAS No. 114.

Non-interest income. The Company s non-interest income is primarily comprised on various fees and service charges on customer accounts, income from bank owned life insurance products, as well as security gains and fees earned from secondary market originations. The Company did not have any investment sales during any of the periods being reported upon. In addition, the Company has been originating residential mortgage loans for its own portfolio over the periods being reported upon and therefore very little secondary marketing income has been generated over those same periods.

Non-interest expense. Non-interest expense decreased by $31,600 to $373,550 for the three month period ended June 30, 2007 from $405,150 for the comparable quarter in 2006. Non-interest expense decreased by $38,350 to $1,136,600 for the nine month period ended June 30, 2007 from $1,174,950 for the same period a year earlier.

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Non-interest expense (continued)

REO provisions and expense decreased by $17,900 during the current quarter and by $63,250 during the nine month period ended June 30, 2007 versus the same periods a year earlier as a result of environmental assessment activities associated with the Company s foreclosed 3.81 acre tract on highway 98 outside of Wake Forest, North Carolina. The decrease in REO expense occurred because a significant portion of the assessment testing was performed during 2006 and this year the Company has primarily been waiting for eligibility approval for certain programs that will make it easier to market the property.

Data processing expense decreased by $4,850 and $25,950 during the current quarter and nine month periods ended June 30, 2007 and other operating expense decreased by $21,050 during the current quarter as compared to the same periods a year earlier because the Company completed a computer systems upgrade and conversion, resulting in certain upfront one-time charges as well as additional travel and training cost in the prior year. Other operating expense increased by $28,900 during the current nine month period ended June 30, 2007 over the same period a year earlier because of increased directors fees, contributions, and convention related expense.

Capital Resources and Liquidity

The term liquidity generally refers to an organization s ability to generate adequate amounts of funds to meet its needs for cash. More specifically for financial institutions, liquidity ensures that adequate funds are available to meet deposit withdrawals, fund loan and capital expenditure commitments, maintain reserve requirements, pay operating expenses, and provide funds for debt service, dividends to stockholders, and other institutional commitments. Funds are primarily provided through financial resources from operating activities, expansion of the deposit base, borrowings, through the sale or maturity of investments, the ability to raise equity capital, or maintenance of shorter term interest-earning deposits.

During the nine month period ended June 30, 2007, cash and cash equivalents, a significant source of liquidity, increased by approximately $2.7 million. A net increase in deposits of $2.2 million and net cash provided by operating activities of $1.5 million were the primary factors which contributed to the increase in cash during the current nine month period. The purchase of US agency bonds amounting to $1.5 million was the most significant use of cash during the nine month period ended June 30, 2007. Given its excess liquidity and its ability to borrow from the Federal Home Loan Bank of Atlanta, the Company believes that it will have sufficient funds available to meet anticipated future loan commitments, unexpected deposit withdrawals, and other cash requirements.

Off-Balance Sheet Transactions

In the normal course of business, the Association engages in a variety of financial transactions that, under generally accepted accounting principles, either are not recorded on the balance sheet or are recorded on the balance sheet in amounts that differ from the full contract or notional amounts. Primarily the Association is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, revolving lines of credit, and the undisbursed portion of construction loans. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the statement of financial condition. The contract or notional amounts of those instruments reflect the extent of involvement the Association has in particular classes of financial instruments. The Association s exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit is represented by the contractual notional amount of those instruments. The Association uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments. At June 30, 2007, the Association had outstanding loan commitments amounting to approximately $2.3 million. The undisbursed portion of construction loans amounted to $10.3 million and unused lines of credit amounted to $5.7 million at June 30, 2007.

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Critical Accounting Policies and Estimates

The accounting policies followed are as set forth in Note 1 of the Notes to Financial Statements in the Company s 2006 Annual Report on Form 10-KSB. The Company has not experienced any material change in its critical accounting policies since September 30, 2006. The Company s discussion and analysis of its financial condition and results of operations are based upon its consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires the Company to make estimates and judgments regarding uncertainties that affect the reported amounts of assets, liabilities, revenues and expenses. On an ongoing basis, the Company evaluates its estimates which are based upon historical experience and on other assumptions that are believed to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions. The Company considers the following accounting policies to be most critical in their potential effect on its financial position or results of operations:

Allowance for Loan Losses

The most critical estimate concerns the Company s allowance for loan losses. The Company records provisions for loan losses based upon known problem loans and estimated deficiencies in the existing loan portfolio. The Company s methodology for assessing the appropriations of the allowance for loan losses consists of two key components, which are a specific allowance for identified problem or impaired loans and a formula allowance for the remainder of the portfolio.

A loan is considered impaired when, based on current information and events, it is probable that the Association will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower s prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan s effective interest rate, the loan s obtainable market price, or the fair value of the collateral if the loan is collateral dependent. This evaluation is inherently subjective as it requires material estimates that may be susceptible to significant change. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Association does not separately identify individual residential loans for impairment disclosures.

The adequacy of the allowance is also reviewed by management based upon its evaluation of then-existing economic and business conditions affecting the key lending areas of the Company and other conditions, such as new loan products, collateral values, loan concentrations, changes in the mix and volume of the loan portfolio; trends in portfolio credit quality, including delinquency and charge-off rates; and current economic conditions that may affect a borrower s ability to repay. Although management believes it has established and maintained the allowance for loan losses at appropriate levels, future adjustments may be necessary if economic, real estate and other conditions differ substantially from the current operating environment.

Interest Income Recognition:

Interest on loans is included in income as earned based upon interest rates applied to unpaid principal. Interest is not accrued on loans 90 days or more past due unless the loans are adequately secured and in the process of collection. Interest is not accrued on other loans when management believes collection is doubtful. All loans considered impaired are non-accruing. Interest on non-accruing loans is recognized as payments are received when the ultimate collectibility of interest is no longer considered doubtful. When a loan is placed on non-accrual status, all interest previously accrued is reversed against current-period interest income.

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Future Reporting and Regulatory Requirements

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes . FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes . FIN 48 prescribes a recognition threshold and measurement attributable for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosures and transitions. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company does not expect the adoption of FIN 48 to have a material impact on its financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standard (SFAS) No. 157, Fair Value Measurements. SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 is effective for the Company on October 1, 2008 and is not expected to have a significant impact on the Company s financial statements.

In September, 2006, The FASB ratified the consensus reached by the FASB s Emerging Issues Task Force (EITF) relating to EITF 06-4 Accounting for the Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements . EITF 06-4 addresses employer accounting for endorsement split-dollar life insurance arrangements that provide a benefit to an employee that extends to postretirement periods should recognize a liability for future benefits in accordance with FASB Statement of Financial Accounting Standards (SFAS) No. 106, Employers Accounting for Postretirement Benefits Other Than Pensions", or Accounting Principles Board (APB) Opinion No. 12, Omnibus Opinion 1967". EITF 06-4 is effective for fiscal years beginning after December 15, 2006. Entities should recognize the effects of applying this Issue through either (a) a change in accounting principle through a cumulative-effect adjustment to retained earnings or to other components of equity or net assets in the statement of financial position as of the beginning of the year of adoption or (b) a change in accounting principle through retrospective application to all prior periods. The Company does not believe the adoption of EITF 06-4 will have a material impact on its financial statements.

On September 13, 2006, the SEC issued Staff Accounting Bulletin No. 108 (SAB 108) which is effective for the Company s fiscal year ending September 30, 2007. SAB 108 provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a potential current year misstatement. Prior to SAB 108, companies might evaluate the materiality of financial statement misstatements using either the income statement or balance sheet approach, with the income statement approach focusing on new misstatements added in the current year, and the balance sheet approach focusing on the cumulative amount of misstatement present in a company s balance sheet. Misstatements that would be material under one approach could be viewed as immaterial under another approach, and not be corrected. SAB 108 now requires that companies view financial statement misstatements as material if they are material according to either the income statement or balance sheet approach. The Company does not believe the adoption of SAB 108 will have a material impact on its financial statements.

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Item 3. Controls and Procedures

Management, including the Company s Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company s disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(f) and 15d-15(e)) as of the end of the period covered by this report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures were effective, in all material respects, to ensure that information required to be disclosed in the reports the Company files and submits under the Exchange Act is recorded, processed, summarized and reported as and when required.

There have been no changes in the Company s internal control over financial reporting identified in connection with the evaluation that occurred during the Company s last fiscal quarter that has materially affected, or that is reasonably 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 is not engaged in any material legal proceedings at the present time. Occasionally, the Association is a party to legal proceedings within the normal course of business wherein it enforces its security interest in loans made by it, and other matters of a similar nature.

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

None

Item 3. Defaults Upon Senior Securities

None

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

None

Item 5. Other Information

None

Item 6. Exhibits

a) Exhibit 31 Certification of Pursuant to 18 U.S.C. Section 1350, as adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

b) Exhibit 32 Certification of Pursuant to 18 U.S.C. Section 1350, as adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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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.

	Wake Forest Bancshares, Inc.
Dated August 13, 2007	By: s/s Robert C. White Robert C. White Chief Executive Officer and Chief Financial Officer

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EXHIBIT INDEX

Exhibit Number	Description
Exhibit 31	Certification of Pursuant to 18 U.S.C. Section 1350, as adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
Exhibit 32	Certification of Pursuant to 18 U.S.C. Section 1350, as adopted Pursuant to Section 906 of the Sarbanes-