

HOME FEDERAL BANCORP INC
Form 10-Q
May 08, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549 FORM 10-Q

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

For the quarterly period ended March 31, 2007

or

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

For the transition period from _____ to _____

Commission File Number: 000-50901

HOME FEDERAL BANCORP, INC.

(Exact name of registrant as specified in its charter)

United States
(State or other jurisdiction of incorporation
or organization)

20-0945587
(I.R.S. Employer
I.D. Number)

500 12th Avenue South, Nampa, Idaho
(Address of principal executive offices)

83651
(Zip Code)

Registrant's telephone number, including area code:

(208) 466-4634

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

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: Common Stock, \$.01 par value per share, 15,189,019 shares outstanding as of May 1, 2007.

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FORM 10-Q
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Item 1. Financial Statements

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HOME FEDERAL BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS

(In thousands, except share data) (Unaudited)

| | March 31, 2007 | September 30, 2006 |
|--|-------------------|-----------------------|
| ASSETS | | |
| Cash and amounts due from depository institutions | \$ 12,558 | \$ 18,385 |
| Mortgage-backed securities available for sale, at fair value | 13,001 | 12,182 |
| Mortgage-backed securities held to maturity, at cost | 171,668 | 183,279 |
| Federal Home Loan Bank of Seattle ("FHLB") stock, at cost | 9,591 | 9,591 |
| Loans receivable, net of allowance for loan losses of \$2,849 and \$2,974 | 503,688 | 503,065 |
| Loans held for sale | 4,489 | 4,119 |
| Accrued interest receivable | 2,941 | 3,025 |
| Property and equipment, net | 12,630 | 12,849 |
| Mortgage servicing rights, net | 2,317 | 2,492 |
| Bank owned life insurance | 10,963 | 10,763 |
| Other assets | 2,108 | 1,542 |
| TOTAL ASSETS | \$745,954 | \$761,292 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| LIABILITIES | | |
| Deposit accounts: | | |
| Noninterest-bearing demand deposits | \$ 36,006 | \$ 44,626 |
| Interest-bearing demand deposits | 135,835 | 128,276 |
| Savings deposits | 23,486 | 23,655 |
| Certificates of deposit | 226,891 | 233,724 |
| Total deposit accounts | 422,218 | 430,281 |
| Advances by borrowers for taxes and insurance | 1,772 | 2,133 |
| Interest payable | 855 | 971 |
| Deferred compensation | 4,242 | 3,875 |
| FHLB advances | 199,495 | 210,759 |
| Deferred income tax liability | 604 | 800 |
| Other liabilities | 5,745 | 4,604 |
| Total liabilities | 634,931 | 653,423 |
| STOCKHOLDERS' EQUITY | | |
| Serial preferred stock, \$.01 par value; 5,000,000 authorized, issued and outstanding, none | - | -- |
| Common stock, \$.01 par value; 50,000,000 authorized, issued and outstanding: | 152 | 152 |
| Mar. 31, 2007 - 15,223,655 issued, 15,189,019 outstanding | | |
| Sept. 30, 2006 - 15,208,750 issued, 15,169,114 outstanding | | |
| Additional paid-in capital | 58,186 | 57,222 |
| Retained earnings | 56,677 | 54,805 |
| Unearned shares issued to employee stock ownership plan ("ESOP") | (3,918) | (4,134) |
| Accumulated other comprehensive loss | (74) | (176) |

| | | |
|---|------------------|------------------|
| Total stockholders' equity | 111,023 | 107,869 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | \$745,954 | \$761,292 |

See accompanying notes.

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HOME FEDERAL BANCORP, INC. AND
SUBSIDIARY

CONSOLIDATED STATEMENTS OF
INCOME

(In thousands, except share data) (Unaudited)

| | Three Months Ended March 31, | | Six Months Ended March 31, | |
|--|---------------------------------|--------------|-------------------------------|---------------|
| | 2007 | 2006 | 2007 | 2006 |
| Interest and dividend income: | | | | |
| Loan interest | \$8,470 | \$7,129 | \$16,997 | \$14,063 |
| Investment interest | 15 | 60 | 44 | 71 |
| Mortgage-backed security interest | 2,244 | 2,386 | 4,550 | 4,772 |
| FHLB dividends | 9 | - | 19 | - |
| Total interest and dividend income | 10,738 | 9,575 | 21,610 | 18,906 |
| Interest expense: | | | | |
| Deposits | 3,005 | 2,097 | 6,015 | 3,694 |
| FHLB advances | 2,372 | 1,844 | 4,735 | 3,596 |
| Total interest expense | 5,377 | 3,941 | 10,750 | 7,290 |
| Net interest income | 5,361 | 5,634 | 10,860 | 11,616 |
| Provision for loan losses | - | 90 | 71 | 145 |
| Net interest income after provision for loan losses | 5,361 | 5,544 | 10,789 | 11,471 |
| Noninterest income: | | | | |
| Service charges and fees | 2,222 | 2,115 | 4,636 | 4,501 |
| Gain on sale of loans | 379 | 195 | 677 | 506 |
| Increase in cash surrender value of bank owned life insurance | 99 | 108 | 199 | 190 |
| Loan servicing fees | 142 | 159 | 286 | 319 |
| Mortgage servicing rights, net | (92) | (64) | (175) | (160) |
| Other | 11 | (24) | 21 | (66) |
| Total noninterest income | 2,761 | 2,489 | 5,644 | 5,290 |

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| | | | | |
|--|------------|------------|------------|------------|
| Noninterest expense: | | | | |
| Compensation and benefits | 3,851 | 3,770 | 7,865 | 7,576 |
| Occupancy and equipment | 727 | 694 | 1,429 | 1,422 |
| Data processing | 493 | 520 | 1,001 | 861 |
| Advertising | 300 | 257 | 596 | 471 |
| Postage and supplies | 174 | 189 | 320 | 420 |
| Professional services | 215 | 176 | 411 | 363 |
| Insurance and taxes | 106 | 111 | 209 | 214 |
| Other | 228 | 334 | 509 | 604 |
| Total noninterest expense | 6,094 | 6,051 | 12,340 | 11,931 |
| Income before income taxes | 2,028 | 1,982 | 4,093 | 4,830 |
| Income tax expense | 787 | 749 | 1,583 | 1,837 |
| NET INCOME | \$1,241 | \$1,233 | \$ 2,510 | \$ 2,993 |
| Earnings per common share: | | | | |
| Basic | \$0.09 | \$0.09 | \$0.17 | \$0.21 |
| Diluted | \$0.08 | \$0.09 | \$0.17 | \$0.21 |
| Weighted average number of shares outstanding: | | | | |
| Basic | 14,591,936 | 14,478,746 | 14,579,440 | 14,472,449 |
| Diluted | 14,692,424 | 14,497,350 | 14,685,143 | 14,483,991 |
| Dividends declared per share: | \$0.055 | \$0.055 | \$0.110 | \$0.105 |

See accompanying notes.

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HOME FEDERAL BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(In thousands, except share data) (Unaudited)

| Common Stock | | Additional Paid-In Capital | Retained Earnings | Unearned Shares Issued to Employee Stock Ownership Plan | Accumulated Other Comprehensive Income (Loss) | Total |
|--------------|--------|----------------------------------|----------------------|---|--|-------|
| Shares | Amount | | | | | |
| | | | | | | |

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| | | | | | | | |
|--|------------|-------|----------|----------|-----------|---------|-----------|
| Balance at Sept. 30, 2005 | 14,910,658 | \$149 | \$56,115 | \$49,818 | \$(4,550) | \$(165) | \$101,367 |
| Restricted stock issued, net of forfeitures | 258,456 | 3 | (3) | | | | - |
| ESOP shares committed to be released | | | 265 | | 416 | | 681 |
| Share-based compensation | | | 845 | | | | 845 |
| Dividends paid (\$0.215 per share) ⁽¹⁾ | | | | (1,225) | | | (1,225) |
| Comprehensive income: | | | | | | | |
| Net income | | | | 6,212 | | | 6,212 |
| Other comprehensive income: | | | | | | | |
| Change in unrealized holding loss on securities available for sale, net of deferred income taxes | | | | | | (11) | (11) |
| Comprehensive income: | | | | | | | 6,201 |
| Balance at Sept. 30, 2006 | 15,169,114 | \$152 | \$57,222 | \$54,805 | \$(4,134) | \$(176) | \$107,869 |
| Restricted stock issued, net of forfeitures | 5,000 | | | | | | - |
| ESOP shares committed to be released | | | 200 | | 216 | | 416 |
| Exercise of stock options | 14,905 | | 182 | | | | 182 |
| Share-based compensation | | | 538 | | | | 538 |
| Excess tax benefits from equity compensation plans | | | 44 | | | | 44 |
| Dividends paid (\$0.11 per share) ⁽¹⁾ | | | | (638) | | | (638) |
| Comprehensive income: | | | | | | | |
| Net income | | | | 2,510 | | | 2,510 |
| Other comprehensive income: | | | | | | | |
| Change in unrealized holding loss on securities available for sale, net of deferred income taxes | | | | | | 102 | 102 |
| Comprehensive income: | | | | | | | 2,612 |
| Balance at Mar. 31, 2007 | 15,189,019 | \$152 | \$58,186 | \$56,677 | \$(3,918) | \$(74) | \$111,023 |

(1)

Home Federal MHC waived its receipt of dividends on the 8,979,246 shares it owns.

See accompanying notes.

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HOME FEDERAL BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands) (Unaudited)

| | Six Months Ended March 31, | |
|--|-------------------------------|----------|
| | 2007 | 2006 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income | \$ 2,510 | \$ 2,993 |
| Adjustments to reconcile net income to cash provided by operating activities: | | |
| Depreciation and amortization | 866 | 825 |
| Net accretion of premiums and discounts on investments | (33) | (45) |
| Loss on sale of fixed assets and repossessed assets | - | 115 |
| ESOP shares committed to be released | 416 | 314 |
| Equity compensation expense | 538 | 412 |
| Provision for loan losses | 71 | 145 |
| Deferred compensation expense | 367 | 403 |
| Net deferred loan fees | 109 | 307 |
| Deferred income tax benefit | (264) | (224) |
| Net gain on sale of loans | (677) | (506) |
| Proceeds from sale of loans held for sale | 44,016 | 37,643 |
| Originations of loans held for sale | (43,814) | (36,821) |
| Net decrease in value of mortgage servicing rights | 175 | 160 |
| Net increase in value of bank owned life insurance | (200) | (190) |
| Change in assets and liabilities: | | |
| Interest receivable | 84 | (318) |
| Other assets | (580) | (261) |
| Interest payable | (116) | (500) |
| Other liabilities | 950 | (352) |
| Net cash provided by operating activities | 4,418 | 4,100 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Proceeds from maturity of mortgage-backed securities held to maturity | 11,652 | 13,800 |
| Purchase of mortgage-backed securities held to maturity | - | (26,172) |
| Proceeds from sale and maturity of mortgage-backed securities available for sale | 1,445 | 1,048 |

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| | | |
|---|-----------|-----------|
| Purchase of mortgage-backed securities available for sale | (2,102) | - |
| Purchases of property and equipment | (611) | (751) |
| Loan originations and principal collections, net | (529) | (6,855) |
| Purchased loans | - | (38,782) |
| Proceeds from disposition of property and equipment | - | 19 |
| Proceeds from sale of repossessed assets | - | 510 |
| | <hr/> | <hr/> |
| Net cash provided (used) by investing activities | 9,855 | (57,183) |
| | <hr/> | <hr/> |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Net increase (decrease) in deposits | (8,063) | 35,309 |
| Net decrease in advances by borrowers for taxes and insurance | (361) | (1,947) |
| Proceeds from FHLB advances | 137,760 | 145,215 |
| Repayment of FHLB advances | (149,024) | (124,606) |
| Proceeds from exercise of stock options | 182 | - |
| Excess tax benefit from equity compensation plans | 44 | - |
| Dividends paid | (638) | (595) |
| | <hr/> | <hr/> |
| Net cash (used) provided by financing activities | (20,100) | 53,376 |
| | <hr/> | <hr/> |
| NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS | (5,827) | 293 |
| CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD | 18,385 | 19,033 |
| | <hr/> | <hr/> |
| CASH AND CASH EQUIVALENTS, END OF PERIOD | \$ 12,558 | \$ 19,326 |
| | <hr/> | <hr/> |

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HOME FEDERAL BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)
(In thousands) (Unaudited)

Six Months Ended
March 31,

| | 2007 | 2006 |
|--|----------|---------|
| | <hr/> | <hr/> |
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION: | | |
| Cash paid during the year for: | | |
| Interest | \$10,866 | \$7,791 |
| Income taxes | 1,925 | 2,521 |
| NONCASH INVESTING AND FINANCING ACTIVITIES: | | |
| Acquisition of real estate and other assets in settlement of loans | - | 2 |
| Fair value adjustment to securities available for sale, net of taxes | 102 | (103) |

See accompanying notes.

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HOME FEDERAL BANCORP, INC. AND SUBSIDIARY
SELECTED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1 - Basis of Presentation

The consolidated financial statements presented in this quarterly report include the accounts of Home Federal Bancorp, Inc. (the "Company") and its wholly-owned subsidiary, Home Federal Bank (the "Bank"). The financial statements of the Company have been prepared in conformity with accounting principles generally accepted in the United States of America for interim financial information and are unaudited. All significant intercompany transactions and balances have been eliminated. In the opinion of the Company's management, all adjustments consisting of normal recurring accruals necessary for a fair presentation of the financial condition and results of operations for the interim periods included herein have been made.

Certain information and note disclosures normally included in the Company's annual consolidated financial statements have been condensed or omitted. Therefore, these consolidated financial statements and notes thereto should be read in conjunction with the Company's audited financial statements and notes included in the Annual Report on Form 10-K for the year ended September 30, 2006 ("2006 Form 10-K") filed with the Securities and Exchange Commission ("SEC") on December 11, 2006.

Note 2 - Summary of Significant Accounting Policies

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect amounts reported in the consolidated financial statements. Changes in these estimates and assumptions are considered reasonably possible and may have a material impact on the consolidated financial statements, and thus actual results could differ from the amounts reported and disclosed herein. The Company considers the allowance for loan losses, mortgage servicing rights, and deferred income taxes to be critical accounting estimates.

The accounting estimate related to the allowance for loan losses is a critical accounting estimate because it is highly susceptible to change from period to period requiring management to make assumptions about future losses on loans. The impact of a sudden large loss could deplete the allowance and potentially require increased provisions to replenish the allowance, which would negatively affect earnings.

The most critical accounting policy associated with mortgage servicing is the methodology used to determine the fair value of capitalized mortgage servicing rights, which requires the development of a number of estimates, the most critical of which is the mortgage loan prepayment speeds assumption. The Company performs a quarterly review of mortgage servicing rights for potential changes in value. This review may include an independent appraisal by an outside party of the fair value of the mortgage servicing rights.

Deferred income taxes are computed using the asset and liability approach as prescribed in Statement of Financial Accounting Standards ("SFAS") No. 109, *Accounting for Income Taxes*. Under this method, a deferred tax asset or liability is determined based on the currently enacted tax rates applicable to the period in which the differences

between the financial statement carrying amounts and tax basis of the existing assets and liabilities are expected to be reported in the Company's income tax returns.

As of October 1, 2006, the Company adopted SFAS No. 156, *Accounting for Servicing of Financial Assets*, to measure mortgage servicing rights using the fair value method. At March 31, 2007, there were no other material changes in the Company's significant accounting policies or critical accounting estimates from those disclosed in the Company's 2006 Form 10-K.

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Note 3 - Mutual Holding Company Reorganization

On May 18, 2004, the Board of Directors of Home Federal Savings and Loan Association of Nampa (the "Association") unanimously adopted a Plan of Reorganization and Stock Issuance. At the special meeting of members of the Association held on September 20, 2004, members approved the Plan of Reorganization and Stock Issuance and the establishment of the Home Federal Foundation, Inc. (the "Foundation") by more than the required majority of the total votes entitled to be cast at the special meeting.

Pursuant to the Plan of Reorganization and Stock Issuance, the Association: (i) converted to a federal stock savings bank (Stock Savings Bank) as the successor to the Association in its current mutual form; (ii) organized a Stock Holding Company as a federally-chartered corporation that owns 100% of the common stock of the Stock Savings Bank; and (iii) organized a Mutual Holding Company as a federally-chartered mutual holding company that owns at least 51% of the common stock of the Stock Holding Company for as long as the Mutual Holding Company remains in existence. The Stock Savings Bank succeeded to the business and operations of the Association in its mutual form, and the Stock Holding Company sold 40.0% of its common stock in a public stock offering that was completed on December 6, 2004.

All depositors who had membership or liquidation rights with respect to the Association as of December 6, 2004 (the effective date of the reorganization) continue to have such rights solely with respect to the Mutual Holding Company for as long as they continue to hold deposit accounts with the Bank. In addition, all persons who become depositors of the Bank subsequent to the reorganization have membership and liquidation rights with respect to the Mutual Holding Company. Borrower members of the Association at the time of the reorganization have the same membership rights in the Mutual Holding Company that they had in the Association immediately prior to the reorganization for as long as their existing borrowings remain outstanding.

On December 6, 2004, the Bank completed the mutual holding company reorganization and minority stock offering. The Company sold 6,083,500 shares of its common stock, \$0.01 par value, at a price of \$10.00 per share. As part of the reorganization and minority stock offering, the Company also established and capitalized the Foundation with a \$1.8 million one-time contribution, which consisted of 146,004 shares of its common stock and \$365,010 in cash. In addition, the Company issued 8,979,246 additional shares, or 59.04% of its outstanding shares, to Home Federal MHC, a federally chartered mutual holding company.

Note 4 - Earnings Per Share

Earnings per share ("EPS") is computed using the basic and diluted weighted average number of common shares outstanding during the period. Basic EPS is computed by dividing the Company's net income or loss by the weighted average number of common shares outstanding for the period. Diluted EPS is computed by dividing net income or loss by diluted weighted average shares outstanding, which include common stock equivalent shares outstanding using

the treasury stock method, unless such shares are anti-dilutive. Common stock equivalents arise from assumed conversion of outstanding stock options awarded under the Company's Stock Option and Incentive Plan ("SOP") and from assumed vesting of shares awarded but not released under the Company's Recognition and Retention Plan ("RRP") plan. ESOP shares are not considered outstanding for earnings per share purposes until they are committed to be released.

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The following table presents the computation of basic and diluted EPS for the periods indicated:

| | Three Months Ended March 31, | | Six Months Ended March 31, | |
|---|---------------------------------|------------|-------------------------------|------------|
| | 2007 | 2006 | 2007 | 2006 |
| (in thousands, except share and per share data) | | | | |
| Basic EPS: | | | | |
| Income available to common stockholders | \$1,241 | \$1,233 | \$2,510 | \$2,993 |
| Weighted-average common shares outstanding | 14,591,936 | 14,478,746 | 14,579,440 | 14,472,449 |
| Basic EPS | \$0.09 | \$0.09 | \$0.17 | \$0.21 |
| Diluted EPS: | | | | |
| Income available to common stockholders | \$1,241 | \$1,233 | \$2,510 | \$2,993 |
| Weighted-average common shares outstanding | 14,591,936 | 14,478,746 | 14,579,440 | 14,472,449 |
| Net effect of dilutive SOP awards | 58,498 | - | 63,334 | - |
| Net effect of dilutive RRP awards | 41,990 | 18,604 | 42,369 | 11,542 |
| Weighted-average common shares outstanding and common stock equivalents | 14,692,424 | 14,497,350 | 14,685,143 | 14,483,991 |
| Diluted EPS | \$0.08 | \$0.09 | \$0.17 | \$0.21 |

Note 5 - Recently Issued Accounting Standards

On February 15, 2007, the Financial Accounting Standards Board issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. The statement permits entities to choose to measure selected financial assets and liabilities at fair value, with changes in fair value recorded in earnings. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. The statement is effective as of the beginning of an entity's first fiscal year beginning after November 15, 2007. An entity may elect to early adopt as of the beginning of a fiscal year that begins on or before November 15, 2007. The Company is in the process of evaluating the impact of the statement on its consolidated financial position and results of operations.

Note 6 - Mortgage-Backed Securities

Mortgage-backed securities available for sale consisted of the following:

| | March 31, 2007 | | | |
|-----------------------------------|-------------------|------------------------------|-------------------------------|---------------|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| | | (in thousands) | | |
| Agency mortgage-backed securities | \$13,123 | \$ - | \$(122) | \$13,001 |
| | | September 30, 2006 | | |
| Agency mortgage-backed securities | \$12,476 | \$ - | \$(294) | \$12,182 |

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The contractual maturities of mortgage-backed securities available for sale are shown below. Expected maturities may differ from contractual maturities because borrowers have the right to prepay obligations without prepayment penalties.

| | March 31, 2007 | |
|--|-------------------|---------------|
| | Amortized Cost | Fair Value |
| | (in thousands) | |
| Due after five years through ten years | \$ 511 | \$ 497 |
| Due after ten years | 12,612 | 12,504 |
| Total | \$ 13,123 | \$ 13,001 |

The Company realized no gains or losses on sales of mortgage-backed securities available for sale for the six months ended March 31, 2007 and 2006.

Mortgage-backed securities held to maturity consisted of the following:

March 31, 2007

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---------------------------------------|-------------------|------------------------------|-------------------------------|------------------|
| (in thousands) | | | | |
| Agency mortgage-backed securities | \$168,173 | \$228 | \$(3,400) | \$165,001 |
| Non-agency mortgage-backed securities | 3,495 | - | (76) | 3,419 |
| Total | <u>\$171,668</u> | <u>\$228</u> | <u>\$(3,476)</u> | <u>\$168,420</u> |

September 30, 2006

| | | | | |
|---------------------------------------|------------------|--------------|------------------|------------------|
| Agency mortgage-backed securities | \$179,738 | \$138 | \$(4,470) | \$175,406 |
| Non-agency mortgage-backed securities | 3,541 | - | (105) | 3,436 |
| Total | <u>\$183,279</u> | <u>\$138</u> | <u>\$(4,575)</u> | <u>\$178,842</u> |

The contractual maturities of mortgage-backed securities held to maturity are shown below. Expected maturities may differ from contractual maturities because borrowers have the right to prepay obligations without prepayment penalties.

| | March 31, 2007 | |
|--|-------------------|------------------|
| | Amortized Cost | Fair Value |
| (in thousands) | | |
| Due within one year | \$ 82 | \$ 82 |
| Due after one year through five years | 451 | 456 |
| Due after five years through ten years | 6,747 | 6,604 |
| Due after ten years | 164,388 | 161,278 |
| Total | <u>\$171,668</u> | <u>\$168,420</u> |

During April 2007, the Company transferred its entire portfolio of held to maturity mortgage-backed securities to available for sale to meet the additional liquidity needs associated with increasing commercial banking activities. As a result, stockholders' equity was decreased by the securities net unrealized holding loss of \$3.2 million at the date of transfer. As part of its liquidity management, the Company does not intend to classify any investments as held-to-maturity in the foreseeable future.

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The fair value of temporarily impaired securities, the amount of unrealized losses and the length of time these unrealized losses existed as of March 31, 2007 are as follows:

| | Less than 12 months | | 12 months or longer | | Total | |
|--|---------------------|-------------------|---------------------|-------------------|------------------|-------------------|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| | (in thousands) | | | | | |
| Mortgage-backed securities, available for sale | \$2,028 | \$ (1) | \$ 9,227 | \$ (121) | \$ 11,255 | \$ (122) |
| Mortgage-backed securities, held to maturity | 2,573 | (9) | 142,568 | (3,467) | 145,141 | (3,476) |
| Total | \$4,601 | \$(10) | \$151,795 | \$(3,588) | \$156,396 | \$(3,598) |

Management has evaluated these securities and has determined that the decline in the value is temporary and not related to the underlying credit quality of the issuers or an industry specific event. The declines in value are on securities that have contractual maturity dates and future principal payments will be sufficient to recover the current amortized cost of the securities. The Company has the ability and intent to hold the securities for a reasonable period of time for a forecasted recovery of the amortized cost.

As of March 31, 2007, the Bank had pledged mortgage-backed securities with an amortized cost of \$98.8 million and a fair value of \$96.1 million as collateral for FHLB advances. The Company has also pledged a mortgage-backed security with an amortized cost of \$2.7 million and a fair value of \$2.6 million as collateral for a \$1.5 million revolving line of credit from the Bank. As of March 31, 2007, there was no balance owed on the line of credit.

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Note 7 - Loans Receivable

Loans receivable are summarized as follows:

| | March 31, 2007 | | September 30, 2006 | |
|---------------------------------|------------------------|------------------|--------------------|------------------|
| | Balance | Percent of Total | Balance | Percent of Total |
| | (dollars in thousands) | | | |
| Real Estate: | | | | |
| One- to four-family residential | \$280,027 | 55.15% | \$293,640 | 57.88% |
| Multi-family residential | 6,953 | 1.37 | 7,049 | 1.39 |

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| | | | | |
|---------------------------------|-----------|---------|-----------|---------|
| Commercial | 132,231 | 26.04 | 125,401 | 24.72 |
| | <hr/> | <hr/> | <hr/> | <hr/> |
| Total real estate | 419,211 | 82.56 | 426,090 | 83.99 |
| | <hr/> | <hr/> | <hr/> | <hr/> |
| Real Estate Construction: | | | | |
| One- to four-family residential | 21,201 | 4.17 | 23,678 | 4.67 |
| Multi-family residential | 850 | 0.17 | - | - |
| Commercial and land development | 21,866 | 4.31 | 16,344 | 3.22 |
| | <hr/> | <hr/> | <hr/> | <hr/> |
| Total real estate construction | 43,917 | 8.65 | 40,022 | 7.89 |
| | <hr/> | <hr/> | <hr/> | <hr/> |
| Consumer: | | | | |
| Home equity | 37,400 | 7.36 | 34,143 | 6.73 |
| Automobile | 2,627 | 0.52 | 3,245 | 0.64 |
| Other consumer | 1,358 | 0.27 | 1,300 | 0.26 |
| | <hr/> | <hr/> | <hr/> | <hr/> |
| Total consumer | 41,385 | 8.15 | 38,688 | 7.63 |
| | <hr/> | <hr/> | <hr/> | <hr/> |
| Commercial business | 3,266 | 0.64 | 2,480 | 0.49 |
| | <hr/> | <hr/> | <hr/> | <hr/> |
| | 507,779 | 100.00% | 507,280 | 100.00% |
| | | <hr/> | | <hr/> |
| Less: | | | | |
| Deferred loan fees | 1,242 | | 1,241 | |
| Allowance for loan losses | 2,849 | | 2,974 | |
| | <hr/> | | <hr/> | |
| | \$503,688 | | \$503,065 | |
| | <hr/> | | <hr/> | |
| Loans receivable, net | | | | |

Note 8 - Mortgage Servicing Rights

Mortgage servicing rights represent the fair value of the future loan servicing fees from the right to service loans for others. The unpaid principal balances of loans serviced at March 31, 2007 and September 30, 2006 were \$202.0 million and \$216.7 million, respectively. Loans serviced for others are not included in the consolidated statements of financial condition. In general, during periods of falling interest rates, mortgage loans prepay faster and the value of the mortgage servicing rights declines. Conversely, during periods of rising rates, the value of the mortgage servicing rights generally increases as a result of slower rates of prepayments. The Company does not use derivatives to hedge fluctuations in the fair value of the servicing rights.

As of October 1, 2006, the Company adopted SFAS No. 156, *Accounting for Servicing of Financial Assets*, to measure mortgage servicing rights using the fair value method. As a result, the Company will measure each class of mortgage servicing rights at fair value at each reporting date, and report changes in fair value in earnings in the period in which the change occurs. Prior to the adoption of SFAS No. 156, the Company elected to account for its mortgage servicing rights using the amortization method previously required by SFAS No. 140.

The Company has identified two classes of mortgage servicing assets based upon the nature of the collateral, interest rate mechanism and nature of the loan. The Company uses an independent third party to periodically value the

residential mortgage servicing rights using information such as prepayment speeds, discount rates and servicing fees associated with the type of loans sold.

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The following table lists the classes of servicing rights, activities in the balance of each class and fees earned for the three and six months ended March 31, 2007:

| Servicing Right Classes | Three Months Ended March 31, 2007 | | Six Months Ended March 31, 2007 | |
|--|--------------------------------------|-----------------------|------------------------------------|-----------------------|
| | Balance | Servicing Fees (1) | Balance | Servicing Fees (1) |
| | | (in thousands) | | |
| Fixed-rate residential mortgage loans: | | \$142 | | \$286 |
| Beginning Balance | \$2,387 | | \$2,468 | |
| Additions (2) | - | | 3 | |
| Adjustments to fair value (2) | (89) | | (173) | |
| Ending Balance | <u>\$2,298</u> | | <u>\$2,298</u> | |
| Commercial real estate loans: | | 3 | | 6 |
| Beginning Balance | \$22 | | \$24 | |
| Additions (2) | - | | - | |
| Adjustments to fair value (2) | (3) | | (5) | |
| Ending Balance | <u>\$19</u> | | <u>\$19</u> | |

(1) Included in "Loan Servicing Fees" on the Consolidated Statements of Income.

(2) Included in "Mortgage servicing rights, net" on the Consolidated Statements of Income.

Fee income excludes late fees and other ancillary fees earned that are immaterial in amount.

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

Forward-Looking Statements

This report contains forward-looking statements, which can be identified by the use of words such as "believes," "intends," "expects," "anticipates," "estimates" or similar expressions. Forward-looking statements include, but are not limited to:

- statements of the Company's goals, intentions and expectations;
- statements regarding the Company's business plan, prospects, growth and operating strategies;
- statements regarding the quality of the Company's loan and investment portfolios; and
- estimates of the Company's risks and future costs and benefits.

These forward-looking statements are subject to significant risks and uncertainties. Actual results may differ materially from those contemplated by the forward-looking statements as a result of, among others, the following factors:

- general economic conditions, either nationally or in the Company's market area, that are worse than expected;
 - changes in the interest rate environment that reduce the Company's interest margins or reduce the fair value of financial instruments;
 - increased competitive pressures among financial services companies;
 - changes in consumer spending, borrowing and savings habits;
 - legislative or regulatory changes that adversely affect the Company's business;
 - adverse changes in the securities markets; and
 - changes in accounting policies and practices, as may be adopted by the bank regulatory agencies, the Public Company Accounting Oversight Board or the Financial Accounting Standards Board.
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These factors should be considered in evaluating the forward-looking statements, and undue reliance should not be placed on such statements. The Company undertakes no obligation to publish revised forward-looking statements to reflect the occurrence of unanticipated events or circumstances after the date hereof.

Overview

The Company was organized as a federally-chartered stock corporation at the direction of the Association in connection with its mutual holding company reorganization. The reorganization was completed on December 6, 2004. In connection with the reorganization, the Association converted to a federally-chartered stock savings bank and changed its corporate title to "Home Federal Bank." In the reorganization, the Company sold 40.00% of its outstanding shares of common stock (6,083,500 shares) to the public and issued 59.04% of its outstanding shares of common stock (8,979,246 shares) to Home Federal MHC, the mutual holding company parent of the Company. In connection with the reorganization, the Company also established and capitalized the Foundation with a \$1.8 million one-time contribution, which consisted of 146,004 shares of its common stock and \$365,010 in cash. The Company's common stock is traded on the NASDAQ Global Market under the symbol "HOME" and is included in the America's Community Bankers NASDAQ Index.

The Bank was founded in 1920 as a building and loan association and reorganized as a federal mutual savings and loan association in 1936. The Bank is a community-oriented financial institution dedicated to serving the financial service needs of consumers and businesses within its market area. The Bank's primary business is attracting deposits from the general public and using these funds to originate loans. We emphasize the origination of loans secured by first mortgages on owner-occupied, residential real estate, residential development and construction, and commercial real estate. The Bank also originates other types of real estate loans, commercial business loans and consumer loans. As a result of a comprehensive and continuing review of the Company's strategic business plan, the Company plans to increase its commercial and small business banking programs, including both loan and deposit products.

The Bank serves the Treasure Valley region of southwestern Idaho, that includes Ada, Canyon, Elmore and Gem counties, through its 15 full-service banking offices and two loan centers. Nearly 40% of the state's population lives and works in the four counties served by Home Federal Bank. Ada County has the largest population and includes the city of Boise, the state capitol. Home Federal Bank maintains its largest branch presence in Ada County with eight locations, followed by Canyon County with five branches, including the Company's corporate headquarters in Nampa. The two remaining branches are located in Elmore and Gem Counties.

The local economy is primarily urban with the city of Boise being the most populous of the markets that the Bank serves, followed by Nampa, the state's second largest city. The regional economy is well diversified with government, healthcare, manufacturing, high technology, call centers and construction providing sources of employment. In addition, agriculture and related industries continue to be key components of the economy in southwestern Idaho. Generally, sources of employment are concentrated in Ada and Canyon counties and include the headquarters of Micron Technology, Washington Group International, J.R. Simplot Company and Boise Cascade, LLC. Other major employers include Hewlett-Packard, two regional medical centers and Idaho state government agencies. The city of Boise is also home to Boise State University, the state's largest and fastest growing university.

Critical Accounting Policies

Allowance for Loan Losses.

Management believes that the accounting estimate related to the allowance for loan losses is a critical accounting estimate because it is highly susceptible to change from period to period. This requires management to make assumptions about future losses on loans as the impact of a sudden large loss could deplete the allowance and potentially require increased provisions to replenish it, which would negatively affect earnings.

Our methodology for analyzing the allowance for loan losses consists of specific allocations on significant individual credits and a general allowance amount, including a range of losses. The specific allowance component is determined when management believes that the collectibility of a specific large loan has been impaired and a loss is probable. The general allowance component relates to assets with no well-defined deficiency or weakness and takes into consideration loss that is inherent within the portfolio but has not been realized. The general allowance is determined by applying a historical loss percentage to various types of loans with similar characteristics and classified loans that are not analyzed specifically. Because of the imprecision in calculating inherent and potential losses, a range is added to the general reserve to provide an allowance for loan losses that is adequate to cover losses

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that may arise as a result of changing economic conditions and other factors that may alter the Bank's historical loss experience.

The Company also estimates a reserve related to unfunded loan commitments. In assessing the adequacy of the reserve, the Company uses a similar approach used in the development of the allowance for loan losses. The reserve for unfunded loan commitments is included in other liabilities on the Consolidated Balance Sheet. The provision for unfunded commitments is charged to noninterest expense.

Mortgage Servicing Rights.

Mortgage servicing rights represent the fair value of the future loan servicing fees from the right to service loans for others. The most critical accounting policy associated with mortgage servicing is the methodology used to determine the fair value of capitalized mortgage servicing rights, which requires the development of a number of estimates, the most critical of which is the mortgage loan prepayment speeds assumption.

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The Company performs a quarterly review of mortgage servicing rights for potential changes in value. Periodically, the Company also obtains an independent appraisal by an outside party of the fair value of the mortgage servicing rights.

Deferred Income Taxes.

Deferred income taxes are reported for temporary differences between items of income or expense reported in the financial statements and those reported for income tax purposes. Deferred taxes are computed using the asset and liability approach as prescribed in SFAS No. 109, *Accounting for Income Taxes*. Under this method, a deferred tax asset or liability is determined based on the currently enacted tax rates applicable to the period in which the differences between the financial statement carrying amounts and tax basis of existing assets and liabilities are expected to be reported in the Company's income tax returns. The deferred tax provision for the year is equal to the net change in the net deferred tax asset from the beginning to the end of the year, less amounts applicable to the change in value related to investments available for sale. The effect on deferred taxes of a change in tax rates is recognized as income in the period that includes the enactment date. The primary differences between financial statement income and taxable income result from depreciation expense, mortgage servicing rights, loan loss reserves and dividends received from the FHLB. Deferred income taxes do not include a liability for pre-1988 bad debt deductions allowed to thrift institutions that may be recaptured if the institution fails to qualify as a thrift for income tax purposes in the future.

Comparison of Financial Condition at March 31, 2007 and September 30, 2006

General.

Total assets decreased \$15.3 million, or 2.0%, to \$746.0 million at March 31, 2007 from \$761.3 million at September 30, 2006. Mortgage-backed securities decreased \$10.8 million, or 5.5%, to \$184.7 million and were the primary reason for the asset decline during the six-month period. As a result, the Company also reduced outstanding FHLB advances by \$11.3 million, or 5.3%, to \$199.5 million. Total deposits decreased \$8.1 million, or 1.9%, to \$422.2 million as customers transferred funds into higher rate deposit products during the past several quarters and as a result of the transfer from the Bank of a single commercial relationship that reduced outstanding balances by approximately \$3.8 million during the six-month period.

Assets.

For the six months ended March 31, 2007, total assets decreased \$15.3 million. The increases and decreases were primarily concentrated in the following asset categories:

| | Balance at March 31, 2007 | Balance at September 30, 2006 | Increase (decrease) | |
|---|---------------------------------|-------------------------------------|---------------------|---------|
| | | | Amount | Percent |
| (dollars in thousands) | | | | |
| Cash and amounts due from depository institutions | \$ 12,558 | \$ 18,385 | \$ (5,827) | (31.7)% |
| Mortgage-backed securities, available for sale | 13,001 | 12,182 | 819 | 6.7 |
| Mortgage-backed securities, held to maturity | 171,668 | 183,279 | (11,611) | (6.3) |
| Loans receivable, net of allowance for loan losses | 503,688 | 503,065 | 623 | 0.1 |

Cash and amounts due from depository institutions decreased \$5.8 million as a result of normal fluctuations of amounts due from other financial institutions.

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Mortgage-backed securities decreased \$10.8 million to \$184.7 million at March 31, 2007, from \$195.5 million at September 30, 2006. For the six months ended March 31, 2007, the Company purchased \$2.1 million of hybrid adjustable-rate mortgage-backed securities. Repayments of principal totaled \$13.1 million for the six months ended March 31, 2007. The Company purchases mortgage-backed securities to manage interest rate sensitivity, supplement loan originations and provide liquidity.

Loans receivable, net, increased \$623,000 to \$503.7 million at March 31, 2007, from \$503.1 million at September 30, 2006. One- to four-family residential mortgage loans decreased \$16.1 million as the Company currently sells the majority of the one- to four-family loans that it originates. Commercial real estate loans increased \$12.4 million, or 8.7%, during the six months ended March 31, 2007. The Bank has made significant progress in building its commercial banking division and expects that there will continue to be considerable growth opportunities, including both loan and deposit products, for the Bank.

Deposits.

Deposits decreased \$8.1 million, or 1.9%, to \$422.2 million at March 31, 2007, from \$430.3 million at September 30, 2006. A significant portion of the decrease in noninterest-bearing demand deposits was the result of a single commercial relationship that reduced outstanding balances by approximately \$3.8 million during the six-month period. Money market deposits accounted for the majority of the increase in interest-bearing deposits as a result of the Company's increased emphasis on commercial accounts and as customers transferred funds into higher rate deposit products. The following table details the changes in deposit accounts:

| | Balance at March 31, 2007 | Balance at September 30, 2006 | Increase (decrease) | |
|-------------------------------------|---------------------------------|-------------------------------------|---------------------|---------------|
| | | | Amount | Percent |
| (dollars in thousands) | | | | |
| Noninterest-bearing demand deposits | \$ 36,006 | \$ 44,626 | \$(8,620) | (19.3)% |
| Interest-bearing demand deposits | 135,835 | 128,276 | 7,559 | 5.9 |
| Savings deposits | 23,486 | 23,655 | (169) | (0.7) |
| Certificates of deposit | 226,891 | 233,724 | (6,833) | (2.9) |
| Total deposit accounts | \$422,218 | \$ 430,281 | \$(8,063) | (1.9)% |

Borrowings.

FHLB advances decreased \$11.3 million, or 5.3%, to \$199.5 million at March 31, 2007, from \$210.8 million at September 30, 2006. The Company uses FHLB advances as an alternative funding source to deposits, and to manage funding costs, reduce interest rate risk, and to leverage the balance sheet.

Equity.

Stockholders' equity increased \$3.2 million, or 2.9%, to \$111.0 million at March 31, 2007, from \$107.9 million at September 30, 2006. The increase was primarily a result of the \$2.5 million in net income and the allocation of earned ESOP shares, equity compensation and the exercise of stock options totaling \$1.1 million, offset by \$638,000 in cash dividends paid to stockholders. On March 15, 2007, the Company paid \$0.055 per share in cash dividends to stockholders of record as of March 1, 2007, excluding shares held by Home Federal MHC.

Comparison of Operating Results for the Three Months ended March 31, 2007 and March 31, 2006

General.

Net income for the three months ended March 31, 2007 was \$1.2 million, or \$0.08 per diluted share, compared to net income of \$1.2 million, or \$0.09 per diluted share, for the three months ended March 31, 2006.

Net Interest Income.

Net interest income decreased \$273,000, or 4.8%, to \$5.4 million for the three months ended March 31, 2007, from \$5.6 million for the three months ended March 31, 2006. The decrease in net interest income was primarily attributable to the ongoing compression of the Company's net interest margin, despite an overall increase in average interest-earning assets and interest-bearing liabilities of \$39.7 million and \$43.8 million, respectively.

The Company's net interest margin decreased 33 basis points to 3.00% for the quarter ended March 31, 2007, from 3.33% for the same quarter last year. The cost of interest-bearing liabilities increased 76 basis points to 3.62% for the second quarter of fiscal 2007 compared to 2.86% for the second quarter of the prior year. The decline in the net interest margin reflects the relatively flat yield curve that currently exists, as the cost of shorter-term deposits and borrowed funds increased more rapidly than the yield on longer-term assets. Although the Company believes the

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repricing of existing loans and the emphasis on expanding the commercial and small business banking programs, including both loan and deposit products, will help counter the trend in net interest margin, pressure will likely continue in the near term as a result of the flat yield curve environment.

The following table sets forth the results of balance sheet growth and changes in interest rates to the Company's net interest income. The rate column shows the effects attributable to changes in rate (changes in rate multiplied by prior volume). The volume column shows the effects attributable to changes in volume (changes in volume multiplied by prior rate). Changes attributable to both rate and volume, which cannot be segregated, are allocated proportionately to the changes in rate and volume.

Three Months Ended March 31, 2007
Compared to March 31, 2006

| | Increase (Decrease) Due to | | Total |
|---|----------------------------|----------------|---------|
| | Rate | Volume | |
| | | | |
| | | (in thousands) | |
| Interest-earning assets: | | | |
| Loans receivable, net | \$415 | \$ 894 | \$1,309 |
| Loans held for sale | (1) | 33 | 32 |
| Investment securities, including interest-bearing | | | |
| deposits in other banks | 10 | (55) | (45) |
| Mortgage-backed securities | 19 | (161) | (142) |
| FHLB stock | 9 | - | 9 |

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| | | | |
|---|-------|--------|----------|
| Total net change in income on interest-earning assets | \$452 | \$ 711 | \$1,163 |
| Interest-bearing liabilities: | | | |
| Savings deposits | \$ 9 | \$ (1) | \$ 8 |
| Interest-bearing demand deposits | 39 | (7) | 32 |
| Money market accounts | 137 | 31 | 168 |
| Certificates of deposit | 575 | 125 | 700 |
| Total deposits | 760 | 148 | 908 |
| FHLB advances | 190 | 338 | 528 |
| Total net change in expense on interest-bearing liabilities | \$950 | \$486 | \$1,436 |
| Total increase (decrease) in net interest income | | | \$ (273) |

Interest and Dividend Income.

Total interest and dividend income for the three months ended March 31, 2007 increased \$1.2 million, or 12.1%, to \$10.7 million, from \$9.6 million for the three months ended March 31, 2006. The increase during the quarter was primarily attributable to the \$39.7 million, or 5.9%, increase in the average balance of interest-earning assets and an increase in the yield on interest-earning assets to 6.00% from 5.67% as a result of the general increase in interest rates and changes in the Company's loan portfolio mix.

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The following table compares detailed average earning asset balances, associated yields, and resulting changes in interest and dividend income for the three months ended March 31, 2007 and 2006:

| | Three Months Ended March 31, | | | | Increase/ (Decrease) in Interest and Dividend Income from 2006 |
|--|------------------------------|-------|--------------------|-------|---|
| | 2007 | | 2006 | | |
| | Average Balance | Yield | Average Balance | Yield | |
| | (dollars in thousands) | | | | |
| Loans receivable, net | \$512,191 | 6.56% | \$456,732 | 6.21% | \$1,309 |
| Loans held for sale | 4,504 | 6.13 | 2,358 | 6.26 | 32 |
| Investment securities, available for sale, including interest-bearing | 1,158 | 5.18 | 5,526 | 4.34 | (45) |

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| | | | | | |
|-------------------------------|-----------|-------|-----------|-------|---------|
| deposits in other banks | | | | | |
| Mortgage-backed securities | 188,113 | 4.77 | 201,647 | 4.73 | (142) |
| FHLB stock | 9,591 | 0.38 | 9,591 | - | 9 |
| | <hr/> | <hr/> | <hr/> | <hr/> | <hr/> |
| Total interest-earning assets | \$715,557 | 6.00% | \$675,854 | 5.67% | \$1,163 |
| | <hr/> | <hr/> | <hr/> | <hr/> | <hr/> |

Interest Expense.

Interest expense increased \$1.4 million, or 36.4%, to \$5.4 million for the three months ended March 31, 2007 from \$3.9 million for the three months ended March 31, 2006. The increase during the quarter was primarily attributable to the \$43.8 million, or 7.9%, increase in average balance of interest-bearing liabilities and a 76 basis point increase in the cost of interest-bearing liabilities to 3.62% from 2.86% as a result of general market rate increases and changes in the Company's deposit mix.

The following table details average balances, cost of funds and the change in interest expense for the three months ended March 31, 2007 and 2006:

Three Months Ended March 31,

| | 2007 | | 2006 | | Increase/ (Decrease) in Interest Expense from 2006 |
|---------------------------------------|------------------------|-------|--------------------|-------|--|
| | Average Balance | Cost | Average Balance | Cost | |
| | (dollars in thousands) | | | | |
| Savings deposits | \$ 23,380 | 0.36% | \$ 25,537 | 0.20% | \$ 8 |
| Interest-bearing demand deposits | 92,586 | 0.58 | 98,914 | 0.41 | 32 |
| Money market deposits | 38,409 | 2.87 | 30,914 | 1.40 | 168 |
| Certificates of deposit | 228,346 | 4.51 | 214,727 | 3.49 | 700 |
| FHLB advances | 211,721 | 4.48 | 180,586 | 4.08 | 528 |
| | <hr/> | <hr/> | <hr/> | <hr/> | <hr/> |
| Total interest-bearing liabilities | \$594,442 | 3.62% | \$550,678 | 2.86% | \$1,436 |
| | <hr/> | <hr/> | <hr/> | <hr/> | <hr/> |

Provision for Loan Losses

. The Company's Asset Liability Committee (the "Committee") assesses the adequacy of the Company's allowance for loan losses on a quarterly basis. The quarterly assessment may include several factors, including changes in size and composition of the loan portfolio, delinquency rates, charge-off rates and the changing risk profile of the loan portfolio, as well as local economic conditions including unemployment rates, bankruptcies and vacancy rates of business and residential properties. The Committee's methodology for analyzing the allowance for loan losses consists of specific allocations on significant individual credits and a general allowance amount, including a range of losses. The specific allowance component is determined when management believes that the collectibility of a specific larger balance loan has been impaired and a loss is probable. The general allowance component relates to groups of homogeneous loans with no well-defined deficiency or weakness and takes into consideration loss that is inherent within the portfolio but has not been realized. The general allowance is

determined by applying a historical loss percentage to various types of loans with similar characteristics and classified loans that are not analyzed specifically. Because of the imprecision in calculating inherent and potential losses, a range is added to the general reserve to provide an allowance for loan losses that is adequate to cover losses that may arise as a result of changing economic conditions and other factors that may alter the Bank's historical loss experience.

In connection with its analysis of the loan portfolio for the quarter ended March 31, 2007, management determined that no provision for loan losses was required for the quarter ended March 31, 2007, compared to a provision for loan losses of \$90,000 established for the same quarter of 2006. The \$90,000 decrease in the provision reflects a reduction in loans receivable and classified assets during the current quarter. The Company's credit quality remains excellent, as non-performing loans were \$273,000, or 0.04% of total assets, at March 31, 2007, compared to \$10,000, or 0.001% of total assets, at March 31, 2006. Non-performing one- to four-family residential loans were \$27,000, or 0.004% of total assets at March 31, 2007, compared to \$4,000, or 0.001% of total assets, at March 31, 2006. The Company does not originate or purchase one- to four-family subprime loans. Management considers the allowance for loan losses at March 31, 2007 to be adequate to cover probable losses inherent in the loan portfolio based on the assessment of the above-mentioned factors affecting the loan portfolio.

Prior to March 31, 2007, the allowance for loan losses included the estimated loss from unfunded loan commitments. The preferred accounting method is to separate the unfunded loan commitments from the disbursed loan amounts and record the unfunded loan commitment portion as a liability. At March 31, 2007, the reserve for unfunded loan commitments was \$192,000, which was reclassified to other liabilities on the Consolidated Balance Sheet. Including the \$192,000 liability for unfunded commitments, the allowance for loan losses was \$3.0 million, or 0.60% of gross loans at March 31, 2007, compared to \$3.0 million, or 0.62% at March 31, 2006.

The following table details selected activity associated with the allowance for loan losses for the three months ended March 31, 2007 and 2006:

| | At or For the Three Months Ended March 31, | |
|--|---|------------|
| | 2007 | 2006 |
| | (dollars in thousands) | |
| Provision for loan losses | \$ - | \$ 90 |
| Net charge-offs | 4 | 30 |
| Allowance for loan losses | 2,849 | 2,984 |
| Allowance for loan losses as a percentage of gross | | |
| loans receivable at the end of the period | 0.56% | 0.62% |
| Nonperforming loans | \$ 273 | \$ 10 |
| Allowance for loan losses as a percentage of nonperforming loans at the end of the period | 1,043.59% | 29,840.00% |
| Nonaccrual and 90 days or more past due loans as a percentage of loans receivable at the end of the period | 0.050 | 0.002 |
| Loans receivable, net | \$503,688 | \$476,227 |
| Noninterest Income | | |

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. Noninterest income increased \$272,000, or 10.9%, to \$2.8 million for the three months ended March 31, 2007 from \$2.5 million for the three months ended March 31, 2006. The increase was primarily attributable to a \$184,000, or 94.4%, increase in gains on the sale of residential mortgage loans and a \$107,000, or 5.1%, increase in service charges and fees. The Company currently sells the majority of the one- to four-family residential mortgage loans that it originates. For the three months ended March 31, 2006, a larger percentage of the residential mortgage loans originated were held in the loan portfolio.

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The following table provides a detailed analysis of the changes in components of noninterest income:

| | Three Months Ended March 31, | | Increase (decrease) | |
|--|---------------------------------|----------------|---------------------|--------------|
| | 2007 | 2006 | Amount | Percent |
| | (dollars in thousands) | | | |
| Service fees and charges | \$2,222 | \$2,115 | \$107 | 5.1% |
| Gain on sale of loans | 379 | 195 | 184 | 94.4 |
| Increase in cash surrender value of bank owned life insurance | 99 | 108 | (9) | (8.3) |
| Loan servicing fees | 142 | 159 | (17) | (10.7) |
| Mortgage servicing rights, net | (92) | (64) | (28) | 43.8 |
| Other | 11 | (24) | 35 | (145.8) |
| Total noninterest income | \$2,761 | \$2,489 | \$272 | 10.9% |

The Company performs a quarterly review of mortgage servicing rights for potential increases or declines in value. For the three months ended March 31, 2007, the Company determined the value of the mortgage servicing rights decreased \$92,000. Excluding changes in value attributable to increases or decreases in interest rates and prepayment speeds of the underlying mortgages, the Company generally expects the value of the mortgage servicing rights to continue to decline as the majority of residential mortgage loans are being sold with the servicing rights released. The mortgage servicing right was 1.15% of mortgage loans serviced for others at March 31, 2007, compared to 1.10% at March 31, 2006. Mortgage servicing rights is an accounting estimate of the present value of the future servicing fees from the right to service mortgage loans for others. This estimate is affected by prepayment speeds of the underlying mortgages and interest rates. In general, during periods of rising interest rates, mortgage loans prepay slower and the value of the mortgage-servicing asset increases.

Noninterest Expense

. Noninterest expense was unchanged at \$6.1 million for the three months ended March 31, 2007 as compared to the three months ended March 31, 2006.

The following table provides a detailed analysis of the changes in components of noninterest expense:

Increase (decrease)

| | Three Months Ended March 31, | | | |
|----------------------------------|---------------------------------|----------------|------------------------|-------------|
| | 2007 | 2006 | Amount | Percent |
| | | | (dollars in thousands) | |
| Compensation and benefits | \$3,851 | \$3,770 | \$ 81 | 2.1% |
| Occupancy and equipment | 727 | 694 | 33 | 4.8 |
| Data processing | 493 | 520 | (27) | (5.2) |
| Advertising | 300 | 257 | 43 | 16.7 |
| Other | 723 | 810 | (87) | (10.7) |
| Total noninterest expense | \$6,094 | \$6,051 | \$ 43 | 0.7% |

Compensation and benefits increased \$81,000, or 2.1%, to \$3.9 million for the quarter ended March 31, 2007 from \$3.8 million for the same quarter a year ago. As of March 31, 2007, the Company employed 211 full-time equivalent employees, compared to 231 at March 31, 2006, a decrease of approximately 9%. The decrease in compensation costs related to the reduction in full-time employees was offset by increased costs related to equity compensation plans and annual merit increases. Advertising costs increased \$43,000, or 16.7% primarily as a result of marketing costs related to a debit card rewards program and business banking campaign that were implemented during the current fiscal year. The debit card rewards program is designed to reward customers for their debit card usage which results in additional interchange income to the Company.

The Company's efficiency ratio, which is the percentage of noninterest expense to net interest income plus noninterest income, was 75.0% for the three months ended March 31, 2007, relatively unchanged from 74.5% for the three months ended March 31, 2006. By definition, a lower efficiency ratio would be an indication that the Company is more efficiently utilizing resources to generate net interest income and other fee income.

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Income Tax Expense.

Income tax expense increased \$38,000, or 5.1%, to \$787,000 for the three months ended March 31, 2007 from \$749,000 million for the same period a year ago. Income before income taxes increased \$46,000, or 2.3%, to \$2.0 million for the three months ended March 31, 2007. The Company's combined federal and state effective income tax rate for the current quarter was 38.8% compared to 37.8% for the same quarter of the prior fiscal year. The effective tax rate increased primarily as a result of increases in ESOP compensation expense due to increases in the Company's stock price. The additional compensation expense is not fully deductible for tax return purposes.

Comparison of Operating Results for the Six Months ended March 31, 2007 and March 31, 2006

General.

Net income for the six months ended March 31, 2007 was \$2.5 million, or \$0.17 per diluted share, compared to net income of \$3.0 million, or \$0.21 per diluted share, for the six months ended March 31, 2006.

Net Interest Income.

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Net interest income decreased \$756,000, or 6.5%, to \$10.9 million for the six months ended March 31, 2007, from \$11.6 million for the six months ended March 31, 2006. The decrease in net interest income was primarily attributable to the ongoing compression of the Company's net interest margin, despite an overall increase in average interest-earning assets and interest-bearing liabilities of \$54.4 million and \$58.1 million, respectively.

The Company's net interest margin decreased 48 basis points to 3.02% for the six months ended March 31, 2007, from 3.50% for the same period of the prior year. The cost of interest-bearing liabilities increased 90 basis points to 3.60% for the six months of fiscal 2007 compared to 2.70% for the same period of the prior year. The decline in the net interest margin reflects the relatively flat yield curve that currently exists, as the cost of shorter-term deposits and borrowed funds increased more rapidly than the yield on longer-term assets. Although the Company believes the repricing of existing loans and the emphasis on expanding the commercial and small business banking programs, including both loan and deposit products, will help counter the trend in net interest margin, pressure will likely continue in the near term as a result of the flat yield curve environment.

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The following table sets forth the results of balance sheet growth and changes in interest rates to the Company's net interest income. The rate column shows the effects attributable to changes in rate (changes in rate multiplied by prior volume). The volume column shows the effects attributable to changes in volume (changes in volume multiplied by prior rate). Changes attributable to both rate and volume, which cannot be segregated, are allocated proportionately to the changes in rate and volume.

| | Six Months Ended March 31, 2007 Compared to March 31, 2006 | | |
|---|---|---------|---------|
| | Increase (Decrease) Due to | | |
| | Rate | Volume | Total |
| | (in thousands) | | |
| Interest-earning assets: | | | |
| Loans receivable, net | \$798 | \$2,166 | \$2,964 |
| Loans held for sale | 1 | (31) | (30) |
| Investment securities, including interest-bearing deposits in other banks | 18 | (45) | (27) |
| Mortgage-backed securities | 22 | (244) | (222) |
| FHLB stock | 19 | - | 19 |
| | \$858 | \$1,846 | \$2,704 |
| Total net change in income on interest-earning assets | | | |

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Interest-bearing liabilities:

| | | | |
|---|--------------|----------------|-----------------|
| Savings deposits | \$ 14 | \$ (2) | \$ 12 |
| Interest-bearing demand deposits | 96 | (8) | 88 |
| Money market accounts | 232 | 36 | 268 |
| Certificates of deposit | 1,537 | 416 | 1,953 |
| | <u>1,879</u> | <u>442</u> | <u>2,321</u> |
| FHLB advances | 379 | 760 | 1,139 |
| | <u>2,258</u> | <u>\$1,202</u> | <u>\$3,460</u> |
| Total net change in expense on interest-bearing liabilities | | | |
| Total increase (decrease) in net interest income | | | <u>\$ (756)</u> |

Interest and Dividend Income.

Total interest and dividend income for the six months ended March 31, 2007 increased \$2.7 million, or 14.3%, to \$21.6 million, from \$18.9 million for the six months ended March 31, 2006. The increase during the quarter was primarily attributable to the \$54.4 million, or 8.2%, increase in the average balance of interest-earning assets and an increase in the yield on interest-earning assets to 6.01% from 5.70% as a result of the general increase in interest rates and changes in the Company's loan portfolio mix.

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The following table compares detailed average earning asset balances, associated yields, and resulting changes in interest and dividend income for the six months ended March 31, 2007 and 2006:

| | Six Months Ended March 31, | | | | Increase/ (Decrease) in Interest and Dividend Income from 2006 |
|--|----------------------------|-------|--------------------|-------|---|
| | 2007 | | 2006 | | |
| | Average Balance | Yield | Average Balance | Yield | |
| | (dollars in thousands) | | | | |
| Loans receivable, net | \$513,622 | 6.54% | \$446,441 | 6.20% | \$2,964 |
| Loans held for sale | 3,239 | 6.30 | 3,852 | 6.07 | (30) |
| Investment securities, available for sale, including interest-bearing | 1,691 | 5.20 | 3,596 | 3.95 | (27) |

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| | | | | | |
|-------------------------------|-----------|-------|-----------|-------|---------|
| deposits in other banks | | | | | |
| Mortgage-backed securities | 190,683 | 4.77 | 200,910 | 4.75 | (222) |
| FHLB stock | 9,591 | 0.40 | 9,591 | - | 19 |
| | <hr/> | <hr/> | <hr/> | <hr/> | <hr/> |
| Total interest-earning assets | \$718,826 | 6.01% | \$664,390 | 5.70% | \$2,704 |
| | <hr/> | <hr/> | <hr/> | <hr/> | <hr/> |

Interest Expense.

Interest expense increased \$3.5 million, or 47.5%, to \$10.7 million for the six months ended March 31, 2007 from \$7.3 million for the six months ended March 31, 2006. The average balance of total interest-bearing liabilities increased \$58.1 million, or 10.8%, to \$597.6 million for the six months ended March 31, 2007 from \$539.5 million for the six months ended March 31, 2006. The increase was primarily a result of growth in certificates of deposits and additional FHLB advances. As a result of general market rate increases, the average cost of funds for total interest-bearing liabilities increased 90 basis points to 3.60% for the six months ended March 31, 2007 compared to 2.70% for the six months ended March 31, 2006.

The following table details average balances, cost of funds and the change in interest expense for the six months ended March 31, 2007 and 2006:

| | Six Months Ended March 31, | | | | Increase/ (Decrease) in Interest Expense from 2006 |
|---------------------------------------|----------------------------|-------|--------------------|-------|--|
| | 2007 | | 2006 | | |
| | Average Balance | Cost | Average Balance | Cost | |
| | (dollars in thousands) | | | | |
| Savings deposits | \$ 23,402 | 0.32% | \$ 25,420 | 0.20% | \$ 12 |
| Interest-bearing demand deposits | 93,729 | 0.60 | 97,688 | 0.39 | 88 |
| Money market deposits | 36,247 | 2.70 | 31,650 | 1.40 | 268 |
| Certificates of deposit | 231,744 | 4.49 | 207,446 | 3.14 | 1,953 |
| FHLB advances | 212,466 | 4.46 | 177,309 | 4.06 | 1,139 |
| | <hr/> | <hr/> | <hr/> | <hr/> | <hr/> |
| Total interest-bearing liabilities | \$597,588 | 3.60% | \$539,513 | 2.70% | \$3,460 |
| | <hr/> | <hr/> | <hr/> | <hr/> | <hr/> |

Provision for Loan Losses

A provision for loan losses of \$71,000 was established by management in connection with its analysis of the loan portfolio for the six months ended March 31, 2007, compared to a provision for loan losses of \$145,000 established for the six months ended March 31, 2006. The \$74,000, or 51% decrease in the provision reflects the increase in loans receivable, offset by a reduction of classified assets, historical loan loss rates and net charge-offs. Management considers the allowance for loan losses at March 31, 2007 to be adequate to cover probable losses inherent in the loan portfolio based on the assessment of the above-mentioned factors affecting the loan portfolio.

The following table details selected activity associated with the allowance for loan losses for the six months ended March 31, 2007 and 2006:

| | At or For the Six Months Ended March 31, | |
|---|---|------------|
| | 2007 | 2006 |
| | (dollars in thousands) | |
| Provision for loan losses | \$ 71 | \$ 145 |
| Net charge-offs | 5 | 43 |
| Allowance for loan losses | 2,849 | 2,984 |
| Allowance for loan losses as a percentage of gross | | |
| loans receivable at the end of the period | 0.56% | 0.62% |
| Nonperforming loans | \$ 273 | \$ 10 |
| Allowance for loan losses as a percentage of nonperforming loans at the end of the period | 1,043.59% | 29,840.00% |
| Nonaccrual and 90 days or more past due loans as a | | |
| percentage of loans receivable at the end of the | | |
| period | 0.050 | 0.002 |
| Loans receivable, net | \$503,688 | \$476,227 |
| Noninterest Income | | |

. Noninterest income increased \$354,000, or 6.7%, to \$5.6 million for the six months ended March 31, 2007 from \$5.3 million for the six months ended March 31, 2006. The increase was primarily attributable to a \$171,000, or 33.8%, increase in gains on the sale of residential mortgage loans and a \$135,000, or 3.0%, increase in service charges and fees. The Company currently sells the majority of the one- to four-family residential mortgage loans that it originates. For the six months ended March 31, 2006, a larger percentage of the residential mortgage loans originated were held in the loan portfolio. As a result of the Company's conversion of its core processing system during the quarter ended December 31, 2005, the Company retired fixed assets and software related to the prior system, resulting in an \$86,000 charge to other noninterest income for the six months ended March 31, 2006.

The following table provides a detailed analysis of the changes in components of noninterest income:

| | Six Months Ended March 31, | | Increase (decrease) | |
|-------------------------------------|-------------------------------|---------|---------------------|---------|
| | 2007 | 2006 | Amount | Percent |
| | (dollars in thousands) | | | |
| Service fees and charges | \$4,636 | \$4,501 | \$135 | 3.0% |
| Gain on sale of loans | 677 | 506 | 171 | 33.8 |
| Increase in cash surrender value | | | | |
| of bank owned life insurance | 199 | 190 | 9 | 4.7 |

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| | | | | |
|-----------------------------------|---------|---------|-------|--------|
| Loan servicing fees | 286 | 319 | (33) | (10.3) |
| Mortgage servicing rights, net | (175) | (160) | (15) | 9.4 |
| Other | 21 | (66) | 87 | 131.8 |
| | <hr/> | <hr/> | <hr/> | <hr/> |
| Total noninterest income | \$5,644 | \$5,290 | \$354 | 6.7% |
| | <hr/> | <hr/> | <hr/> | <hr/> |

Noninterest Expense

. Noninterest expense increased \$409,000, or 3.4%, to \$12.3 million for the six months ended March 31, 2007 from \$11.9 million for the six months ended March 31, 2006.

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The following table provides a detailed analysis of the changes in components of noninterest expense:

| | Six Months Ended March 31, | | Increase (decrease) | |
|---------------------------|-------------------------------|----------|---------------------|---------|
| | 2007 | 2006 | Amount | Percent |
| | <hr/> | | | |
| | (dollars in thousands) | | | |
| Compensation and benefits | \$ 7,865 | \$ 7,576 | \$ 289 | 3.8% |
| Occupancy and equipment | 1,429 | 1,422 | 7 | 0.5 |
| Data processing | 1,001 | 861 | 140 | 16.3 |
| Advertising | 596 | 471 | 125 | 26.5 |
| Other | 1,449 | 1,601 | (152) | (9.5) |
| | <hr/> | <hr/> | <hr/> | <hr/> |
| Total noninterest expense | \$12,340 | \$11,931 | \$ 409 | 3.4% |
| | <hr/> | <hr/> | <hr/> | <hr/> |

Compensation and benefits increased \$289,000, or 3.8%, to \$7.9 million for the six months ended March 31, 2007 from \$7.6 million for the same period a year ago. The majority of the increase was primarily attributable to increased costs related to equity compensation plans and annual merit increases, offset by decreases in training and recruiting costs. As of March 31, 2007, the Company employed 211 full-time equivalent employees, compared to 231 at March 31, 2006, a decrease of approximately 9%. Data processing expenses increased \$140,000, or 16%, primarily as a result of the outsourcing of the Company's check processing function as part of the conversion of its core processing system in November 2005. Advertising costs increased \$125,000, or 26.5%, primarily as a result of marketing costs related to a debit card rewards program and business banking campaign that were initiated during the current fiscal year.

The Company's efficiency ratio, which is the percentage of noninterest expense to net interest income plus noninterest income, was 74.8% for the six months ended March 31, 2007 compared to 70.6% for the six months ended March 31,

2006. The increase in efficiency ratio was primarily attributable to a \$756,000, or 6.5%, decrease in net interest income. By definition, a lower efficiency ratio would be an indication that the Company is more efficiently utilizing resources to generate net interest income and other fee income.

Income Tax Expense.

Income tax expense decreased \$254,000, or 13.8%, to \$1.6 million for the six months ended March 31, 2007 from \$1.8 million for the same period a year ago. Income before income taxes decreased \$737,000, or 15.3%, to \$4.1 million for the six months ended March 31, 2007 compared to \$4.8 million for the six months ended March 31, 2006. The Company's combined federal and state effective income tax rate for the current period was 38.7% compared to 38.0% for the same period of the prior fiscal year. The increase in the effective tax rate was primarily as a result of increases in ESOP compensation expense due to increases in the Company's stock price. The additional compensation expense is not fully deductible for tax return purposes.

Liquidity, Commitments and Capital Resources

Liquidity.

The Company actively analyzes and manages the Bank's liquidity with the objectives of maintaining an adequate level of liquidity and to ensure the availability of sufficient cash flows to support loan growth, fund deposit withdrawals, fund operations and satisfy other financial commitments. See the "Consolidated Statements of Cash Flows" contained in Item 1 - Financial Statements, included herein.

The primary sources of funds are customer deposits, loan repayments, loan sales, maturing investment securities, and FHLB advances. These sources of funds, together with retained earnings and equity, are used to make loans, acquire investment securities and other assets, and fund continuing operations. While maturities and the scheduled amortization of loans are a predictable source of funds, deposit flows and mortgage prepayments are greatly influenced by the level of interest rates, economic conditions and competition. Management believes that its current liquidity position and forecasted operating results are sufficient to fund all existing commitments.

At March 31, 2007, the Bank maintained a line of credit with the FHLB equal to 40% of total assets to the extent the Bank provides qualifying collateral and holds sufficient FHLB stock. At March 31, 2007, the Bank was in compliance with the collateral requirements and \$90.9 million of the line of credit was available. In addition, the Company holds readily saleable loans and mortgage-backed securities available for sale for liquidity purposes.

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At March 31, 2007, certificates of deposits amounted to \$226.9 million, or 53.7% of total deposits, including \$190.7 million that are scheduled to mature by March 31, 2008. Historically, the Company has been able to retain a significant amount of the deposits as they mature. Management believes the Company has adequate resources to fund all loan commitments through deposits, FHLB advances, loan repayments, maturing investment securities, and the sale of mortgage loans in the secondary markets.

Off-Balance Sheet Arrangements.

The Company 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 generally include commitments to originate mortgage, commercial and consumer loans, and involve to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet. The maximum exposure to credit loss in the event of nonperformance by the borrower is represented by the contractual amount of those instruments. Since some commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company uses the same credit policies in making commitments as it does for on-balance sheet instruments. Collateral is not required to support commitments.

Undisbursed balances of loans closed include funds not disbursed but committed for construction projects. Unused lines of credit include funds not disbursed, but committed to, home equity, commercial and consumer lines of credit. Commercial letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party.

The following is a summary of commitments and contingent liabilities with off-balance sheet risks as of March 31, 2007:

| | Contract or Notional Amount |
|-------------------------------------|--------------------------------|
| | (in thousands) |
| Commitments to originate loans: | |
| Fixed rate | \$11,166 |
| Adjustable rate | 2,756 |
| Undisbursed balance of loans closed | 16,267 |
| Unused lines of credit | 33,420 |
| Commercial letters of credit | - |
| | <hr/> |
| Total | \$63,609 |
| | <hr/> |

Capital.

Consistent with the objective to operate a sound and profitable financial institution, the Company has maintained and will continue to focus on maintaining a "well capitalized" rating from regulatory authorities. In addition, the Company is subject to certain capital requirements set by its regulatory agencies. At March 31, 2007, the Company exceeded all regulatory capital requirements. Total equity of the Company was \$111.0 million at March 31, 2007, or 14.9% of total assets on that date.

The Bank's regulatory capital ratios at March 31, 2007 were as follows: Tier 1 capital of 12.4%; Tier 1 risk-based capital of 19.4%; and total risk-based capital of 20.0%. The regulatory capital requirements to be considered well capitalized are 5.0%, 6.0%, and 10.0%, respectively.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

The Board of Directors has established an asset and liability management policy to guide management in maximizing net interest spread by managing the differences in terms between interest-earning assets and interest-bearing liabilities while maintaining acceptable levels of liquidity, capital adequacy, interest rate sensitivity, credit risk and profitability. The Asset Liability Management Committee, consisting of certain members of senior management, communicate, coordinate and manage the asset/liability positions consistent with the Company's business plan and Board-approved policies, as well as to price savings and lending products, and to develop new products.

One of the primary financial objectives is to generate ongoing profitability. The Company's profitability depends primarily on its net interest income, which is the difference between the income it receives on its loan and investment portfolio and its cost of funds, which consists of interest paid on deposits and borrowings. The rates the Bank earns on assets and pays on liabilities generally are established contractually for a period of time. Market

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interest rates change over time. The Bank's loans generally have longer maturities than deposits. Accordingly, the Bank's results of operations, like those of other financial institutions, are affected by changes in interest rates and the interest rate sensitivity of its assets and liabilities. The Bank measures its interest rate sensitivity on a quarterly basis using an internal model.

Management employs various strategies to manage the Bank's interest rate sensitivity including: (1) selling long-term fixed-rate mortgage loans in the secondary market to Fannie Mae, Freddie Mac and other financial institutions; (2) borrowing intermediate to long-term funds at fixed rates from the FHLB; (3) originating commercial and consumer loans at shorter maturities or at variable rates; (4) originating adjustable rate mortgage loans; (5) appropriately modifying loan and deposit pricing to capitalize on the then current market opportunities; and (6) increasing lower cost core deposits, such as savings and checking accounts. At March 31, 2007, the Company had no off-balance sheet derivative financial instruments, and did not maintain a trading account for any class of financial instruments or engage in hedging activities or purchase high risk derivative instruments. Furthermore, the Company is not subject to foreign currency exchange rate risk or commodity price risk.

There has not been any material change in the market risk disclosures contained in the Company's 2006 Form 10-K.

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures.

An evaluation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934 (the "Exchange Act")) was carried out under the supervision and with the participation of the Company's Chief Executive Officer, Chief Financial Officer, and other members of the Company's management team as of the end of the period covered by this quarterly report. The Company's Chief Executive Officer and Chief Financial Officer concluded that as of March 31, 2007 the Company's disclosure controls and procedures were effective in ensuring that the information required to be disclosed by the Company in the reports it files or submits under the Act is (i) accumulated and communicated to the Company's management (including the Chief Executive Officer and Chief Financial Officer) in a timely manner, and (ii) recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms.

(b) Changes in Internal Controls.

There have been no changes in the Company's internal control over financial reporting (as defined in 13a-15(f) of the Exchange Act) that occurred during the quarter ended March 31, 2007, that have materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting. A number of internal control procedures were, however, modified during the quarter in conjunction with the Company's internal control testing. The Company also continued to implement suggestions from its internal auditor and independent auditors on ways to strengthen existing controls.

The Company intends to continually review and evaluate the design and effectiveness of its disclosure controls and procedures and to improve its controls and procedures over time and to correct any deficiencies that it may discover in the future. The goal is to ensure that senior management has timely access to all material non-financial information concerning the Company's business. While the Company believes the present design of its disclosure controls and procedures is effective to achieve its goal, future events affecting its business may cause the Company to modify its disclosure controls and procedures. The Company does not expect that its disclosure controls and procedures and

internal control over financial reporting will prevent all error and fraud. A control procedure, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control procedure are met. Because of the inherent limitations in all control procedures, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns in controls or procedures can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any control procedure is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control procedure, misstatements due to error or fraud may occur and not be detected.

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PART II - OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, the Company is engaged in legal proceedings in the ordinary course of business, none of which are currently considered to have a material impact on the Company's financial position or results of operations.

In April 2006, the State of Idaho Department of Finance ("Department") issued a cease and desist order to a former investment representative of the Bank with respect to marketing and selling unregistered securities in 2005. The investment representative was subsequently indicted and a civil action was brought against him by the Department. In February 2007, the investment representative pleaded guilty as part of a plea agreement that requires repayment of \$173,000 to the victims by August 30, 2007. The Bank was not named as a party in that action and no other actions have been filed against the Bank to date. The Bank's contract with its third-party broker-dealer includes an indemnity clause protecting the Bank against losses attributable to any non-deposit investment product transaction. The broker-dealer has been actively engaged in the investigation and in direct contact with the affected customers throughout the process. At this time, the Company believes the plea agreement will have no impact on the Company's financial position or results of operations.

Item 1A. Risk Factors

There have been no material changes in the Risk Factors previously disclosed in Item 1A of the Company's 2006 Form 10-K.

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

Not applicable.

Stock Repurchases.

The Company did not repurchase any shares of its outstanding common stock during the three months ended March 31, 2007. In addition, the Company has no publicly announced plans to repurchase any shares of its common stock.

Item 3. Defaults Upon Senior Securities

Not applicable.

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

The Company's Annual Meeting of Stockholders was held on January 16, 2007. The results of the vote on the two items presented at the meeting were as follows:

Proposal 1. Election of Directors

| | Term to Expire | FOR | | WITHHELD | |
|--------------------|-------------------|--------------------|------------|--------------------|------------|
| | | Number of Votes | Percentage | Number of Votes | Percentage |
| James R. Stamey | 2010 | 13,968,625 | 99.08% | 129,840 | 0.92% |
| Robert A. Tinstman | 2010 | 14,008,011 | 99.36% | 90,454 | 0.64% |

Each of the following directors who were not up for re-election at the annual meeting of stockholders will continue in office: N. Charles Hedemark, Thomas W. Malson, Fred H. Helpenstell, M.D., Richard J. Navarro, and Daniel L. Stevens.

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Proposal 2. Ratification of the appointment of Independent Auditor

Stockholders ratified the appointment of Moss Adams LLP as the Company's independent auditor for the fiscal year ending September 30, 2007 by the following vote:

| | Number of Votes | Percentage |
|---------|--------------------|------------|
| FOR | 14,042,208 | 99.60% |
| AGAINST | 50,062 | 0.36% |
| ABSTAIN | 6,195 | 0.04% |

The 8,979,246 shares held by Home Federal MHC were included in the voting for both proposals.

Item 5. Other Information

Not applicable.

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Item 6. Exhibits

- 3.1 Articles of Incorporation of the Registrant (1)
- 3.2 Amended and Restated Bylaws of the Registrant (2)
- 10.1 Form of Employment Agreement for President and Chief Executive Officer with Home Federal Bank (1)
- 10.2 Form of Employment Agreement for President and Chief Executive Officer with Home Federal Bancorp, Inc. (1)
- 10.3 Form of Severance Agreement for Executive Officers (1)
- 10.4 Form of Home Federal Savings and Loan Association of Nampa Employee Severance Compensation Plan (1)
- 10.5 Form of Director Indexed Retirement Agreement entered into by Home Federal Savings and Loan Association of Nampa with each of its Directors (1)
- 10.6 Form of Director Deferred Incentive Agreement entered into by Home Federal Savings and Loan Association of Nampa with each of its Directors (1)
- 10.7 Form of Split Dollar Agreement entered into by Home Federal Savings and Loan Association of Nampa with Daniel L. Stevens, N. Charles Hedemark, Fred H. Helpenstell, M.D., Richard J. Schrandt, James R. Stamey and Robert A. Tinstman (1)
- 10.8 Form of Executive Deferred Incentive Agreement, and amendment thereto, entered into by Home Federal Savings and Loan Association of Nampa with Daniel L. Stevens, Robert A. Schoelkoph, Roger D. Eisenbarth, Lynn A. Sander and Karen Wardwell (1)
- 10.9 Form of Amended and Restated Salary Continuation Agreement entered into by Home Federal Savings and Loan Association of Nampa with Daniel L. Stevens, Len E. Williams, Robert A. Schoelkoph, Roger D. Eisenbarth, Lynn A. Sander and Karen Wardwell (1)
- 10.10 2005 Stock Option and Incentive Plan approved by stockholders on June 23, 2005 and Form of Incentive Stock Option Agreement and Non-Qualified Stock Option Agreement (3)
- 10.11 2005 Recognition and Retention Plan approved by stockholders on June 23, 2005 and Form of Award Agreement (3)
- 10.12 Form of new Director Retirement Plan entered into by Home Federal Bank with each of its Directors (4)
- 10.13 Transition Agreement with Daniel L. Stevens (5)

- 10.14 Agreement Regarding Terms of Employment Offer with Len E. Williams (5)
- 10.15 Employment Agreement entered into by Home Federal Bank with Len E. Williams (6)
- 14 Code of Ethics (7)
- 31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act
- 31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act
- 32 Certification Pursuant to Section 906 of the Sarbanes-Oxley Act

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- (1) Filed as an exhibit to the Registrant's Registration Statement on Form S-1 (333-35817).
 - (2) Filed as an exhibit to the Registrant's Current Report on Form 8-K dated April 17, 2007.
 - (3) Filed as an exhibit to the Registrant's Registration Statement on Form S-8 (333-127858).
 - (4) Filed as an exhibit to the Registrant's Current Report on Form 8-K dated October 21, 2005.
 - (5) Filed as an exhibit to the Registrant's Current Report on Form 8-K dated August 21, 2006.
 - (6) Filed as an exhibit to the Registrant's Current Report on Form 8-K dated November 6, 2006.
 - (7) Filed as an exhibit to the Registrant's Annual Report on Form 10-K for the year ended September 30, 2004.

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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.

Home Federal Bancorp, Inc.

Date: May 8, 2007

/s/ Daniel L. Stevens
Daniel L. Stevens
Chairman, President and
Chief Executive Officer
(Principal Executive Officer)

Date: May 8, 2007

/s/ Robert A. Schoelkoph
Robert A. Schoelkoph
Senior Vice President and
Chief Financial Officer
(Principal Financial and Accounting Officer)

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EXHIBIT INDEX

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EXHIBIT 31.1

Certification of Chief Executive Officer Pursuant to
Section 302 of the Sarbanes-Oxley Act of 2002

I, Daniel L. Stevens, President and Chief Executive Officer of Home Federal Bancorp, Inc., certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Home Federal Bancorp, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fiscal fourth quarter in the case of an annual report) that has materially affected, or is reasonably

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likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
- (a) All significant deficiencies and material weakness in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial data information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 8, 2007

/s/ Daniel L. Stevens

Daniel L. Stevens
Chairman, President and
Chief Executive Officer

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EXHIBIT 31.2

Certification of Chief Financial Officer Pursuant to
Section 302 of the Sarbanes-Oxley Act of 2002

I, Robert A. Schoelkoph, Chief Financial Officer of Home Federal Bancorp, Inc., certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Home Federal Bancorp, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation;
and

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- (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fiscal fourth quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
- (a) All significant deficiencies and material weakness in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial data information; and
- (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 8, 2007

/s/ Robert A. Schoelkoph

Robert A. Schoelkoph
Senior Vice President and
Chief Financial Officer

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EXHIBIT 32

Certification of Chief Executive Officer and Chief Financial Officer of Home Federal Bancorp, Inc.
Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

The undersigned hereby certify, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and in connection with this Quarterly Report on Form 10-Q, that:

1. the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
2. the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Daniel L. Stevens /s/ Robert A. Schoelkoph Daniel L. Stevens Robert A. Schoelkoph
Chairman, President
and Senior Vice President and Chief Executive Officer Chief Financial Officer

Dated:

May 8, 2007

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