ATLANTIC TELE NETWORK INC /DE
Form 10-Q
May 12, 2014
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended March 31, 2014

OR

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

For the transition period from to

Commission File Number 001-12593

Atlantic Tele-Network, Inc.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**47-0728886** (I.R.S. Employer Identification Number)

600 Cummings Center

Beverly, MA 01915

(Address of principal executive offices, including zip code)

(978) 619-1300

(Registrant s telephone number, including area code)

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 x No o

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

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

Large accelerated filer o	Accelerated filer x
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

As of May 12, 2014, the registrant had outstanding 15,909,815 shares of its common stock ($.01 par value).

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ATLANTIC TELE-NETWORK, INC.

FORM 10-Q

Quarter Ended March 31, 2014

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Cautionary Statement Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q (or the Report) contains forward-looking statements relating to, among other matters, our future financial performance and results of operations; the competitive environment in our key markets, demand for our services and industry trends; the outcome of litigation and regulatory matters; our continued access to the credit and capital markets; the pace of our network expansion and improvement, including our level of estimated future capital expenditures and our realization of the benefits of these investments; and management s plans and strategy for the future. These forward-looking statements are based on estimates, projections, beliefs, and assumptions and are not guarantees of future events or results. Actual future events and results could differ materially from the events and results indicated in these statements as a result of many factors, including, among others, (1) the general performance of our operations, including operating margins, wholesale revenues, and the future growth and retention of our subscriber base; (2) regulatory changes affecting our businesses, including the loss of certain FCC and other telecommunications licenses; (3) economic, political and other risks facing our foreign operations; (4) our ability to maintain favorable roaming arrangements; (5) our ability to efficiently and cost-effectively upgrade our networks and IT platforms to address rapid and significant technological changes in the telecommunications industry; (6) the loss of or our inability to recruit skilled personnel in our various jurisdictions, including key members of management; (7) our ability to find investment or acquisition or disposition opportunities that fit our strategic goals for the Company; (8) increased competition; (9) our reliance on a limited number of key suppliers and vendors for timely supply of equipment and services relating to our network infrastructure; (10) the adequacy and expansion capabilities of our network capacity and customer service system to support our customer growth; (11) the occurrence of severe weather and natural catastrophes; (12) our continued access to capital and credit markets; and (13) our ability to realize the value that we believe exists in our businesses. These and other additional factors that may cause actual future events and results to differ materially from the events and results indicated in the forwardlooking statements above are set forth more fully under Item 1A Risk Factors of the Company s Annual Report on Form 10-K for the year ended December 31, 2013, filed with the SEC on March 17, 2014 and the other reports we file from time to time with the SEC. The Company undertakes no obligation to update these forward-looking statements to reflect actual results, changes in assumptions or changes in other factors that may affect such forward-looking statements.

In this Report, the words the Company , we, our, ours, us and ATN refer to Atlantic Tele-Network, Inc. and its subsidiaries. This Report c trademarks, service marks and trade names that are the property of, or licensed by, ATN, and its subsidiaries.

Reference to dollars ($) refer to U.S. dollars unless otherwise specifically indicated.

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PART I FINANCIAL INFORMATION

Item 1. Unaudited Condensed Consolidated Financial Statements

ATLANTIC TELE-NETWORK, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(Dollars in thousands, except per share amounts)

	December 31, 2013	March 31, 2014
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 356,607	$ 352,826
Restricted cash	39,000	58,796
Accounts receivable, net of allowances of $9.7 million and $9.8 million, respectively	37,680	37,526
Materials and supplies	7,269	8,124
Deferred income taxes	1,994	1,994
Prepayments and other current assets	24,705	21,700
Assets of discontinued operations	4,748	163
Total current assets	472,003	481,129
Fixed Assets:		
Property, plant and equipment	606,912	614,148
Less: accumulated depreciation	(352,280)	(361,845)
Net fixed assets	254,632	252,303
Telecommunication licenses, net	39,687	39,532
Goodwill	45,077	45,077
Trade name license, net	417	417
Customer relationships, net	1,807	1,723
Restricted cash	39,000	
Other assets	7,096	6,341
Total assets	$ 859,719	$ 826,522
LIABILITIES AND EQUITY		
Current Liabilities:		
Accounts payable and accrued liabilities	$ 41,709	$ 40,767
Dividends payable	4,279	4,307
Accrued taxes	36,081	8,363
Advance payments and deposits	8,327	6,679
Deferred income taxes	1,601	1,601
Other current liabilities	17,889	14,975
Liabilities of discontinued operations	11,187	4,173
Total current liabilities	121,073	80,865
Deferred income taxes	26,007	26,406
Other liabilities	12,784	14,550
Total liabilities	159,864	121,821
Commitments and contingencies (Note 12)		
Atlantic Tele-Network, Inc. Stockholders Equity:		
Preferred stock, $0.01 par value per share; 10,000,000 shares authorized, none issued and outstanding		
	164	165

Common stock, $0.01 par value per share; 50,000,000 shares authorized; 16,494,982 and 16,613,957 shares issued, respectively, and 15,816,189 and 15,907,315 shares outstanding, respectively				
Treasury stock, at cost; 678,793 and 706,642 shares, respectively		(13,389)		(15,144)
Additional paid-in capital		139,106		141,093
Retained earnings		519,651		523,186
Accumulated other comprehensive loss		(2,202)		(2,202)
Total Atlantic Tele-Network, Inc. stockholders equity		643,330		647,098
Non-controlling interests		56,525		57,603
Total equity		699,855		704,701
Total liabilities and equity	$	859,719	$	826,522

The accompanying condensed notes are an integral part of these condensed consolidated financial statements.

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ATLANTIC TELE-NETWORK, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED INCOME STATEMENTS

FOR THE THREE MONTHS ENDED MARCH 31, 2013 and 2014

(Unaudited)

(Dollars in thousands, except per share amounts)

	Three Months Ended March 31, 2013	Three Months Ended March 31, 2014
REVENUE:		
U.S. wireless	$ 21,213	$ 28,392
International wireless	21,430	23,148
Wireline	20,564	21,530
Equipment and other	1,625	2,104
Total revenue	64,832	75,174
OPERATING EXPENSES (*excluding depreciation and amortization unless otherwise indicated*):		
Termination and access fees	13,055	15,862
Engineering and operations	9,658	9,630
Sales and marketing	4,489	5,020
Equipment expense	2,667	2,715
General and administrative	11,909	13,698
Transaction-related charges	63	21
Depreciation and amortization	11,988	11,980
Gain on disposition of long lived assets	(1,076)	
Total operating expenses	52,753	58,926
Income from operations	12,079	16,248
OTHER INCOME (EXPENSE):		
Interest expense, net	(2,264)	(186)
Other income (expense), net	14	(109)
Other income (expense), net	(2,250)	(295)
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	9,829	15,953
Income tax expense	3,945	5,552
INCOME FROM CONTINUING OPERATIONS	5,884	10,401
Income from discontinued operations, net of tax	4,034	
NET INCOME	9,918	10,401
Net income attributable to non-controlling interests, net of tax:		
Continuing operations	(1,055)	(2,560)
Discontinued operations	(87)	
	(1,142)	(2,560)
NET INCOME ATTRIBUTABLE TO ATLANTIC TELE-NETWORK, INC. STOCKHOLDERS	$ 8,776	$ 7,841
NET INCOME PER WEIGHTED AVERAGE BASIC SHARE ATTRIBUTABLE TO ATLANTIC TELE-NETWORK, INC. STOCKHOLDERS:		
Continuing operations	$ 0.31	$ 0.50
Discontinued operations	0.25	
Total	$ 0.56	$ 0.50

NET INCOME PER WEIGHTED AVERAGE DILUTED SHARE ATTRIBUTABLE TO ATLANTIC TELE-NETWORK, INC. STOCKHOLDERS:				
Continued operations	$	0.31	$	0.49
Discontinued operations		0.25		
Total	$	0.56	$	0.49
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING:				
Basic		15,588		15,830
Diluted		15,695		15,950
DIVIDENDS PER SHARE APPLICABLE TO COMMON STOCK	$	0.25	$	0.27

The accompanying condensed notes are an integral part of these condensed consolidated financial statements.

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ATLANTIC TELE-NETWORK, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

FOR THE THREE MONTHS ENDED MARCH 31, 2013 AND 2014

(Unaudited)

(Dollars in thousands)

	Three Months Ended March 31, 2013	Three Months Ended March 31, 2014
Net income	$ 9,918	$ 10,401
Other comprehensive income:		
Unrealized gain on interest rate swap, net of tax expense of $0.4 million and $0.0 million, respectively	641	
Other comprehensive income, net of tax	641	
Comprehensive income	10,559	10,401
Less: Comprehensive income attributable to non-controlling interests	(1,142)	(2,560)
Comprehensive income attributable to Atlantic Tele-Network, Inc.	$ 9,417	$ 7,841

The accompanying condensed notes are an integral part of these condensed consolidated financial statements.

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ATLANTIC TELE-NETWORK, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE THREE MONTHS ENDED MARCH 31, 2013 AND 2014

(Unaudited)

(Dollars in thousands)

	Three Months Ended March 31, 2013	Three Months Ended March 31, 2014
Cash flows from operating activities:		
Net income	$ 9,918	$ 10,401
Adjustments to reconcile net income to net cash flows provided by operating activities:		
Depreciation and amortization	11,988	11,980
Provision for doubtful accounts	256	914
Amortization of debt discount and debt issuance costs	321	24
Stock-based compensation	806	1,058
Income from discontinued operations, net of tax	(4,034)	
Gain on disposition of long-lived assets	(1,076)	
Changes in operating assets and liabilities, excluding the effects of acquisitions:		
Accounts receivable, net	(2)	(761)
Materials and supplies, prepayments, and other current assets	(1,921)	(2,323)
Accounts payable and accrued liabilities, advance payments and deposits and other current liabilities	11,911	(2,585)
Accrued taxes	(18,481)	(23,128)
Other	(666)	(2,186)
Net cash provided by (used in) operating activities of continuing operations	9,020	(6,606)
Net cash provided by (used in) operating activities of discontinued operations	15,961	(2,429)
Net cash provided by (used in) operating activities	24,981	(9,035)
Cash flows from investing activities:		
Capital expenditures	(15,355)	(8,736)
Proceeds from disposition of long-lived assets	1,500	1,371
Decrease in restricted cash		19,204
Net cash provided by (used in) investing activities of continuing operations	(13,855)	11,839
Net cash provided by (used in) investing activities of discontinued operations, net	(5,521)	
Net cash provided by (used in) investing activities	(19,376)	11,839
Cash flows from financing activities:		
Dividends paid on common stock		(4,278)
Distributions to non-controlling interests	(577)	(1,482)
Payment of debt issuance costs	(5)	
Proceeds from stock option exercises	297	435
Purchase of common stock	(879)	(1,260)
Investments made by minority shareholders in consolidated affiliates	60	
Net cash used in financing activities of continuing operations	(1,104)	(6,585)
Net cash used in financing activities of discontinued operations, net	(358)	
Net cash used in financing activities	(1,462)	(6,585)
Net change in cash and cash equivalents	4,143	(3,781)
Cash and cash equivalents, beginning of period	136,647	356,607
Cash and cash equivalents, end of period	$ 140,790	$ 352,826

The accompanying condensed notes are an integral part of these condensed consolidated financial statements.

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ATLANTIC TELE-NETWORK, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. ORGANIZATION AND BUSINESS OPERATIONS

The Company is a telecommunications holdings company that, through its operating subsidiaries, provides wireless and wireless telecommunications services in North America, Bermuda and the Caribbean. The Company is actively evaluating strategic acquisitions and investment opportunities, both domestic and international, that meet its return-on-investment and other acquisition criteria.

The Company offers the following principal services:

- ***Wireless.*** In the United States, the Company offers wholesale wireless voice and data roaming services to national, regional, local and selected international wireless carriers in rural markets located principally in the Southwest and Midwest. The Company also offers wireless voice and data services to retail customers in Bermuda, Guyana, the Caribbean and smaller markets in the United States.

- ***Wireline.*** The Company s local telephone and data services include its operations in Guyana and the mainland United States. The Company is the exclusive licensed provider of domestic wireline local and long-distance telephone services in Guyana and international voice and data communications into and out of Guyana. The Company also offers facilities-based integrated voice and data communications services to enterprise and residential customers in New England, primarily in Vermont, and wholesale transport services in Vermont and New York State. In addition, the Company offers wholesale long-distance voice services to telecommunications carriers.

The following chart summarizes the operating activities of the Company s principal subsidiaries, the segments in which the Company reports its revenue and the markets it served as of March 31, 2014:

Services	Segment	Markets	Tradenames
Wireless	U.S. Wireless	United States (rural markets)	Commnet, Choice
	Island Wireless	Aruba, Bermuda, Turks and Caicos, U.S. Virgin Islands	Mio, CellOne, Islandcom, Choice
	International Integrated Telephony	Guyana	Cellink
Wireline	International Integrated Telephony	Guyana	GT&T, eMagine
	U.S. Wireline	United States (New England and New York State)	Sovernet, ION, EssexTel

The Company provides management, technical, financial, regulatory, and marketing services to its subsidiaries and typically receives a management fee equal to a percentage of their respective revenue. Management fees from subsidiaries are eliminated in consolidation. For information about the Company s business segments and geographical information about its revenue, operating income and long-lived assets, see

Note 11 to the Condensed Consolidated Financial Statements.

2. BASIS OF PRESENTATION

The accompanying condensed consolidated financial statements have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). The financial information included herein is unaudited; however, the Company believes such information and the disclosures herein are adequate to make the information presented not misleading and reflect all adjustments (consisting only of normal recurring adjustments) that are necessary for a fair statement of the Company s financial position and results of operations for such periods. The year-end condensed balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. Results of interim periods may not be indicative of results for the full year. These condensed consolidated financial statements and related notes should be read in conjunction with the Company s 2013 Annual Report on Form 10-K.

See Note 4 for information regarding the Company s sale of its U.S. retail wireless business operated under the Alltel name. The assets, liabilities and operations of the Alltel business have been classified as discontinued for all periods presented. Unless indicated otherwise, the information in the notes to the Condensed Consolidated Financial Statements refer to our continuing operations.

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Consolidation

The consolidated financial statements include the accounts of the Company, its majority-owned subsidiaries and certain entities, which are consolidated in accordance with the provisions of the Financial Accounting Standards Board s (FASB) authoritative guidance on the consolidation of variable interest entities since it is determined that the Company is the primary beneficiary of these entities.

During the three months ended March 31, 2014, the Company recognized approximately $0.7 million in general and administrative expenses to correct for an understatement of transactional tax liabilities generated in periods during 2013. The Company determined that the impact of the correction of this error was not material to the current or any prior period financial statements.

The Company s effective tax rate declined in 2014 as the result of increased income in lower taxed jurisdictions, such as Bermuda, as compared to 2013. The Company s effective tax rate in 2013 was higher than the statutory federal income tax rate of 35% (plus applicable statutory state income tax rates) due primarily to (i) the portion of our earnings that are taxed in Guyana at 45%, and (ii) a portion of the Company s earnings that include losses generated in foreign jurisdictions for which we receive no tax benefit since these are non-tax jurisdictions. The Company s effective tax rates for the three months ended March 31, 2013 and 2014 were 40.1% and 34.8%, respectively.

Recent Accounting Pronouncements

In April 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-08, Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity. ASU 2014-08 provides guidance on determining when disposals can be presented as discontinued operations. ASU 2014-08 requires that only disposals representing a strategic shift in operations should be presented as discontinued operations. A strategic shift may include a disposal of a major line of business, major equity method investment or a major part of an entity. Additionally, ASU 2014-08 requires expanded disclosures regarding discontinued operations. This standard is effective prospectively for reporting periods beginning after December 15, 2014. The adoption of this amendment is not expected to have a material impact on the Company s consolidated financial statements.

In March 2013, the FASB issued ASU 2013-05, Foreign Currency Matters (Topic 830): Parent s Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity. ASU 2013-05 provides clarification regarding whether ASC 810-10, Consolidation Overall or ASC 830-30, Foreign Currency Matters Translation of Financial Statements, applies to the release of cumulative translation adjustments into net income when a reporting entity either sells a part or all of its investment in a foreign entity or ceases to have a controlling financial interest in a subsidiary or group of assets that constitute a business within a foreign entity. The revised standard is effective for reporting periods beginning after December 15, 2013. The adoption of this amendment did not have a material impact on the Company s consolidated financial statements.

In July 2013, the FASB issued Accounting Standards Update No. 2013-11, Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists (a consensus of the Emerging Issues Task Force), which states that an unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward. If a company does not have: (i) a net operating loss carryforward; (ii) a similar tax loss; or (iii) a tax credit carryforward is not available at the

reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the entity does not intend to use the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. The authoritative guidance is effective for fiscal years and the interim periods within those fiscal years beginning on or after December 15, 2013 and was applied on a prospective basis. The adoption of this authoritative guidance did not have a material impact on the Company s consolidated financial statements.

3. USE OF ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenue and expenses during the reporting periods. The most significant estimates relate to the allowance for doubtful accounts, useful lives of the Company s fixed

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and finite-lived intangible assets, allocation of purchase price to assets acquired and liabilities assumed in purchase business combinations, fair value of indefinite-lived intangible assets, goodwill and income taxes. Actual results could differ significantly from those estimates.

4. DISCONTINUED OPERATIONS SALE OF U.S. RETAIL WIRELESS BUSINESS

On September 20, 2013, the Federal Communications Commission announced its approval of the previously announced proposed sale of the Company s U.S. retail wireless business operated under the Alltel name to AT&T Mobility for approximately $780.0 million in cash plus $16.8 million in working capital adjustments. The Company previously reported the operations of this business within its U.S. Wireless segment. As a result of that approval, the Company completed the sale of certain U.S. retail wireless assets on that date.

The $796.8 million in cash proceeds included $78.0 million of cash to be held in a general indemnity escrow account. Subject to the terms and conditions of the purchase agreement between AT&T Mobility and the Company governing the sale, the restrictions on $19.5 million of these funds expired March 2014. The remaining $58.5 million has been recorded as restricted cash on the Company s March 31, 2014 balance sheet and classified as a current asset since $19.5 million and $39.0 million will be released, subject to any indemnity claims, to the Company in September 2014 and March 2015, respectively.

As of March 31, 2014, the Company has also recorded $10.2 million for the minority shareholders interests in the sold operation which is based on the estimated final distributions to the minority shareholders and is included in non-controlling interests on its balance sheet.

The Company has reclassified the assets of its Alltel operations, consisting of prepaid expenses and other current assets, and liabilities of its Alltel operations, consisting of accounts payable and other current liabilities, to assets of discontinued operations and liabilities of discontinued operations, respectively, within its December 31, 2013 and March 31, 2014 balance sheets.

Revenues and income from discontinued operations related to the Alltel business for the three months ended March 31, 2013 and 2014 were as follows (in thousands):

	Three Months Ended March 31, 2013	2014
Revenue from discontinued operations	$ 108,037	$
Income from discontinued operations, net of tax expense of $2,417	4,034	

5. FAIR VALUE MEASUREMENTS

In accordance with the provisions of fair value accounting, a fair value measurement assumes that a transaction to sell an asset or transfer a liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability and defines fair value based upon an exit price model.

The fair value measurement guidance establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The guidance describes three levels of inputs that may be used to measure fair value:

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Level 1 Quoted prices in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions for the asset and liability occur in sufficient frequency and volume to provide pricing information on an ongoing basis. Level 1 assets and liabilities include money market funds, debt and equity securities and derivative contracts that are traded in an active exchange market.

Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include debt securities with quoted prices that are traded less frequently than exchange-traded instruments and derivative contracts whose value is determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data. This category generally includes corporate obligations and non-exchange traded derivative contracts.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments and intangible assets that have been impaired whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

Assets and liabilities of the Company measured at fair value on a recurring basis as of December 31, 2013 and March 31, 2014 are summarized as follows (in thousands):

	December 31, 2013		
Description	**Quoted Prices in Active Markets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Total**
Certificates of deposit	$	$ 363	$ 363
Money market funds	$ 2,244	$	$ 2,244
Total assets measured at fair value	$ 2,244	$ 363	$ 2,607

	March 31, 2014		
Description	**Quoted Prices in Active Markets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Total**
Certificate of deposit	$	$ 363	$ 363
Money market funds	$ 2,538	$	$ 2,538
Total assets measured at fair value	$ 2,538	$ 363	$ 2,901

Certificate of Deposit

As of December 31, 2013 and March 31, 2014, this asset class consisted of a time deposit at a financial institution denominated in U.S. dollars. The asset class is classified within Level 2 of the fair value hierarchy because the fair value was based on observable market data.

Money Market Funds

As of December 31, 2013 and March 31, 2014, this asset class consisted of a money market portfolio that comprises Federal government and U.S. Treasury securities. The asset class is classified within Level 1 of the fair value hierarchy because its underlying investments are valued using quoted market prices in active markets for identical assets.

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6. LONG-TERM DEBT

The Company has a credit facility (the Credit Facility) which previously included two term loans and currently provides for a revolver loan of up to $100.0 million. The revolver loan also has a $10.0 million swingline sub-facility and a $55.0 million letter of credit sub-facility for issuance in connection with the Company s Mobility Fund Grant obligations (see Note 8).

On September 20, 2013 the Company repaid its outstanding term loans in full. Amounts borrowed under the term loans bore interest at a rate equal to, at the Company s option, either (i) at the London Interbank Offered Rate (LIBOR) plus an applicable margin ranging between 2.00% to 4.00% or (ii) a base rate plus an applicable margin ranging from 1.00% to 3.00%. The base rate was equal to the higher of (i) 1.50% plus the higher of (x) the one-week LIBOR and (y) the one-month LIBOR; or (ii) the prime rate (as defined in the Credit Facility). The applicable margin was determined based on the ratio of our indebtedness (as defined in the Credit Facility) to our EBITDA (as defined in the Credit Facility).

Amounts borrowed under the revolver loan bear interest at a rate equal to, at our option, either (i) LIBOR plus an applicable margin ranging between 2.00% to 3.50% or (ii) a base rate plus an applicable margin ranging from 1.00% to 2.50% (or, in the case of amounts borrowed under the swing-line sub- facility, an applicable margin ranging from 0.50% to 2.00%.) We must also pay a fee ranging from 0.25% to 0.50% of the average daily unused portion of the revolver loan over each calendar quarter, which fee is payable in arrears on the last day of each calendar quarter.

The Credit Facility contains customary representations, warranties and covenants, including covenants by the Company limiting additional indebtedness, liens, guaranties, mergers and consolidations, substantial asset sales, investments and loans, sale and leasebacks, transactions with affiliates and fundamental changes. In addition, the Credit Facility contains financial covenants by the Company that (i) impose a maximum leverage ratio of indebtedness to EBITDA, (ii) require a minimum debt service ratio of EBITDA to principal, interest and taxes payments and (iii) require a minimum ratio of equity to consolidated assets. As of March 31, 2014, we were in compliance with all of the financial covenants of the Credit Facility.

Note Payable Other

In connection with the CellOne Merger with M3 Wireless, Ltd., the Company assumed a term loan of approximately $7.0 million owed to Keytech Ltd., the former parent company of M3 and current 42% minority shareholder in the Company s Bermuda operations. This term loan, which bore interest at 7% per annum, was repaid in full in July 2013.

7. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

The Company s objective in using interest rate derivatives was to add stability to interest expense and to manage its exposure to the interest rate movements of its variable-rate debt. To accomplish this objective, the Company primarily used interest rate derivatives as part of its interest rate risk management strategy. Interest rate derivatives designated as cash flow hedges involved the receipt of variable-rate amounts from a

counterparty in exchange for the Company making fixed-rate payments over the life of the agreements without exchange of the underlying notional amount.

The effective portion of changes in the fair value of interest rate derivatives designated and that qualified as cash flow hedges was recorded in accumulated other comprehensive income and was subsequently reclassified into earnings in the period that the hedged forecasted transaction affected earnings.

Amounts previously reported in accumulated other comprehensive income related to the interest rate derivatives were reclassified to Unrealized loss on interest rate derivative contracts as of the date of the prepayment of the Company s outstanding term notes.

The table below presents the effect of the Company s derivative financial instruments on the consolidated income statements for the three months ended March 31, 2013 and 2014 (in thousands):

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Three Months Ended March 31,	Derivative in Cash Flow Hedging Relationships		Amount of Gain or (Loss) Recognized in Other Comprehensive Income on Derivative (Effective Portion)	Location of Gain or (Loss) Reclassified from Accumulated Other Comprehensive Income into Income (Effective Portion)		Amount of Gain or (Loss) Reclassified from Accumulated Other Comprehensive Income into Income (Effective Portion)
2013	Interest Rate Swap	$	(1,068)	Interest expense	$	1,033
2014	Interest Rate Swap	$		Interest expense	$	

8. GOVERNMENT GRANTS

The Company has received funding from the U.S. Government and its agencies under Stimulus and Universal Services Fund programs. These are generally designed to fund telecommunications infrastructure expansion into rural or underserved areas of the United States. The fund programs are evaluated to determine if they represent funding related to capital expenditures (capital grants) or operating activities (income grants).

Stimulus Grants

The Company was awarded several federal stimulus grants in 2009 and 2010 by the U.S. Government under provisions of the American Recovery and Reinvestment Act of 2009 intended to stimulate the deployment of broadband infrastructure and services to rural, unserved and underserved areas. As of March 31, 2014, the Company has spent (i) $35.7 million in capital expenditures (of which $27.5 million has been funded by the federal stimulus grant) in connection with the Company s build of ten new segments of fiber-optic, middle-mile broadband infrastructure in upstate New York and parts of Pennsylvania and Vermont; (ii) $7.6 million in capital expenditures (of which $5.3 million has been funded by the federal stimulus grant) in connection with the Company s last-mile broadband infrastructure buildout in the Navajo Nation across Arizona, New Mexico and Utah; and (iii) $44.8 million in capital expenditures (of which $31.4 million has been or will be funded by the federal stimulus grant) in connection with the Company s fiber-optic middle mile network buildout to provide broadband and transport services to over 340 community anchor institutions in Vermont. The results of the Company s New York and Vermont stimulus projects are included in the Company s U.S. Wireline segment and the results of the Company s Navajo stimulus project are included in the Company s U.S. Wireless segment. The New York and Navajo Stimulus projects were completed during 2013. The Vermont stimulus project will be completed during the latter half of 2014 and the Company anticipates that it will incur an additional $3.0 million of capital expenditures of which $2.1 million is expected to be funded by the federal stimulus grants.

Mobility Fund Grants

As part of the Federal Communications Commission s (FCC) reform of its Universal Service Fund (USF) program, which previously provided support to carriers seeking to offer telecommunications services in high-cost areas and to low-income households, the FCC created two new funds, including the Mobility Fund, a one-time award meant to support wireless coverage in underserved geographic areas in the United States. In August 2013, the Company received FCC final approval for approximately $21.7 million of Mobility Fund support to its wholesale wireless business (the Mobility Funds) to expand voice and broadband networks in certain geographic areas in order to offer either 3G or 4G coverage. As part of the receipt of the Mobility Funds, the Company committed to comply with certain additional FCC construction and other requirements. A portion of these funds will be used to offset network capital costs and a portion is used to offset the costs of supporting the networks for a period of five years. In connection with the Company s application for the Mobility Funds, the Company has posted

approximately $9.9 million in letters of credit to the Universal Service Administrative Company (USAC) to secure these obligations. If the Company fails to comply with any of the terms and conditions upon which the Mobility Funds were granted, or if it loses eligibility for the Mobility Funds, USAC will be entitled to draw the entire amount of the letter of credit applicable to the affected project plus penalties and may disqualify the Company from the receipt of additional Mobility Fund support. As of March 31, 2014, all of the letters of credit remain outstanding. and no amounts have been drawn thereon

The Company began the construction of its Mobility Funds projects during the third quarter of 2013 and its results are included in the Company s U.S. Wireless segment. As of March 31, 2014, the Company has received approximately $7.3 million in Mobility Funds. Of these funds, $1.0 million was recorded as an offset to the cost of the property, plant, and equipment associated with these projects and, consequentially, a reduction of future depreciation expense and $6.3 million was recorded as a liability to reduce future operating expenses.. The balance sheet presentation is based on the timing of the expected recognition of the funds and

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accordingly, $2.5 million is recorded within other current liabilities while the remaining $3.8 million is recorded within other long-term liabilities.

9. EQUITY

Stockholders equity was as follows (in thousands):

	Three Months Ended March 31,					
	2013			2014		
	Atlantic Tele-Network, Inc.	Non-Controlling Interests	Total Equity	Atlantic Tele-Network, Inc.	Non-Controlling Interests	Total Equity
Equity, beginning of period	$ 334,146	$ 60,094	$ 394,240	$ 643,330	$ 56,525	$ 699,855
Stock-based compensation	844		844	1,058		1,058
Comprehensive income:						
Net income	8,776	1,142	9,918	7,841	2,560	10,401
Other comprehensive income-Gain on interest rate swap (net of tax)	641		641			
Total comprehensive income	9,417	1,142	10,559	7,841	2,560	10,401
Issuance of common stock upon exercise of stock options	2,667		2,667	930		930
Dividends declared on common stock	(3,933)		(3,933)	(4,305)		(4,305))
Distributions to non-controlling interests		(1,469)	(1,469)		(1,482)	(1,482)
Investments made by minority shareholders		60	60			
Purchase of treasury stock	(3,272)		(3,272)	(1,756)		(1,756)
Equity, end of period	$ 339,869	$ 59,827	$ 399,696	$ 647,098	$ 57,603	$ 704,701

10. NET INCOME PER SHARE

For the three months ended March 31, 2013 and 2014, outstanding stock options were the only potentially dilutive securities. The reconciliation from basic to diluted weighted average common shares outstanding is as follows (in thousands):

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	Three Months Ended March 31,	
	2013	2014
Basic weighted-average common shares outstanding	15,588	15,830
Stock options	107	120
Diluted weighted-average common shares outstanding	15,695	15,950

The above calculation for the three months ended March 31, 2013 does not include 240,000 shares related to certain stock options because the effects of such were anti-dilutive. There were no anti-dilutive securities for the three months ended March 31, 2014.

11. SEGMENT REPORTING

The Company has four reportable segments for separate disclosure in accordance with the FASB s authoritative guidance on disclosures about segments of an enterprise. Those four segments are: i) U.S. Wireless, which generates all of its revenues in and has all of its assets located in the United States, ii) International Integrated Telephony, which generates all of its revenues in and has all of its assets located in Guyana, iii) Island Wireless, which generates a majority of its revenues in, and has a majority of its assets located in, Bermuda and which also generates revenues in and has assets located in the U.S. Virgin Islands, Aruba and Turks and Caicos and iv) U.S. Wireline, which generates all of its revenues in and has all of its assets located in the United States. The operating segments are managed separately because each offers different services and serves different markets.

The following tables provide information for each operating segment (in thousands):

	For the Three Months Ended March 31, 2013					
	U.S. Wireless	International Integrated Telephony	Island Wireless	U.S. Wireline	Reconciling Items	Consolidated
Revenue						
U.S. wireless	$ 21,213	$	$	$	$	$ 21,213
International wireless		6,754	14,676			21,430
Wireline	152	15,683		6,581	(1,852)	20,564
Equipment and other	103	254	1,218	50		1,625
Total revenue	21,468	22,691	15,894	6,631	(1,852)	64,832
Depreciation and amortization	3,611	4,781	2,595	642	359	11,988
Non-cash stock-based compensation					806	806
Operating income (loss)	9,717	5,942	1,634	(408)	(4,806)	12,079

	For the Three Months Ended March 31, 2014					
	U.S. Wireless	International Integrated Telephony	Island Wireless	U.S. Wireline	Reconciling Items	Consolidated
Revenue						
U.S. wireless	$ 28,392	$	$	$	$	$ 28,392

International wireless		6,897	16,251			23,148
Wireline	152	14,706		7,308	(636)	21,530
Equipment and other	179	194	1,672	59		2,104
Total revenue	28,723	21,797	17,923	7,367	(636)	75,174
Depreciation and amortization	3,303	4,313	2,608	1,140	616	11,980
Non-cash stock-based compensation					1,058	1,058
Operating income (loss)	13,589	5,635	3,426	(1,074)	(5,328)	16,248

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	Segment Assets					
	U.S. Wireless	International Integrated Telephony	Island Wireless	U.S. Wireline	Reconciling Items	Consolidated
December 31, 2013:						
Net fixed assets	$ 73,592	$ 118,917	$ 29,310	$ 26,082	$ 6,731	$ 254,632
Goodwill	32,148		5,438	7,491		45,077
Total assets	151,094(1)	197,903	74,427	45,351	390,944	859,719
March 31, 2014:						
Net fixed assets	$ 67,550	$ 115,465	$ 27,363	$ 26,447	$ 15,478	$ 252,303
Goodwill	32,148		5,438	7,491		45,077
Total assets	153,675(1)	201,665	76,476	43,542	351,164	826,522

(1) Includes $4,748 and $163 of assets associated with our discontinued operations as of December 31, 2013 and March 31, 2014, respectively.

	Capital Expenditures					
	U.S. Wireless	International Integrated Telephony	Island Wireless	U.S. Wireline	Reconciling Items	Consolidated
Three Months Ended March 31,						
2013	$ 4,480	$ 4,120	$ 1,111	$ 5,095	$ 549	$ 15,355
2014	5,337	2,176	366	430	427	8,736

12. COMMITMENTS AND CONTINGENCIES

Regulatory and Litigation Matters

The Company and its subsidiaries are subject to certain regulatory and legal proceedings and other claims arising in the ordinary course of business, some of which involve claims for damages and taxes that are substantial in amount. The Company believes that, except for the items discussed below and in our Annual Report on Form 10-K for the year ended December 31, 2013, for which the Company is currently unable to predict the final outcome, the disposition of proceedings currently pending will not have a material adverse effect on the Company s financial position or results of operations.

On May 8, 2009, Digicel filed a lawsuit in Guyana challenging the legality of GT&T s exclusive license rights under Guyana s constitution. Digicel initially filed this lawsuit against the Attorney General of Guyana in the High Court. On May 13, 2009, GT&T petitioned to intervene in the suit in order to oppose Digicel s claims and that petition was granted on May 18, 2009. GT&T filed an answer to the charge on June 22, 2009 and the case is pending. The Company believes that any legal challenge to GT&T s exclusive license rights granted in 1990 is without merit and the Company is vigorously defending against the legal challenge.

In Bermuda, the Regulatory Authority continued its implementation of the Electronic Communications Act of 2011, which allows communications service providers to enter new lines of business and introduces competition in the sector. As the government of Bermuda continues to reform the local telecommunications market it is possible that new or amended regulations may establish regulatory and other fees that could increase our regulatory costs. We cannot predict when or if these proposals will be adopted, or, if adopted, the impact that their implementation will have on our Island Wireless Segment.

The term of the Company s telecommunications license to operate in Aruba expired on January 15, 2014. The government of Aruba informed the Company earlier in January 2014 that a renewed license would be issued only upon payment by the Company of a fee in the amount of approximately $4.0 million. In addition, the government of Aruba demanded that the Company pay overdue spectrum invoices in the amount of approximately $1.0 million no later than May 1, 2014. While the Company has contested the assessment of these fees, it is continuing to operate and is actively seeking to reach a resolution with the Aruba government with respect to the fees, if any, to be paid in relation to a renewed license and the assessed spectrum fees.

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ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The discussion and analysis of our financial condition and results of operations that follows are based upon our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of our financial statements requires us to make estimates and judgments that affect the reported amounts of assets and liabilities, revenues and expenses, and the related disclosure of contingent assets and liabilities at the date of our financial statements. Actual results may differ significantly from these estimates under different assumptions or conditions. This discussion should be read in conjunction with our condensed consolidated financial statements herein and the accompanying notes thereto, and our Annual Report on Form 10-K for the year ended December 31, 2013, in particular, the information set forth therein under Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations .

Overview

We are a telecommunications holdings company that, through our operating subsidiaries, provides wireless and wireless telecommunications services in North America, Bermuda and the Caribbean. We are actively evaluating strategic acquisitions and investment opportunities, both domestic and international, that meet our return-on-investment and other acquisition criteria. For a discussion of our investment strategy and risks involved, see *Risk Factors We are actively evaluating strategic investment and acquisition opportunities, which may affect our long-term growth prospects* in our Form 10-K for the year ended December 31, 2013

We offer the following principal services:

- ***Wireless.*** In the United States, we offer wholesale wireless voice and data roaming services to national, regional, local and selected international wireless carriers in rural markets located principally in the Southwest and Midwest. We also offer wireless voice and data services to retail customers in Bermuda, Guyana, the Caribbean and smaller markets in the United States.

- ***Wireline***. Our local telephone and data services include our operations in Guyana and the mainland United States. We are the exclusive licensed provider of domestic wireline local and long-distance telephone services in Guyana and international voice and data communications into and out of Guyana. We also offer facilities-based integrated voice and data communications services to enterprise and residential customers in New England, primarily in Vermont, and wholesale transport services in Vermont and New York State. In addition, we offer wholesale long-distance voice services to telecommunications carriers.

The following chart summarizes the operating activities of our principal subsidiaries, the segments in which we report our revenue and the markets we served as of March 31, 2014:

Services	Segment	Markets	Tradenames
Wireless	U.S. Wireless	United States (rural markets)	Commnet, Choice

	Island Wireless	Aruba, Bermuda, Turks and Caicos, U.S. Virgin Islands	Mio, CellOne, Islandcom, Choice
	International Integrated Telephony	Guyana	Cellink
Wireline	International Integrated Telephony	Guyana	GT&T, eMagine
	U.S. Wireline	United States (New England and New York State)	Sovernet, ION, Essextel

We provide management, technical, financial, regulatory, and marketing services to our subsidiaries and typically receive a management fee equal to a percentage of their respective revenue. Management fees from our subsidiaries are eliminated in consolidation.

Discontinued Operations Sale of U.S. Retail Wireless Business

On September 20, 2013, the Federal Communications Commission announced its approval of, and we completed, our previously announced proposed sale of our U.S. retail wireless business operated under the Alltel name to AT&T Mobility LLC for approximately $796.8 million in cash that included a sale price adjustment for the working capital of the business of $16.8 million (the Alltel Sale).

The operations of the Alltel business, which were previously included in our U.S. Wireless segment, have been classified as discontinued operations in all periods presented. Unless indicated otherwise, the information in this Management s Discussion and Analysis relates only to our continuing operations.

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Stimulus Grants

We were awarded several federal stimulus grants in 2009 and 2010 by the U.S. Government under provisions of the American Recovery and Reinvestment Act of 2009 intended to stimulate the deployment of broadband infrastructure and services to rural, unserved and underserved areas. As of March 31, 2014, we have spent (i) $35.7 million in capital expenditures (of which $27.5 million has been funded by the federal stimulus grant) in connection with our build of ten new segments of fiber-optic, middle-mile broadband infrastructure in upstate New York and parts of Pennsylvania and Vermont; (ii) $7.6 million in capital expenditures (of which $5.3 million has been funded by the federal stimulus grant) in connection with our last-mile broadband infrastructure buildout in the Navajo Nation across Arizona, New Mexico and Utah; and (iii) $44.8 million in capital expenditures (of which $31.4 million has been or will be funded by the federal stimulus grant) in connection with our fiber-optic middle mile network buildout to provide broadband and transport services to over 340 community anchor institutions in Vermont. The results of our New York and Vermont stimulus projects are included in our U.S. Wireline segment and the results of our Navajo stimulus project are included in our U.S. Wireless segment. The New York and Navajo Stimulus projects were completed during 2013. The Vermont stimulus project will be completed during the latter half of 2014 and we anticipate that it will incur an additional $3.0 million of capital expenditures of which $2.1 million is expected to be funded by the federal stimulus grants.

Mobility Fund Grants

As part of the Federal Communications Commission s (FCC) reform of its Universal Service Fund (USF) program, which previously provided support to carriers seeking to offer telecommunications services in high-cost areas and to low-income households, the FCC created two new funds, including the Mobility Fund, a one-time award meant to support wireless coverage in underserved geographic areas in the United States. In August 2013, we received FCC final approval for approximately $21.7 million of Mobility Fund support to our wholesale wireless business (the Mobility Funds), to expand voice and broadband networks in certain geographic areas in order to offer either 3G or 4G coverage. As part of the receipt of the Mobility Funds, we committed to comply with certain additional FCC construction and other requirements. In connection with our application for the Mobility Funds, we posted approximately $9.9 million in letters of credit to the Universal Service Administrative Company (USAC) to secure these obligations. If we fail to comply with any of the terms and conditions upon which the Mobility Funds were granted, or if we lose eligibility for the Mobility Funds, USAC will be entitled to draw the entire amount of the letter of credit applicable to the affected project plus penalties and may disqualify us from the receipt of additional Mobility Fund support. As of March 31, 2014, all of the letters of credit remain outstanding and no amounts have been drawn thereon.

We began the construction of our Mobility Funds projects during the fourth quarter of 2013 and its results are included in our U.S. Wireless segment. As of March 31, 2014, we have received approximately $7.3 million in Mobility Funds. Of these funds, $1.0 million has been recorded as an offset to the cost of the property, plant and equipment associated with these projects and, consequentially, a reduction of the future depreciation expense and $6.3 million was recorded as a liability to reduce future operating expenses.. The presentation of current versus long-term is based on the timing of the expected usage of the funds and accordingly, $2.5 million is recorded within other current liabilities while the remaining $3.8 million is recorded within other long-term liabilities.

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Results of Operations

Three Months Ended March 31, 2013 and 2014

	Three Months Ended March 31, 2013	2014	Amount of Increase (Decrease)	Percent Increase (Decrease)
		(In thousands)		
REVENUE:				
U.S. Wireless	$ 21,213	$ 28,392	$ 7,179	33.8%
International Wireless	21,430	23,148	1,718	8.0
Wireline	20,564	21,530	966	4.7
Equipment and Other	1,625	2,104	479	29.5
Total revenue	64,832	75,174	10,342	16.0
OPERATING EXPENSES(*excluding depreciation and amortization unless otherwise indicated*)**:**				
Termination and access fees	13,055	15,862	2,807	21.5
Engineering and operations	9,658	9,630	(28)	(0.3)
Sales, marketing and customer services	4,489	5,020	531	

				Unrealized Losses		
September 30, 2013 Securities Available for Sale						
State and municipal securities	$ 4,883,362	$ 319,641	$ -	$ -	$4,883,362	$319,641
Residential mortgage-backed securities	9,716,208	149,394	1,746,935	31,245	11,463,143	180,639
	$ 14,599,570	$ 469,035	$ 1,746,935	$ 31,245	$16,346,505	$500,280
December 31, 2012 Securities Available for Sale						
State and municipal securities	$ 1,160,173	$ 12,266	$ -	$ -	$1,160,173	$12,266
Residential mortgage-backed securities	4,318,926	73,606	2,587,548	26,406	6,906,474	100,012
	$ 5,479,099	$ 85,872	$ 2,587,548	$ 26,406	$8,066,647	$112,278

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OTTAWA SAVINGS BANCORP, INC.

Notes to Unaudited Consolidated Financial Statements

(continued)

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability to retain and whether it is not more likely than not the Company will be required to sell its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and industry analysts' reports.

At September 30, 2013, 26 securities had unrealized losses with an aggregate depreciation of 2.97% from the Company's amortized cost basis. The Company does not consider these investments to be other than temporarily impaired at September 30, 2013 due to the following:

Decline in value is attributable to interest rates.
The value did not decline due to credit quality.
The Company does not intend to sell these securities.
The Company has adequate liquidity such that it will not more likely than not have to sell these securities before recovery of the amortized cost basis, which may be at maturity.

There were no proceeds from the sales of securities for the three months ended September 30, 2013 and 2012, resulting in no realized gains or losses for the three months ended September 30, 2013 and 2012.

There were no proceeds from the sales of securities for the nine months ended September 30, 2013 and proceeds of $3.0 million for the nine months ended September 30, 2012. There were no realized gains for the nine months ended September 30, 2013 and gross realized gains of $58,614 for the nine months ended September 30, 2012. There were no realized losses for the nine months ended September 30, 2013 and gross realized losses of $44,666 for the nine months ended September 30, 2012. The tax provision applicable to these net realized gains amounted to none and $4,742, respectively.

NOTE 8 – LOANS AND ALLOWANCE FOR CREDIT LOSSES

The components of loans, net of deferred loan costs (fees), are as follows:

	September 30, 2013	December 31, 2012
Mortgage loans:		
One-to-four family residential loans	$78,606,568	$83,018,756
Multi-family residential loans	2,794,137	4,849,766
Total mortgage loans	81,400,705	87,868,522
Other loans:		
Non-residential real estate loans	18,542,330	20,506,860
Commercial loans	6,797,594	8,648,191
Consumer direct	513,581	542,652
Purchased auto	9,093,619	7,810,067
Total other loans	34,947,124	37,507,770
Gross loans	116,347,829	125,376,292
Less: Allowance for loan losses	(3,214,275)	(3,381,441)
Loans, net	$113,133,554	$121,994,851

Purchases of loans receivable, segregated by class of loans, for the periods indicated were as follows:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2013	2012	2013	2012
Purchased auto	$510,729	$504,550	$3,536,965	$5,351,138

OTTAWA SAVINGS BANCORP, INC.

Notes to Unaudited Consolidated Financial Statements

(continued)

Net (charge-offs) / recoveries, segregated by class of loans, for the periods indicated were as follows:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2013	2012	2013	2012
One-to-four family	$(523,236)	$(763,244)	$(705,543)	$(2,000,218)
Multi-family	(286,906)	-	(286,906)	(133,429)
Non-residential	(54,591)	(183,257)	52,596	(271,021)
Commercial	-	-	-	(7,259)
Consumer direct	(647)	(379)	(647)	(350)
Purchased auto	4,433	(8,656)	(1,666)	(8,546)
Net (charge-offs)/recoveries	$(860,947)	$(955,536)	$(942,166)	$(2,420,823)

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OTTAWA SAVINGS BANCORP, INC.

Notes to Unaudited Consolidated Financial Statements

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The following table presents the activity in the allowance for loan losses by portfolio segment for the three months ended September 30, 2013 and 2012:

September 30, 2013	One-to-Four Family	Multi-family	Non-residential	Commercial	Consumer Direct	Purchased Auto	Total
Balance at beginning of period	$2,908,642	$55,991	$713,094	$83,560	$3,674	$85,261	$3,850,222
Provision charged to income	(30,762)	377,410	(60,564)	(52,086)	(1,294)	(7,704)	225,000
Loans charged off	(528,313)	(286,906)	(54,680)	-	(647)	-	(870,546)
Recoveries of loans previously charged off	5,077	-	89	-	-	4,433	9,599
Balance at end of period	$2,354,644	$146,495	$597,939	$31,474	$1,733	$81,990	$3,214,275

September 30, 2012	One-to-Four Family	Multi-family	Non-residential	Commercial	Consumer Direct	Purchased Auto	Total
Balance at beginning of period	$2,753,034	$201,375	$1,226,121	$45,355	$7,746	$50,494	$4,284,125
Provision charged to income	483,059	(9,062)	(175,009)	(11,797)	(5,588)	48,397	330,000
Loans charged off	(763,244)	-	(183,257)	-	(531)	(11,042)	(958,074)
Recoveries of loans previously charged off	-	-	-	-	152	2,386	2,538
Balance at end of period	$2,472,849	$192,313	$867,855	$33,558	$1,779	$90,235	$3,658,589

The following table presents the activity in the allowance for loan losses by portfolio segment for the nine months ended September 30, 2013 and 2012:

September 30, 2013	One-to-Four Family	Multi-family	Non-residential	Commercial	Consumer Direct	Purchased Auto	Total
Balance at beginning of year	$2,057,336	$161,901	$1,012,119	$75,130	$1,465	$73,490	$3,381,441
Provision charged to income	1,002,851	271,500	(466,776)	(43,656)	915	10,166	775,000
Loans charged off	(715,620)	(286,906)	(83,587)	-	(647)	(9,596)	(1,096,356)
Recoveries of loans previously charged off	10,077	-	136,183	-	-	7,930	154,190
Balance at end of period	$2,354,644	$146,495	$597,939	$31,474	$1,733	$81,990	$3,214,275

September 30, 2012	One-to-Four Family	Multi-family	Non-residential	Commercial	Consumer Direct	Purchased Auto	Total
Balance at beginning of year	$3,113,345	$438,542	$1,145,889	$10,571	$3,578	$35,487	$4,747,412
Provision charged to income	1,359,722	(112,800)	(7,013)	30,246	(1,449)	63,294	1,332,000
Loans charged off	(2,007,501)	(133,429)	(271,021)	(7,259)	(531)	(14,973)	(2,434,714)
Recoveries of loans previously charged off	7,283	-	-	-	181	6,427	13,891
Balance at end of period	$2,472,849	$192,313	$867,855	$33,558	$1,779	$90,235	$3,658,589

OTTAWA SAVINGS BANCORP, INC.

Notes to Unaudited Consolidated Financial Statements

(continued)

The following table presents the recorded investment in loans and the related allowances allocated by portfolio segment and based on impairment method as of September 30, 2013 and December 31, 2012:

September 30, 2013	One-to-four Family	Multi-family	Non-residential	Commercial	Consumer Direct	Purchased Auto	Total
Loans individually evaluated for impairment	$3,289,437	$-	$2,031,956	$-	$-	$-	$5,321,393
Loans collectively evaluated for impairment	75,317,131	2,794,137	16,510,374	6,797,594	513,581	9,093,619	111,026,436
Ending Balance	$78,606,568	$2,794,137	$18,542,330	$6,797,594	$513,581	$9,093,619	$116,347,829
Period-end amount allocated to:							
Loans individually evaluated for impairment	$492,409	$-	$8,771	$-	$-	$-	$501,180
Loans collectively evaluated for impairment	1,862,235	146,495	589,168	31,474	1,733	81,990	2,713,095
Balance at end of period	$2,354,644	$146,495	$597,939	$31,474	$1,733	$81,990	$3,214,275

December 31, 2012	One-to-four Family	Multi-family	Non-residential	Commercial	Consumer Direct	Purchased Auto	Total
Loans individually evaluated for impairment	$2,891,821	$-	$2,726,297	$-	$-	$-	$5,618,118
Loans collectively evaluated for impairment	80,126,935	4,849,766	17,780,563	8,648,191	542,652	7,810,067	119,758,174
Ending Balance	$83,018,756	$4,849,766	$20,506,860	$8,648,191	$542,652	$7,810,067	$125,376,292

Period-end amount allocated to:							
Loans individually evaluated for impairment	$147,209	$-	$31,208	$-	$-	$-	$178,417
Loans collectively evaluated for impairment	1,910,127	161,901	980,911	75,130	1,465	73,490	3,203,024
Balance at end of year	$2,057,336	$161,901	$1,012,119	$75,130	$1,465	$73,490	$3,381,441

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OTTAWA SAVINGS BANCORP, INC.

Notes to Unaudited Consolidated Financial Statements

(continued)

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions.

The following table presents loans individually evaluated for impairment, by class of loans, as of September 30, 2013 and December 31, 2012:

September 30, 2013	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment
One-to-four family	$3,630,860	$1,890,588	$1,398,849	$3,289,437	$ 492,409	$3,578,310
Multi-family	286,906	-	-	-	-	21,378
Non-residential	4,646,709	2,023,185	8,771	2,031,956	8,771	2,175,093
Commercial	-	-	-	-	-	-
Consumer direct	-	-	-	-	-	-
Purchased auto	-	-	-	-	-	-
	$8,564,475	$3,913,773	$1,407,620	$5,321,393	$ 501,180	$5,774,781

December 31, 2012	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment
One-to-four family	$3,664,253	$820,150	$2,071,671	$2,891,821	$ 147,209	$6,141,106
Multi-family	-	-	-	-	-	104,209
Non-residential	6,596,593	683,589	2,042,708	2,726,297	31,208	1,814,361

Commercial	-	-	-	-	-	605
Consumer direct	-	-	-	-	-	12,057
Purchased auto	-	-	-	-	-	12,057
	$10,260,846	$1,503,739	$4,114,379	$5,618,118	$178,417	$8,084,395

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For the three and nine months ended September 30, 2013 and 2012, the Company recognized no accrued or cash basis interest income on impaired loans.

At September 30, 2013, there were 33 impaired loans totaling approximately $5.3 million, compared to 22 impaired loans totaling approximately $5.6 million at December 31, 2012. The change in impaired loans was a result of adding 28 loans totaling approximately $3.0 million to the impaired loan list, offset by writing down and moving seven impaired loans totaling approximately $614,000 to OREO, returning five impaired loans totaling approximately $631,000 to performing status, writing down two impaired loans by a total of approximately $147,000, and restructuring 12 impaired loans using A/B note restructurings in which there were five modified loans at market rates remaining which resulted in charge offs of approximately $616,000. Additionally, there were four impaired loan payoffs totaling approximately $1.2 million, and an impaired loan of approximately $269,000 moved to held for sale which was subsequently sold.

Our loan portfolio also includes certain loans that have been modified in a troubled debt restructuring (“TDR”), where economic concessions have been granted to borrowers who have experienced financial difficulties. These concessions typically result from our loss mitigation activities and could include reductions in the interest rate, payment extensions, forbearance or other actions. TDRs are classified as nonperforming at the time of restructuring and typically are returned to performing status after considering the borrower’s sustained repayment performance for a reasonable period of at least six months.

When we modify loans in a TDR, we evaluate any possible impairment similar to other impaired loans based on the present value of expected future cash flows, discounted at the contractual interest rate of the original loan agreement, or use the current fair value of the collateral, less estimated selling costs, for collateral dependent loans. If we determine that the value of the modified loan is less than the recorded investment in the loan (net of previous charge-offs, deferred loan fees or costs and unamortized premium or discount), impairment is recognized through an allowance estimate or a charge-off to the allowance. In periods subsequent to modification, we evaluate all TDRs, including those that have payment defaults, for possible impairment and recognize impairment through the allowance.

Impaired loans at September 30, 2013 included $3.5 million of loans whose terms have been modified in troubled debt restructurings compared to $3.1 million at December 31, 2012. The restructured loans are being monitored as they have not attained per accounting guidelines the performance requirements for the set time period to achieve being returned to accrual status.

Loans classified as troubled debt restructuring during the three and nine months ended September 30, 2013 and 2012, segregated by class are shown in the tables below.

	Three Months Ended September 30, 2013			Three Months Ended September 30, 2012		
	Number of Modifications	Recorded Investment (as of period end)	Increase in Allowance	Number of Modifications	Recorded Investment (as of period end)	Increase in Allowance
One-to-four family	5	$ 657,180	$ -	5	$ 509,875	$ -
Multi-family	-	-	-	-	-	-
Non-residential	-	-	-	-	-	-
Commercial	-	-	-	-	-	-
Consumer direct	-	-	-	-	-	-
Purchased auto	-	-	-	-	-	-
	5	$ 657,180	$ -	5	$ 509,875	$ -

During the three months ended September 30, 2013, all five of the one-to-four family loan modifications were classified as TDRs due to A/B note restructurings which involved principal reductions. One of the new modifications paid-off two existing TDRs, with one new note at a market rate. Another of the new modifications restructured 7 impaired loans into an A/B note structure with the new note at a market rate and the B note being charged off. The other three of the new modifications restructured 3 impaired loans for the same borrower into three A/B note structures with three new notes at market rates and the associated B notes being charged off. Total charge-offs were $616,000 for these TDRs.

	Nine Months Ended September 30, 2013			Nine Months Ended September 30, 2012		
	Number of Modifications	Recorded Investment (as of period end)	Increase in Allowance	Number of Modifications	Recorded Investment (as of period end)	Increase in Allowance
One-to-four family	5	$ 657,180	$ -	6	$ 629,770	$ -
Multi-family	-	-	-	-	-	-
Non-residential	-	-	-	-	-	-
Commercial	-	-	-	-	-	-
Consumer direct	-	-	-	-	-	-
Purchased auto	-	-	-	-	-	-
	5	$ 657,180	$ -	6	$ 629,770	$ -

Troubled debt restructured loans that were restructured during the twelve months prior to the dates indicated and had payment defaults (i.e., 60 days or more past due following a modification), during the three and nine months ended September 30, 2013 and 2012, segregated by class are shown below.

There were no payment defaults during the three months ended September 30, 2013 and 2012.

	Nine Months Ended September 30, 2013		Nine Months Ended September 30, 2012	
	Number of Defaults	Recorded Investment (as of period end)	Number of Defaults	Recorded Investment (as of period end)
One-to-four family	-	$ -	1	$ 212,014
Multi-family	-	-	-	-
Non-residential	-	-	-	-
Commercial	-	-	-	-
Consumer direct	-	-	-	-
Purchased auto	-	-	-	-
	-	$ -	1	$ 212,014

All TDRs are evaluated for possible impairment and any impairment identified is recognized through the allowance. Additionally, the qualitative factors are updated quarterly for trends in economic and nonperforming factors, including consideration of TDRs.

The following table presents the recorded investment in nonaccrual loans and loans past due over 90 days still on accrual status, by class of loans, as of September 30, 2013 and December 31, 2012:

September 30, 2013	Nonaccrual	Loans Past Due Over 90 Days Still Accruing
One-to-four family	$3,384,846	$ -
Multi-family	-	-
Non-residential	2,031,956	-
Commercial	-	-
Consumer direct	-	-
Purchased auto	-	-
	$5,416,802	$ -

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December 31, 2012	Nonaccrual	Loans Past Due Over 90 Days Still Accruing
One-to-four family	$3,067,190	$106,457
Multi-family	-	-
Non-residential	2,985,987	164,305
Commercial	-	-
Consumer direct	-	-
Purchased auto	-	-
	$6,053,177	$270,762

The following table presents the aging of the recorded investment in loans, by class of loans, as of September 30, 2013 and December 31, 2012:

September 30, 2013	Loans 30-59 Days Past Due	Loans 60-89 Days Past Due	Loans 90 or More Days Past Due	Total Past Due Loans	Current Loans	Total Loans
One-to-four family	$2,437,129	$300,780	$897,682	$3,635,591	$74,970,977	$78,606,568
Multi-family	265,611	-	-	265,611	2,528,526	2,794,137
Non-residential	436,748	235,000	-	671,748	17,870,582	18,542,330
Commercial	-	-	-	-	6,797,594	6,797,594
Consumer direct	-	-	-	-	513,581	513,581
Purchased auto	-	-	-	-	9,093,619	9,093,619
	$3,139,488	$535,780	$897,682	$4,572,950	$111,774,879	$116,347,829

December 31, 2012	Loans 30-59 Days Past Due	Loans 60-89 Days Past Due	Loans 90 or More Days Past Due	Total Past Due Loans	Current Loans	Total Loans
One-to-four family	$2,322,111	$616,274	$1,621,408	$4,559,793	$78,458,963	$83,018,756
Multi-family	97,267	-	-	97,267	4,752,499	4,849,766
Non-residential	473,458	334,389	516,414	1,324,261	19,182,599	20,506,860

Commercial	23,601	-	-	23,601	8,624,590	8,648,191
Consumer direct	-	-	-	-	542,652	542,652
Purchased auto	6,422	19,257	-	25,679	7,784,388	7,810,067
	$2,922,859	$969,920	$2,137,822	$6,030,601	$119,345,691	$125,376,292

Credit Quality Indicators:

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information and current economic trends, among other factors. The Company analyzes loans individually by classifying the loans as to credit risk. For commercial and non-residential real estate loans, the Company's credit quality indicator is internally assigned risk ratings. Each commercial and non-residential real estate loan is assigned a risk rating upon origination. The risk rating is reviewed annually, at a minimum, and on an as needed basis depending on the specific circumstances of the loan.

For residential real estate loans, multi-family, consumer direct and purchased auto loans, the Company's credit quality indicator is performance determined by delinquency status. Delinquency status is updated regularly by the Company's loan system for real estate loans, multi-family and consumer direct loans. The Company receives monthly reports on the delinquency status of the purchased auto loan portfolio from the servicing company.

The Company uses the following definitions for risk ratings:

Pass – loans classified as pass are of a higher quality and do not fit any of the other "rated" categories below (e.g. special mention, substandard or doubtful). The likelihood of loss is considered remote.

Special Mention – loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date.

Substandard – loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Doubtful – loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable.
Not Rated – loans in this bucket are not evaluated on an individual basis.

As of September 30, 2013 and December 31, 2012, the risk category of loans by class is as follows:

September 30, 2013	Pass	Special Mention	Substandard	Doubtful	Not rated
One-to-four family	$-	$2,284,598	$3,289,437	$ -	$73,032,533
Multi-family	-	-	-	-	2,794,137
Non-residential	14,654,770	1,855,604	2,031,956	-	-
Commercial	6,638,131	159,463	-	-	-
Consumer direct	-	859	-	-	512,722
Purchased auto	-	-	-	-	9,093,619
Total	$21,292,901	$4,300,524	$5,321,393	$ -	$85,433,011

December 31, 2012	Pass	Special Mention	Substandard	Doubtful	Not rated
One-to-four family	$-	$3,925,077	$2,891,821	$ -	$76,201,858
Multi-family	-	3,826	-	-	4,845,940
Non-residential	17,466,220	314,343	2,726,297	-	-
Commercial	8,486,147	162,044	-	-	-
Consumer direct	-	3,766	-	-	538,886
Purchased auto	-	-	-	-	7,810,067
Total	$25,952,367	$4,409,056	$5,618,118	$ -	$89,396,751

NOTE 9 – STOCK COMPENSATION

Total stock-based compensation expense was approximately $20,000 and $11,000 for the nine months ended September 30, 2013 and 2012, respectively. In accordance with FASB ASC 718, *Compensation-Stock Compensation,* compensation expense is recognized on a straight-line basis over the grantees' vesting period or to the grantees' retirement eligibility date, if earlier. During the nine months ended September 30, 2013 and 2012, the Company did not grant additional options or shares under the MRP.

NOTE 10 – RECENT ACCOUNTING DEVELOPMENTS

In February 2013, the FASB issued ASU No. 2013-02, *Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*. The Update improves the reporting of reclassifications out of accumulated other comprehensive income by requiring an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under U.S. generally accepted accounting principles (GAAP) to be reclassified in its entirety to net income. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other disclosures required under U.S. GAAP that provide additional detail about those amounts. The adoption of ASU No. 2013-02 on January 1, 2013 did not have an impact on the Company's financial position, results of operation or cash flows.

NOTE 11 – FAIR VALUE MEASUREMENT AND DISCLOSURE

FASB ASC Topic 820, Fair Value Measurements and Disclosures, clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants and is not adjusted for transaction costs. This guidance also establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement inputs) and the lowest priority to unobservable inputs (Level 3 measurement inputs). The three levels of the fair value hierarchy under FASB ASC 820 are described below:

Basis of Fair Value Measurement:

- Level 1 - Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets.

- Level 2 - Significant other observable inputs other than Level 1 prices such as quoted prices in markets that are not active, quoted prices for similar assets, or other inputs that are observable, either directly or indirectly, for substantially the full term of the asset.

- Level 3 - Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported by little or no market activity).

Following is a description of valuation methodologies used for assets and liabilities recorded at fair value:

Securities Available for Sale

Securities classified as available for sale are recorded at fair value on a recurring basis using pricing obtained from an independent pricing service. Where quoted market prices are available in an active market, securities are classified within Level 1. The Company has no securities classified within Level 1. If quoted market prices are not available, the pricing service estimates the fair values by using pricing models or quoted prices of securities with similar characteristics. For these securities, the inputs used by the pricing service to determine fair value consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and bonds' terms and conditions, among other things resulting in classification within Level 2. Level 2 securities include state and municipal securities, and residential mortgage-backed securities. In cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3. The Company has no securities classified within Level 3.

Foreclosed Assets

Foreclosed assets consisting of foreclosed real estate and repossessed assets, are adjusted to fair value less estimated costs to sell upon transfer of the loans to foreclosed assets. Subsequently, foreclosed assets are carried at the lower of cost or fair value. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the foreclosed asset as non-recurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the foreclosed asset as non-recurring Level 3.

Impaired Loans

Impaired loans are evaluated and adjusted to the lower of carrying value or fair value less estimated costs to sell at the time the loan is identified as impaired. Impaired loans are carried at the lower of cost or fair value. Fair value is measured based on the value of the collateral securing these loans. When the fair value of the collateral is based on an

observable market price or a current appraised value, the Company records the impaired loan as non-recurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the impaired loan as non-recurring Level 3.

The Company did not have any transfers of assets or liabilities between Levels 1 and 2 of the fair value hierarchy during the nine months ended September 30, 2013 and the year ended December 31, 2012. The Company's policy for determining transfers between levels occurs at the end of the reporting period when circumstances in the underlying valuation criteria change and result in transfers between levels.

The tables below present the recorded amount of assets measured at fair value on a recurring basis at September 30, 2013 and December 31, 2012.

September 30, 2013	**Level 1**	**Level 2**	**Level 3**	**Total** Fair Value
State and municipal securities available for sale	$ -	$8,460,769	$ -	$8,460,769
Residential mortgage-backed securities available for sale	-	26,491,691	-	26,491,691
	$ -	$34,952,460	$ -	$34,952,460

December 31, 2012	**Level 1**	**Level 2**	**Level 3**	**Total** Fair Value
State and municipal securities available for sale	$ -	$7,120,522	$ -	$7,120,522
Residential mortgage-backed securities available for sale	-	21,743,081	-	21,743,081
	$ -	$28,863,603	$ -	$28,863,603

The tables below present the recorded amount of assets measured at fair value on a non-recurring basis at September 30, 2013 and December 31, 2012.

September 30, 2013	**Level 1**	**Level 2**	**Level 3**	**Total** Fair Value
Foreclosed assets	$ -	$ -	$955,785	$955,785
Impaired loans, net	-	-	906,440	906,440

December 31, 2012	**Level 1**	**Level 2**	**Level 3**	**Total** Fair Value
Foreclosed assets	$ -	$ -	$1,305,921	$1,305,921
Impaired loans, net	-	-	3,597,690	3,597,690

In accordance with accounting pronouncements, the carrying value and estimated fair value of the Company's financial instruments as of September 30, 2013 and December 31, 2012 are as follows:

	Carrying	Fair Value Measurements at September 30, 2013 using:			
	Amount	Level 1	Level 2	Level 3	Total
Financial Assets:					
Cash and cash equivalents	$5,208,959	$5,208,959	$-	$-	$5,208,959
Federal funds sold	2,885,000	2,885,000	-	-	2,885,000
Securities	36,185,996	-	36,185,996	-	36,185,996
Accrued interest receivable	670,709	670,709	-	-	670,709
Net loans	113,133,554	-	-	114,264,000	114,264,000
Loans held for sale	-	-	-	-	-
Mortgage servicing rights	160,532	-	-	160,532	160,532
Financial Liabilities:					
Non-interest bearing deposits	5,015,782	5,015,782	-	-	5,015,782
Interest bearing deposits	142,644,024	-	-	142,634,218	142,634,218
Accrued interest payable	2,780	2,780	-	-	2,780

	Carrying	Fair Value Measurements at December 31, 2012 using:			
	Amount	Level 1	Level 2	Level 3	Total

Financial Assets:					
Cash and cash equivalents	$10,787,989	$10,787,989	$-	$-	$10,787,989
Federal funds sold	1,666,000	1,666,000	-	-	1,666,000
Securities	30,198,051	-	30,198,052	-	30,198,052
Accrued interest receivable	696,638	696,638	-	-	696,638
Net loans	121,994,851	-	-	123,748,000	123,748,000
Loans held for sale	171,095	171,095	-	-	171,095
Mortgage servicing rights	152,873	-	-	152,873	152,873
Financial Liabilities:					
Non-interest bearing deposits	4,313,635	4,313,635	-	-	4,313,635
Interest bearing deposits	150,761,010	-	-	150,921,365	150,921,365
Accrued interest payable	806	806	-	-	806

The following methods and assumptions were used by the Bank in estimating the fair value of financial instruments:

Cash and Cash Equivalents: The carrying amounts reported in the balance sheets for cash and cash equivalents approximate fair values.

Federal Funds Sold: The carrying amounts reported in the balance sheets for federal funds sold approximate fair values.

Securities: The Company obtains fair value measurements of available for sale securities from an independent pricing service. See Note 11 - Fair Value Measurement and Disclosure for further detail on how fair values of securities available for sale are determined. The carrying value of non-marketable equity securities approximates fair value.

Loans: For variable-rate loans that re-price frequently and with no significant change in credit risk, fair values are based on carrying amounts. The fair values for other loans (for example, fixed rate commercial real estate and rental property mortgage loans and commercial and industrial loans) are estimated using discounted cash flow analysis, based on market interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Loan fair value estimates include judgments regarding future expected loss experience and risk characteristics. Fair values for impaired loans are estimated using underlying collateral values, where applicable or discounted cash flows.

Loans held for sale: The carrying amounts reported in the balance sheets for loans held for sale approximate fair values, as usually these loans are originated with the intent to sell and funding of the sales usually occurs within three days.

Accrued Interest Receivable and Payable: The carrying amounts of accrued interest receivable and payable approximate fair values.

Mortgage Servicing Rights: The carrying amounts of mortgage servicing rights approximate their fair values.

Deposits: The fair values disclosed for demand deposits are, by definition, equal to the amount payable on demand at the reporting date (that is, their carrying amounts). The carrying amounts of variable-rate, fixed-term money market accounts and certificates of deposit approximate their fair values. Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies market interest rates currently offered on certificates to a schedule of aggregated expected monthly maturities on time deposits.

Loan Commitments: Commitments to extend credit were evaluated and fair value was estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counter-parties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates. The Bank does not charge fees to enter into these agreements. As of September 30, 2013 and December 31, 2012, the fair values of the commitments are immaterial in nature.

In addition, other assets and liabilities of the Bank that are not defined as financial instruments, such as property and equipment are not included in the above disclosures. Also, non-financial instruments typically not recognized in financial statements nevertheless may have value but are not included in the above disclosures. These include, among other items, the estimated earnings power of core deposit accounts, the trained work force, customer goodwill and similar items.

ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Management’s discussion and analysis of the financial condition and results of operations is intended to assist in understanding the financial condition and results of operations of the Company. The information contained in this section should be read in conjunction with the Unaudited Consolidated Financial Statements and footnotes appearing in Part I, Item 1 of this document.

FORWARD-LOOKING INFORMATION

Statements contained in this report that are not historical facts may constitute forward-looking statements (within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended), which involve significant risks and uncertainties. The Company intends such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995, and is including this statement for purposes of invoking these safe harbor provisions. Forward-looking statements, which are based on certain assumptions and describe future plans, strategies and expectations of the Company, are generally identifiable by the use of the words “believe,” “expect,” “intend,” “anticipate,” “estimate,” “project,” “plan,” or similar express The Company’s ability to predict results or the actual effect of future plans or strategies is inherently uncertain and actual results may differ from those predicted. The Company undertakes no obligation to update these forward-looking statements in the future. The Company cautions readers of this report that a number of important factors could cause the Company’s actual results subsequent to September 30, 2013 to differ materially from those expressed in forward-looking statements. Factors that could cause actual results to differ from those predicted and could affect the future prospects of the Company include, but are not limited to, fluctuations in market rates of interest and loan and deposit pricing, changes in the securities or financial market, a deterioration of general economic conditions either nationally or locally, delays in obtaining the necessary regulatory approvals, our ability to consummate proposed transactions in a timely manner, legislative or regulatory changes that adversely affect our business, adverse developments or changes in the composition of our loan or investment portfolios, significant increases in competition, changes in real estate values, difficulties in identifying attractive acquisition opportunities or strategic partners to complement our Company’s approach and the products and services the Company offers, the possible dilutive effect of potential acquisitions or expansion, and our ability to raise new capital as needed and the timing, amount and type of such capital raises. These risks and uncertainties should be considered in evaluating forward-looking statements. Additionally, other risks and uncertainties may be described in the Company’s Annual Report on form 10-K as filed with the Securities and Exchange Commission on March 28, 2013

GENERAL

The Bank is a community and customer-oriented savings bank. The Bank's business has historically consisted of attracting deposits from the general public and using those funds to originate and purchase one-to-four family, multi-family and non-residential real estate, construction, commercial and consumer loans, which the Bank primarily holds for investment. The Bank has continually diversified its products to meet the needs of the community. The Bank completed its reorganization pursuant to its Plan of Conversion on July 11, 2005, upon which the Bank converted from an Illinois-chartered mutual savings bank to a federally-chartered mutual savings bank, and on that same date, converted from a federally-chartered mutual savings bank to a federally-chartered stock savings bank, all of the outstanding stock of which was issued to the Company. As part of the reorganization, the Company issued 1,001,210 shares to the public and 1,223,701 shares to Ottawa Savings Bancorp MHC, a mutual holding company.

COMPARISON OF FINANCIAL CONDITION AT SEPTEMBER 30, 2013 AND DECEMBER 31, 2012

The Company's total assets decreased $7.2 million, or 4.0%, to $171.9 million at September 30, 2013, from $179.0 million at December 31, 2012. The decrease in assets was primarily due to a decrease in loans of $8.9 million, and a decrease in cash and cash equivalents of $5.6 million. The decrease in assets was partially offset by an increase in securities available for sale of $6.1 million and an increase in federal funds sold of $1.2 million.

Cash and cash equivalents decreased $5.6 million, or 51.7%, to $5.2 million at September 30, 2013 from $10.8 million at December 31, 2012, primarily as a result of cash used in investing and financing activities exceeding the cash provided by operating activities, and decrease in deposits which resulted from management strategically pricing deposits based on market conditions.

Securities available for sale increased $6.1 million, or 21.1%, to $35.0 million at September 30, 2013 from $28.9 million at December 31, 2012. The increase was primarily the result of $12.8 million in purchases offset by pay-downs of $5.5 million.

Loans, net of the allowance for loan losses, decreased $8.9 million, or 7.3%, to $113.1 million at September 30, 2013 from $122.0 million at December 31, 2012. The decrease in loans, net of the allowance for loan losses, was primarily caused by a combination of normal attrition, pay-downs, loan charge-offs and strategic initiatives to reduce lending exposure in one-to-four family residential, non-residential loans, and multifamily residential loans, augmented by a decrease in the allowance for loan losses of $0.2 million and partially offset by an increase of $1.3 million in the purchased auto loan portfolio. The Company is focusing its lending efforts on customers based primarily in its local market and purchased auto loans from regulated financial institutions.

Foreclosed real estate decreased approximately $0.4 million, or 30.1%, to $0.9 million at September 30, 2013 from $1.3 million at December 31, 2012. The decrease was primarily due to the sale of 19 properties for aggregate proceeds of $0.8 million offset by the addition of 11 properties valued at $0.6 million acquired through loan foreclosures due to the continued stress the economic environment has placed on the Company's customers and further write-downs of $0.1 million due to declines in real estate values.

Other assets comprised primarily of prepaid expenses, deferred director compensation accounts, and auto loan repossessions, increased approximately $0.4 million, or 25.2%, to $1.8 million at September 30, 2013 from $1.4 million at December 31, 2012.

Total deposits decreased $7.4 million, or 4.8%, to $147.7 million at September 30, 2013, from $155.1 million at December 31, 2012. The decrease is primarily due to a decrease in certificates of deposit of $8.7 million, or 8.5% and a decrease in money market accounts of $0.6 million, or 3.0%, from December 31, 2012 to September 30, 2013. The decrease was partially offset by an increase in savings accounts of $0.8 million, or 5.0%, and an increase in checking accounts of $1.2 million, or 6.9% from December 31, 2012 to September 30, 2013. The increase in savings and checking accounts is primarily due to customers moving funds into non-term products as they wait for a better rate environment. The reduction in certificate of deposit accounts is due to management's strategic initiative to pay competitive rates, but not the highest rates in the market.

Other liabilities comprised of primarily deferred compensation expenses, accrued expenses and escrow payable, remained constant, increasing about $42,000, or 1.6%, to remain at $2.7 million at September 30, 2013.

Equity increased approximately $129,000, or 0.6%, to $21.2 million at September 30, 2013, from $21.0 million at December 31, 2012. The increase in equity is primarily a result of net income for the nine months ended September 30, 2013 of approximately $0.6 million, offset by other comprehensive losses on available for sale securities during the period of approximately $0.5 million.

The ongoing state of economic uncertainty continues to affect our asset quality. We continue to experience a decline in the market values of homes in our market area in general and also on specific properties held as collateral. In addition, higher unemployment locally continues to affect some of our borrowers' ability to timely repay their obligations to the Company. These conditions have resulted in nonperforming loans totaling 4.6% of total loan receivables as of September 30, 2013, which is down slightly from 5.0% at December 31, 2012.

The Company's nonperforming assets consist of non-accrual loans, loans past due greater than 90 days and still accruing and foreclosed real estate. Loans are generally placed on non-accrual status when it is apparent all of the contractual payments (i.e. principal and interest) will not be received; however, they may be placed on non-accrual status sooner if management has significant doubt as to the collection of all amounts due. Interest previously accrued but uncollected is reversed and charged against interest income. During the first nine months of 2013, nonaccrual loans decreased 8.8% to $5.5 million from $6.1 million as of December 31, 2012. The decrease is a result of payoffs on four loans totaling approximately $1.2 million, five loans totaling approximately $0.6 million that were upgraded to performing status, two loans with partial charge-offs totaling approximately $0.1 million, one loan of approximately $0.3 million was moved to held for sale and subsequently sold, and seven loans of approximately $0.6 million were moved to foreclosed real estate. The decreases were offset by the addition of 26 one-to-four family loans totaling approximately $2.8 million and two non-residential loans totaling approximately $0.2 million that were placed on non-accrual status, as certain customers continue to be challenged by local economic conditions during these difficult economic times.

The following table summarizes nonperforming assets for the prior five quarters.

	September 30, 2013	**June 30,** 2013	**March 31,** 2013	**December 31,** 2012	**September 30,** 2012
Non-accrual:	**(In Thousands)**				
One-to-four family	$3,385	$3,433	$4,153	$ 3,067	$ 5,687
Multi-family	-	-	-	-	5
Non-residential real estate	2,032	2,480	2,355	2,986	1,618
Commercial	-	-	-	-	-
Consumer direct	-	-	-	-	-
Purchased auto	-	-	-	-	17
Total non-accrual loans	5,417	5,913	6,508	6,053	7,327
Past due greater than 90 days and still accruing:					
One-to-four family	-	15	15	107	64
Non-residential real estate	-	51	-	164	-
Commercial	-	23	-	-	-
Consumer direct	-	1	1	-	-
Total nonperforming loans	5,417	6,003	6,524	6,324	7,391
Foreclosed real estate	907	763	900	1,297	1,122
Other repossessed assets	48	50	12	9	19
Total nonperforming assets	$6,372	$6,816	$7,436	$ 7,630	$ 8,532

The table below presents selected asset quality ratios for the prior five quarters.

	September 30, 2013	**June 30, 2013**	**March 31, 2013**	**December 31, 2012**	**September 30, 2012**
Allowance for loan losses as a percent of gross loans receivable	2.73 %	3.21 %	2.90 %	2.69 %	2.80 %
Allowance for loan losses as a percent of total nonperforming loans	59.33 %	64.13 %	55.13 %	53.46 %	49.47 %
Nonperforming loans as a percent of gross loans receivable	4.61 %	5.01 %	5.25 %	5.04 %	5.66 %
Nonperforming loans as a percent of total assets	3.15 %	3.39 %	3.58 %	3.53 %	4.06 %
Nonperforming assets as a percent of total assets	3.71 %	3.85 %	4.08 %	4.26 %	4.68 %

COMPARISON OF RESULTS OF OPERATION FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2013 AND 2012

General. Net income for the three months ended September 30, 2013 was $169,000 compared to net income of $179,000 for the three months ended September 30, 2012. Net income decreased slightly during the third quarter of 2013 primarily due to lower interest and dividend income, decreases in other income, and an increase in operating costs. The decreases were slightly offset by lower levels of provision for loan losses than in the 2012 period, lower funding costs, and decreased tax expenses.

Net Interest Income. The following table summarizes interest and dividend income and interest expense for the three months ended September 30, 2013 and 2012.

	Nine Months Ended			
	September 30,			
	2013	**2012**	**$ change**	**% change**
	(Dollars in thousands)			
Interest and dividend income:				
Interest and fees on loans	$4,761	$5,291	$ (530)	(10.02)%
Securities:				
Residential mortgage-backed securities	334	499	(165)	(33.07)
U.S. agency securities	-	38	(38)	(100.00)
State and municipal securities	197	151	46	30.46
Dividends on non-marketable equity securities	3	3	-	-
Interest-bearing deposits	4	3	1	33.33
Total interest and dividend income	5,299	5,985	(686)	(11.46)
Interest expense:				
Deposits	1,152	1,670	(518)	(31.02)
Total interest expense	1,152	1,670	(518)	(31.02)
Net interest income	$4,147	$4,315	$ (168)	(3.89)%

The following table presents for the periods indicated the total dollar amount of interest income from average interest-earning assets and the resultant yields, as well as the interest expense on average interest bearing liabilities, expressed both in dollars and rates. No tax equivalent adjustments were made. All average balances are monthly average balances. Non-accruing loans have been included in the table as loans carrying a zero yield. The amortization of loan fees is included in computing interest income; however, such fees are not material.

	Three Months Ended September 30,							
	2013				**2012**			
	AVERAGE BALANCE	**INTEREST**	**AVERAGE** YIELD/ COST		**AVERAGE** BALANCE	**INTEREST**	**AVERAGE** YIELD/ COST	
	(Dollars in thousands)							
Interest-earning assets								
Loans receivable, net (1)	$113,958	$ 1,495	5.25	%	$127,504	$ 1,708	5.36	%
Securities, net (2)	34,681	183	2.11	%	31,822	211	2.65	%
Non-marketable equity securities	1,234	1	0.32	%	1,475	1	0.27	%
Interest-bearing deposits	7,461	1	0.05	%	5,758	-	0.00	%
Total interest-earning assets	157,334	1,680	4.27	%	166,559	1,920	4.61	%
Interest-bearing liabilities								
Money Market accounts	$20,375	$ 12	0.24	%	$20,328	$ 19	0.37	%
Passbook accounts	16,324	3	0.07	%	15,097	4	0.11	%
Certificates of Deposit accounts	94,488	328	1.39	%	107,337	505	1.88	%
Checking accounts	13,130	1	0.03	%	11,980	2	0.07	%
Total interest-bearing liabilities	144,317	344	0.95	%	154,742	530	1.37	%
NET INTEREST INCOME		$ 1,336				$ 1,390		
NET INTEREST RATE SPREAD (3)			3.32	%			3.24	%
NET INTEREST MARGIN (4)			3.40	%			3.34	%
RATIO OF AVERAGE INTEREST-EARNING ASSETS TO AVERAGE INTEREST-BEARING LIABILITIES			109.02	%			107.64	%

(1)Amount is net of deferred loan origination (costs) fees, undisbursed loan funds, unamortized discounts and allowance for loans and includes non-performing loans.

(2) Includes unamortized discounts and premiums.

(3) Net interest rate spread represents the difference between the yield on average interest-earning assets and the average cost of interest-bearing liabilities.

(4) Net interest margin represents net interest income divided by average interest-earning assets.

(1) Amount is net of deferred loan origination (costs) fees, undisbursed loan funds, unamortized discounts and allowance for loan losses and includes

The following table summarizes the changes in net interest income due to rate and volume for the three months ended September 30, 2013 and 2012. The column "Net" is segmented into the changes attributable to variations in volume and the changes attributable to changes in interest rates. The variations attributable to simultaneous volume and rate changes have been proportionately allocated to rate and volume.

	Three Months Ended September 30,		
	2013 Compared to 2012		
	Increase (Decrease) Due to		
	VOLUME	**RATE**	**NET**
	(Dollars in Thousands)		
Interest and dividends earned on			
Loans receivable, net	$(177)	$(36)	$(213)
Securities, net	15	(43)	(28)
Non-marketable equity securities	-	-	-
Interest-bearing deposits	-	1	1
Total interest-earning assets	$(162)	$(78)	$(240)
Interest expense on			
Money Market accounts	$-	$(7)	$(7)
Passbook accounts	-	(1)	(1)
Certificates of Deposit accounts	(45)	(132)	(177)
Checking	-	(1)	(1)
Total interest-bearing liabilities	(45)	(141)	(186)
Change in net interest income	$(117)	$63	$(54)

Net interest income decreased $54,000, or 3.9%, to $1.3 million for the three months ended September 30, 2013 compared to $1.4 million for the three months ended September 30, 2012. Interest and dividend income decreased $240,000 due to the decline in average interest earning assets of $9.2 million and the yield decreasing on interest earning assets from 4.6% to 4.3%. The decline in the loan portfolios contributed to a significant amount of the decline in earning assets. The yield on the investment portfolio and the loan portfolio declined as the low rate environment continued during the third quarter of 2013. This decline in interest income was offset by an $186,000, or 35.1%, reduction in interest expense. The cost of funds declined 42 basis points, or 30.7%, for the three months ended September 30, 2013 compared to the three months ended September 30, 2012, due to the continued low rate environment. Additionally, the average balance of interest bearing liabilities declined by $10.4 million, or 6.7%. Net interest margin improved during the three months ended September 30, 2013 to 3.4% compared to 3.3% at September 30, 2012.

Provision for Loan Losses. Management recorded a loan loss provision of $225,000 for the three months ended September 30, 2013, compared to $330,000 for the three months ended September 30, 2012. The provision is primarily attributed to the reserves required for the one-to-four family segment as the economic conditions in the local market continue to negatively impact collateral values of real estate and the ability of borrowers to keep current per terms of their obligations. The slow payment activity and continued degradation of property values are the result of local economic conditions continuing to lag national indicators, including higher levels of unemployment locally of 11.3%, versus 9.2% for the State of Illinois and the national level of 7.3%. For the three months ended September 30, 2013, charge-offs increased due to several A/B note restructurings in which $616,000 related to the B notes was charged off. This level is elevated in comparison to the first and second quarters of 2013 but lower than the charge-off levels experienced for the three months ended September 30, 2012.

Management uses available information to establish the appropriate level of the allowance for loan losses. Future additions or reductions to the allowance may be necessary based on estimates that are susceptible to change as a result of changes in economic conditions and other factors. As a result, our allowance for loan losses may not be sufficient to cover actual loan losses, and future provisions for loan losses could materially adversely affect the Company's operating results. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses. Such agencies may require the Company to recognize adjustments to the allowance based on their judgments about information available to them at the time of their examination.

Other Income. The following table summarizes other income for the three months ended September 30, 2013 and 2012.

	Three months ended			
	September 30,			
	2013	**2012**	**$ change**	**% change**
	(Dollars in thousands)			

Other income:				
Gain on sale of securities	$-	$-	$ -	- %
Gain on sale of loans	18	19	(1)	(5.26)
Gain on sale of OREO	-	27	(27)	(100.00)
Origination of mortgage servicing rights, net of amortization	3	(6)	9	150.00
Customer service fees	81	73	8	10.96
(Loss) income on bank owned life insurance	(2)	8	(10)	(125.00)
Other	16	22	(6)	(27.27)
Total other income	$116	$143	$ (27)	(18.88)%

The decrease in total other income was primarily a result of no gains on the sale of OREO for the three months ended September 30, 2013, compared to gains of $27,000 for the three months ended September 30, 2012. Also contributing to the decrease were losses on bank owned life insurance, offset by increases in mortgage servicing rights and customer service fees.

Other Expenses. The following table summarizes other expenses for the three months ended September 30, 2013 and 2012.

	Three months ended September 30,			
	2013	**2012**	**$ change**	**% change**
	(Dollars in thousands)			
Other expenses:				
Salaries and employee benefits	$389	$400	$ (11)	(2.75)%
Directors fees	25	21	4	19.05
Occupancy	116	111	5	4.50
Deposit insurance premium	57	62	(5)	(8.06)
Legal and professional services	80	53	27	50.94
Data processing	68	81	(13)	(16.05)
Valuation adjustments and expenses on foreclosed real estate	72	61	11	18.03
Loss on sale of OREO	18	-	18	100.00
Other	131	120	11	9.17
Total other expenses	$956	$909	$ 47	5.17 %
Efficiency ratio (1)	65.84%	59.30%		

(1) Computed as other expenses divided by the sum of net interest income and other income.

The increase in other expenses was primarily due to increases in valuation adjustments and expenses on foreclosed real estate, increases in losses on the sale of OREO due to the number of OREO properties, and an increase in legal and professional services due to compliance related activities. The increases were slightly offset by decreases in salaries and employee benefits, decreases in data processing, and decreases in deposit insurance premium during the three months ended September 30, 2013 as compared to the three months ended September 30, 2012. The efficiency ratio increased due to higher costs for the period and lower revenue levels.

Income Taxes. The Company recorded income tax expenses of $102,000 and $115,000 for the three months ended September 30, 2013 and 2012, respectively.

COMPARISON OF RESULTS OF OPERATION FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2013 AND 2012

General. Net income for the nine months ended September 30, 2013 was $635,000 compared to net income of $574,000 for the nine months ended September 30, 2012. Net income improved during the nine months of 2013 primarily due to lower levels of provision for loan losses than in the 2012 period, lower funding costs, and increases in other income. These positive variances were slightly offset by lower interest and dividend income, an increase in operating costs, and increased tax expenses.

Net Interest Income. The following table summarizes interest and dividend income and interest expense for the nine months ended September 30, 2013 and 2012.

	Nine Months Ended			
	September 30,			
	2013	**2012**	**$ change**	**% change**
	(Dollars in thousands)			
Interest and dividend income:				
Interest and fees on loans	$4,761	$5,291	$ (530)	(10.02)%
Securities:				
Residential mortgage-backed securities	334	499	(165)	(33.07)
U.S. agency securities	-	38	(38)	(100.00)
State and municipal securities	197	151	46	30.46
Dividends on non-marketable equity securities	3	3	-	-
Interest-bearing deposits	4	3	1	33.33
Total interest and dividend income	5,299	5,985	(686)	(11.46)
Interest expense:				
Deposits	1,152	1,670	(518)	(31.02)
Total interest expense	1,152	1,670	(518)	(31.02)
Net interest income	$4,147	$4,315	$ (168)	(3.89)%

The following table presents for the periods indicated the total dollar amount of interest income from average interest-earning assets and the resultant yields, as well as the interest expense on average interest bearing liabilities, expressed both in dollars and rates. No tax equivalent adjustments were made. All average balances are monthly average balances. Non-accruing loans have been included in the table as loans carrying a zero yield. The amortization of loan fees is included in computing interest income; however, such fees are not material.

	Nine Months Ended September 30,							
	2013				**2012**			
	AVERAGE BALANCE	**INTEREST**	**AVERAGE** YIELD/ COST		**AVERAGE** BALANCE	**INTEREST**	**AVERAGE** YIELD/ COST	
	(Dollars in thousands)							
Interest-earning assets								
Loans receivable, net (1)	$116,950	$ 4,761	5.43	%	$125,977	$ 5,291	5.60	%
Securities, net (2)	33,186	531	2.13	%	33,437	688	2.74	%
Non-marketable equity securities	1,278	3	0.31	%	1,807	3	0.22	%
Interest-bearing deposits	9,346	4	0.06	%	6,049	3	0.07	%
Total interest-earning assets	160,760	5,299	4.39	%	167,270	5,985	4.77	%
Interest-bearing liabilities								
Money Market accounts	$20,835	$ 38	0.24	%	$20,363	$ 67	0.44	%
Passbook accounts	16,534	11	0.09	%	15,008	15	0.13	%
Certificates of Deposit accounts	98,099	1,098	1.49	%	108,833	1,580	1.94	%
Checking accounts	13,358	5	0.05	%	12,642	8	0.08	%
Total interest-bearing liabilities	148,826	1,152	1.03	%	156,846	1,670	1.42	%
NET INTEREST INCOME		$ 4,147				$ 4,315		
NET INTEREST RATE SPREAD (3)			3.36	%			3.35	%
NET INTEREST MARGIN (4)			3.44	%			3.44	%
RATIO OF AVERAGE INTEREST-EARNING ASSETS TO AVERAGE INTEREST-BEARING LIABILITIES			108.02	%			106.65	%

(1)Amount is net of deferred loan origination (costs) fees, undisbursed loan funds, unamortized discounts and allowance for loans and includes non-performing loans.

(2) Includes unamortized discounts and premiums.

(3) Net interest rate spread represents the difference between the yield on average interest-earning assets and the average cost of interest-bearing liabilities.

(4) Net interest margin represents net interest income divided by average interest-earning assets.

The following table summarizes the changes in net interest income due to rate and volume for the nine months ended September 30, 2013 and 2012. The column "Net" is segmented into the changes attributable to variations in volume and the changes attributable to changes in interest rates. The variations attributable to simultaneous volume and rate changes have been proportionately allocated to rate and volume.

	Nine Months Ended September 30,		
	2013 Compared to 2012		
	Increase (Decrease) Due to		
	VOLUME	**RATE**	**NET**
	(Dollars in Thousands)		
Interest and dividends earned on			
Loans receivable, net	$(367)	$(163)	$(530)
Securities, net	(4)	(153)	(157)
Non-marketable equity securities	(1)	1	-
Interest-bearing deposits	1	-	1
Total interest-earning assets	$(371)	$(315)	$(686)
Interest expense on			
Money Market accounts	$1	$(30)	$(29)
Passbook accounts	1	(5)	(4)
Certificates of Deposit accounts	(120)	(362)	(482)
Checking	-	(3)	(3)
Total interest-bearing liabilities	(118)	(400)	(518)
Change in net interest income	$(253)	$85	$(168)

Net interest income decreased $168,000, or 3.9%, to $4.1 million for the nine months ended September 30, 2013 compared to $4.3 million for the nine months ended September 30, 2012. Interest and dividend income decreased $686,000 due to the decline in average interest earning assets of $6.5 million and the yield decreasing on interest earning assets from 4.8% to 4.4%. The decline in the loan portfolio contributed to a significant amount of the decline in earning assets. The yield on the investment portfolio and the loan portfolio declined as the low rate environment continued during the first nine months of 2013. This decline in interest income was offset by a $518,000, or 31.0%, reduction in interest expense. The cost of funds declined 39 basis points, or 27.5%, for the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012, due to the continued low rate environment. Additionally, the average balance of interest bearing liabilities decreased by $8.0 million, or 5.1%. The net interest margin for the nine months ended September 30, 2013 and 2012 remained constant at 3.4%.

Provision for Loan Losses. Management recorded a loan loss provision of $775,000 for the nine months ended September 30, 2013, compared to $1.3 million for the nine months ended September 30, 2012. The provision is primarily attributed to the reserves required for the one-to-four family segment as the economic conditions in the local market continue to negatively impact collateral values of real estate and the ability of borrowers to keep current per terms of their obligations. The slow payment activity and continued degradation of property values are the result of local economic conditions continuing to lag national indicators, including higher levels of unemployment locally of 11.3%, versus 9.2% for the State of Illinois and the national level of 7.3%. During the nine months ended September 30, 2013, the level of charge-off has declined by about $1.5 million in comparison to the nine months ended September 30, 2012 due to a slight improvement in asset quality.

Management uses available information to establish the appropriate level of the allowance for loan losses. Future additions or reductions to the allowance may be necessary based on estimates that are susceptible to change as a result of changes in economic conditions and other factors. As a result, our allowance for loan losses may not be sufficient to cover actual loan losses, and future provisions for loan losses could materially adversely affect the Company's operating results. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses. Such agencies may require the Company to recognize adjustments to the allowance based on their judgments about information available to them at the time of their examination.

Other Income. The following table summarizes other income for the nine months ended September 30, 2013 and 2012.

	Nine months ended			
	September 30,			
	2013	**2012**	**$ change**	**% change**
	(Dollars in thousands)			

Other income:				
Gain on sale of securities	$-	$14	$ (14)	(100.00)%
Gain on sale of loans	65	77	(12)	(15.58)
Gain on sale of OREO	-	97	(97)	(100.00)
Origination of mortgage servicing rights, net of amortization	8	(3)	11	366.67
Customer service fees	224	212	12	5.66
Income on bank owned life insurance	10	23	(13)	(56.52)
Other	174	52	122	234.62
Total other income	$481	$472	$ 9	1.91 %

The increase in total other income was primarily a result of the receipt of a $108,000 recovery of fraud losses on consumer loans, related to frauds which occurred during 2011 and 2012. The increase was partially offset by decreases in gains on the sales of OREO, securities, and loans. During the first nine months of 2013 the Company sold 19 of its OREO properties for a net loss of $4,000 and during the first nine months of 2012 the Company sold ten of its OREO properties for a net gain of $97,000. The decrease in gain on sale of securities is a result of there being no securities sold during 2013, while six securities were sold for a net gain of $14,000 during 2012. The decrease in gain on sale of loans is a result of fewer loan originations and sales of loans during 2013 as compared to 2012.

Other Expenses. The following table summarizes other expenses for the nine months ended September 30, 2013 and 2012.

	Nine months ended September 30,			
	2013	**2012**	**$ change**	**% change**
	(Dollars in thousands)			
Other expenses:				
Salaries and employee benefits	$1,144	$1,103	$ 41	3.72 %
Directors fees	76	63	13	20.63
Occupancy	336	328	8	2.44
Deposit insurance premium	172	182	(10)	(5.49)
Legal and professional services	223	165	58	35.15
Data processing	219	242	(23)	(9.50)
Valuation adjustments and expenses on foreclosed real estate	247	107	140	130.84
Loss on sale of OREO	4	-	4	100.00
Loss on sale of repossessed assets	-	14	(14)	(100.00)
Loss on consumer loans	-	42	(42)	(100.00)
Other	429	378	51	13.49
Total other expenses	$2,850	$2,624	$ 226	8.61 %
Efficiency ratio (1)	61.58%	54.82%		

(1) Computed as other expenses divided by the sum of net interest income and other income.

The increase in other expenses was primarily due to increases in valuation adjustments and expenses on foreclosed real estate and increased insurance expenses, both due to the number of OREO properties, increases in salaries and employee benefits, and an increase in legal and professional services due to compliance related activities. The increases were offset by decreases in deposit insurance premiums, decreases in data processing, the absence of losses on the sale of repossessed assets, and the absence of losses on consumer loans during the nine months ended September 30, 2013 as compared to the nine months ended September 30, 2012. The efficiency ratio increased due to higher costs for the period and lower revenues.

Income Taxes. The Company recorded income tax expense of $367,000 for the nine months ended September 30, 2013 and income tax expense of $258,000 for the nine months ended September 30, 2012.

LIQUIDITY AND CAPITAL RESOURCES

Liquidity. Liquidity management for the Bank is measured and monitored on both a short and long-term basis, allowing management to better understand and react to emerging balance sheet trends. After assessing actual and projected cash flow needs, management seeks to obtain funding at the most economical cost to the Bank. Our primary sources of funds are deposits, amortization, prepayments and maturities of outstanding loans and mortgage-backed and related securities, and other short-term investments, and funds provided from operations. While scheduled payments from amortization of loans and mortgage-backed related securities and maturing investment securities and short-term investments are relatively predictable sources of funds, deposit flows and loan prepayments are greatly influenced by general interest rates, economic conditions and competition. We invest excess funds in short-term interest-earning assets, including federal funds sold, which enable us to meet lending requirements or long-term investments when loan demand is low.

At September 30, 2013 the Bank had outstanding commitments to originate $0.3 million in loans, unfunded lines of credit of $8.5 million, a commitment to purchase $5.5 million in auto loans, and $1.2 million in commitments on construction loans. In addition, as of September 30, 2013, the total amount of certificates of deposit that were scheduled to mature in the next 12 months was $45.5 million, as compared to $54.7 million as of June 30, 2013 and $62.0 million as of December 31, 2012. Based on prior experience, management believes that a majority of such deposits will remain with us, although there can be no assurance that this will be the case. In the event a significant portion of our deposits are not retained by us, we will have to utilize other funding sources, such as Federal Home Loan Bank of Chicago (“FHLBC”) advances, in order to maintain our level of assets. Alternatively, we could reduce our level of liquid assets, such as our cash and cash equivalents. As of September 30, 2013, the Bank had $51.6 million of available credit from the FHLBC. There were no FHLBC advances outstanding at September 30, 2013. In addition, as of September 30, 2013, the Bank had $5.0 million of available credit from Bankers Bank of Wisconsin to purchase Federal Funds.

The Company is a separate legal entity from the Bank and must provide for its own liquidity. In addition to its operating expenses, the Company is responsible for paying any dividends declared to its shareholders and for any repurchased shares of its common stock. Whether dividends are declared, and the timing and amount of any dividends declared, is subject to the discretion of our Board of Directors and depends on various factors, including our net earnings, financial condition, cash requirements, future prospects and other factors that our Board of Directors deems relevant to its analysis and decision making. The Company's primary source of income is dividends received from the Bank. The amount of dividends that the Bank may declare and pay to the Company in any calendar year, without the receipt of prior approval from the regulatory agencies but with prior notice to the regulatory agencies, cannot exceed net income for that year to date plus retained net income (as defined) for the preceding two calendar years. At September 30, 2013, the Company had cash and cash equivalents of $238,000.

Capital. The Bank is required to maintain regulatory capital sufficient to meet Tier 1 leverage, Tier 1 risk-based and total risk-based capital ratios of at least 4.0%, 4.0% and 8.0%, respectively. The Bank exceeded each of its minimum capital requirements and was considered "well capitalized" within the meaning of federal regulatory requirements with ratios at September 30, 2013 of 11.01%, 18.08% and 19.35%, respectively, compared to ratios at December 31, 2012 of 10.30%, 16.92% and 18.19%, respectively.

OFF-BALANCE SHEET ARRANGEMENTS

For the nine months ended September 30, 2013, we did not engage in any off-balance sheet transactions reasonably likely to have a material effect on our financial condition, results of operations or cash flows.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

This Item is not applicable as the Company is a smaller reporting company.

ITEM 4. CONTROLS AND PROCEDURES

Controls and Procedures

As of the end of the period covered by this report, the Company carried out an evaluation under the supervision and with the participation of the Company's principal executive officer and principal financial officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based on this evaluation, the Company's principal executive officer and principal financial officer concluded that the Company's disclosure controls and procedures were effective as of the end of the period covered by this report for the purpose of ensuring that the information required to be disclosed in the reports that the Company files or submits under the Securities Exchange Act of 1934, as amended, with the Securities and Exchange Commission (the "SEC") (1) is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and (2) is accumulated and communicated to the Company's management, including, its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. It should be noted that the design of any system of controls 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, regardless of how remote.

In addition, there have been no changes in the Company's internal control over financial reporting during the most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Part II – Other Information

ITEM 1 - LEGAL PROCEEDINGS

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

ITEM 1A – RISK FACTORS

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part 1, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2012, which could materially affect our business, financial condition or future results. As of September 30, 2013, the risk factors of the Company have not changed materially from those reported in the Company's Annual Report on Form 10-K. However, the risks described in our Annual Report on Form 10-K are not the only risks that we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

ITEM 2 - UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Not applicable.

ITEM 3 - DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4 - MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5 - OTHER INFORMATION

Not applicable.

ITEM 6 - EXHIBITS

Exhibit No.	Description
3.1	Certificate of Incorporation of Ottawa Savings Bancorp, Inc. (incorporated by reference to Exhibit 3.1 to Company's Registration Statement on Form SB-2, No. 333-123455, filed on May 3, 2005, as amended)
3.2	Bylaws of Ottawa Savings Bancorp, Inc. (incorporated by reference to Exhibit 3.2 to Company's Registration Statement on Form SB-2, No. 333-123455, filed on May 3, 2005, as amended)
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certifications of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.1	Certifications pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.0	The following materials from the Ottawa Savings Bancorp, Inc. Quarterly Report on form 10-Q for the quarter ended September 30, 2013 formatted in Extensible Business Reporting Language (XBRL): (i) the Condensed Consolidated Statements of Financial Condition, (ii) the Condensed Consolidated Statements of Operations, (iii) the Condensed Consolidated Statements of Cash Flows and (iv) related notes.

Signature

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.

	OTTAWA SAVINGS BANCORP, INC. Registrant
Date: November 13, 2013	/s/ Jon L. Kranov Jon L. Kranov President and Chief Executive Officer (Principal Executive Officer)
Date: November 13, 2013	/s/ Marc N. Kingry Marc N. Kingry Chief Financial Officer (Principal Financial Officer)

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