

Ottawa Savings Bancorp, Inc.  
Form 10-Q  
August 13, 2010  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**

**FORM 10-Q**

(mark one)

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

For the quarterly period ended June 30, 2010

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 000-51367

**OTTAWA SAVINGS BANCORP, INC.**

(Exact name of registrant as specified in its charter)

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

**20-3074627**  
(I.R.S. Employer

Identification Number)

**925 LaSalle Street**

**Ottawa, Illinois 61350**

(Address of principal executive offices)

**(815) 433-2525**

(Registrant's telephone number, including area code)

**Not Applicable**

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant 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 (Section 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  No

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 the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer  (Do not check if a smaller reporting company)

Smaller Reporting Company

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

**Class**  
Common Stock, \$0.01 par value

**Outstanding as of August 12, 2010**  
2,121,045

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**OTTAWA SAVINGS BANCORP, INC.**

**FORM 10-Q**

**For the quarterly period ended June 30, 2010**

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**Table of Contents****Part I Financial Information**

## ITEM 1 FINANCIAL STATEMENTS

**OTTAWA SAVINGS BANCORP, INC.****Consolidated Balance Sheets****June 30, 2010 and December 31, 2009**

(Unaudited)

|   | <b>June 30,<br/>2010</b> | <b>December 31,<br/>2009</b> |
|---|--------------------------|------------------------------|
| <b>Assets</b>   |                          |                              |
| Cash and due from banks   | \$ 2,042,551             | \$ 1,858,421                 |
| Interest bearing deposits   | 3,346,427                | 1,114,371                    |
| <b>Total cash and cash equivalents</b>  | <b>5,388,978</b>         | <b>2,972,792</b>             |
| Federal funds sold  | 1,574,000                | 3,917,000                    |
| Securities held to maturity (fair value of \$21 and \$723,413 at June 30, 2010 and December 31, 2009, respectively)         | 19                       | 721,101                      |
| Securities available for sale   | 35,271,563               | 27,118,824                   |
| Non-marketable equity securities  | 2,534,952                | 2,534,952                    |
| Loans, net of allowance for loan losses of \$3,977,380 and \$3,514,704 at June 30, 2010 and December 31, 2009, respectively | 141,736,953              | 148,700,290                  |
| Premises and equipment, net   | 7,163,118                | 7,282,235                    |
| Accrued interest receivable   | 909,959                  | 889,562                      |
| Foreclosed real estate  | 1,201,502                | 832,809                      |
| Deferred tax asset  | 2,118,879                | 1,901,837                    |
| Cash value of life insurance  | 1,503,597                | 1,489,657                    |
| Prepaid FDIC premiums   | 843,983                  | 1,013,083                    |
| Other assets  | 1,192,466                | 1,322,757                    |
| <b>Total assets</b>   | <b>\$ 201,439,969</b>    | <b>\$ 200,696,899</b>        |
| <b>Liabilities and Stockholders Equity</b>  |                          |                              |
| <b>Liabilities</b>  |                          |                              |
| Deposits:   |                          |                              |
| Non-interest bearing  | \$ 3,199,879             | \$ 3,141,577                 |
| Interest bearing  | 173,354,180              | 172,867,675                  |
| <b>Total deposits</b>   | <b>176,554,059</b>       | <b>176,009,252</b>           |
| Accrued interest payable  | 88,063                   | 144,246                      |
| Other liabilities   | 2,268,482                | 2,268,085                    |
| <b>Total liabilities</b>  | <b>178,910,604</b>       | <b>178,421,583</b>           |
| <b>Commitments and contingencies</b>  |                          |                              |
| Redeemable common stock held by ESOP plan   | 205,616                  | 227,906                      |
| <b>Stockholders Equity</b>  |                          |                              |
| Common stock, \$.01 par value, 12,000,000 shares authorized; 2,224,911 shares issued  | 22,249                   | 22,249                       |

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|  |                |                |
|--|----------------|----------------|
| Additional paid-in-capital                       | 8,744,046      | 8,726,277      |
| Retained earnings                                | 14,998,061     | 15,045,706     |
| Unallocated ESOP shares                          | (483,322)      | (508,760)      |
| Unearned management recognition plan shares      | (232,771)      | (267,336)      |
| Accumulated other comprehensive income           | 678,089        | 454,167        |
|  | 23,726,352     | 23,472,303     |
| Less:  |                |                |
| Treasury shares, at cost, 103,866 shares         | (1,196,987)    | (1,196,987)    |
| Maximum cash obligation related to ESOP shares   | (205,616)      | (227,906)      |
| <b>Total stockholders equity</b>                 | 22,323,749     | 22,047,410     |
| <b>Total liabilities and stockholders equity</b> | \$ 201,439,969 | \$ 200,696,899 |

See accompanying notes to these unaudited consolidated financial statements.

**Table of Contents****OTTAWA SAVINGS BANCORP, INC.****Consolidated Statements of Operations****Three and Six Months Ended June 30, 2010 and 2009**

(Unaudited)

|   | Three Months Ended |                  | Six Months Ended |                  |
|---|--------------------|------------------|------------------|------------------|
|   | June 30,           |                  | June 30,         |                  |
|   | 2010               | 2009             | 2010             | 2009             |
| <b>Interest and dividend income:</b>                          |                    |                  |                  |                  |
| Interest and fees on loans                                    | \$ 2,190,749       | \$ 2,384,731     | \$ 4,376,162     | \$ 4,783,025     |
| <b>Securities:</b>  |                    |                  |                  |                  |
| Mortgage-backed and related securities                        | 230,030            | 254,157          | 479,705          | 534,650          |
| U.S. agency securities  | 79,343             | 76,754           | 139,150          | 163,592          |
| Interest-bearing deposits                                     | 2,035              | 797              | 4,550            | 1,217            |
| <b>Total interest and dividend income</b>                     | <b>2,502,157</b>   | <b>2,716,439</b> | <b>4,999,567</b> | <b>5,482,484</b> |
| <b>Interest expense:</b>                                      |                    |                  |                  |                  |
| Deposits  | 872,880            | 1,257,484        | 1,813,069        | 2,563,165        |
| Other borrowings  |                    | 10               |                  | 5,943            |
| <b>Total interest expense</b>                                 | <b>872,880</b>     | <b>1,257,494</b> | <b>1,813,069</b> | <b>2,569,108</b> |
| <b>Net interest income</b>                                    | <b>1,629,277</b>   | <b>1,458,945</b> | <b>3,186,498</b> | <b>2,913,376</b> |
| Provision for loan losses                                     | 833,074            | 676,605          | 1,080,574        | 938,598          |
| <b>Net interest income after provision for loan losses</b>    | <b>796,203</b>     | <b>782,340</b>   | <b>2,105,924</b> | <b>1,974,778</b> |
| <b>Other income:</b>  |                    |                  |                  |                  |
| (Loss) gain on sale of securities                             | (1,984)            | 22,480           | (422)            | 22,480           |
| Gain on sale of loans   | 12,370             | 80,564           | 21,102           | 136,669          |
| Origination of mortgage servicing rights, net of amortization | 2,324              | 33,932           | 3,687            | 52,157           |
| Customer service fees   | 65,142             | 72,270           | 131,805          | 135,211          |
| Income on bank owned life insurance                           | 8,071              | 5,428            | 13,940           | 10,464           |
| Other   | 14,027             | 8,002            | 26,462           | 18,951           |
| <b>Total other income</b>                                     | <b>99,950</b>      | <b>222,676</b>   | <b>196,574</b>   | <b>375,932</b>   |
| <b>Other expenses:</b>  |                    |                  |                  |                  |
| Salaries and employee benefits                                | 705,540            | 472,983          | 1,137,261        | 941,016          |
| Directors fees  | 21,009             | 21,033           | 42,018           | 42,065           |
| Occupancy   | 125,481            | 120,248          | 251,099          | 247,696          |
| Deposit insurance premium                                     | 111,410            | 174,341          | 183,594          | 300,043          |
| Legal and professional services                               | 81,953             | 47,876           | 143,461          | 95,608           |
| Data processing   | 74,100             | 67,265           | 142,666          | 135,683          |
| Foreclosed real estate  | 44,147             | 84,284           | 67,669           | 152,373          |
| (Gain) loss on sale of foreclosed real estate                 | (33,751)           |                  | 20,311           |                  |
| Loss on sale of repossessed assets                            | 2,007              | 8,477            | 2,200            | 13,930           |
| Other   | 149,749            | 162,658          | 264,083          | 293,812          |

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|  |              |              |           |           |
|--|--------------|--------------|-----------|-----------|
| <b>Total other expenses</b>              | 1,281,645    | 1,159,165    | 2,254,362 | 2,222,226 |
| <b>Income (loss) before income taxes</b> | (385,492)    | (154,149)    | 48,136    | 128,484   |
| Income tax expense (benefit)             | (146,701)    | (51,701)     | 11,489    | 51,248    |
| <b>Net (loss) income</b>                 | \$ (238,791) | \$ (102,448) | \$ 36,647 | \$ 77,236 |
| <b>Basic (loss) earnings per share</b>   | \$ (0.12)    | \$ (0.05)    | \$ 0.02   | \$ 0.04   |
| <b>Diluted (loss) earnings per share</b> | \$ (0.12)    | \$ (0.05)    | \$ 0.02   | \$ 0.04   |
| <b>Dividends per share</b>               | \$ 0.05      | \$ 0.05      | \$ 0.10   | \$ 0.10   |

See accompanying notes to these unaudited consolidated financial statements.

**Table of Contents****OTTAWA SAVINGS BANCORP, INC.****Consolidated Statements of Comprehensive Income (Loss)****Three and Six Months Ended June 30, 2010 and 2009**

(Unaudited)

|  | <b>Three Months Ended<br/>June 30,</b> |              | <b>Six Months Ended<br/>June 30,</b> |             |
|--|--|--------------|--------------------------------------|-------------|
|  | <b>2010</b>                            | <b>2009</b>  | <b>2010</b>                          | <b>2009</b> |
| Comprehensive income (loss):   |  |              |                                      |             |
| Net (loss) income  | \$ (238,791)                           | \$ (102,448) | \$ 36,647                            | \$ 77,236   |
| Other comprehensive income (loss), net of tax:   |  |              |                                      |             |
| Unrealized gain on securities available for sale arising during period, net of income taxes      | 217,357                                | (106,577)    | 223,644                              | 55,145      |
| Reclassification adjustment for (gains) losses included in net (loss) income, net of tax expense | 1,309                                  | (14,837)     | 278                                  | (14,837)    |
| Comprehensive (loss) income  | \$ (20,125)                            | \$ (223,862) | \$ 260,569                           | \$ 117,544  |

See accompanying notes to these unaudited consolidated financial statements.



**Table of Contents****OTTAWA SAVINGS BANCORP, INC.****Consolidated Statements of Cash Flows****Six Months Ended June 30, 2010 and 2009**

(Unaudited)

|   | <b>2010</b>      | <b>2009</b>      |
|---|------------------|------------------|
| <b>Cash Flows from Operating Activities</b>                                       |                  |                  |
| Net income  | \$ 36,647        | \$ 77,236        |
| Adjustments to reconcile net income to net cash provided by operating activities: |                  |                  |
| Depreciation  | 121,239          | 114,127          |
| Provision for loan losses   | 1,080,574        | 938,598          |
| Provision for deferred income taxes   | (332,396)        | (336,143)        |
| Net amortization of premiums and discounts on securities                          | 59,661           | 12,738           |
| Loss (gain) on sale of available for sale securities                              | 422              | (22,480)         |
| Origination of mortgage loans held for sale                                       | (1,661,806)      | (12,176,431)     |
| Proceeds from sale of mortgage loans held for sale                                | 1,682,908        | 12,313,100       |
| Gain on sale of loans, net  | (21,102)         | (136,669)        |
| Origination of mortgage servicing rights, net of amortization                     | (3,687)          | (52,157)         |
| Amortization of prepaid FDIC insurance premiums                                   | 169,100          |                  |
| Loss on sale of foreclosed real estate  | 20,311           |                  |
| Loss on sale of repossessed assets  | 2,200            | 13,930           |
| ESOP compensation expense   | 21,562           | 24,124           |
| MRP compensation expense  | 34,565           | 59,292           |
| Compensation expense on RRP options granted                                       | 21,645           | 24,144           |
| Increase in cash surrender value of life insurance                                | (13,940)         | (10,464)         |
| Change in assets and liabilities:   |                  |                  |
| (Increase) decrease in accrued interest receivable                                | (20,397)         | 50,506           |
| Decrease (increase) in other assets   | 122,978          | (68,490)         |
| (Decrease) increase in accrued interest payable and other liabilities             | (55,786)         | 313,277          |
| <b>Net cash provided by operating activities</b>                                  | <b>1,264,698</b> | <b>1,138,238</b> |
| <b>Cash Flows from Investing Activities</b>                                       |                  |                  |
| Securities available for sale:  |                  |                  |
| Purchases   | (15,132,247)     | (1,798,933)      |
| Sales, calls, maturities and paydowns   | 7,283,215        | 4,380,564        |
| Securities held to maturity:  |                  |                  |
| Sales and paydowns  | 696,568          | 60,039           |
| Net decrease in loans   | 5,394,669        | 4,263,076        |
| Net decrease in federal funds sold  | 2,343,000        |                  |
| Proceeds from sale of foreclosed real estate                                      | 84,162           |                  |
| Proceeds from sale of repossessed assets  | 23,728           | 55,990           |
| Purchase of premises and equipment  | (2,122)          | (23,214)         |
| <b>Net cash provided by investing activities</b>                                  | <b>690,973</b>   | <b>6,937,522</b> |
| <b>Cash Flows from Financing Activities</b>                                       |                  |                  |
| Net increase in deposits  | 544,807          | 3,740,522        |
| Principal reduction of Federal Home Loan Bank advances                            |                  | (6,300,000)      |
| Proceeds from Federal funds purchased   |                  | 461,000          |
| Cash dividends paid   | (84,292)         | (83,681)         |

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|  |              |              |
|--|--------------|--------------|
| <b>Net cash provided by (used in) financing activities</b> | 460,515      | (2,182,159)  |
| <b>Net increase in cash and cash equivalents</b>           | 2,416,186    | 5,893,601    |
| Cash and cash equivalents:                                 |              |              |
| Beginning  | 2,972,792    | 3,096,742    |
| Ending   | \$ 5,388,978 | \$ 8,990,343 |

(Continued)

See accompanying notes to these unaudited consolidated financial statements.

**Table of Contents****OTTAWA SAVINGS BANCORP, INC.****Consolidated Statements of Cash Flows****Six Months Ended June 30, 2010 and 2009**

(Unaudited)

(Continued)

|   | 2010         | 2009         |
|---|--------------|--------------|
| Supplemental Disclosures of Cash Flow Information                   |              |              |
| Cash payments for:  |              |              |
| Interest paid to depositors   | \$ 1,869,252 | \$ 2,568,582 |
| Interest paid on other borrowings                                   |              | 6,943        |
| Income taxes  | 543,909      | 463,152      |
| Supplemental Schedule of Noncash Investing and Financing Activities |              |              |
| Real estate acquired through or in lieu of foreclosure              | 1,056,038    | 592,259      |
| Other assets acquired in settlement of loans                        | 14,928       | 74,500       |
| Sale of foreclosed real estate through loan origination             | 582,872      |              |
| (Decrease) increase in liability arising from ESOP put option       | (22,290)     | 33,683       |

See accompanying notes to these unaudited consolidated financial statements.

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**OTTAWA SAVINGS BANCORP, INC.**

**Notes to Unaudited Consolidated Financial Statements**

**NOTE 1 NATURE OF BUSINESS**

Ottawa Savings Bancorp, Inc. (the Company) is the federally chartered savings and loan holding company of Ottawa Savings Bank (the Bank) and was formed upon completion of the Bank's reorganization from a mutual to stock form of organization on July 11, 2005.

**NOTE 2 BASIS OF PRESENTATION**

The consolidated financial statements presented in this quarterly report include the accounts of the Company and the Bank. The consolidated financial statements of the Company have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and predominant practices followed by the financial services industry, and are unaudited. In the opinion of the Company's management, all adjustments, consisting of normal recurring adjustments, which the Company considers necessary to fairly state the Company's financial position and the results of operations and cash flows have been recorded. The interim financial statements should be read in conjunction with the audited financial statements and accompanying notes of the Company for the year ended December 31, 2009. Certain amounts in the accompanying financial statements and footnotes for 2009 have been reclassified with no effect on net income or stockholders equity to be consistent with the 2010 classifications. The results of the Company's operations for any interim period are not necessarily indicative of the results of the Company's operations for any other interim period or for a full fiscal year.

**NOTE 3 USE OF ESTIMATES**

The preparation of the financial statements in conformity with GAAP requires management to make estimates and assumptions that affect amounts reported in the consolidated financial statements. Changes in these estimates and assumptions are considered reasonably possible and may have a material impact on the consolidated financial statements and, thus, actual results could differ from the amounts reported and disclosed herein.

At June 30, 2010, there were no material changes in the Company's significant accounting policies from those disclosed in the Form 10-K filed with the Securities and Exchange Commission on March 30, 2010.

**NOTE 4 CRITICAL ACCOUNTING POLICIES**

We consider accounting policies involving significant judgments and assumptions by management that have, or could have, a material impact on the carrying value of certain assets or on income to be critical accounting policies. We consider the allowance for loan losses to be our critical accounting policy.

*Allowance for Loan Losses.* The allowance for loan losses is an amount necessary to absorb known or inherent losses that are both probable and reasonably estimable and is established through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect each borrower's ability to repay, the estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

A loan is considered impaired when, based on current information and events, it is probable that we will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record and the

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amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price or the fair value of the collateral if the loan is collateral dependent.

**Table of Contents****OTTAWA SAVINGS BANCORP, INC.****Notes to Unaudited Consolidated Financial Statements**

(continued)

**NOTE 5 EARNINGS PER SHARE**

Basic earnings per share is based on net income divided by the weighted average number of shares outstanding during the period, including allocated and committed-to-be-released Employee Stock Ownership Plan ( ESOP ) shares and vested Management Recognition Plan ( MRP ) shares. Diluted earnings per share show the dilutive effect, if any, of additional common shares issuable under stock options and awards.

|  | Three Months ended<br>June 30, |              | Six Months ended<br>June 30, |           |
|--|--------------------------------|--------------|------------------------------|-----------|
|  | 2010                           | 2009         | 2010                         | 2009      |
| Net (loss) income available to common stockholders       | \$ (238,791)                   | \$ (102,448) | \$ 36,647                    | \$ 77,236 |
| Basic potential common shares:                           |                                |              |                              |           |
| Weighted average shares outstanding                      | 2,121,045                      | 2,123,017    | 2,121,045                    | 2,123,017 |
| Weighted average unallocated ESOP shares                 | (49,166)                       | (54,259)     | (49,798)                     | (54,886)  |
| Weighted average unvested MRP shares                     | (20,939)                       | (28,786)     | (20,939)                     | (28,786)  |
| Basic weighted average shares outstanding                | 2,050,940                      | 2,039,972    | 2,050,308                    | 2,039,345 |
| Dilutive potential common shares:                        |                                |              |                              |           |
| Weighted average unrecognized compensation on MRP shares | 13,543                         | 20,218       | 13,776                       | 15,462    |
| Weighted average RRP options outstanding **              |                                |              |                              |           |
| Dilutive weighted average shares outstanding             | 2,064,483                      | 2,060,190    | 2,064,084                    | 2,054,807 |
| Basic (loss) earnings per share                          | \$ (0.12)                      | \$ (0.05)    | \$ 0.02                      | \$ 0.04   |
| Diluted (loss) earnings per share                        | \$ (0.12)                      | \$ (0.05)    | \$ 0.02                      | \$ 0.04   |

\*\* The effect of share options was not included in the calculation of diluted earnings per share because to do so would have been anti-dilutive.

**NOTE 6 EMPLOYEE STOCK OWNERSHIP PLAN**

On July 11, 2005, the Company adopted an ESOP for the benefit of substantially all employees. Upon adoption of the ESOP, the ESOP borrowed \$763,140 from the Company and used those funds to acquire 76,314 shares of the Company's stock in the initial public offering at a price of \$10.00 per share.

Shares purchased by the ESOP with the loan proceeds are held in a suspense account and are allocated to ESOP participants on a pro rata basis as principal and interest payments are made by the ESOP to the Company. The loan is secured by shares purchased with the loan proceeds and will be repaid by the ESOP with funds from the Company's discretionary contributions to the ESOP and earnings on the ESOP assets. Annual principal and interest payments of approximately \$77,000 are to be made by the ESOP.

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As shares are released from collateral, the Company will report compensation expense equal to the current market price of the shares, and the shares will become outstanding for earnings-per-share ( EPS ) computations. Dividends on allocated ESOP shares reduce retained earnings, and dividends on unallocated ESOP shares reduce accrued interest.

A terminated participant or the beneficiary of a deceased participant who received a distribution of employer stock from the ESOP has the right to require the Company to purchase such shares at their fair market value any time within 60 days of the distribution date. If this right is not exercised, an additional 60 day exercise period is available in the year following the year in which the distribution is made and begins after a new valuation of the stock has been determined and communicated to the participant or beneficiary. At June 30, 2010, 25,702 shares at a fair value of \$8.00 have been classified as mezzanine capital.

**Table of Contents****OTTAWA SAVINGS BANCORP, INC.****Notes to Unaudited Consolidated Financial Statements**

(continued)

The following table reflects the status of the shares held by the ESOP:

|                                      | June 30,<br>2010 | December 31,<br>2009 |
|--------------------------------------|------------------|----------------------|
| Shares allocated                     | 27,982           | 25,438               |
| Shares withdrawn from the plan       | (2,280)          | (1,321)              |
| Unallocated shares                   | 48,332           | 50,876               |
| <br>Total ESOP shares                | <br>74,034       | <br>74,993           |
| <br>Fair value of unallocated shares | <br>\$ 386,656   | <br>\$ 480,778       |

**NOTE 7 INVESTMENT SECURITIES**

The amortized cost and fair values of securities, with gross unrealized gains and losses, follows:

|                               | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
|-------------------------------|-------------------|------------------------------|-------------------------------|---------------|
| <b>June 30, 2010:</b>         |                   |                              |                               |               |
| <b>Held to Maturity</b>       |                   |                              |                               |               |
| Mortgage-backed securities    | \$ 19             | \$ 2                         | \$                            | \$ 21         |
| <br><b>Available for Sale</b> |                   |                              |                               |               |
| U.S. agency securities        | \$ 12,914,998     | \$ 55,610                    | \$                            | \$ 12,970,608 |
| Mortgage-backed securities    | 21,329,157        | 974,214                      | 2,416                         | 22,300,955    |
|                               | \$ 34,244,155     | \$ 1,029,824                 | \$ 2,416                      | \$ 35,271,563 |
| <br><b>December 31, 2009:</b> |                   |                              |                               |               |
| <b>Held to Maturity</b>       |                   |                              |                               |               |
| Mortgage-backed securities    | \$ 721,101        | \$ 7,132                     | \$ 4,820                      | \$ 723,413    |
| <br><b>Available for Sale</b> |                   |                              |                               |               |
| U.S. agency securities        | \$ 4,506,404      | \$ 65,854                    | \$                            | \$ 4,572,258  |
| Mortgage-backed securities    | 21,924,288        | 672,800                      | 50,522                        | 22,546,566    |
|                               | \$ 26,430,692     | \$ 738,654                   | \$ 50,522                     | \$ 27,118,824 |



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The amortized cost and fair value at June 30, 2010, by contractual maturity, are shown below. Maturities may differ from contractual maturities in mortgage-backed securities because the mortgages underlying the securities may be called or repaid without penalties. Therefore, stated maturities of mortgage-backed securities are not disclosed.

|  | Securities Held to Maturity |               | Securities Available for Sale |               |
|--|-----------------------------|---------------|-------------------------------|---------------|
|  | Amortized<br>Cost           | Fair<br>Value | Amortized<br>Cost             | Fair<br>Value |
| Due within one year                    | \$                          | \$            | \$                            | \$            |
| Due after one year through five years  |                             |               | 6,547,764                     | 6,562,358     |
| Due after five years through ten years |                             |               | 6,367,234                     | 6,408,250     |
| Due after ten years                    |                             |               |                               |               |
| Mortgage-backed securities             | 19                          | 21            | 21,329,157                    | 22,300,955    |
|  | \$ 19                       | \$ 21         | \$ 34,244,155                 | \$ 35,271,563 |

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(continued)

The following table reflects securities with gross unrealized losses for less than 12 months and for 12 months or more at June 30, 2010 and December 31, 2009:

|                                      | Less than 12 Months |                   | 12 Months or More |                   | Total        |                   |
|--------------------------------------|---------------------|-------------------|-------------------|-------------------|--------------|-------------------|
|                                      | Fair Value          | Unrealized Losses | Fair Value        | Unrealized Losses | Fair Value   | Unrealized Losses |
| <b>June 30, 2010:</b>                |                     |                   |                   |                   |              |                   |
| <b>Securities Available for Sale</b> |                     |                   |                   |                   |              |                   |
| Mortgage-backed securities           | \$ 829,738          | \$ 2,416          | \$                | \$                | \$ 829,738   | \$ 2,416          |
| <b>December 31, 2009:</b>            |                     |                   |                   |                   |              |                   |
| <b>Securities Held to Maturity</b>   |                     |                   |                   |                   |              |                   |
| Mortgage-backed securities           | \$                  | \$                | \$ 359,176        | \$ 4,820          | \$ 359,176   | \$ 4,820          |
| <b>Securities Available for Sale</b> |                     |                   |                   |                   |              |                   |
| Mortgage-backed securities           | \$ 3,554,876        | \$ 50,111         | \$ 18,210         | \$ 411            | \$ 3,573,086 | \$ 50,522         |

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 June 30, 2010, one security had unrealized losses with aggregate depreciation of .29% from the Company's amortized cost basis. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell this security and it is not more likely than not the Company will be required to sell this security before recovery of the amortized cost basis, which may be maturity, the Company does not consider this investment to be other than temporarily impaired at June 30, 2010.

Proceeds from the sales of securities were \$67,283 and \$861,295 for the three months ended June 30, 2010 and 2009, respectively. There were no gross realized gains for the three months ended June 30, 2010 and \$22,831 in gross realized gains for the three months ended June 30, 2009. Gross realized losses amounted to \$1,984 and \$351 for the three months ended June 30, 2010 and 2009, respectively. The tax provision applicable to these net realized losses and gains amounted to \$(675) and \$7,643, respectively.

Proceeds from the sales of securities were \$1.6 million and \$861,295 for the six months ended June 30, 2010 and 2009, respectively. There were \$24,367 and \$22,831 in gross realized gains for the six months ended June 30, 2010 and 2009, respectively. Gross realized losses amounted to \$24,789 and \$351 for the six months ended June 30, 2010 and 2009, respectively. The tax provision applicable to these net realized losses and gains amounted to \$(143) and \$7,643, respectively.

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**NOTE 8 ASSET QUALITY**

The following is a summary of information pertaining to impaired and non-accrual loans:

|  | <b>June 30,<br/>2010</b> | <b>December 31,<br/>2009</b> |
|--|--------------------------|------------------------------|
| Impaired loans without a valuation allowance                         | \$                       | \$ 602,629                   |
| Impaired loans with a valuation allowance                            | 10,101,851               | 5,540,654                    |
| <b>Total impaired loans</b>  | <b>\$ 10,101,851</b>     | <b>\$ 6,143,283</b>          |
| Valuation allowance related to impaired loans                        | \$ 2,574,029             | \$ 2,005,863                 |
| <b>Total non-accrual loans</b>                                       | <b>\$ 6,368,331</b>      | <b>\$ 5,901,237</b>          |
| Total loans past due ninety days or more and still accruing interest | \$ 737,774               | \$ 248,279                   |

Total impaired loans increased approximately \$4.0 million primarily due to the addition to impaired status of three loans secured by non-residential real estate totaling approximately \$3.3 million. The remaining increase is attributable to an increase in the total number of impaired loans, off-set by loans removed from impaired status by becoming current or by being transferred to OREO. Total non-accrual loans increased approximately \$467,000 due primarily to increased delinquencies of loans secured by non-residential real estate offset by a slight decrease in delinquencies of loans secured by one-to-four family real estate.

The loan portfolio is reviewed on a regular basis to determine whether any loans require classification in accordance with applicable regulations. Not all non-performing assets are classified assets.

On the basis of management's review of its assets at June 30, 2010 and December 31, 2009, we classified \$4.9 million and \$10.6 million, respectively, of our assets as special mention, \$11.1 million and \$6.8 million, respectively, of our assets as substandard, and \$175,000 and \$175,000, respectively, of our assets as doubtful.

Following is a summary of activity in the allowance for loan losses for the six months ended June 30, 2010 and 2009.

|  | <b>2010</b>         | <b>2009</b>         |
|--|---------------------|---------------------|
| Balance at beginning of year               | \$ 3,514,704        | \$ 1,604,731        |
| Provision charged to income                | 1,080,574           | 938,598             |
| Loans charged off                          | (629,367)           | (925,054)           |
| Recoveries of loans previously charged off | 11,469              | 9,512               |
| <b>Balance at end of period</b>            | <b>\$ 3,977,380</b> | <b>\$ 1,627,787</b> |

NOTE 9 STOCK COMPENSATION

Total stock-based compensation expense for the six months ended June 30, 2010 and 2009, was approximately \$56,000 and \$83,000, 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. The decrease in stock-based compensation expense was due to the forfeiture of options and shares as a result of the release agreement between the Company and its former CEO effective May 31, 2010. For the six months ended June 30, 2010 and 2009, the Company did not grant additional options or shares under the MRP.

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**OTTAWA SAVINGS BANCORP, INC.**

**Notes to Unaudited Consolidated Financial Statements**

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**NOTE 10 RECENT ACCOUNTING DEVELOPMENTS**

In January 2010, the FASB issued ASU 2010-06, *Fair Value Measurements and Disclosures (Topic 820) Improving Disclosures about Fair Value Measurements*. ASU 2010-06 requires new disclosures on transfers into and out of Level 1 and 2 measurements of the fair value hierarchy and requires separate disclosures about purchases, sales, issuances, and settlements relating to Level 3 measurements. It also clarifies existing fair value disclosures relating to the level of disaggregation and inputs and valuation techniques used to measure fair value. It is effective for the first reporting period (including interim periods) beginning after December 15, 2009, except for the requirement to provide the Level 3 activity of purchase, sales, issuances, and settlements on a gross basis, which will be effective for fiscal years beginning after December 15, 2010. The adoption of this accounting guidance did not have a material impact on the Company's consolidated financial statements.

In July 2010, the FASB issued ASU 2010-20, *Receivables (Topic 310) Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*. ASU 2010-20 will require an entity to provide enhanced and disaggregated disclosures about the credit quality of an entity's financing receivables and its allowance for credit losses. The objective of this guidance is to provide financial statement users with greater transparency about an entity's allowance for credit losses and the credit quality of its financing receivables by providing additional information to assist financial statement users in assessing an entity's credit risk exposures and evaluating the adequacy of its allowance for credit losses. For public entities, the disclosures as of the end of a reporting period are effective for interim and annual reporting periods ending on or after December 15, 2010. The disclosures about activity that occurs during a reporting period are effective for interim and annual reporting periods beginning on or after December 15, 2010. We do not expect the adoption of this accounting guidance to have a material impact on the Company's consolidated financial statements.

**NOTE 11 FAIR VALUE MEASUREMENT AND DISCLOSURE**

The Company has adopted FASB ASC Topic 820, *Fair Value Measurements and Disclosures*, which 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 Topic 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 obligations of U.S. government corporations and agencies, and 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.

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## OTTAWA SAVINGS BANCORP, INC.

## Notes to Unaudited Consolidated Financial Statements

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Foreclosed Assets

Foreclosed assets consisting of foreclosed real estate and repossessed assets, are adjusted to fair value upon transfer of the loans to foreclosed assets. 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 fair value 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. Impaired loans are reviewed and evaluated on at least a quarterly basis for additional impairment and adjusted accordingly, based on the same factors identified above.

The Company did not have any transfers of assets or liabilities between Levels 1 and 2 of the fair value hierarchy during the second quarter of 2010.

The tables below present the recorded amount of assets measured at fair value on a recurring basis at June 30, 2010 and December 31, 2009.

|   | Level 1 | Level 2       | Level 3 | Total Fair Value |
|---|---------|---------------|---------|------------------|
| <b>June 30, 2010</b>                          |         |               |         |                  |
| U.S. agency securities available for sale     | \$      | \$ 12,970,608 | \$      | \$ 12,970,608    |
| Mortgage-backed securities available for sale |         | 22,300,955    |         | 22,300,955       |
|   | \$      | \$ 35,271,563 | \$      | \$ 35,271,563    |
|   |         |               |         |                  |
|   | Level 1 | Level 2       | Level 3 | Total Fair Value |
| <b>December 31, 2009</b>                      |         |               |         |                  |
| U.S. agency securities available for sale     | \$      | \$ 4,572,258  | \$      | \$ 4,572,258     |
| Mortgage-backed securities available for sale |         | 22,546,566    |         | 22,546,566       |
|   | \$      | \$ 27,118,824 | \$      | \$ 27,118,824    |

The tables below present the recorded amount of assets measured at fair value on a non-recurring basis at June 30, 2010 and December 31, 2009.

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|                          | Level 1 | Level 2      | Level 3 | Total Fair Value |
|--------------------------|---------|--------------|---------|------------------|
| <b>June 30, 2010</b>     |         |              |         |                  |
| Foreclosed assets        | \$      | \$ 1,212,002 | \$      | \$ 1,212,002     |
| Impaired loans, net      |         | 7,527,822    |         | 7,527,822        |
| <b>December 31, 2009</b> |         |              |         |                  |
| Foreclosed assets        | \$      | \$ 854,309   | \$      | \$ 854,309       |
| Impaired loans, net      |         | 4,137,420    |         | 4,137,420        |



**Table of Contents****OTTAWA SAVINGS BANCORP, INC.****Notes to Unaudited Consolidated Financial Statements**

(continued)

The following information presents estimated fair value of the Company's financial instruments as of June 30, 2010 and December 31, 2009.

|                               | June 30, 2010   |              | December 31, 2009 |              |
|-------------------------------|-----------------|--------------|-------------------|--------------|
|                               | Carrying Amount | Fair Value   | Carrying Amount   | Fair Value   |
| <b>Financial Assets:</b>      |                 |              |                   |              |
| Cash and cash equivalents     | \$ 5,388,978    | \$ 5,388,978 | \$ 2,972,792      | \$ 2,972,792 |
| Federal funds sold            | 1,574,000       | 1,574,000    | 3,917,000         | 3,917,000    |
| Securities                    | 37,806,534      | 37,806,536   | 30,374,877        | 30,377,189   |
| Accrued interest receivable   | 909,959         | 909,959      | 889,562           | 889,562      |
| Loans                         | 141,736,953     | 148,944,000  | 148,700,290       | 154,333,000  |
| Mortgage servicing rights     | 168,336         | 168,336      | 164,649           | 164,649      |
| <b>Financial Liabilities:</b> |                 |              |                   |              |
| Deposits                      | 176,554,059     | 180,882,000  | 176,009,252       | 178,964,000  |
| Accrued interest payable      | 88,063          | 88,063       | 144,246           | 144,246      |

The following methods and assumptions were used by the Bank in estimating its fair value disclosures for 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 and held to maturity securities from an independent pricing service. See Note 11 - Fair Value Measurement and Disclosure for further detail on how fair values of marketable securities are determined. The carrying value of non-marketable equity securities approximates fair value.

*Loans:* For variable-rate loans that reprice 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.

*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.

*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.



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**OTTAWA SAVINGS BANCORP, INC.**

**Notes to Unaudited Consolidated Financial Statements**

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*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 June 30, 2010 and December 31, 2009, the fair value of the commitments is 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.

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**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 expressions. The Company's 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 June 30, 2010, 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.

**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 one-to-four family residential loans, consumer loans and other loans. 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.

**COMPARISON OF FINANCIAL CONDITION AT JUNE 30, 2010 AND DECEMBER 31, 2009**

The Company's total assets increased \$743,000, or .37%, to \$201.4 million at June 30, 2010, from \$200.7 million at December 31, 2009. The increase is the result of an increase in securities available for sale of \$8.2 million, an increase in cash and cash equivalents of \$2.4 million, an increase in foreclosed real estate of \$369,000, an increase in deferred tax assets of \$217,000, an increase in accrued interest receivable of \$20,000, and an increase in the value of bank owned life insurance of \$14,000. The increases were offset by a decrease in loans of \$7.0 million, a decrease in federal funds sold of \$2.3 million, a decrease in premises and equipment of \$119,000 due primarily to depreciation, a decrease in securities held to maturity of \$721,000 due primarily to the sale of 30 securities, a decrease in prepaid FDIC insurance premiums of \$169,000, and a decrease in other assets of \$130,000.

Cash and cash equivalents increased \$2.4 million, or 81.28%, to \$5.4 million at June 30, 2010 from \$3.0 million at December 31, 2009 as a result of cash provided by operating and investing activities exceeding the cash used.

Federal funds sold decreased \$2.3 million, or 59.82%, to \$1.6 million at June 30, 2010 from \$3.9 million at December 31, 2009 primarily as a result of the increase in cash and cash equivalents.

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Securities held to maturity decreased \$721,000, or 99.99%, to \$19 at June 30, 2010 from \$721,000 at December 31, 2009. The decrease was primarily the result of the sale of 30 held to maturity securities and principal pay-downs. The purpose of the sale was to eliminate the safekeeping fees and administrative costs associated with the remnants of the original issues.

Securities available for sale increased \$8.2 million, or 30.06%, to \$35.3 million at June 30, 2010 from \$27.1 million at December 31, 2009. The increase was primarily the result of \$15.1 million in purchases and a \$339,000 increase in market values of the available for sale securities, offset by sales, calls and maturities of \$4.1 million and principal pay-downs of \$3.2 million.

Loans, net of allowances for loan losses, decreased \$7.0 million, or 4.68%, to \$141.7 million at June 30, 2010 from \$148.7 million at December 31, 2009. The decrease in loans, net of allowances for loan losses, was primarily due to pay-offs and principal reductions of one-to-four family mortgages, construction loans, and personal loans, in addition to an increase in the allowance for loan losses, offset by a slight increase in commercial loans and line of credit advances.

Accrued interest receivable increased \$20,000, or 2.29%, to \$910,000 at June 30, 2010 from \$890,000 at December 31, 2009. The increase was due to an increase in accrued interest on loans of \$74,000 and an increase in accrued interest on securities of \$15,000, offset by an increase in the reserve for uncollected interest on non-accrual loans of \$69,000.

Other assets comprised primarily of prepaid expenses, deferred director compensation accounts, and auto loan repossessions decreased \$130,000, or 9.85%, to \$1.2 million at June 30, 2010 from \$1.3 million at December 31, 2009. The decrease is primarily due to a decrease in other charges due on loans of \$44,000, a decrease in prepaid dealer reserve on purchased auto loans of \$30,000, a decrease in auto loan repossessions, net of proceeds from sales, totaling \$11,000, a decrease in the deferred director compensation investment accounts of \$14,000 due to investment losses offset by contributions, and a decrease in prepaid expenses of \$41,000. The decreases were offset by an increase of \$1,000 in interest advanced on purchased securities, an increase of \$5,000 in funds due from the ESOP trustee, and an increase in mortgage servicing rights of \$4,000.

Prepaid FDIC premiums decreased \$169,000, or 16.69%, to \$844,000 at June 30, 2010 from \$1.0 million at December 31, 2009 as a result of recording the first and second quarters FDIC premium expenses.

Total deposits increased \$545,000, or .31%, to \$176.6 million at June 30, 2010, from \$176.0 million at December 31, 2009. The increase is due to an increase in certificates of deposit of \$843,000, primarily in terms of eighteen months or less as a safe haven from continued volatility in financial markets and historically low interest rates on longer term investment products. The increase also included increases in passbook savings accounts of \$681,000 and increases in non-interest bearing checking accounts of \$58,000. The increases were offset by decreases in money market accounts of \$1.0 million, due primarily to reduced interest rates and decreases in interest bearing checking accounts of \$37,000.

Accrued interest payable decreased \$56,000, or 38.95%, to \$88,000 at June 30, 2010, from \$144,000 at December 31, 2009. The decrease is primarily a result of declining interest rates on money market and certificates of deposit accounts.

Other liabilities remained constant at \$2.3 million at June 30, 2010 and December 31, 2009. Accounts payable increased approximately \$158,000 as a result of the release agreement entered into between the Company and its former CEO. Escrow payable increased \$59,000, in addition to an increase in the accrued SERP payable of \$49,000. The increases were offset by decreases in professional and accounting fees payable of \$18,000, a decrease in property taxes payable of \$13,000, a decrease in deferred director compensation payable of \$22,000 and a decrease in income taxes payable of \$199,000.

Equity increased \$276,000, or 1.25%, to \$22.3 million at June 30, 2010 from \$22.0 million at December 31, 2009. The increase in equity reflects net income for the six months ended June 30, 2010 of approximately \$37,000, an increase in other comprehensive income, net of taxes of \$224,000, due to increases in the market value of the available for sale securities portfolio, offset by dividends of \$84,000 paid to stockholders. The remaining changes to equity include increases of \$77,000 from the allocation and amortization of ESOP shares, MRP shares, and RRP options, and an increase to stockholders' equity of \$22,000 to decrease the cash obligation related to redeemable common stock held by the ESOP.

## **COMPARISON OF RESULTS OF OPERATION FOR THE THREE MONTHS ENDED JUNE 30, 2010 AND 2009**

*Net Income.* The Company had a net loss of \$239,000 for the three months ended June 30, 2010, compared to a net loss of \$102,000 for the three months ended June 30, 2009.



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*Net Interest Income.* The following table summarizes interest and dividend income and interest expense for the three months ended June 30, 2010 and 2009.

|   | 2010            | Three Months Ended<br>June 30, |                                     | % change       |
|---|-----------------|--------------------------------|-------------------------------------|----------------|
|   |                 | 2009                           | \$ change<br>(Dollars in thousands) |                |
| <b>Interest and dividend income:</b>      |                 |                                |                                     |                |
| Interest and fees on loans                | \$ 2,191        | \$ 2,385                       | \$ (194)                            | (8.13)%        |
| <b>Securities:</b>                        |                 |                                |                                     |                |
| Mortgage-backed and related securities    | 230             | 254                            | (24)                                | (9.45)         |
| U.S. agency securities                    | 79              | 77                             | 2                                   | 2.60           |
| Interest-bearing deposits                 | 2               | 1                              | 1                                   | 100.00         |
| <b>Total interest and dividend income</b> | <b>2,502</b>    | <b>2,717</b>                   | <b>(215)</b>                        | <b>(7.91)</b>  |
| <b>Interest expense:</b>                  |                 |                                |                                     |                |
| Deposits                                  | 873             | 1,258                          | (385)                               | (30.60)        |
| <b>Total interest expense</b>             | <b>873</b>      | <b>1,258</b>                   | <b>(385)</b>                        | <b>(30.60)</b> |
| <b>Net interest income</b>                | <b>\$ 1,629</b> | <b>\$ 1,459</b>                | <b>\$ 170</b>                       | <b>11.65%</b>  |

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.

|   | 2010               |                 | Three Months Ended June 30,                         |                    |                 |                           |
|---|--------------------|-----------------|---|--------------------|-----------------|---------------------------|
|   |                    |                 | 2009  |                    |                 |                           |
|   | AVERAGE<br>BALANCE | INTEREST        | AVERAGE<br>YIELD/<br>COST<br>(Dollars in thousands) | AVERAGE<br>BALANCE | INTEREST        | AVERAGE<br>YIELD/<br>COST |
| <b>Interest-earning assets</b>            |                    |                 |   |                    |                 |                           |
| Loans receivable, net (1)                 | \$ 143,445         | \$ 2,191        | 6.11%   | \$ 152,238         | \$ 2,385        | 6.27%                     |
| Securities, net (2)                       | 34,986             | 309             | 3.54%   | 28,201             | 331             | 4.69%                     |
| Interest-bearing deposits                 | 6,378              | 2               | 0.13%   | 7,517              | 1               | 0.05%                     |
| <b>Total interest-earning assets</b>      | <b>184,809</b>     | <b>2,502</b>    | <b>5.42%</b>  | <b>187,956</b>     | <b>2,717</b>    | <b>5.78%</b>              |
| <b>Interest-bearing liabilities</b>       |                    |                 |   |                    |                 |                           |
| Money Market accounts                     | \$ 23,694          | \$ 73           | 1.23%   | \$ 13,614          | \$ 69           | 2.03%                     |
| Passbook accounts                         | 12,172             | 10              | 0.32%   | 11,960             | 11              | 0.37%                     |
| Certificates of Deposit accounts          | 128,671            | 782             | 2.43%   | 141,931            | 1,169           | 3.29%                     |
| Checking accounts                         | 10,483             | 8               | 0.29%   | 9,434              | 9               | 0.38%                     |
| <b>Total interest-bearing liabilities</b> | <b>175,020</b>     | <b>873</b>      | <b>2.00%</b>  | <b>176,939</b>     | <b>1,258</b>    | <b>2.84%</b>              |
| <b>NET INTEREST INCOME</b>                |                    | <b>\$ 1,629</b> |   |                    | <b>\$ 1,459</b> |                           |
| <b>NET INTEREST RATE SPREAD (3)</b>       |                    |                 | <b>3.42%</b>  |                    |                 | <b>2.94%</b>              |

|   |         |         |
|---|---------|---------|
| <b>NET INTEREST MARGIN (4)</b>  | 3.53%   | 3.10%   |
| <b>RATIO OF AVERAGE INTEREST-EARNING ASSETS<br/>TO AVERAGE INTEREST-BEARING LIABILITIES</b> | 105.59% | 106.23% |

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



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The following table summarizes the changes in net interest income due to rate and volume for the three months ended June 30, 2010 and 2009. 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.

|   | <b>Three Months Ended June 30,</b> |                 |                 |
|---|------------------------------------|-----------------|-----------------|
|   | <b>2010 Compared to 2009</b>       |                 |                 |
|   | <b>VOLUME</b>                      | <b>RATE</b>     | <b>NET</b>      |
|   | <b>Increase (Decrease) Due to</b>  |                 |                 |
|   | <b>(Dollars in Thousands)</b>      |                 |                 |
| <b>Interest and dividends earned on</b>   |                                    |                 |                 |
| Loans receivable, net                     | \$ (134)                           | \$ (60)         | (194)           |
| Securities, net                           | 60                                 | (82)            | \$ (22)         |
| Interest-bearing deposits                 | (1)                                | 2               | 1               |
| <b>Total interest-earning assets</b>      | <b>\$ (75)</b>                     | <b>\$ (140)</b> | <b>\$ (215)</b> |
| <b>Interest expense on</b>                |                                    |                 |                 |
| Money Market accounts                     | \$ 31                              | \$ (27)         | \$ 4            |
| Passbook accounts                         | 1                                  | (2)             | (1)             |
| Certificates of Deposit accounts          | (81)                               | (306)           | (387)           |
| Checking                                  | 1                                  | (2)             | (1)             |
| <b>Total interest-bearing liabilities</b> | <b>(48)</b>                        | <b>(337)</b>    | <b>(385)</b>    |
| <b>Change in net interest income</b>      | <b>\$ (27)</b>                     | <b>\$ 197</b>   | <b>\$ 170</b>   |

Net interest income increased \$170,000, or 11.68%, for the three months ended June 30, 2010 compared to the three months ended June 30, 2009. Interest and dividend income decreased \$215,000, or 7.89%, to \$2.5 million for the three months ended June 30, 2010 from \$2.7 million for the three months ended June 30, 2009 due to a decrease in the average rate on interest-earning assets to 5.42% from 5.78%, due to a declining interest rate environment and a decrease of \$3.1 million in average interest-earning assets to \$184.8 million from \$188.0 million for the three months ended June 30, 2010 compared to the same period in 2009. Interest expense decreased \$385,000, or 30.59%, due to a decrease in the average cost of interest-bearing liabilities to 2.00% from 2.84%, due to a declining interest rate environment and a decrease of \$1.9 million in average interest-bearing liabilities for the three months ended June 30, 2010 compared to the same period in 2009.

*Provision for Loan Losses.* Management recorded a loan loss provision of \$833,000 for the three months ended June 30, 2010, compared to \$677,000 for the three months ended June 30, 2009. The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect each borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. Based on its review at June 30, 2010, management believes that the allowance is maintained at a level that represents its best estimate of inherent losses in the loan portfolio that were both probable and reasonably estimable.

*Other Income.* The following table summarizes other income for the three months ended June 30, 2010 and 2009.

|   | <b>2010</b> | <b>Three months ended</b> |                               |                 |
|---|-------------|---------------------------|-------------------------------|-----------------|
|   |             | <b>2009</b>               | <b>\$ change</b>              | <b>% change</b> |
|   |             |                           | <b>June 30,</b>               |                 |
|   |             |                           | <b>(Dollars in thousands)</b> |                 |
| <b>Other income:</b>  |             |                           |                               |                 |
| (Loss) gain on sale of securities                             | \$ (2)      | \$ 23                     | \$ (25)                       | (108.70)%       |
| Gain on sale of loans   | 13          | 81                        | (68)                          | (83.95)         |
| Origination of mortgage servicing rights, net of amortization | 2           | 34                        | (32)                          | (94.12)         |

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|                                     |        |        |          |          |
|-------------------------------------|--------|--------|----------|----------|
| Customer service fees               | 65     | 72     | (7)      | (9.72)   |
| Income on bank owned life insurance | 8      | 5      | 3        | 60.00    |
| Other                               | 14     | 8      | 6        | 75.00    |
| <b>Total other income</b>           | \$ 100 | \$ 223 | \$ (123) | (55.16)% |

The decrease in total other income was primarily due to decreased gains on sale of loans and origination of mortgage servicing rights, net of amortization, due to a decline in the origination of mortgage loans for sale, as a result of a continued decrease in demand for new mortgage loans and a decline in refinancing existing loans to be sold to Freddie Mac.

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*Other Expenses.* The following table summarizes other expenses for the three months ended June 30, 2010 and 2009.

|   | 2010            | Three months ended<br>June 30, |                                     | % change      |
|---|-----------------|--------------------------------|-------------------------------------|---------------|
|   |                 | 2009                           | \$ change<br>(Dollars in thousands) |               |
| <b>Other expenses:</b>                        |                 |                                |                                     |               |
| Salaries and employee benefits                | \$ 706          | \$ 473                         | \$ 233                              | 49.26%        |
| Directors fees                                | 21              | 21                             |                                     |               |
| Occupancy                                     | 125             | 120                            | 5                                   | 4.17          |
| Deposit insurance premium                     | 111             | 174                            | (63)                                | (36.21)       |
| Legal and professional services               | 82              | 48                             | 34                                  | 70.83         |
| Data processing                               | 74              | 67                             | 7                                   | 10.45         |
| Foreclosed real estate                        | 44              | 84                             | (40)                                | (47.62)       |
| (Gain) loss on sale of foreclosed real estate | (34)            |                                | (34)                                | 100.00        |
| Loss on sale of repossessed assets            | 2               | 9                              | (7)                                 | (77.78)       |
| Other   | 150             | 163                            | (13)                                | (7.98)        |
| <b>Total other expenses</b>                   | <b>\$ 1,281</b> | <b>\$ 1,159</b>                | <b>\$ 122</b>                       | <b>10.53%</b> |

The increase in other expenses was primarily due to an increase in salaries and employee benefits of \$233,000, primarily as a result of a June 2010 payment, and a January 2011 payable, of approximately \$158,000 each, partially offset by a decrease of approximately \$27,000 in expenses related to the forfeiture of shares and options, in connection with the release agreement entered into between the Company and its former CEO. The increase in salaries and employee benefits is offset by a decrease of \$31,000 due to the termination of the defined benefit plan in December 2009. The increase in legal and professional expenses was primarily a result of fees associated with preparation of the release agreement. Expenses on foreclosed real estate decreased \$40,000, primarily due to the absence of expenses of approximately \$73,000 paid in 2009 on one property, offset by an increase in expenses to maintain and sell foreclosed real estate. The Company also recognized a net gain on sale of foreclosed real estate of \$34,000 due to the sale of three properties during the second quarter of 2010 compared to no sales during the same period in 2009. Deposit insurance premiums decreased \$63,000 due to the special assessment accrual in 2009 that was not required in 2010, offset by increased assessments imposed by the FDIC.

*Income Taxes.* The income tax benefit was \$147,000 for the three months ended June 30, 2010, compared to an income tax benefit of \$52,000 for the same period in 2009. The difference in income taxes for the periods is primarily a result of the differences in pre-tax loss for the applicable periods.

**COMPARISON OF RESULTS OF OPERATION FOR THE SIX MONTHS ENDED JUNE 30, 2010 AND 2009**

*Net Income.* The Company had net income of \$37,000 for the six months ended June 30, 2010, compared to net income of \$77,000 for the six months ended June 30, 2009.

*Net Interest Income.* The following table summarizes interest and dividend income and interest expense for the six months ended June 30, 2010 and 2009.

|  | 2010     | Six Months Ended<br>June 30, |                                     | % change |
|--|----------|------------------------------|-------------------------------------|----------|
|  |          | 2009                         | \$ change<br>(Dollars in thousands) |          |
| <b>Interest and dividend income:</b>   |          |                              |                                     |          |
| Interest and fees on loans             | \$ 4,376 | \$ 4,783                     | \$ (407)                            | (8.51)%  |
| <b>Securities:</b>                     |          |                              |                                     |          |
| Mortgage-backed and related securities | 480      | 535                          | (55)                                | (10.28)  |
| U.S. agency securities                 | 139      | 163                          | (24)                                | (14.72)  |

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|   |                 |                 |               |                |
|---|-----------------|-----------------|---------------|----------------|
| Interest-bearing deposits                 | 4               | 1               | 3             | 300.00         |
| <b>Total interest and dividend income</b> | <b>4,999</b>    | <b>5,482</b>    | <b>(483)</b>  | <b>(8.81)</b>  |
| Interest expense:                         |                 |                 |               |                |
| Deposits                                  | 1,813           | 2,563           | (750)         | (29.26)        |
| Borrowings                                |                 | 6               | (6)           | (100.00)       |
| <b>Total interest expense</b>             | <b>1,813</b>    | <b>2,569</b>    | <b>(756)</b>  | <b>(29.43)</b> |
| <b>Net interest income</b>                | <b>\$ 3,186</b> | <b>\$ 2,913</b> | <b>\$ 273</b> | <b>9.37%</b>   |

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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.

|   | Six Months Ended June 30, |                 |   |                    |                 |                           |
|---|---------------------------|-----------------|---|--------------------|-----------------|---------------------------|
|   | 2010                      |                 |   | 2009               |                 |                           |
|   | AVERAGE<br>BALANCE        | INTEREST        | AVERAGE<br>YIELD/<br>COST<br>(Dollars in thousands) | AVERAGE<br>BALANCE | INTEREST        | AVERAGE<br>YIELD/<br>COST |
| <b>Interest-earning assets</b>  |                           |                 |   |                    |                 |                           |
| Loans receivable, net (1)   | \$ 144,977                | \$ 4,376        | 6.04%   | \$ 154,081         | \$ 4,783        | 6.21%                     |
| Securities, net (2)   | 33,112                    | 619             | 3.74%   | 28,998             | 698             | 4.82%                     |
| Interest-bearing deposits   | 8,187                     | 4               | 0.11%   | 4,893              | 1               | 0.04%                     |
| <b>Total interest-earning assets</b>  | <b>186,276</b>            | <b>4,999</b>    | <b>5.37%</b>  | <b>187,972</b>     | <b>5,482</b>    | <b>5.83%</b>              |
| <b>Interest-bearing liabilities</b>   |                           |                 |   |                    |                 |                           |
| Money Market accounts   | \$ 24,623                 | \$ 178          | 1.45%   | \$ 12,714          | \$ 131          | 2.05%                     |
| Passbook accounts   | 11,876                    | 19              | 0.32%   | 11,784             | 21              | 0.36%                     |
| Certificates of Deposit accounts  | 130,236                   | 1,599           | 2.46%   | 141,364            | 2,392           | 3.38%                     |
| Checking accounts   | 10,149                    | 17              | 0.33%   | 9,499              | 19              | 0.41%                     |
| Advances and borrowed funds   |                           |                 | 0.00%   | 1,710              | 6               | 0.70%                     |
| <b>Total interest-bearing liabilities</b>   | <b>176,884</b>            | <b>1,813</b>    | <b>2.05%</b>  | <b>177,071</b>     | <b>2,569</b>    | <b>2.90%</b>              |
| <b>NET INTEREST INCOME</b>  |                           | <b>\$ 3,186</b> |   |                    | <b>\$ 2,913</b> |                           |
| <b>NET INTEREST RATE SPREAD (3)</b>   |                           |                 | <b>3.32%</b>  |                    |                 | <b>2.93%</b>              |
| <b>NET INTEREST MARGIN (4)</b>  |                           |                 | <b>3.42%</b>  |                    |                 | <b>3.10%</b>              |
| <b>RATIO OF AVERAGE INTEREST-EARNING ASSETS<br/>TO AVERAGE INTEREST-BEARING LIABILITIES</b> |                           |                 | <b>105.31%</b>                                      |                    |                 | <b>106.16%</b>            |

(1) Amount is net of deferred loan origination (costs) fees, undisbursed loan funds, unamortized discounts and allowance for loan losses 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 six months ended June 30, 2010 and 2009.

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.

**Six Months Ended June 30,**  
**2010 Compared to 2009**  
**Increase (Decrease) Due to**  
**VOLUME      RATE      NET**

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|   | (Dollars in Thousands) |                 |                 |
|---|------------------------|-----------------|-----------------|
| <b>Interest and dividends earned on</b>   |                        |                 |                 |
| Loans receivable, net                     | \$ (275)               | \$ (132)        | \$ (407)        |
| Securities, net                           | 77                     | (156)           | (79)            |
| Interest-bearing deposits                 | 2                      | 1               | 3               |
| <b>Total interest-earning assets</b>      | <b>\$ (196)</b>        | <b>\$ (287)</b> | <b>\$ (483)</b> |
| <b>Interest expense on</b>                |                        |                 |                 |
| Money Market accounts                     | \$ 86                  | \$ (39)         | \$ 47           |
| Passbook accounts                         |                        | (2)             | (2)             |
| Certificates of Deposit accounts          | (136)                  | (657)           | (793)           |
| Checking                                  | 1                      | (3)             | (2)             |
| Advances and borrowed funds               |                        | (6)             | (6)             |
| <b>Total interest-bearing liabilities</b> | <b>(49)</b>            | <b>(707)</b>    | <b>(756)</b>    |
| <b>Change in net interest income</b>      | <b>\$ (147)</b>        | <b>\$ 420</b>   | <b>\$ 273</b>   |

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Net interest income increased \$273,000, or 9.37%, for the six months ended June 30, 2010 compared to the six months ended June 30, 2009. Interest and dividend income decreased \$483,000, or 8.81%, to \$5.0 million for the six months ended June 30, 2010 from \$5.5 million for the six months ended June 30, 2009 due to a decrease in the average rate on interest-earning assets to 5.37% from 5.83%, due to a declining interest rate environment and by a decrease of \$1.7 million in average interest-earning assets to \$186.3 million from \$188.0 million for the six months ended June 30, 2010 compared to the same period in 2009. Interest expense decreased \$756,000, or 29.43%, to \$1.8 million for the six months ended June 30, 2010, from \$2.6 million for the six months ended June 30, 2009 due to a decrease in the average cost of interest-bearing liabilities to 2.05% from 2.90%, due to a declining interest rate environment, in addition to a decrease of \$187,000 in average interest-bearing liabilities.

*Provision for Loan Losses.* Management recorded a loan loss provision of \$1.1 million for the six months ended June 30, 2010, compared to \$939,000 for the six months ended June 30, 2009. The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect each borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. Based on its review at June 30, 2010, management believes that the allowance is maintained at a level that represents its best estimate of inherent losses in the loan portfolio that were both probable and reasonably estimable.

*Other Income.* The following table summarizes other income for the six months ended June 30, 2010 and 2009.

|   | 2010   | 2009   | Six months ended<br>June 30,<br>\$ change<br>(Dollars in thousands) | % change |
|---|--------|--------|---|----------|
| <b>Other income:</b>  |        |        |   |          |
| Gain on sale of securities                                    | \$     | \$ 23  | \$ (23)   | 100.00%  |
| Gain on sale of loans   | 21     | 137    | (116)   | (84.67)  |
| Origination of mortgage servicing rights, net of amortization | 4      | 52     | (48)  | (92.31)  |
| Customer service fees   | 132    | 135    | (3)   | (2.22)   |
| Income on bank owned life insurance                           | 14     | 10     | 4   | 40.00    |
| Other   | 26     | 19     | 7   | 36.84    |
| <b>Total other income</b>                                     | \$ 197 | \$ 376 | \$ (179)  | (47.61)% |

The decrease in total other income was primarily due to decreased gains on sale of loans and origination of mortgage servicing rights, net of amortization, due to a decline in the origination of mortgage loans for sale, as a result of a continued decrease in demand for new mortgage loans and a decline in refinancing existing loans to be sold to Freddie Mac.

*Other Expenses.* The following table summarizes other expenses for the six months ended June 30, 2010 and 2009.

|  | 2010     | 2009   | Six months ended<br>June 30,<br>\$ change<br>(Dollars in thousands) | % change |
|--|----------|--------|---|----------|
| <b>Other expenses:</b>                 |          |        |   |          |
| Salaries and employee benefits         | \$ 1,137 | \$ 941 | \$ 196  | 20.83%   |
| Directors fees                         | 42       | 42     |   |          |
| Occupancy                              | 251      | 248    | 3   | 1.21     |
| Deposit insurance premium              | 184      | 300    | (116)   | (38.67)  |
| Legal and professional services        | 143      | 96     | 47  | 48.96    |
| Data processing                        | 143      | 135    | 8   | 5.93     |
| Foreclosed real estate                 | 68       | 152    | (84)  | (55.26)  |
| Loss on sale of foreclosed real estate | 20       |        | 20  | 100.00   |
| Loss on sale of repossessed assets     | 2        | 14     | (12)  | (85.71)  |
| Other                                  | 264      | 294    | (30)  | (10.20)  |

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|                             |          |          |       |       |
|-----------------------------|----------|----------|-------|-------|
| <b>Total other expenses</b> | \$ 2,254 | \$ 2,222 | \$ 32 | 1.44% |
|-----------------------------|----------|----------|-------|-------|



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The increase in other expenses was primarily due to an increase in salaries and employee benefits of \$196,000, primarily as a result of a June 2010 payment, and a January 2011 payable, of approximately \$158,000 each, partially offset by a decrease of approximately \$27,000 in expenses related to the forfeiture of shares and options, in connection with the release agreement entered into between the Company and its former CEO. The increase in salaries and employee benefits is offset by a decrease of \$61,000 due to the termination of the defined benefit plan in December 2009. The increase in legal and professional expenses was primarily a result of fees associated with the preparation of the release agreement. Expenses on foreclosed real estate decreased \$84,000, primarily due to the absence of expenses of approximately \$123,000 paid in 2009 on one property, offset by an increase in expenses to maintain and sell foreclosed real estate. Deposit insurance premiums decreased \$116,000 due to the special assessment accrual in 2009 that was not required in 2010, offset by increased assessments imposed by the FDIC.

*Income Taxes.* The income tax expense was \$11,000 for the six months ended June 30, 2010, compared to income tax expense of \$51,000 for the same period in 2009. The difference in income taxes for the periods is primarily a result of the differences in pre-tax income for the applicable periods and the disproportionate impact of tax exempt transactions on the net income (loss) in each period.

## 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 June 30, 2010, the Bank had outstanding commitments to originate \$761,000 in loans, unfunded lines of credit of \$10.7 million, unfunded commitments on construction loans of \$476,000, and unfunded standby letters of credit of \$496,000. In addition, as of June 30, 2010, the total amount of certificates of deposit that were scheduled to mature in the next 12 months was \$70.5 million. The Bank believes that it has adequate resources to fund all of its commitments and that it can adjust the rate on certificates of deposit to retain deposits in changing interest rate environments. If the Bank requires funds beyond its internal funding capabilities, advances from the Federal Home Loan Bank of Chicago are available as an additional source of funds. As of June 30, 2010, the Bank had \$46.9 million of available credit from the Federal Home Loan Bank of Chicago, based on 20 times the amount of our capital stock in the Federal Home Loan Bank of Chicago. There were no Federal Home Loan Bank advances outstanding at June 30, 2010. In addition, as of June 30, 2010, 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. 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 OTS but with prior notice to the OTS, cannot exceed net income for that year to date plus retained net income (as defined) for the preceding two calendar years. At June 30, 2010, the Company had cash and cash equivalents of \$375,000.

*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 capital requirements with ratios at June 30, 2010 of 9.71%, 17.64% and 18.89%, respectively, compared to ratios at December 31, 2009 of 9.70%, 15.82% and 17.09%, respectively.

## OFF-BALANCE SHEET ARRANGEMENTS

In the normal course of operations, we engage in a variety of financial transactions that, in accordance with generally accepted accounting principles, are not recorded in our financial statements. These transactions involve, to varying degrees, elements of credit, interest rate and liquidity risk. Such transactions are used primarily to manage customers' requests for funding and take the form of loan commitments and lines of credit.

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For the six months ended June 30, 2010, 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 are effective in timely alerting them to material information to be included in the Company's periodic SEC reports. 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. The resignation of our former CEO effective May 31, 2010, resulted in the promotion of our CFO to the position of CEO, while retaining the CFO duties until a new CFO is appointed by the Board. While some, mostly administrative and supervisory duties have been re-assigned, the Company does not feel that any of the changes resulting from the resignation had a material effect on 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, 2009, which could materially affect our business, financial condition or future results. As of June 30, 2010, 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.

#### **Recently enacted regulatory reform may have a material impact on our operations.**

On July 21, 2010, the President signed into law The Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act). The Dodd-Frank Act restructures the regulation of depository institutions. The Dodd-Frank Act contains various provisions designed to enhance the regulation of depository institutions and prevent the recurrence of a financial crisis such as occurred in 2008-2009. Also included is the creation of a new federal agency to administer and enforce consumer and fair lending laws, a function that is now performed by the depository institution regulators. The federal preemption of state laws currently accorded federally chartered depository institutions will be reduced as well. The full impact of the Dodd-Frank Act on our business and operations will not be known for years until regulations implementing the statute are written and adopted. The Dodd-Frank Act may have a material impact on our operations, particularly through increased compliance costs resulting from possible future consumer and fair lending regulations.

### ITEM 2 UNREGISTERED SALES OF SECURITIES AND USE OF PROCEEDS

Not applicable.



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ITEM 3 DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4 (REMOVED AND RESERVED)

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)  |
| 10.1        | Release Agreement by and among Ottawa Savings Bancorp, Inc., Ottawa Savings Bank, Ottawa Savings MHC and Gary Ocepek (incorporated by reference to the exhibit to the Company's Form 8-K, No. 000-51367, filed on May 24, 2010) |
| 31.1        | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002  |
| 32.1        | Certifications pursuant to Section 906 of the Sarbanes-Oxley Act of 2002  |

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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: August 12, 2010

/s/ Jon L. Kranov  
Jon L. Kranov  
President, Chief Executive Officer and Chief Financial Officer  
(Principal Executive Officer and Principal Financial Officer)