

Ottawa Savings Bancorp, Inc.  
Form 10-Q  
August 13, 2013  
**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, 2013**

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)

**United States**

**20-3074627**

(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification Number)

**925 LaSalle Street**

**61350**

**Ottawa, Illinois**

(Zip Code)

(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 (§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

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

| <b>Class</b>                   | <b>Outstanding as of August 13, 2013</b> |
|--------------------------------|--|
| Common Stock, \$0.01 par value | 2,117,979                                |

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**OTTAWA SAVINGS BANCORP, INC.**

**FORM 10-Q**

**For the quarterly period ended June 30, 2013**

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**Part I – Financial Information**

## ITEM 1 – FINANCIAL STATEMENTS

**OTTAWA SAVINGS BANCORP, INC.****Consolidated Balance Sheets****June 30, 2013 and December 31, 2012**

(Unaudited)

|   | <b>June 30,<br/>2013</b> | <b>December<br/>31,<br/>2012</b> |
|---|--------------------------|----------------------------------|
| <b>Assets</b>   |                          |                                  |
| Cash and due from banks   | \$2,035,212              | \$1,439,637                      |
| Interest bearing deposits   | 3,697,334                | 9,348,352                        |
| <b>Total cash and cash equivalents</b>  | <b>5,732,546</b>         | <b>10,787,989</b>                |
| Federal funds sold  | 3,851,000                | 1,666,000                        |
| Securities held to maturity (fair value of \$13 at December 31, 2012)   | -                        | 12                               |
| Securities available for sale   | 35,868,479               | 28,863,603                       |
| Non-marketable equity securities  | 1,233,536                | 1,334,436                        |
| Loans, net of allowance for loan losses of \$3,850,222 and \$3,381,441 at June 30, 2013 and December 31, 2012, respectively | 115,884,943              | 121,994,851                      |
| Loans held for sale   | 83,600                   | 171,095                          |
| Premises and equipment, net   | 6,544,887                | 6,629,794                        |
| Accrued interest receivable   | 751,773                  | 696,638                          |
| Foreclosed real estate  | 762,656                  | 1,297,214                        |
| Deferred tax assets   | 2,658,512                | 2,243,663                        |
| Cash value of life insurance  | 2,099,763                | 1,587,436                        |
| Prepaid FDIC premiums   | -                        | 163,999                          |
| Income tax refunds receivable   | 159,783                  | 166,590                          |
| Other assets  | 1,337,787                | 1,442,841                        |
| <b>Total assets</b>   | <b>\$176,969,265</b>     | <b>\$179,046,161</b>             |
| <b>Liabilities and Stockholders' Equity</b>   |                          |                                  |
| <b>Liabilities</b>  |                          |                                  |
| <b>Deposits:</b>  |                          |                                  |
| Non-interest bearing  | \$4,730,037              | \$4,313,635                      |
| Interest bearing  | 147,869,772              | 150,761,010                      |
| <b>Total deposits</b>   | <b>152,599,809</b>       | <b>155,074,645</b>               |
| Accrued interest payable  | 2,420                    | 806                              |
| Other liabilities   | 3,028,738                | 2,686,620                        |
| <b>Total liabilities</b>  | <b>155,630,967</b>       | <b>157,762,071</b>               |

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|  |                |                |
|--|----------------|----------------|
| Commitments and contingencies  |                |                |
| Redeemable common stock held by ESOP plan  | 314,964        | 237,712        |
| <b>Stockholders' Equity</b>  |                |                |
| Common stock, \$.01 par value, 12,000,000 shares authorized; 2,224,911 shares issued | 22,249         | 22,249         |
| Additional paid-in-capital   | 8,702,698      | 8,705,547      |
| Retained earnings  | 14,156,489     | 13,689,967     |
| Unallocated ESOP shares  | (330,694 )     | (356,132 )     |
| Unearned management recognition plan shares  | (27,565 )      | (33,977 )      |
| Accumulated other comprehensive income   | 27,239         | 468,554        |
|  | 22,550,416     | 22,496,208     |
| Less:  |                |                |
| Treasury stock, at cost; 106,932 shares  | (1,212,118 )   | (1,212,118 )   |
| Maximum cash obligation related to ESOP shares                                       | (314,964 )     | (237,712 )     |
| <b>Total stockholders' equity</b>  | 21,023,334     | 21,046,378     |
| <b>Total liabilities and stockholders' equity</b>                                    | \$ 176,969,265 | \$ 179,046,161 |

See accompanying notes to these unaudited consolidated financial statements.

**OTTAWA SAVINGS BANCORP, INC.****Consolidated Statements of Operations****Three and Six Months Ended June 30, 2013 and 2012**

(Unaudited)

|   | <b>Three Months Ended<br/>June 30,</b> |                  | <b>Six Months Ended<br/>June 30,</b> |                  |
|---|--|------------------|--------------------------------------|------------------|
|   | <b>2013</b>                            | <b>2012</b>      | <b>2013</b>                          | <b>2012</b>      |
| Interest and dividend income:                                 |  |                  |                                      |                  |
| Interest and fees on loans                                    | \$1,606,395                            | \$1,805,713      | \$3,266,143                          | \$3,582,616      |
| Securities:   |  |                  |                                      |                  |
| Residential mortgage-backed and related securities            | 106,002                                | 163,581          | 220,195                              | 352,567          |
| U.S. agency securities  | -                                      | 16,663           | -                                    | 33,422           |
| State and municipal securities                                | 66,089                                 | 51,014           | 127,470                              | 92,072           |
| Dividends on non-marketable equity securities                 | 848                                    | 1,270            | 1,713                                | 1,861            |
| Interest-bearing deposits                                     | 1,841                                  | 1,484            | 3,069                                | 2,573            |
| <b>Total interest and dividend income</b>                     | <b>1,781,175</b>                       | <b>2,039,725</b> | <b>3,618,590</b>                     | <b>4,065,111</b> |
| Interest expense:   |  |                  |                                      |                  |
| Deposits  | 384,895                                | 552,941          | 808,528                              | 1,139,631        |
| Borrowings  | -                                      | -                | -                                    | 1                |
| <b>Total interest expense</b>                                 | <b>384,895</b>                         | <b>552,941</b>   | <b>808,528</b>                       | <b>1,139,632</b> |
| <b>Net interest income</b>                                    | <b>1,396,280</b>                       | <b>1,486,784</b> | <b>2,810,062</b>                     | <b>2,925,479</b> |
| Provision for loan losses                                     | 220,000                                | 563,500          | 550,000                              | 1,002,000        |
| <b>Net interest income after provision for loan losses</b>    | <b>1,176,280</b>                       | <b>923,284</b>   | <b>2,260,062</b>                     | <b>1,923,479</b> |
| Other income:   |  |                  |                                      |                  |
| Gain on sale of securities                                    | -                                      | -                | -                                    | 13,948           |
| Gain on sale of loans   | 28,220                                 | 30,516           | 46,745                               | 58,372           |
| Gain on sale of OREO  | -                                      | -                | 14,150                               | 69,722           |
| Origination of mortgage servicing rights, net of amortization | 430                                    | (750)            | 4,654                                | 2,751            |
| Customer service fees   | 72,138                                 | 70,406           | 143,414                              | 139,296          |
| Income on bank owned life insurance                           | 4,912                                  | 7,790            | 12,327                               | 15,403           |
| Other   | 127,986                                | 18,475           | 158,557                              | 29,836           |
| <b>Total other income</b>                                     | <b>233,686</b>                         | <b>126,437</b>   | <b>379,847</b>                       | <b>329,328</b>   |
| Other expenses:   |  |                  |                                      |                  |
| Salaries and employee benefits                                | 378,351                                | 363,723          | 755,657                              | 703,290          |
| Directors fees  | 25,200                                 | 21,000           | 50,400                               | 42,000           |
| Occupancy   | 110,429                                | 112,118          | 220,413                              | 217,067          |
| Deposit insurance premium                                     | 56,656                                 | 60,410           | 114,664                              | 120,439          |
| Legal and professional services                               | 73,975                                 | 56,166           | 142,368                              | 111,729          |
| Data processing   | 74,475                                 | 64,717           | 150,471                              | 161,264          |
| Valuation adjustments and expenses on foreclosed real estate  | 70,302                                 | 25,546           | 175,032                              | 46,044           |
| Loss on sale of OREO  | 37,048                                 | 9,601            | -                                    | -                |
| Loss on sale of repossessed assets                            | 385                                    | 2,612            | 385                                  | 14,472           |

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|   |                  |                  |                  |                  |
|---|------------------|------------------|------------------|------------------|
| Loss on consumer loans                  | -                | -                | -                | 41,514           |
| Other                                   | 148,965          | 145,319          | 298,371          | 257,403          |
| <b>Total other expenses</b>             | <b>975,786</b>   | <b>861,212</b>   | <b>1,907,761</b> | <b>1,715,222</b> |
| <b>Income before income tax expense</b> | <b>434,180</b>   | <b>188,509</b>   | <b>732,148</b>   | <b>537,585</b>   |
| Income tax expense                      | 234,131          | 33,301           | 265,626          | 142,707          |
| <b>Net income</b>                       | <b>\$200,049</b> | <b>\$155,208</b> | <b>\$466,522</b> | <b>\$394,878</b> |
| <b>Basic earnings per share</b>         | <b>\$0.10</b>    | <b>\$0.07</b>    | <b>\$0.22</b>    | <b>\$0.19</b>    |
| <b>Diluted earnings per share</b>       | <b>\$0.10</b>    | <b>\$0.07</b>    | <b>\$0.22</b>    | <b>\$0.19</b>    |

See accompanying notes to these unaudited consolidated financial statements.



**OTTAWA SAVINGS BANCORP, INC.****Consolidated Statements of Comprehensive (Loss) Income****Three and Six Months Ended June 30, 2013 and 2012**

(Unaudited)

|  | <b>Three Months<br/>Ended<br/>June 30,</b> |                  | <b>Six Months Ended<br/>June 30,</b> |                  |
|--|--|------------------|--------------------------------------|------------------|
|  | <b>2013</b>                                | <b>2012</b>      | <b>2013</b>                          | <b>2012</b>      |
| Net income   | \$200,049                                  | \$155,208        | \$466,522                            | \$394,878        |
| Other comprehensive (loss) income, before tax:                                     |  |                  |                                      |                  |
| Securities available for sale:   |  |                  |                                      |                  |
| Unrealized holding (losses) gains arising during the period                        | (553,844)                                  | 91,483           | (668,659)                            | 74,198           |
| Reclassification adjustment for (gains) included in net income                     | -  | -                | -                                    | (13,948)         |
| <b>Other comprehensive (loss) income, before tax</b>                               | <b>(553,844)</b>                           | <b>91,483</b>    | <b>(668,659)</b>                     | <b>60,250</b>    |
| Income tax (benefit) expense related to items of other comprehensive (loss) income | (188,307)                                  | 31,104           | (227,344)                            | 20,485           |
| <b>Other comprehensive (loss) income, net of tax</b>                               | <b>(365,537)</b>                           | <b>60,379</b>    | <b>(441,315)</b>                     | <b>39,765</b>    |
| <b>Comprehensive (loss) income</b>   | <b>\$(165,488)</b>                         | <b>\$215,587</b> | <b>\$25,207</b>                      | <b>\$434,643</b> |

See accompanying notes to these unaudited consolidated financial statements.

**OTTAWA SAVINGS BANCORP, INC.****Consolidated Statements of Cash Flows****Six Months Ended June 30, 2013 and 2012**

(Unaudited)

|   | <b>2013</b>      | <b>2012</b>      |
|---|------------------|------------------|
| Cash Flows from Operating Activities  |                  |                  |
| Net income  | \$466,522        | \$394,878        |
| Adjustments to reconcile net income to net cash provided by operating activities: |                  |                  |
| Depreciation  | 93,479           | 100,383          |
| Provision for loan losses   | 550,000          | 1,002,000        |
| Provision for deferred income taxes   | (187,505 )       | 149,939          |
| Net amortization of premiums and discounts on securities                          | 291,687          | 243,935          |
| Gain on sale of securities  | -                | (13,948 )        |
| Origination of mortgage loans held for sale                                       | (3,748,533 )     | (4,428,809)      |
| Proceeds from sale of mortgage loans held for sale                                | 3,882,773        | 4,397,187        |
| Gain on sale of loans, net  | (46,745 )        | (58,372 )        |
| Origination of mortgage servicing rights, net of amortization                     | (4,654 )         | (2,751 )         |
| Proceeds from sale of non-mortgage loans held for sale                            | 268,634          | -                |
| Gain on sale of foreclosed real estate  | (14,150 )        | (69,722 )        |
| Write down of foreclosed real estate  | 63,284           | -                |
| Loss on sale of repossessed assets  | 385              | 14,472           |
| Loss on consumer loans  | -                | 41,514           |
| ESOP compensation expense   | 15,435           | 12,481           |
| MRP compensation expense  | 6,412            | 601              |
| Compensation expense on RRP options granted                                       | 7,154            | 3,634            |
| Increase in cash surrender value of life insurance                                | (12,327 )        | (15,403 )        |
| Change in assets and liabilities:   |                  |                  |
| Decrease in prepaid FDIC insurance premiums                                       | 163,999          | 115,153          |
| (Increase) decrease in accrued interest receivable                                | (55,135 )        | 10,468           |
| Decrease in other assets  | 150,708          | 8,730            |
| Decrease in income tax refunds receivable   | 6,807            | 51,257           |
| Increase in accrued interest payable and other liabilities                        | 343,732          | 220,237          |
| <b>Net cash provided by operating activities</b>                                  | <b>2,241,962</b> | <b>2,177,864</b> |
| Cash Flows from Investing Activities  |                  |                  |
| Securities available for sale:  |                  |                  |
| Purchases   | (11,562,856)     | (7,896,364)      |
| Sales, maturities and paydowns  | 3,597,634        | 6,979,240        |
| Securities held to maturity:  |                  |                  |
| Sales, maturities and paydowns  | 12               | 1                |
| Purchase of bank-owned life insurance   | (500,000 )       | -                |
| Net decrease in loans   | 4,977,626        | 527,737          |
| Net increase in federal funds sold  | (2,185,000 )     | (1,682,000)      |

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|   |                     |                    |
|---|---------------------|--------------------|
| Proceeds from sale of foreclosed real estate                        | 754,572             | 270,884            |
| Proceeds from sale of repossessed assets                            | 3,115               | 26,516             |
| Purchase of premises and equipment                                  | (8,572 )            | (23,236 )          |
| Sale of non-marketable equity securities                            | 100,900             | 778,932            |
| <b>Net cash used in investing activities</b>                        | <b>(4,822,569 )</b> | <b>(1,018,290)</b> |
| Cash Flows from Financing Activities                                |                     |                    |
| Net (decrease) increase in deposits                                 | (2,474,836 )        | 2,056,247          |
| <b>Net cash (used in) provided by financing activities</b>          | <b>(2,474,836 )</b> | <b>2,056,247</b>   |
| <b>Net (decrease) increase in cash and cash equivalents</b>         | <b>(5,055,443 )</b> | <b>3,215,821</b>   |
| Cash and cash equivalents:  |                     |                    |
| Beginning   | 10,787,989          | 2,945,465          |
| Ending  | \$5,732,546         | \$6,161,286        |
| Supplemental Disclosures of Cash Flow Information                   |                     |                    |
| Cash payments for:  |                     |                    |
| Interest paid to depositors   | \$806,914           | \$1,135,775        |
| Interest paid on borrowings   | -                   | 1                  |
| Income taxes paid, net of (refunds) received                        | 125,000             | (127,935 )         |
| Supplemental Schedule of Noncash Investing and Financing Activities |                     |                    |
| Real estate acquired through or in lieu of foreclosure              | 269,148             | 1,217,148          |
| Other assets acquired in settlement of loans                        | 44,500              | 1,100              |
| Sale of foreclosed real estate through loan origination             | -                   | 328,436            |
| Transfer of non-mortgage loans to held for sale                     | 268,634             | -                  |
| Deferred gains on the sale of OREO properties                       | -                   | 17,618             |
| Increase in ESOP put option liability                               | 77,252              | 41,740             |

See accompanying notes to these unaudited consolidated financial statements.

**OTTAWA SAVINGS BANCORP, INC.**

**Notes to Unaudited Consolidated Financial Statements**

**(continued)**

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**NOTE 1 – NATURE OF BUSINESS**

Ottawa Savings Bancorp, Inc. (the “Company”) was incorporated under the laws of the United States on July 11, 2005, for the purpose of serving as the holding company of Ottawa Savings Bank (the “Bank”), as part of the Bank’s conversion from a mutual to a stock form of organization. The Company is a publicly traded banking company with assets of \$177.0 million at June 30, 2013 and is headquartered in Ottawa, Illinois.

In 2005, the Board of Directors of the Bank unanimously adopted a plan of conversion providing for the conversion of the Bank from an Illinois chartered mutual savings bank to a federally chartered stock savings bank and the purchase of all of the common stock of the Bank by the Company. The depositors of the Bank approved the plan at a meeting held in 2005.

In adopting the plan, the Board of Directors of the Bank determined that the conversion was advisable and in the best interests of its depositors and the Bank. The conversion was completed in 2005 when the Company issued 1,223,701 shares of common stock to Ottawa Savings Bancorp MHC (a mutual holding company), and 1,001,210 shares of common stock to the public. As of June 30, 2013, Ottawa Savings Bancorp MHC holds 1,223,701 shares of common stock, representing 57.8% of the Company’s common shares outstanding.

The Bank’s business is to attract deposits from the general public and use those funds to originate and purchase one-to-four family, multi-family and non-residential real estate, construction, commercial and consumer loans, which the Bank primarily holds for investment. The Bank has continually diversified its products to meet the needs of the community.

**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, 2012. Certain amounts in the accompanying financial statements and footnotes for 2012 have been reclassified with no effect on net income or stockholders' equity to be consistent with the 2013 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, 2013, 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 28, 2013. Reference should be made to Note 4 below for explanation of a change the Company made to the calculation it uses to determine historical loss rates that are used in the allowance for loan losses calculation.

#### 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 and deferred income taxes to be our critical accounting policies.

**OTTAWA SAVINGS BANCORP, INC.**

**Notes to Unaudited Consolidated Financial Statements**

**(continued)**

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*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 collectability 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. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

Due to changing economic conditions which has resulted in reduced charge-offs through June 30, 2013, management evaluated and changed the historical loss period used in the allowance for loan losses calculation during the quarter ended June 30, 2013. Through March 31, 2013, management used the most recent eight quarters of loss history to calculate historical loss rates. The weighting applied to the quarters was graduated, with heavier weightings applied to the most recent quarters of loss history. Beginning with the quarter ended June 30, 2013, management expanded the loss period and began using the most recent twelve quarters of loss history to calculate historical loss rates. The weighting applied to the quarters is still graduated, with heavier weightings applied to the most recent quarters of loss history; however, the weighting applied has a lesser graduation than the previous methodology. The new weighting applies 40% to each of the most recent four quarters and 30% to each of the next eight quarters. Management evaluated the impact of the change in methodology by calculating the allowance for loan losses using both the old methodology and the new methodology at June 30, 2013, and determined that the change in methodology did not have a material impact on the allowance for loan losses as of June 30, 2013.

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 amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis using 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.

*Deferred Income Taxes.* Deferred income tax assets and liabilities are computed for differences between the financial statement and tax basis of assets and liabilities that will result in taxable or deductible amounts in the future based on enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. Deferred tax assets are also recognized for operating loss and tax credit carry-forwards. Accounting guidance requires that companies assess whether a valuation allowance should be established against their deferred tax assets based on the consideration of all available evidence using a “more likely than not” standard.

Per accounting guidance, the Company reviewed its deferred tax assets at June 30, 2013 and determined that no valuation allowance was necessary. Despite a continued challenging economic environment, the Company has a history of strong earnings, is well-capitalized, and has positive expectations regarding future taxable income.

The deferred tax asset will be analyzed quarterly to determine if a valuation allowance is warranted. There can be no guarantee that a valuation allowance will not be necessary in future periods. In making such judgments, significant weight is given to evidence that can be objectively verified. In making decisions regarding any valuation allowance, the Company considers both positive and negative evidence and analyzes changes in near-term market conditions as well as other factors which may impact future operating results.

**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.

|  | <b>Three Months Ended</b> |             | <b>Six Months Ended</b> |             |
|--|---------------------------|-------------|-------------------------|-------------|
|  | <b>June 30,</b>           |             | <b>June 30,</b>         |             |
|  | <b>2013</b>               | <b>2012</b> | <b>2013</b>             | <b>2012</b> |
| Net income available to common stockholders              | \$200,049                 | \$155,208   | \$466,522               | \$394,878   |
| Basic potential common shares:                           |                           |             |                         |             |
| Weighted average shares outstanding                      | 2,117,979                 | 2,117,979   | 2,117,979               | 2,117,979   |
| Weighted average unallocated ESOP shares                 | (33,903 )                 | (38,991 )   | (34,535 )               | (39,627 )   |
| Weighted average unvested MRP shares                     | (6,719 )                  | (8,899 )    | (6,719 )                | (8,899 )    |
| Basic weighted average shares outstanding                | 2,077,357                 | 2,070,089   | 2,076,725               | 2,069,453   |
| Dilutive potential common shares:                        |                           |             |                         |             |
| Weighted average unrecognized compensation on MRP shares | 4,916                     | 5,373       | 4,931                   | 19,419      |
| Weighted average RRP options outstanding *               | -                         | -           | -                       | -           |
| Dilutive weighted average shares outstanding             | 2,082,273                 | 2,075,462   | 2,081,655               | 2,088,872   |
| Basic earnings per share                                 | \$0.10                    | \$0.07      | \$0.22                  | \$0.19      |
| Diluted earnings per share                               | \$0.10                    | \$0.07      | \$0.22                  | \$0.19      |

\* 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.

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, 2013, 34,996 shares at a fair value of \$9.00 have been classified as mezzanine capital.

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

|                                  | <b>June 30,<br/>2013</b> | <b>December<br/>31,<br/>2012</b> |
|----------------------------------|--------------------------|----------------------------------|
| Shares allocated                 | 43,245                   | 40,701                           |
| Shares withdrawn from the plan   | (8,249 )                 | (6,250 )                         |
| Unallocated shares               | 33,069                   | 35,613                           |
| Total ESOP shares                | 68,065                   | 70,064                           |
| Fair value of unallocated shares | \$297,621                | \$245,730                        |

**OTTAWA SAVINGS BANCORP, INC.****Notes to Unaudited Consolidated Financial Statements****(continued)****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, 2013:</b>                  |                   |                              |                               |               |
| <b>Available for Sale</b>              |                   |                              |                               |               |
| State and municipal securities         | \$8,698,899       | \$ 128,714                   | \$ 228,875                    | \$8,598,738   |
| Residential mortgage-backed securities | 27,128,308        | 349,566                      | 208,133                       | 27,269,741    |
|  | \$35,827,207      | \$ 478,280                   | \$ 437,008                    | \$35,868,479  |
| <b>December 31, 2012:</b>              |                   |                              |                               |               |
| <b>Held to Maturity</b>                |                   |                              |                               |               |
| Residential mortgage-backed securities | \$ 12             | \$ 1                         | \$ -                          | \$ 13         |
| <b>Available for Sale</b>              |                   |                              |                               |               |
| State and municipal securities         | 6,789,496         | 343,292                      | 12,266                        | 7,120,522     |
| Residential mortgage-backed securities | 21,364,176        | 478,917                      | 100,012                       | 21,743,081    |
|  | \$28,153,672      | \$ 822,209                   | \$ 112,278                    | \$28,863,603  |

The amortized cost and fair value at June 30, 2013, by contractual maturity, are shown below. Maturities may differ from contractual maturities in residential mortgage-backed securities because the mortgages underlying the securities may be called or prepaid without penalties. Therefore, stated maturities of residential mortgage-backed securities are not disclosed.

|   | Securities Available for<br>Sale |               |
|---|----------------------------------|---------------|
|   | Amortized<br>Cost                | Fair<br>Value |
| Due after three months through one year | \$-                              | \$-           |
| Due after one year through five years   | -                                | -             |
| Due after five years through ten years  | 3,335,049                        | 3,344,517     |
| Due after ten years                     | 5,363,850                        | 5,254,221     |
| Residential mortgage-backed securities  | 27,128,308                       | 27,269,741    |
|   | \$35,827,207                     | \$35,868,479  |

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The following table reflects securities with gross unrealized losses for less than 12 months and for 12 months or more at June 30, 2013 and December 31, 2012:

|  | Less than 12 Months |                   | 12 Months or More |                   | Total        |                   |
|--|---------------------|-------------------|-------------------|-------------------|--------------|-------------------|
|  | Fair Value          | Unrealized Losses | Fair Value        | Unrealized Losses | Fair Value   | Unrealized Losses |
| <b>June 30, 2013</b>                   |                     |                   |                   |                   |              |                   |
| <b>Securities Available for Sale</b>   |                     |                   |                   |                   |              |                   |
| State and municipal securities         | \$4,291,803         | \$ 228,875        | \$-               | \$-               | \$4,291,803  | \$ 228,875        |
| Residential mortgage-backed securities | 9,037,265           | 100,352           | 4,560,115         | 107,781           | 13,597,380   | 208,133           |
|  | \$13,329,068        | \$ 329,227        | \$4,560,115       | \$ 107,781        | \$17,889,183 | \$ 437,008        |
| <b>December 31, 2012</b>               |                     |                   |                   |                   |              |                   |
| <b>Securities Available for Sale</b>   |                     |                   |                   |                   |              |                   |
| State and municipal securities         | \$1,160,173         | \$ 12,266         | \$-               | \$-               | \$1,160,173  | \$ 12,266         |
| Residential mortgage-backed securities | 4,318,926           | 73,606            | 2,587,548         | 26,406            | 6,906,474    | 100,012           |
|  | \$5,479,099         | \$ 85,872         | \$2,587,548       | \$ 26,406         | \$8,066,647  | \$ 112,278        |

**OTTAWA SAVINGS BANCORP, INC.**

**Notes to Unaudited Consolidated Financial Statements**

**(continued)**

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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, 2013, 26 securities had unrealized losses with an aggregate depreciation of 2.38% from the Company's amortized cost basis. The Company does not consider these investments to be other than temporarily impaired at June 30, 2013 due to the following:

Decline in value is attributable to interest rates.

The value did not decline due to credit quality.

The Company does not intend to sell these securities.

The Company has adequate liquidity such that it will not more likely than not have to sell these securities before recovery of the amortized cost basis, which may be at maturity.

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

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

**NOTE 8 – LOANS AND ALLOWANCE FOR CREDIT LOSSES**

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

|                                      | June 30,<br>2013     | December 31,<br>2012 |
|--------------------------------------|----------------------|----------------------|
| Mortgage loans:                      |                      |                      |
| One-to-four family residential loans | \$80,822,485         | \$83,018,756         |
| Multi-family residential loans       | 2,914,806            | 4,849,766            |
| <b>Total mortgage loans</b>          | <b>83,737,291</b>    | <b>87,868,522</b>    |
| Other loans:                         |                      |                      |
| Non-residential real estate loans    | 18,622,127           | 20,506,860           |
| Commercial loans                     | 7,929,054            | 8,648,191            |
| Consumer direct                      | 509,971              | 542,652              |
| Purchased auto                       | 8,936,722            | 7,810,067            |
| <b>Total other loans</b>             | <b>35,997,874</b>    | <b>37,507,770</b>    |
| <b>Gross loans</b>                   | <b>119,735,165</b>   | <b>125,376,292</b>   |
| Less: Allowance for loan losses      | (3,850,222 )         | (3,381,441 )         |
| <b>Loans, net</b>                    | <b>\$115,884,943</b> | <b>\$121,994,851</b> |

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

|                | Three Months Ended<br>June 30, |             | Six Months Ended<br>June 30, |             |
|----------------|--------------------------------|-------------|------------------------------|-------------|
|                | 2013                           | 2012        | 2013                         | 2012        |
| Purchased auto | \$1,523,085                    | \$2,314,056 | \$3,026,236                  | \$4,846,588 |

**OTTAWA SAVINGS BANCORP, INC.****Notes to Unaudited Consolidated Financial Statements****(continued)**


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

|                                | Three Months Ended |               | Six Months Ended |                |
|--------------------------------|--------------------|---------------|------------------|----------------|
|                                | June 30,<br>2013   | 2012          | June 30,<br>2013 | 2012           |
| One-to-four family             | \$(69,722 )        | \$(977,802 )  | \$(182,307 )     | \$(1,236,974 ) |
| Multi-family                   | -                  | (133,429 )    | -                | (133,429 )     |
| Non-residential                | 107,187            | (39,024 )     | 107,187          | (87,764 )      |
| Commercial                     | -                  | -             | -                | (7,259 )       |
| Consumer direct                | -                  | 29            | -                | 29             |
| Purchased auto                 | (4,447 )           | 2,372         | (6,099 )         | 110            |
| Net (charge-offs) / recoveries | \$33,018           | \$(1,147,854) | \$(81,219 )      | \$(1,465,287)  |

## OTTAWA SAVINGS BANCORP, INC.

## Notes to Unaudited Consolidated Financial Statements

(continued)

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

| <b>June 30, 2013</b>                       | One-to-Four<br>Family | Multi-family | Non-residential | Commercial | Consumer<br>Direct | Purchased<br>Auto | Total        |
|--|-----------------------|--------------|-----------------|------------|--------------------|-------------------|--------------|
| Balance at beginning of period             | \$ 2,648,601          | \$ 130,898   | \$ 676,883      | \$ 56,441  | \$ -               | \$ 84,381         | \$ 3,597,204 |
| Provision charged to income                | 329,763               | (74,907 )    | (70,976 )       | 27,119     | 3,674              | 5,327             | 220,000      |
| Loans charged off                          | (72,222 )             | -            | (28,907 )       | -          | -                  | (6,474 )          | (107,603 )   |
| Recoveries of loans previously charged off | 2,500                 | -            | 136,094         | -          | -                  | 2,027             | 140,621      |
| Balance at end of period                   | \$ 2,908,642          | \$ 55,991    | \$ 713,094      | \$ 83,560  | \$ 3,674           | \$ 85,261         | \$ 3,850,222 |

| <b>June 30, 2012</b>                       | One-to-Four<br>Family | Multi-family | Non-residential | Commercial | Consumer<br>Direct | Purchased<br>Auto | Total        |
|--|-----------------------|--------------|-----------------|------------|--------------------|-------------------|--------------|
| Balance at beginning of period             | \$ 3,230,276          | \$ 317,218   | \$ 1,186,968    | \$ 91,274  | \$ 4,952           | \$ 37,791         | \$ 4,868,479 |
| Provision charged to income                | 500,533               | 17,583       | 78,215          | (45,921 )  | 2,765              | 10,325            | 563,500      |
| Loans charged off                          | (984,685 )            | (133,429 )   | (39,024 )       | -          | -                  | -                 | (1,157,138)  |
| Recoveries of loans previously charged off | 6,883                 | -            | -               | -          | 29                 | 2,372             | 9,284        |
| Balance at end of period                   | \$ 2,753,007          | \$ 201,372   | \$ 1,226,159    | \$ 45,353  | \$ 7,746           | \$ 50,488         | \$ 4,284,125 |

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

| <b>June 30, 2013</b>         | One-to-Four<br>Family | Multi-family | Non-residential | Commercial | Consumer<br>Direct | Purchased<br>Auto | Total        |
|------------------------------|-----------------------|--------------|-----------------|------------|--------------------|-------------------|--------------|
| Balance at beginning of year | \$ 2,057,336          | \$ 161,901   | \$ 1,012,119    | \$ 75,130  | \$ 1,465           | \$ 73,490         | \$ 3,381,441 |
| Provision charged to income  | 1,033,613             | (105,910 )   | (406,212 )      | 8,430      | 2,209              | 17,870            | 550,000      |
| Loans charged off            | (187,307 )            | -            | (28,907 )       | -          | -                  | (9,596 )          | (225,810 )   |
|                              | 5,000                 | -            | 136,094         | -          | -                  | 3,497             | 144,591      |

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Recoveries of loans  
previously charged off

Balance at end of period \$ 2,908,642 \$ 55,991 \$ 713,094 \$ 83,560 \$ 3,674 \$ 85,261 \$ 3,850,222

| <b>June 30, 2012</b>                          | One-to-Four<br>Family | Multi-family | Non-residential | Commercial | Consumer<br>Direct | Purchased<br>Auto | Total        |
|---|-----------------------|--------------|-----------------|------------|--------------------|-------------------|--------------|
| Balance at beginning of<br>year               | \$ 3,113,345          | \$ 438,542   | \$ 1,145,889    | \$ 10,571  | \$ 3,578           | \$ 35,487         | \$ 4,747,412 |
| Provision charged to<br>income                | 876,636               | (103,741 )   | 168,034         | 42,041     | 4,139              | 14,891            | 1,002,000    |
| Loans charged off                             | (1,244,257)           | (133,429 )   | (87,764 )       | (7,259 )   | -                  | (3,931 )          | (1,476,640)  |
| Recoveries of loans<br>previously charged off | 7,283                 | -            | -               | -          | 29                 | 4,041             | 11,353       |
| Balance at end of period                      | \$ 2,753,007          | \$ 201,372   | \$ 1,226,159    | \$ 45,353  | \$ 7,746           | \$ 50,488         | \$ 4,284,125 |



**OTTAWA SAVINGS BANCORP, INC.****Notes to Unaudited Consolidated Financial Statements****(continued)**

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

| <b>June 30, 2013</b>                        | One-to-four<br>Family | Multi-family | Non-residential | Commercial  | Consumer<br>Direct | Purchased<br>Auto | Total         |
|---|-----------------------|--------------|-----------------|-------------|--------------------|-------------------|---------------|
| Loans individually evaluated for impairment | \$3,335,911           | \$-          | \$2,230,225     | \$-         | \$-                | \$-               | \$5,566,136   |
| Loans collectively evaluated for impairment | 77,486,574            | 2,914,806    | 16,391,902      | 7,929,054   | 509,971            | 8,936,722         | 114,169,029   |
| Ending Balance                              | \$80,822,485          | \$2,914,806  | \$18,622,127    | \$7,929,054 | \$509,971          | \$8,936,722       | \$119,735,165 |
| Period-end amount allocated to:             |                       |              |                 |             |                    |                   |               |
| Loans individually evaluated for impairment | \$908,889             | \$-          | \$106,029       | \$-         | \$-                | \$-               | \$1,014,918   |
| Loans collectively evaluated for impairment | 1,999,753             | 55,991       | 607,065         | 83,560      | 3,674              | 85,261            | 2,835,304     |
| Balance at end of period                    | \$2,908,642           | \$55,991     | \$713,094       | \$83,560    | \$3,674            | \$85,261          | \$3,850,222   |
| <b>December 31, 2012</b>                    | One-to-four<br>Family | Multi-family | Non-residential | Commercial  | Consumer<br>Direct | Purchased<br>Auto | Total         |
| Loans individually evaluated for impairment | \$2,891,821           | \$-          | \$2,726,297     | \$-         | \$-                | \$-               | \$5,618,118   |
| Loans collectively evaluated for impairment | 80,126,935            | 4,849,766    | 17,780,563      | 8,648,191   | 542,652            | 7,810,067         | 119,758,174   |
| Ending Balance                              | \$83,018,756          | \$4,849,766  | \$20,506,860    | \$8,648,191 | \$542,652          | \$7,810,067       | \$125,376,292 |

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Period-end  
amount allocated  
to:

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

**OTTAWA SAVINGS BANCORP, INC.****Notes to Unaudited Consolidated Financial Statements****(continued)**

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

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

| <b>June 30, 2013</b>     | Unpaid<br>Contractual<br>Principal<br>Balance | Recorded<br>Investment<br>With No<br>Allowance | Recorded<br>Investment<br>With<br>Allowance | Total<br>Recorded<br>Investment | Related<br>Allowance | Average<br>Recorded<br>Investment |
|--------------------------|---|--|---|---------------------------------|----------------------|-----------------------------------|
| One-to-four family       | \$3,399,944                                   | \$511,772                                      | \$2,824,139                                 | \$3,335,911                     | \$908,889            | \$3,620,166                       |
| Multi-family             | -   | -  | -   | -                               | -                    | -                                 |
| Non-residential          | 4,844,978                                     | 1,813,278                                      | 416,947                                     | 2,230,225                       | 106,029              | 2,233,749                         |
| Commercial               | -   | -  | -   | -                               | -                    | -                                 |
| Consumer direct          | -   | -  | -   | -                               | -                    | -                                 |
| Purchased auto           | -   | -  | -   | -                               | -                    | -                                 |
|                          | \$8,244,922                                   | \$2,325,050                                    | \$3,241,086                                 | \$5,566,136                     | \$1,014,918          | \$5,853,915                       |
| <b>December 31, 2012</b> | Unpaid<br>Contractual<br>Principal<br>Balance | Recorded<br>Investment<br>With No<br>Allowance | Recorded<br>Investment<br>With<br>Allowance | Total<br>Recorded<br>Investment | Related<br>Allowance | Average<br>Recorded<br>Investment |
| One-to-four family       | \$3,664,253                                   | \$820,150                                      | \$2,071,671                                 | \$2,891,821                     | \$147,209            | \$6,141,106                       |
| Multi-family             | -   | -  | -   | -                               | -                    | 104,209                           |
| Non-residential          | 6,596,593                                     | 683,589  | 2,042,708                                   | 2,726,297                       | 31,208               | 1,814,361                         |
| Commercial               | -   | -  | -   | -                               | -                    | 605                               |
| Consumer direct          | -   | -  | -   | -                               | -                    | 12,057                            |
| Purchased auto           | -   | -  | -   | -                               | -                    | 12,057                            |
|                          | \$10,260,846                                  | \$1,503,739                                    | \$4,114,379                                 | \$5,618,118                     | \$178,417            | \$8,084,395                       |



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

At June 30, 2013, there were 30 impaired loans totaling approximately \$5.6 million, compared to 22 impaired loans totaling approximately \$5.6 million at December 31, 2012. The change in impaired loans was a result of adding 17 loans totaling approximately \$2.2 million to the impaired loan list, offset by writing down and moving three impaired loans totaling approximately \$260,000 to OREO, writing down two impaired loans by a total of approximately \$147,000, two impaired loan payoffs totaling approximately \$1.1 million, and an impaired loan of approximately \$269,000 moved to held for sale which was subsequently sold.

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

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

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

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

| Three Months Ended<br>June 30, 2013 |                          | Three Months Ended<br>June 30, 2012 |                          |
|-------------------------------------|--------------------------|-------------------------------------|--------------------------|
| Number<br>of                        | Increase in<br>Allowance | Number<br>of                        | Increase in<br>Allowance |

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|                    | Modifications<br>(as of period end) |      |      | Modifications<br>(as of period end) |            |           |
|--------------------|-------------------------------------|------|------|-------------------------------------|------------|-----------|
| One-to-four family | -                                   | \$ - | \$ - | 1                                   | \$ 121,427 | \$ 13,561 |
| Multi-family       | -                                   | -    | -    | -                                   | -          | -         |
| Non-residential    | -                                   | -    | -    | -                                   | -          | -         |
| Commercial         | -                                   | -    | -    | -                                   | -          | -         |
| Consumer direct    | -                                   | -    | -    | -                                   | -          | -         |
| Purchased auto     | -                                   | -    | -    | -                                   | -          | -         |
|                    | -                                   | \$ - | \$ - | 1                                   | \$ 121,427 | \$ 13,561 |

|                    | Six Months Ended<br>June 30, 2013                   |                          |      | Six Months Ended<br>June 30, 2012                   |                          |           |
|--------------------|---|--------------------------|------|---|--------------------------|-----------|
|                    | Number<br>of<br>Modifications<br>(as of period end) | Increase in<br>Allowance |      | Number<br>of<br>Modifications<br>(as of period end) | Increase in<br>Allowance |           |
| One-to-four family | -   | \$ -                     | \$ - | 1   | \$ 121,427               | \$ 13,561 |
| Multi-family       | -   | -                        | -    | -   | -                        | -         |
| Non-residential    | -   | -                        | -    | -   | -                        | -         |
| Commercial         | -   | -                        | -    | -   | -                        | -         |
| Consumer direct    | -   | -                        | -    | -   | -                        | -         |
| Purchased auto     | -   | -                        | -    | -   | -                        | -         |
|                    | -   | \$ -                     | \$ - | 1   | \$ 121,427               | \$ 13,561 |

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

|                    | Three Months<br>Ended<br>June 30, 2013          | Three Months<br>Ended<br>June 30, 2012          |
|--------------------|---|---|
|                    | Number<br>of Recorded                           | Number<br>of Recorded                           |
|                    | Investment<br>Defaults<br>(as of period<br>end) | Investment<br>Defaults<br>(as of period<br>end) |
| One-to-four family | - \$ -  | - \$ -  |
| Multi-family       | - -   | - -   |
| Non-residential    | - -   | - -   |
| Commercial         | - -   | - -   |
| Consumer direct    | - -   | - -   |
| Purchased auto     | - -   | - -   |
|                    | - \$ -  | - \$ -  |

|                    | Six Months<br>Ended<br>June 30, 2013            | Six Months<br>Ended<br>June 30, 2012            |
|--------------------|---|---|
|                    | Number<br>of Recorded                           | Number<br>of Recorded                           |
|                    | Investment<br>Defaults<br>(as of period<br>end) | Investment<br>Defaults<br>(as of period<br>end) |
| One-to-four family | - \$ -  | 1 \$ 212,014                                    |
| Multi-family       | - -   | - -   |
| Non-residential    | - -   | - -   |
| Commercial         | - -   | - -   |
| Consumer direct    | - -   | - -   |
| Purchased auto     | - -   | - -   |
|                    | - \$ -  | 1 \$ 212,014                                    |

All TDRs are evaluated for possible impairment and any impairment identified is recognized through the allowance. Qualitative factors are updated quarterly for trends in economic and nonperforming factors.

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

| <b>June 30, 2013</b> | Loans<br>Past Due |                          |
|----------------------|-------------------|--------------------------|
|                      | Nonaccrual        | Over 90<br>Days<br>Still |
|                      |                   | Accruing                 |
| One-to-four family   | \$3,432,835       | \$ 14,737                |
| Multi-family         | -                 | -                        |
| Non-residential      | 2,479,715         | 51,353                   |
| Commercial           | -                 | 23,490                   |
| Consumer direct      | -                 | 647                      |
| Purchased auto       | -                 | -                        |
|                      | \$5,912,550       | \$ 90,227                |



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

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

|                      | Loans<br>30-59<br>Days Past<br>Due | Loans 60-<br>89 Days<br>Past Due | Loans 90<br>or<br>More<br>Days<br>Past Due | Total Past<br>Due Loans | Current<br>Loans | Total Loans   |
|----------------------|------------------------------------|----------------------------------|--|-------------------------|------------------|---------------|
| <b>June 30, 2013</b> |                                    |                                  |  |                         |                  |               |
| One-to-four family   | \$2,269,570                        | \$947,795                        | \$907,860                                  | \$4,125,225             | \$76,697,260     | \$80,822,485  |
| Multi-family         | -                                  | -                                | -  | -                       | 2,914,806        | 2,914,806     |
| Non-residential      | 45,213                             | 168,587                          | 51,353                                     | 265,153                 | 18,356,974       | 18,622,127    |
| Commercial           | 21,539                             | -                                | 23,490                                     | 45,029                  | 7,884,025        | 7,929,054     |
| Consumer direct      | -                                  | -                                | 647  | 647                     | 509,324          | 509,971       |
| Purchased auto       | -                                  | -                                | -  | -                       | 8,936,722        | 8,936,722     |
|                      | \$2,336,322                        | \$1,116,382                      | \$983,350                                  | \$4,436,054             | \$115,299,111    | \$119,735,165 |

|                          | Loans<br>30-59<br>Days Past<br>Due | Loans 60-<br>89 Days<br>Past Due | Loans 90<br>or<br>More Days<br>Past Due | Total Past<br>Due Loans | Current<br>Loans | Total Loans |
|--------------------------|------------------------------------|----------------------------------|---|-------------------------|------------------|-------------|
| <b>December 31, 2012</b> |                                    |                                  |   |                         |                  |             |

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|                    |             |           |             |             |               |               |
|--------------------|-------------|-----------|-------------|-------------|---------------|---------------|
| One-to-four family | \$2,322,111 | \$616,274 | \$1,621,408 | \$4,559,793 | \$78,458,963  | \$83,018,756  |
| Multi-family       | 97,267      | -         | -           | 97,267      | 4,752,499     | 4,849,766     |
| Non-residential    | 473,458     | 334,389   | 516,414     | 1,324,261   | 19,182,599    | 20,506,860    |
| Commercial         | 23,601      | -         | -           | 23,601      | 8,624,590     | 8,648,191     |
| Consumer direct    | -           | -         | -           | -           | 542,652       | 542,652       |
| Purchased auto     | 6,422       | 19,257    | -           | 25,679      | 7,784,388     | 7,810,067     |
|                    | \$2,922,859 | \$969,920 | \$2,137,822 | \$6,030,601 | \$119,345,691 | \$125,376,292 |

Credit Quality Indicators:

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

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

The Company uses the following definitions for risk ratings:

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

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

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

Doubtful – loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable.

Not Rated – loans in this bucket are not evaluated on an individual basis.

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

| <b>June 30, 2013</b> | Pass         | Special<br>Mention | Substandard | Doubtful | Not rated    |
|----------------------|--------------|--------------------|-------------|----------|--------------|
| One-to-four family   | \$-          | \$3,962,734        | \$3,335,911 | \$ -     | \$73,523,840 |
| Multi-family         | -            | 195,270            | -           | -        | 2,719,536    |
| Non-residential      | 14,650,533   | 1,741,369          | 2,230,225   | -        | -            |
| Commercial           | 7,766,765    | 162,289            | -           | -        | -            |
| Consumer direct      | -            | -                  | -           | -        | 509,971      |
| Purchased auto       | -            | -                  | -           | -        | 8,936,722    |
| Total                | \$22,417,298 | \$6,061,662        | \$5,566,136 | \$ -     | \$85,690,069 |

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

#### NOTE 9 – STOCK COMPENSATION

Total stock-based compensation expense was approximately \$14,000 and \$4,000 for the six months ended June 30, 2013 and 2012, respectively. In accordance with FASB ASC 718, *Compensation-Stock Compensation*, compensation expense is recognized on a straight-line basis over the grantees' vesting period or to the grantees' retirement eligibility date, if earlier. During the six months ended June 30, 2013 and 2012, the Company did not grant additional options or shares under the MRP.

#### NOTE 10 – RECENT ACCOUNTING DEVELOPMENTS

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

NOTE 11 – FAIR VALUE MEASUREMENT AND DISCLOSURE

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

Basis of Fair Value Measurement:

- Level 1 - Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets.
  
- Level 2 - Significant other observable inputs other than Level 1 prices such as quoted prices in markets that are not active, quoted prices for similar assets, or other inputs that are observable, either directly or indirectly, for substantially the full term of the asset.
  
- Level 3 - Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported by little or no market activity).

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

Securities Available for Sale

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

corporations and agencies, state and municipal securities, 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.

#### Foreclosed Assets

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

#### Impaired Loans

Impaired loans are evaluated and adjusted to the lower of carrying value or fair value less estimated costs to sell at the time the loan is identified as impaired. Impaired loans are carried at the lower of cost or fair value. Fair value is measured based on the value of the collateral securing these loans. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the impaired loan as non-recurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the impaired loan as non-recurring Level 3.

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

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

| <b>June 30, 2013</b>                                      | <b>Level</b> | <b>Level 2</b> | <b>Level</b> | <b>Total</b>      |
|---|--------------|----------------|--------------|-------------------|
|   | <b>1</b>     |                | <b>3</b>     | <b>Fair Value</b> |
| State and municipal securities available for sale         | \$ -         | \$8,598,738    | \$ -         | \$8,598,738       |
| Residential mortgage-backed securities available for sale | -            | 27,269,741     | -            | 27,269,741        |
|   | \$ -         | \$35,868,479   | \$ -         | \$35,868,479      |

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

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

| <b>June 30, 2013</b> | <b>Level</b> | <b>Level</b> | <b>Level 3</b> | <b>Total</b>      |
|----------------------|--------------|--------------|----------------|-------------------|
|                      | <b>1</b>     | <b>2</b>     |                | <b>Fair Value</b> |
| Foreclosed assets    | \$ -         | \$ -         | \$812,362      | \$812,362         |
| Impaired loans, net  | -            | -            | 2,226,168      | 2,226,168         |

| <b>December 31, 2012</b> | <b>Level</b> | <b>Level</b> | <b>Level 3</b> | <b>Total</b>      |
|--------------------------|--------------|--------------|----------------|-------------------|
|                          | <b>1</b>     | <b>2</b>     |                | <b>Fair Value</b> |
| Foreclosed assets        | \$ -         | \$ -         | \$1,305,921    | \$1,305,921       |
| Impaired loans, net      | -            | -            | 3,597,690      | 3,597,690         |

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

| Carrying<br>Amount | Fair Value Measurements at<br>June 30, 2013 using: |         |         |       |
|--------------------|--|---------|---------|-------|
|                    | Level 1  | Level 2 | Level 3 | Total |

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Financial Assets:

|                             |             |             |            |             |             |
|-----------------------------|-------------|-------------|------------|-------------|-------------|
| Cash and cash equivalents   | \$5,732,546 | \$5,732,546 | \$-        | \$-         | \$5,732,546 |
| Federal funds sold          | 3,851,000   | 3,851,000   | -          | -           | 3,851,000   |
| Securities                  | 37,102,015  | -           | 37,102,015 | -           | 37,102,015  |
| Accrued interest receivable | 751,773     | 751,773     | -          | -           | 751,773     |
| Net loans                   | 115,884,943 | -           | -          | 117,576,000 | 117,576,000 |
| Loans held for sale         | 83,600      | 83,600      | -          | -           | 83,600      |
| Mortgage servicing rights   | 157,527     | -           | -          | 157,527     | 157,527     |

Financial Liabilities:

|                               |             |           |   |             |             |
|-------------------------------|-------------|-----------|---|-------------|-------------|
| Non-interest bearing deposits | 4,730,037   | 4,730,037 | - | -           | 4,730,037   |
| Interest bearing deposits     | 147,869,772 | -         | - | 147,884,963 | 147,884,963 |
| Accrued interest payable      | 2,420       | 2,420     | - | -           | 2,420       |



|                               | Carrying<br>Amount | Fair Value Measurements at<br>December 31, 2012 using: |            |             | Total         |
|-------------------------------|--------------------|--|------------|-------------|---------------|
|                               |                    | Level 1  | Level 2    | Level 3     |               |
| <b>Financial Assets:</b>      |                    |  |            |             |               |
| Cash and cash equivalents     | \$ 10,787,989      | \$ 10,787,989  | \$ -       | \$ -        | \$ 10,787,989 |
| Federal funds sold            | 1,666,000          | 1,666,000  | -          | -           | 1,666,000     |
| Securities                    | 30,198,051         | -  | 30,198,052 | -           | 30,198,052    |
| Accrued interest receivable   | 696,638            | 696,638  | -          | -           | 696,638       |
| Net Loans                     | 121,994,851        | -  | -          | 123,748,000 | 123,748,000   |
| Loans held for sale           | 171,095            | 171,095  | -          | -           | 171,095       |
| Mortgage servicing rights     | 152,873            | -  | -          | 152,873     | 152,873       |
| <b>Financial Liabilities:</b> |                    |  |            |             |               |
| Non-interest bearing deposits | 4,313,635          | 4,313,635  | -          | -           | 4,313,635     |
| Interest bearing deposits     | 150,761,010        | -  | -          | 150,921,365 | 150,921,365   |
| Accrued interest payable      | 806                | 806  | -          | -           | 806           |

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

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

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

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

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

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

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

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

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

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

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

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

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

### FORWARD-LOOKING INFORMATION

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

## GENERAL

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

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

The Company's total assets decreased \$2.1 million, or 1.2%, to \$177.0 million at June 30, 2013, from \$179.0 million at December 31, 2012. The decrease in assets was primarily due to a decrease in loans of \$6.1 million, and a decrease in cash and cash equivalents of \$5.1 million. The decrease in assets was partially offset by an increase in securities available for sale of \$7.0 million and an increase in federal funds sold of \$2.2 million.

Cash and cash equivalents decreased \$5.1 million, or 46.9%, to \$5.7 million at June 30, 2013 from \$10.8 million at December 31, 2012, primarily as a result of cash used in investing and financing activities exceeding the cash provided by operating activities.

Securities available for sale increased \$7.0 million, or 24.3%, to \$35.9 million at June 30, 2013 from \$28.9 million at December 31, 2012. The increase was primarily the result of \$11.6 million in purchases offset by pay-downs of \$3.6 million.

Loans, net of the allowance for loan losses, decreased \$6.1 million, or 5.0%, to \$115.9 million at June 30, 2013 from \$122.0 million at December 31, 2012. The decrease in loans, net of the allowance for loan losses, was primarily caused by a combination of normal attrition, pay-downs, loan charge-offs and strategic initiatives to reduce lending exposure in one-to-four family residential, non-residential loans, and multifamily residential loans, augmented by an increase in the allowance for loan losses of \$0.5 million and partially offset by an increase of \$1.1 million in the purchased auto loan portfolio. The Company is focusing its lending efforts on customers based primarily in its local market and purchased auto loans from regulated financial institutions.

Foreclosed real estate decreased approximately \$0.5 million, or 41.2%, to \$0.8 million at June 30, 2013 from \$1.3 million at December 31, 2012. The decrease was primarily due to the sale of 13 properties for aggregate proceeds of \$0.8 million offset by the addition of four properties valued at \$0.3 million acquired through loan foreclosures due to the continued stress the economic environment has placed on the Company's customers.

Other assets comprised primarily of prepaid expenses, deferred director compensation accounts, and auto loan repossessions, were comparable between periods as the balances were \$1.3 million at June 30, 2013 and \$1.4 million at December 31, 2012.

Total deposits decreased \$2.5 million, or 1.6%, to \$152.6 million at June 30, 2013, from \$155.1 million at December 31, 2012. The decrease is primarily due to a decrease in certificates of deposit of \$5.7 million, or 5.6%, from December 31, 2012 to June 30, 2013. The decrease was partially offset by an increase in savings accounts of \$1.4 million, or 8.9%, an increase in money market accounts of \$0.6 million, or 2.7%, and an increase in checking accounts of \$1.3 million, or 7.8% from December 31, 2012 to June 30, 2013. The increase in savings, money market, and checking accounts is primarily due to customers moving funds into non-term products as they wait for a better rate environment. The reduction in certificate of deposit accounts is due to management's strategic initiative to pay competitive rates, but not the highest rates in the market.

Other liabilities comprised of primarily deferred compensation expenses, accrued expenses and escrow payable, increased slightly as the balances were \$3.0 million at June 30, 2013 compared to \$2.7 million at December 31, 2012.

Equity remained constant, decreasing about \$20,000, or 0.1%, to remain \$21.0 million at June 30, 2013. The slight decrease in equity is primarily a result of other comprehensive losses on available for sale securities during the period of approximately \$0.4 million and an increase in the cash obligation related to ESOP shares of approximately \$0.1 million, offset by net income for the six months ended June 30, 2013 of approximately \$0.5 million.

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

The Company's nonperforming assets consist of non-accrual loans, loans past due greater than 90 days and still accruing and foreclosed real estate. Loans are generally placed on non-accrual status when it is apparent all of the contractual payments (i.e. principal and interest) will not be received; however, they may be placed on non-accrual status sooner if management has significant doubt as to the collection of all amounts due. Interest previously accrued but uncollected is reversed and charged against interest income. During the first six months of 2013, nonaccrual loans decreased 2.3% to \$5.9 million from \$6.1 million as of December 31, 2012. The decrease is a result of payoffs on two loans totaling approximately \$1.1 million, three loans totaling approximately \$0.4 million that were upgraded to performing status, two loans with partial charge-offs totaling approximately \$0.1 million, one loan of approximately \$0.3 million was moved to held for sale and subsequently sold, and three loans of approximately \$0.3 million were moved to foreclosed real estate. The decreases were offset by the addition of 15 one-to-four family loans totaling approximately \$2.0 million and two non-residential loans totaling approximately \$0.2 million that were placed on non-accrual status, as certain customers continue to be challenged by local economic conditions during these difficult economic times.

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

|   | <b>June<br/>30,<br/>2013</b> | <b>March<br/>31,<br/>2013</b> | <b>December<br/>31,<br/>2012</b> | <b>September<br/>30,<br/>2012</b> | <b>June<br/>30,<br/>2012</b> |
|---|------------------------------|-------------------------------|----------------------------------|-----------------------------------|------------------------------|
|   | <b>(In Thousands)</b>        |                               |                                  |                                   |                              |
| Non-accrual:                                      |                              |                               |                                  |                                   |                              |
| One-to-four family                                | \$3,433                      | \$4,153                       | \$ 3,067                         | \$ 5,687                          | \$6,481                      |
| Multi-family                                      | -                            | -                             | -                                | 5                                 | 6                            |
| Non-residential real estate                       | 2,480                        | 2,355                         | 2,986                            | 1,618                             | 1,740                        |
| Commercial  | -                            | -                             | -                                | -                                 | -                            |
| Consumer direct                                   | -                            | -                             | -                                | -                                 | 18                           |
| Purchased auto                                    | -                            | -                             | -                                | 17                                | -                            |
| Total non-accrual loans                           | 5,913                        | 6,508                         | 6,053                            | 7,327                             | 8,245                        |
| Past due greater than 90 days and still accruing: |                              |                               |                                  |                                   |                              |
| One-to-four family                                | 15                           | 15                            | 107                              | 64                                | -                            |
| Non-residential real estate                       | 51                           | -                             | 164                              | -                                 | -                            |
| Commercial  | 23                           | -                             | -                                | -                                 | -                            |
| Consumer direct                                   | 1                            | 1                             | -                                | -                                 | -                            |
| Total nonperforming loans                         | 6,003                        | 6,524                         | 6,324                            | 7,391                             | 8,245                        |
| Foreclosed real estate                            | 763                          | 900                           | 1,297                            | 1,122                             | 1,247                        |
| Other repossessed assets                          | 50                           | 12                            | 9                                | 19                                | -                            |
| Total nonperforming assets                        | \$6,816                      | \$7,436                       | \$ 7,630                         | \$ 8,532                          | \$9,492                      |

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

|   | <b>June<br/>30,<br/>2013</b> | <b>March<br/>31,<br/>2013</b> | <b>December<br/>31,<br/>2012</b> | <b>September<br/>30,<br/>2012</b> | <b>June<br/>30,<br/>2012</b> |
|---|------------------------------|-------------------------------|----------------------------------|-----------------------------------|------------------------------|
| Allowance for loan losses as a percent of gross loans receivable    | 3.21 %                       | 2.90 %                        | 2.69 %                           | 2.80 %                            | 3.29 %                       |
| Allowance for loan losses as a percent of total nonperforming loans | 64.13 %                      | 55.13 %                       | 53.46 %                          | 49.47 %                           | 51.96 %                      |
| Nonperforming loans as a percent of gross loans receivable          | 5.01 %                       | 5.25 %                        | 5.04 %                           | 5.66 %                            | 6.34 %                       |

|   |        |        |        |        |        |
|---|--------|--------|--------|--------|--------|
| Nonperforming loans as a percent of total assets  | 3.39 % | 3.58 % | 3.53 % | 4.06 % | 4.44 % |
| Nonperforming assets as a percent of total assets | 3.85 % | 4.08 % | 4.26 % | 4.68 % | 5.11 % |

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

*General.* Net income for the three months ended June 30, 2013 was \$200,000 compared to net income of \$155,000 for the three months ended June 30, 2012. Net income improved during the second quarter of 2013 primarily due to lower levels of provision for loan losses than in the 2012 period, lower funding costs, and increases in other income. These positive variances were slightly offset by lower interest and dividend income, an increase in operating costs, and increased tax expenses.

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

|   | Three Months Ended<br>June 30, |                |                 |                 |
|---|--------------------------------|----------------|-----------------|-----------------|
|   | 2013                           | 2012           | \$<br>change    | %<br>change     |
| <b>(Dollars in thousands)</b>                 |                                |                |                 |                 |
| Interest and dividend income:                 |                                |                |                 |                 |
| Interest and fees on loans                    | \$1,606                        | \$1,806        | \$ (200 )       | (11.07 )%       |
| Securities:                                   |                                |                |                 |                 |
| Residential mortgage-backed securities        | 106                            | 164            | (58 )           | (35.37 )        |
| U.S. agency securities                        | -                              | 16             | (16 )           | (100.00)        |
| State and municipal securities                | 66                             | 51             | 15              | 29.41           |
| Dividends on non-marketable equity securities | 1                              | 1              | -               | -               |
| Interest-bearing deposits                     | 2                              | 2              | -               | -               |
| <b>Total interest and dividend income</b>     | <b>1,781</b>                   | <b>2,040</b>   | <b>(259 )</b>   | <b>(12.70 )</b> |
| Interest expense:                             |                                |                |                 |                 |
| Deposits                                      | 385                            | 553            | (168 )          | (30.38 )        |
| <b>Total interest expense</b>                 | <b>385</b>                     | <b>553</b>     | <b>(168 )</b>   | <b>(30.38 )</b> |
| <b>Net interest income</b>                    | <b>\$1,396</b>                 | <b>\$1,487</b> | <b>\$ (91 )</b> | <b>(6.12 )%</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.

|   | <b>Three Months Ended June 30,</b> |                 |                |               |                |                 |                |               |
|---|------------------------------------|-----------------|----------------|---------------|----------------|-----------------|----------------|---------------|
|   | <b>2013</b>                        |                 | <b>2012</b>    |               | <b>2013</b>    |                 | <b>2012</b>    |               |
|   | <b>AVERAGE</b>                     | <b>INTEREST</b> | <b>AVERAGE</b> | <b>YIELD/</b> | <b>AVERAGE</b> | <b>INTEREST</b> | <b>AVERAGE</b> | <b>YIELD/</b> |
|   | <b>BALANCE</b>                     | <b>COST</b>     | <b>BALANCE</b> | <b>COST</b>   | <b>BALANCE</b> | <b>COST</b>     | <b>BALANCE</b> | <b>COST</b>   |
|   | <b>(Dollars in thousands)</b>      |                 |                |               |                |                 |                |               |
| Interest-earning assets   |                                    |                 |                |               |                |                 |                |               |
| Loans receivable, net (1)   | \$ 115,603                         | \$ 1,606        | 5.56           | %             | \$ 126,288     | \$ 1,806        | 5.72           | %             |
| Securities, net (2)   | 33,808                             | 172             | 2.04           | %             | 34,514         | 231             | 2.68           | %             |
| Non-marketable equity securities  | 1,267                              | 1               | 0.32           | %             | 1,815          | 1               | 0.22           | %             |
| Interest-bearing deposits   | 9,478                              | 2               | 0.80           | %             | 7,169          | 2               | 0.11           | %             |
| Total interest-earning assets   | 160,156                            | 1,781           | 4.45           | %             | 169,786        | 2,040           | 4.81           | %             |
| Interest-bearing liabilities  |                                    |                 |                |               |                |                 |                |               |
| Money Market accounts   | \$ 21,060                          | \$ 12           | 0.23           | %             | \$ 21,257      | \$ 22           | 0.41           | %             |
| Passbook accounts   | 16,925                             | 3               | 0.07           | %             | 15,574         | 7               | 0.18           | %             |
| Certificates of Deposit accounts  | 98,348                             | 368             | 1.50           | %             | 108,453        | 521             | 1.92           | %             |
| Checking accounts   | 13,664                             | 2               | 0.06           | %             | 13,199         | 3               | 0.09           | %             |
| Total interest-bearing liabilities  | 149,997                            | 385             | 1.03           | %             | 158,483        | 553             | 1.40           | %             |
| <b>NET INTEREST INCOME</b>  |                                    | \$ 1,396        |                |               |                | \$ 1,487        |                |               |
| <b>NET INTEREST RATE SPREAD (3)</b>   |                                    |                 | 3.42           | %             |                |                 | 3.41           | %             |
| <b>NET INTEREST MARGIN (4)</b>  |                                    |                 | 3.49           | %             |                |                 | 3.50           | %             |
| <b>RATIO OF AVERAGE INTEREST-EARNING ASSETS TO AVERAGE INTEREST-BEARING LIABILITIES</b> |                                    |                 | 106.77         | %             |                |                 | 107.13         | %             |

(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 three months ended June 30, 2013 and 2012. The column "Net" is segmented into the changes attributable to variations in volume and the changes attributable to changes in interest rates. The variations attributable to simultaneous volume and rate changes have been proportionately allocated to rate and volume.

|                                    | <b>Three Months Ended<br/>June 30,<br/>2013 Compared to<br/>2012</b> |             |            |
|------------------------------------|--|-------------|------------|
|                                    | <b>Increase (Decrease)</b>   |             |            |
|                                    | <b>Due to</b>  |             |            |
|                                    | <b>VOLUME</b>  | <b>RATE</b> | <b>NET</b> |
|                                    | <b>(Dollars in<br/>Thousands)</b>                                    |             |            |
| Interest and dividends earned on   |  |             |            |
| Loans receivable, net              | \$(148)  | \$(52 )     | \$(200)    |
| Securities, net                    | (4 )   | (55 )       | (59 )      |
| Non-marketable equity securities   | -  | -           | -          |
| Interest-bearing deposits          | -  | -           | -          |
| Total interest-earning assets      | \$(152)  | \$(107 )    | \$(259)    |
| Interest expense on                |  |             |            |
| Money Market accounts              | \$-  | \$(10 )     | \$(10 )    |
| Passbook accounts                  | -  | (4 )        | (4 )       |
| Certificates of Deposit accounts   | (38 )  | (115 )      | (153)      |
| Checking                           | -  | (1 )        | (1 )       |
| Total interest-bearing liabilities | (38 )  | (130 )      | (168)      |
| Change in net interest income      | \$(114)  | \$23        | \$(91 )    |

Net interest income decreased \$91,000, or 6.1%, to \$1.4 million for the three months ended June 30, 2013 compared to \$1.5 million for the three months ended June 30, 2012. Interest and dividend income decreased \$259,000 due to the decline in average interest earning assets of \$9.6 million and the yield decreasing on interest earning assets from 4.8% to 4.5%. The decline in the securities and loan portfolios contributed to a significant amount of the decline in earning assets. The yield on the investment portfolio and the loan portfolio declined as the low rate environment continued during the second quarter of 2013. This decline in interest income was offset by a \$168,000, or 30.4%, reduction in interest expense. The cost of funds declined 37 basis points, or 26.4%, for the three months ended June 30, 2013 compared to the three months ended June 30, 2012, due to the continued low rate environment. Additionally, the average balance of interest bearing liabilities declined by \$8.5 million, or 5.4%.

*Provision for Loan Losses.* Management recorded a loan loss provision of \$220,000 for the three months ended June 30, 2013, compared to \$563,500 for the three months ended June 30, 2012. The provision is primarily attributed to the reserves required for the one-to-four family segment as the economic conditions in the local market continue to negatively impact collateral values of real estate and the ability of borrowers to keep current per terms of their obligations. The decreased payment activity and continued degradation of property values are the result of local economic conditions continuing to lag national indicators, including higher levels of unemployment locally of 9.3%, versus 9.1% for the State of Illinois and the national level of 7.6%. During the current period, the level of charge-off has declined due to a recovery on a large loan which had a positive impact on our historical loss results.

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

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

|   | <b>Three months ended<br/>June 30,</b> |             |                  |                 |
|---|--|-------------|------------------|-----------------|
|   | <b>2013</b>                            | <b>2012</b> | <b>\$ change</b> | <b>% change</b> |
|   | <b>(Dollars in thousands)</b>          |             |                  |                 |
| Other income:   |  |             |                  |                 |
| Gain on sale of securities                                    | \$ -                                   | \$ -        | \$ -             | - %             |
| Gain on sale of loans   | 28                                     | 31          | (3 )             | (9.68 )         |
| Gain on sale of OREO  | -                                      | -           | -                | -               |
| Origination of mortgage servicing rights, net of amortization | 1                                      | -           | 1                | 100.00          |
| Customer service fees   | 72                                     | 70          | 2                | 2.86            |

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|                                     |               |               |               |                |
|-------------------------------------|---------------|---------------|---------------|----------------|
| Income on bank owned life insurance | 5             | 7             | (2 )          | (28.57 )       |
| Other                               | 128           | 18            | 110           | 611.11         |
| <b>Total other income</b>           | <b>\$ 234</b> | <b>\$ 126</b> | <b>\$ 108</b> | <b>85.71 %</b> |

The increase in total other income was primarily a result of the receipt of a \$108,000 recovery of fraud losses on consumer loans, related to frauds which occurred during 2011 and 2012.

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

|  | <b>Three months ended<br/>June 30,</b> |               |                  |  |                 |
|--|--|---------------|------------------|--|-----------------|
|  | <b>2013</b>                            | <b>2012</b>   | <b>\$ change</b> |  | <b>% change</b> |
|  | <b>(Dollars in thousands)</b>          |               |                  |  |                 |
| Other expenses:  |  |               |                  |  |                 |
| Salaries and employee benefits                               | \$ 379                                 | \$ 364        | \$ 15            |  | 4.12 %          |
| Directors fees   | 25                                     | 21            | 4                |  | 19.05           |
| Occupancy  | 111                                    | 112           | (1 )             |  | (0.89 )         |
| Deposit insurance premium                                    | 57                                     | 60            | (3 )             |  | (5.00 )         |
| Legal and professional services                              | 73                                     | 56            | 17               |  | 30.36           |
| Data processing  | 75                                     | 65            | 10               |  | 15.38           |
| Valuation adjustments and expenses on foreclosed real estate | 70                                     | 26            | 44               |  | 169.23          |
| Loss on sale of OREO   | 37                                     | 10            | 27               |  | 270.00          |
| Loss on sale of repossessed assets                           | -                                      | 2             | (2 )             |  | (100.00 )       |
| Loss on consumer loans                                       | -                                      | -             | -                |  | -               |
| Other  | 149                                    | 145           | 4                |  | 2.76            |
| <b>Total other expenses</b>                                  | <b>\$ 976</b>                          | <b>\$ 861</b> | <b>\$ 115</b>    |  | <b>13.36 %</b>  |
| Efficiency ratio (1)   | 59.88 %                                | 53.38 %       |                  |  |                 |

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

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

*Income Taxes.* The Company recorded income tax expenses of \$234,000 and \$33,300 for the three months ended June 30, 2013 and 2012, respectively.

## **COMPARISON OF RESULTS OF OPERATION FOR THE SIX MONTHS ENDED JUNE 30, 2013 AND 2012**

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*General.* Net income for the six months ended June 30, 2013 was \$466,500 compared to net income of \$394,900 for the six months ended June 30, 2012. Net income improved during the six months of 2013 primarily due to lower levels of provision for loan losses than in the 2012 period, lower funding costs, and increases in other income. These positive variances were slightly offset by lower interest and dividend income, an increase in operating costs, and increased tax expenses.

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

|   | <b>Six Months Ended</b>       |                |                  |                 |
|---|-------------------------------|----------------|------------------|-----------------|
|   | <b>June 30,</b>               |                |                  |                 |
|   | <b>2013</b>                   | <b>2012</b>    | <b>\$</b>        | <b>%</b>        |
|   |                               |                | <b>change</b>    | <b>change</b>   |
|   | <b>(Dollars in thousands)</b> |                |                  |                 |
| Interest and dividend income:                 |                               |                |                  |                 |
| Interest and fees on loans                    | \$3,266                       | \$3,583        | \$ (317 )        | (8.85 )%        |
| Securities:                                   |                               |                |                  |                 |
| Residential mortgage-backed securities        | 220                           | 352            | (132 )           | (37.50 )        |
| U.S. agency securities                        | -                             | 33             | (33 )            | (100.00)        |
| State and municipal securities                | 128                           | 92             | 36               | 39.13           |
| Dividends on non-marketable equity securities | 2                             | 2              | -                | -               |
| Interest-bearing deposits                     | 3                             | 3              | -                | -               |
| <b>Total interest and dividend income</b>     | <b>3,619</b>                  | <b>4,065</b>   | <b>(446 )</b>    | <b>(10.97 )</b> |
| Interest expense:                             |                               |                |                  |                 |
| Deposits                                      | 809                           | 1,140          | (331 )           | (29.04 )        |
| <b>Total interest expense</b>                 | <b>809</b>                    | <b>1,140</b>   | <b>(331 )</b>    | <b>(29.04 )</b> |
| <b>Net interest income</b>                    | <b>\$2,810</b>                | <b>\$2,925</b> | <b>\$ (115 )</b> | <b>(3.93 )%</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.

|   | Six Months Ended June 30,<br>2013 |                 |                           |          | 2012               |                 |                           |          |
|---|-----------------------------------|-----------------|---------------------------|----------|--------------------|-----------------|---------------------------|----------|
|   | AVERAGE<br>BALANCE                | INTEREST        | AVERAGE<br>YIELD/<br>COST |          | AVERAGE<br>BALANCE | INTEREST        | AVERAGE<br>YIELD/<br>COST |          |
|   | <b>(Dollars in thousands)</b>     |                 |                           |          |                    |                 |                           |          |
| Interest-earning assets   |                                   |                 |                           |          |                    |                 |                           |          |
| Loans receivable, net (1)   | \$ 118,446                        | \$ 3,266        | 5.51                      | %        | \$ 125,214         | \$ 3,583        | 5.72                      | %        |
| Securities, net (2)   | 32,439                            | 348             | 2.15                      | %        | 34,244             | 477             | 2.79                      | %        |
| Non-marketable equity securities  | 1,301                             | 2               | 0.31                      | %        | 1,974              | 2               | 0.20                      | %        |
| Interest-bearing deposits   | 10,288                            | 3               | 0.06                      | %        | 6,194              | 3               | 0.10                      | %        |
| Total interest-earning assets   | 162,474                           | 3,619           | 4.45                      | %        | 167,626            | 4,065           | 4.85                      | %        |
| Interest-bearing liabilities  |                                   |                 |                           |          |                    |                 |                           |          |
| Money Market accounts   | \$ 21,065                         | \$ 26           | 0.25                      | %        | \$ 20,381          | \$ 48           | 0.47                      | %        |
| Passbook accounts   | 16,640                            | 8               | 0.10                      | %        | 14,963             | 11              | 0.15                      | %        |
| Certificates of Deposit accounts  | 99,904                            | 772             | 1.55                      | %        | 109,581            | 1,075           | 1.96                      | %        |
| Checking accounts   | 13,472                            | 3               | 0.04                      | %        | 12,974             | 6               | 0.90                      | %        |
| Total interest-bearing liabilities  | 151,081                           | 809             | 1.07                      | %        | 157,899            | 1,140           | 1.44                      | %        |
| <b>NET INTEREST INCOME</b>  |                                   | <b>\$ 2,810</b> |                           |          |                    | <b>\$ 2,925</b> |                           |          |
| <b>NET INTEREST RATE SPREAD (3)</b>   |                                   |                 | <b>3.38</b>               | <b>%</b> |                    |                 | <b>3.41</b>               | <b>%</b> |
| <b>NET INTEREST MARGIN (4)</b>  |                                   |                 | <b>3.46</b>               | <b>%</b> |                    |                 | <b>3.49</b>               | <b>%</b> |
| <b>RATIO OF AVERAGE<br/>INTEREST-EARNING ASSETS TO<br/>AVERAGE INTEREST-BEARING<br/>LIABILITIES</b> |                                   |                 | <b>107.54</b>             | <b>%</b> |                    |                 | <b>106.16</b>             | <b>%</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, 2013 and 2012. The column "Net" is segmented into the changes attributable to variations in volume and the changes attributable to changes in interest rates. The variations attributable to simultaneous volume and rate changes have been proportionately allocated to rate and volume.

**Six Months Ended  
June 30,  
2013 Compared to  
2012  
Increase (Decrease)  
Due to  
VOLUNTARY NET  
(Dollars in  
Thousands)**

|                                    |         |          |         |
|------------------------------------|---------|----------|---------|
| Interest and dividends earned on   |         |          |         |
| Loans receivable, net              | \$(188) | \$(129 ) | \$(317) |
| Securities, net                    | (19 )   | (110 )   | (129)   |
| Non-marketable equity securities   | (1 )    | 1        | -       |
| Interest-bearing deposits          | 1       | (1 )     | -       |
| Total interest-earning assets      | \$(207) | \$(239 ) | \$(446) |
| Interest expense on                |         |          |         |
| Money Market accounts              | \$1     | \$(23 )  | \$(22 ) |
| Passbook accounts                  | 1       | (4 )     | (3 )    |
| Certificates of Deposit accounts   | (75 )   | (228 )   | (303)   |
| Checking                           | -       | (3 )     | (3 )    |
| Total interest-bearing liabilities | (73 )   | (258 )   | (331)   |
| Change in net interest income      | \$(134) | \$19     | \$(115) |



Net interest income decreased \$115,000, or 3.9%, to \$2.8 million for the six months ended June 30, 2013 compared to \$2.9 million for the six months ended June 30, 2012. Interest and dividend income decreased \$446,000 due to the decline in average interest earning assets of \$5.1 million and the yield decreasing on interest earning assets from 4.9% to 4.5%. The decline in the securities and loan portfolios contributed to a significant amount of the decline in earning assets. The yield on the investment portfolio and the loan portfolio declined as the low rate environment continued during the first six months of 2013. This decline in interest income was offset by a \$331,000, or 29.0%, reduction in interest expense. The cost of funds declined 37 basis points, or 25.7%, for the six months ended June 30, 2013 compared to the six months ended June 30, 2012, due to the continued low rate environment. Additionally, the average balance of interest bearing liabilities decreased by \$6.8 million, or 4.3%.

*Provision for Loan Losses.* Management recorded a loan loss provision of \$550,000 for the six months ended June 30, 2013, compared to \$1.0 million for the six months ended June 30, 2012. The provision is primarily attributed to the reserves required for the one-to-four family segment as the economic conditions in the local market continue to negatively impact collateral values of real estate and the ability of borrowers to keep current per terms of their obligations. The decreased payment activity and continued degradation of property values are the result of local economic conditions continuing to lag national indicators, including higher levels of unemployment locally of 9.3%, versus 9.1% for the State of Illinois and the national level of 7.6%. During the current period, the level of charge-off has declined due to a recovery on a large loan which had a positive impact on our historical loss results.

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

*Other Income.* The following table summarizes other income for the six months ended June 30, 2013 and 2012.

|   | <b>Six months ended</b>       |             |                  |                 |
|---|-------------------------------|-------------|------------------|-----------------|
|   | <b>June 30,</b>               |             |                  |                 |
|   | <b>2013</b>                   | <b>2012</b> | <b>\$ change</b> | <b>% change</b> |
|   | <b>(Dollars in thousands)</b> |             |                  |                 |
| Other income:   |                               |             |                  |                 |
| Gain on sale of securities                                    | \$ -                          | \$ 14       | \$ (14 )         | (100.00 )%      |
| Gain on sale of loans   | 47                            | 58          | (11 )            | (18.97 )        |
| Gain on sale of OREO  | 14                            | 70          | (56 )            | (80.00 )        |
| Origination of mortgage servicing rights, net of amortization | 5                             | 3           | 2                | 66.67           |
| Customer service fees   | 143                           | 139         | 4                | 2.88            |

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|                                     |               |               |              |                |
|-------------------------------------|---------------|---------------|--------------|----------------|
| Income on bank owned life insurance | 12            | 15            | (3 )         | (20.00 )       |
| Other                               | 159           | 30            | 129          | 430.00         |
| <b>Total other income</b>           | <b>\$ 380</b> | <b>\$ 329</b> | <b>\$ 51</b> | <b>15.50 %</b> |

The increase in total other income was primarily a result of the receipt of a \$108,000 recovery of fraud losses on consumer loans, related to frauds which occurred during 2011 and 2012. The increase was partially offset by decreases in gains on the sales of OREO, securities, and loans. During the first six months of 2013 the Company sold 13 of its OREO properties for a net gain of \$14,000 and during the first six months of 2012 the Company sold three of its OREO properties for a net gain of \$70,000. The decrease in gain on sale of securities is a result of there being no securities sold during 2013, while six securities were sold for a net gain during the 2012. The decrease in gain on sale of loans is a result of fewer loan originations and sales of loans during 2013 as compared to 2012.

*Other Expenses.* The following table summarizes other expenses for the six months ended June 30, 2013 and 2012.

|  | <b>Six months ended</b>       |                 |                  |                 |
|--|-------------------------------|-----------------|------------------|-----------------|
|  | <b>June 30,</b>               |                 |                  |                 |
|  | <b>2013</b>                   | <b>2012</b>     | <b>\$ change</b> | <b>% change</b> |
|  | <b>(Dollars in thousands)</b> |                 |                  |                 |
| Other expenses:  |                               |                 |                  |                 |
| Salaries and employee benefits                               | \$ 756                        | \$ 703          | \$ 53            | 7.54 %          |
| Directors fees   | 50                            | 42              | 8                | 19.05           |
| Occupancy  | 221                           | 217             | 4                | 1.84            |
| Deposit insurance premium                                    | 115                           | 120             | (5 )             | (4.17 )         |
| Legal and professional services                              | 142                           | 112             | 30               | 26.79           |
| Data processing  | 151                           | 161             | (10 )            | (6.21 )         |
| Valuation adjustments and expenses on foreclosed real estate | 175                           | 46              | 129              | 280.43          |
| Loss on sale of OREO   | -                             | -               | -                | -               |
| Loss on sale of repossessed assets                           | -                             | 14              | (14 )            | (100.00 )       |
| Loss on consumer loans                                       | -                             | 42              | (42 )            | (100.00 )       |
| Other  | 298                           | 258             | 40               | 15.50           |
| <b>Total other expenses</b>                                  | <b>\$ 1,908</b>               | <b>\$ 1,715</b> | <b>\$ 193</b>    | <b>11.25 %</b>  |
| Efficiency ratio (1)   | 59.81 %                       | 52.70 %         |                  |                 |

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

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

*Income Taxes.* The Company recorded income tax expense of \$265,600 for the six months ended June 30, 2013 and income tax expense of \$142,700 for the six months ended June 30, 2012.

## LIQUIDITY AND CAPITAL RESOURCES

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

At June 30, 2013 the Bank had outstanding commitments to originate \$0.6 million in loans, unfunded lines of credit of \$7.8 million, a commitment to purchase \$2.5 million in auto loans, and \$0.1 million in commitments on construction loans. In addition, as of June 30, 2013 the total amount of certificates of deposit that were scheduled to mature in the next 12 months was \$54.7 million, as compared to \$59.6 million as of March 31, 2013 and \$62.0 million as of December 31, 2012. Based on prior experience, management believes that a significant portion of such deposits will remain with us, although there can be no assurance that this will be the case. In the event a significant portion of our deposits are not retained by us, we will have to utilize other funding sources, such as Federal Home Loan Bank of Chicago (“FHLBC”) advances, in order to maintain our level of assets. Alternatively, we could reduce our level of liquid assets, such as our cash and cash equivalents. As of June 30, 2013, the Bank had \$53.2 million of available credit from the FHLBC. There were no FHLBC advances outstanding at June 30, 2013. In addition, as of June 30, 2013, the Bank had \$5.0 million of available credit from Bankers Bank of Wisconsin to purchase Federal Funds.

The Company is a separate legal entity from the Bank and must provide for its own liquidity. In addition to its operating expenses, the Company is responsible for paying any dividends declared to its shareholders and for any repurchased shares of its common stock. Whether dividends are declared, and the timing and amount of any dividends declared, is subject to the discretion of our Board of Directors and depends on various factors, including our net earnings, financial condition, cash requirements, future prospects and other factors that our Board of Directors deems relevant to its analysis and decision making. The Company's primary source of income is dividends received from the Bank. The amount of dividends that the Bank may declare and pay to the Company in any calendar year, without the receipt of prior approval from the regulatory agencies but with prior notice to the regulatory agencies, cannot exceed net income for that year to date plus retained net income (as defined) for the preceding two calendar years. At June 30, 2013, the Company had cash and cash equivalents of \$259,000.

*Capital.* The Bank is required to maintain regulatory capital sufficient to meet Tier 1 leverage, Tier 1 risk-based and total risk-based capital ratios of at least 4.0%, 4.0% and 8.0%, respectively. The Bank exceeded each of its minimum capital requirements and was considered "well capitalized" within the meaning of federal regulatory requirements with ratios at June 30, 2013 of 10.48%, 17.49% and 18.77%, respectively, compared to ratios at December 31, 2012 of 10.30%, 16.92% and 18.19%, respectively.

#### OFF-BALANCE SHEET ARRANGEMENTS

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

#### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

#### ITEM 4. CONTROLS AND PROCEDURES

##### *Controls and Procedures*

As of the end of the period covered by this report, the Company carried out an evaluation under the supervision and with the participation of the Company's principal executive officer and principal financial officer, of the effectiveness

of the design and operation of the Company's disclosure controls and procedures. Based on this evaluation, the Company's principal executive officer and principal financial officer concluded that the Company's disclosure controls and procedures were effective as of the end of the period covered by this report for the purpose of ensuring that the information required to be disclosed in the reports that the Company files or submits under the Securities Exchange Act of 1934, as amended, with the Securities and Exchange Commission (the "SEC") (1) is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and (2) is accumulated and communicated to the Company's management, including, its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. It should be noted that the design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote.

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

## **Part II – Other Information**

### **ITEM 1 - LEGAL PROCEEDINGS**

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

## ITEM 1A – RISK FACTORS

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

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

Not applicable.

## ITEM 3 - DEFAULTS UPON SENIOR SECURITIES

Not applicable.

## ITEM 4 – MINE SAFETY DISCLOSURES

Not applicable.

## ITEM 5 - OTHER INFORMATION

Not applicable.

## ITEM 6 - EXHIBITS

| <u>Exhibit No.</u> | <u>Description</u>  |
|--------------------|---|
| 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               | Ottawa Savings Bank Employee Incentive Compensation Plan  |
| 31.1               | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002  |
| 31.2               | Certifications of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002   |
| 32.1               | Certifications pursuant to Section 906 of the Sarbanes-Oxley Act of 2002  |
| 101.0              | The following materials from the Ottawa Savings Bancorp, Inc. Quarterly Report on form 10-Q for the quarter ended June 30, 2013 formatted in Extensible Business Reporting Language (XBRL): (i) the Condensed Consolidated Statements of Financial Condition, (ii) the Condensed Consolidated Statements of Operations, (iii) the Condensed Consolidated Statements of Cash Flows and (iv) related notes. |



SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

OTTAWA SAVINGS BANCORP, INC.

Registrant

Date: August 13, 2013    /s/ Jon L. Kranov  
Jon L. Kranov  
President and Chief Executive Officer  
(Principal Executive Officer)

Date: August 13, 2013    /s/ Marc N. Kingry  
Marc N. Kingry  
Chief Financial Officer  
(Principal Financial Officer)