

HOME FEDERAL BANCORP INC
Form 10-Q
May 09, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2006

or

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

For the transition period from _____ to _____

Commission File Number: 000-50901

HOME FEDERAL BANCORP, INC.

(Exact name of registrant as specified in its charter)

United States

(State or other jurisdiction of incorporation or organization)

20-0945587

(I.R.S. Employer I.D. Number)

500 12th Avenue South, Nampa, Idaho

(Address of principal executive offices)

83651

(Zip Code)

Registrant's telephone number, including area code:

466-4634

(208)

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

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

Large accelerated filer [] Accelerated filer [] Non-accelerated filer [X]

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: Common Stock, \$.01 par value per share, 15,154,114 shares outstanding as of May 1, 2006.

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HOME FEDERAL BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
(In thousands, except share data) (Unaudited)

| | March 31, 2006 | September 30, 2005 |
|---|-------------------|-----------------------|
| ASSETS | | |
| Cash and amounts due from depository institutions | \$ 19,326 | \$ 19,033 |
| Mortgage-backed securities available for sale, at fair value | 13,600 | 14,830 |
| Mortgage-backed securities held to maturity, at cost | 193,402 | 180,974 |
| Federal Home Loan Bank stock, at cost | 9,591 | 9,591 |
| Loans receivable, net of allowance for loan losses of \$2,984 and \$2,882 | 476,227 | 430,944 |
| Loans held for sale | 5,139 | 5,549 |
| Accrued interest receivable | 2,777 | 2,458 |
| Property and equipment, net | 13,296 | 11,995 |
| Mortgage servicing rights, net | 2,511 | 2,671 |
| Bank owned life insurance | 10,289 | 10,099 |
| Real estate and other property owned | - | 534 |
| Other assets | 1,138 | 899 |
| TOTAL ASSETS | \$747,296 | \$689,577 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| LIABILITIES | | |
| Deposit accounts | | |
| Noninterest-bearing demand deposits | \$ 49,068 | \$ 46,311 |
| Interest-bearing demand deposits | 132,342 | 127,330 |
| Savings deposits | 25,583 | 25,219 |
| Certificates of deposit | 224,642 | 197,465 |

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| | | |
|---|-----------|-----------|
| Total deposit accounts | 431,635 | 396,325 |
| Advances by borrowers for taxes and insurance | 1,951 | 3,898 |
| Interest payable | 1,170 | 1,670 |
| Deferred compensation | 3,452 | 3,049 |
| Federal Home Loan Bank advances | 196,542 | 175,932 |
| Deferred income tax liability | 913 | 1,205 |
| Other liabilities | 7,245 | 6,131 |
| Total liabilities | 642,908 | 588,210 |
| CONTINGENCIES (Note 4) | | |
| STOCKHOLDERS' EQUITY | | |
| Serial preferred stock, \$.01 par value; 5,000,000 authorized, issued and outstanding, none | - | - |
| Common stock, \$.01 par value; 50,000,000 authorized, issued and outstanding: | 152 | 149 |
| Mar. 31, 2006 - 15,208,750 issued, 15,154,114 outstanding | | |
| Sept. 30, 2005 - 15,208,750 issued, 14,910,658 outstanding | | |
| Additional paid-in capital | 56,632 | 56,115 |
| Retained earnings | 52,216 | 49,818 |
| Unearned shares issued to employee stock ownership plan ("ESOP") | (4,344) | (4,550) |
| Accumulated other comprehensive loss | (268) | (165) |
| Total stockholders' equity | 104,388 | 101,367 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | \$747,296 | \$689,577 |

See accompanying notes.

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HOME FEDERAL BANCORP, INC. AND
SUBSIDIARY

CONSOLIDATED STATEMENTS OF
INCOME

(In thousands, except share data) (Unaudited)

| | Three Months Ended | | Six Months Ended | |
|------------------------------------|--------------------|---------|------------------|----------|
| | March 31, | | March 31, | |
| | 2006 | 2005 | 2006 | 2005 |
| Interest and dividend income: | | | | |
| Loan interest | \$7,129 | \$6,315 | \$14,063 | \$12,384 |
| Investment interest | 60 | 17 | 71 | 260 |
| Mortgage-backed security interest | 2,386 | 2,045 | 4,772 | 3,408 |
| Federal Home Loan Bank dividends | - | 30 | - | 30 |
| Total interest and dividend income | 9,575 | 8,407 | 18,906 | 16,082 |
| Interest expense: | | | | |
| Deposits | 2,097 | 1,465 | 3,694 | 2,890 |
| Federal Home Loan Bank advances | 1,844 | 1,448 | 3,596 | 2,709 |
| Total interest expense | 3,941 | 2,913 | 7,290 | 5,599 |
| Net interest income | 5,634 | 5,494 | 11,616 | 10,483 |

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| | | | | |
|---|------------|------------|------------|------------|
| Provision for loan losses | 90 | 236 | 145 | 295 |
| Net interest income after provision for loan losses | 5,544 | 5,258 | 11,471 | 10,188 |
| Noninterest income: | | | | |
| Service charges and fees | 2,115 | 1,952 | 4,501 | 3,911 |
| Gain on sale of loans | 195 | 72 | 506 | 140 |
| Increase in cash surrender value of bank owned life insurance | 108 | 87 | 190 | 162 |
| Loan servicing fees | 159 | 168 | 319 | 340 |
| Mortgage servicing rights, net | (64) | (58) | (160) | (154) |
| Other | (24) | 420 | (66) | 459 |
| Total noninterest income | 2,489 | 2,641 | 5,290 | 4,858 |
| Noninterest expense: | | | | |
| Compensation and benefits | 3,770 | 3,096 | 7,576 | 6,149 |
| Occupancy and equipment | 694 | 682 | 1,422 | 1,401 |
| Data processing | 520 | 376 | 861 | 819 |
| Advertising | 257 | 310 | 471 | 650 |
| Postage and supplies | 189 | 188 | 420 | 398 |
| Professional services | 176 | 203 | 363 | 422 |
| Insurance and taxes | 111 | 84 | 214 | 150 |
| Charitable contribution to Foundation | - | - | - | 1,825 |
| Other | 334 | 254 | 604 | 436 |
| Total noninterest expense | 6,051 | 5,193 | 11,931 | 12,250 |
| Income before income taxes | 1,982 | 2,706 | 4,830 | 2,796 |
| Income tax expense | 749 | 1,032 | 1,837 | 1,048 |
| NET INCOME | \$1,233 | \$1,674 | \$ 2,993 | \$ 1,748 |
| Earnings per common share: | | | | |
| Basic | \$0.09 | \$0.11 | \$0.21 | \$0.12 |
| Diluted | \$0.09 | \$0.11 | \$0.21 | \$0.12 |
| Weighted average number of shares outstanding: | | | | |
| Basic | 14,478,746 | 14,720,524 | 14,472,449 | 14,718,364 |
| Diluted | 14,497,350 | 14,720,524 | 14,483,991 | 14,718,364 |

See accompanying notes.

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

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| | Common Stock | | Additional Paid-In Capital | Retained Earnings | Unearned Shares Issued to Employee Stock Ownership Plan | Accumulated Other Comprehensive Loss | Total |
|---|--------------|-------|----------------------------------|----------------------|---|---|-----------|
| Balance at Sept. 30, 2004 | - | \$ - | \$ - | \$45,099 | \$ - | \$ (2) | \$ 45,097 |
| Common stock issued | 15,062,746 | 151 | 58,424 | | (4,984) | | 53,591 |
| Common stock issued to Foundation | 146,004 | 1 | 1,459 | | | | 1,460 |
| Distribution to capitalize Mutual Holding Company | | | (50) | | | | (50) |
| ESOP shares committed to be released | | | 181 | | 434 | | 615 |
| Treasury shares purchased | (298,092) | (3) | (3,899) | | | | (3,902) |
| Dividends paid (\$0.10 per share) ⁽¹⁾ | | | | (564) | | | (564) |
| Comprehensive income: | | | | | | | |
| Net income | | | | 5,283 | | | 5,283 |
| Other comprehensive income: | | | | | | | |
| Change in unrealized holding loss on securities available for sale, net of deferred income taxes | | | | | | (163) | (163) |
| Comprehensive income: | | | | | | | 5,120 |
| Balance at Sept. 30, 2005 | 14,910,658 | \$149 | \$56,115 | \$49,818 | \$(4,550) | \$(165) | \$101,367 |
| Restricted stock issued, net of forfeitures | 243,456 | 3 | (3) | | | | - |
| ESOP shares committed to be released | | | 108 | | 206 | | 314 |
| Share-based compensation expense | | | 412 | | | | 412 |
| Dividends paid (\$0.105 per share) ⁽¹⁾ | | | | (595) | | | (595) |
| Comprehensive income: | | | | | | | |
| Net income | | | | 2,993 | | | 2,993 |
| Other comprehensive income: | | | | | | | |
| Change in unrealized holding loss on securities available for sale, net of deferred income | | | | | | (103) | (103) |

| | | | | | | | | |
|--------------------------|------------|-------|----------|----------|-----------|---------|--|-----------|
| taxes | | | | | | | | |
| Comprehensive income: | | | | | | | | 2,890 |
| Balance at Mar. 31, 2006 | 15,154,114 | \$152 | \$56,632 | \$52,216 | \$(4,344) | \$(268) | | \$104,388 |
| (1) | | | | | | | | |

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

See accompanying notes.

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

| | Six Months Ended March 31, | |
|---|-------------------------------|----------|
| | 2006 | 2005 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income | \$ 2,993 | \$ 1,748 |
| Adjustments to reconcile net income to cash provided by operating activities: | | |
| Depreciation and amortization | 825 | 857 |
| Net accretion of premiums and discounts on investments | (45) | (24) |
| Loss (gain) on sale of fixed assets and repossessed assets | 115 | (391) |
| ESOP shares committed to be released | 314 | 251 |
| Equity compensation expense | 412 | - |
| Contribution to Foundation | - | 1,825 |
| Provision for loan losses | 145 | 295 |
| Federal Home Loan Bank stock dividend | - | (30) |
| Deferred compensation expense | 403 | 333 |
| Net deferred loan fees | 307 | (130) |
| Deferred income tax benefit | (224) | (834) |
| Net gain on sale of loans | (506) | (140) |
| Proceeds from sale of loans held for sale | 37,643 | 25,757 |
| Originations of loans held for sale | (36,821) | (23,628) |
| Impairment of mortgage servicing rights | - | 100 |
| Net increase in value of bank owned life insurance | (190) | (162) |
| Change in assets and liabilities: | | |
| Interest receivable | (318) | (241) |
| Other assets | (101) | (614) |
| Interest payable | (500) | 187 |
| Other liabilities | (352) | 1,564 |
| Net cash provided by operating activities | 4,100 | 6,723 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Proceeds from maturity of mortgage-backed securities held to maturity | 13,800 | 8,040 |
| Purchase of mortgage-backed securities held to maturity | (26,172) | (66,443) |
| Proceeds from sale and maturity of mortgage-backed securities | 1,048 | 746 |

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| | | |
|---|------------------|------------------|
| available for sale | | |
| Purchase of mortgage-backed securities available for sale | - | (19,261) |
| Purchases of property and equipment | (751) | (1,028) |
| Purchase of Federal Home Loan Bank stock | - | (766) |
| Loan originations and principal collections, net | (6,855) | (27,245) |
| Purchased loans | (38,782) | - |
| Proceeds from disposition of property and equipment | 19 | 543 |
| Proceeds from sale of repossessed assets | 510 | 148 |
| Net cash used in investing activities | (57,183) | (105,266) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Net increase in deposits | 35,309 | 30,063 |
| Net decrease in advances by borrowers for taxes and insurance | (1,947) | (6) |
| Proceeds from Federal Home Loan Bank advances | 145,215 | 132,400 |
| Repayment of Federal Home Loan Bank advances | (124,606) | (100,480) |
| Stock subscription orders refunded | - | (220,813) |
| Dividends paid | (595) | - |
| Net proceeds from stock issuance | - | 53,591 |
| Net cash provided by (used in) financing activities | 53,376 | (105,245) |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | 293 | (203,788) |
| CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD | 19,033 | 215,663 |
| CASH AND CASH EQUIVALENTS, END OF PERIOD | \$ 19,326 | \$ 11,875 |

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HOME FEDERAL BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS

(Continued)

(In thousands) (Unaudited)

| | Six Months Ended March 31, | |
|--|-------------------------------|---------|
| | 2006 | 2005 |
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION: | | |
| Cash paid during the year for: | | |
| Interest | \$7,791 | \$5,412 |
| Income taxes | 2,521 | 1,675 |
| NONCASH INVESTING AND FINANCING ACTIVITIES: | | |
| Acquisition of real estate and other assets in settlement of loans | 2 | 591 |
| Fair value adjustment to securities available for sale, net of taxes | (103) | (155) |

See accompanying notes.

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

Note 1 - Basis of Presentation

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

Certain information and note disclosures normally included in the Company's annual consolidated financial statements have been condensed or omitted. Therefore, these consolidated financial statements and notes thereto should be read in conjunction with the Company's audited financial statements and notes included in the Annual Report on Form 10-K for the year ended September 30, 2005 ("2005 Form 10-K") filed with the Securities and Exchange Commission ("SEC") on December 9, 2005.

Note 2 - Summary of Significant Accounting Policies

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

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

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

Deferred income taxes are computed using the asset and liability approach as prescribed in Statement of Financial Accounting Standards ("SFAS") No. 109, *Accounting for Income Taxes*. Under this method, a deferred tax asset or

liability is determined based on the currently enacted tax rates applicable to the period in which the differences between the financial statement carrying amounts and tax basis of the existing assets and liabilities are expected to be reported in the Company's income tax returns.

At March 31, 2006, there were no material changes in the Company's significant accounting policies or critical accounting estimates from those disclosed in the Company's 2005 Form 10-K.

Note 3 - Mutual Holding Company Reorganization

On May 18, 2004, the Board of Directors of Home Federal Savings and Loan Association of Nampa (the "Association") unanimously adopted a Plan of Reorganization and Stock Issuance. At the special meeting of members of the Association held on September 20, 2004, members approved the Plan of Reorganization and Stock

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Issuance and the establishment of the Home Federal Foundation, Inc. (the "Foundation") by more than the required majority of the total votes entitled to be cast at the special meeting.

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

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

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

Note 4 - Contingencies

On November 7, 2005, the Company completed the conversion of its core processing system, including the conversion of its internal check processing system to an outside vendor. After the conversion, the Company experienced difficulties reconciling certain general ledger accounts related to the new check processing system. The Company assembled a team dedicated to researching and resolving any discrepancies in reconciling the affected general ledger accounts. As a result of the research, the Company wrote-off an immaterial amount of items that were determined to

be uncollectible. The Company also established new procedures and controls for the reconciliation of the related general ledger accounts. The Company does not anticipate any material losses related to this issue in the future.

Note 5 - Stock-Based Compensation

On June 23, 2005, stockholders approved long-term stock-based benefit plans that enable the Company to grant stock options, stock appreciation rights and restricted stock awards to employees and directors. The Company has adopted SFAS No. 123(R), *Share Based Payment*, which requires the recognition of compensation costs relating to share based payment transactions in the financial statements. The Company has elected the modified prospective application method of reporting, which provides for no restatement of prior periods and no cumulative adjustment to equity accounts. Prior to the adoption of SFAS No. 123(R), the Company elected to account for its stock-based compensation plans using the intrinsic value-based method of recognizing compensation costs outlined in Accounting Principles Board Opinion ("APB") No. 25, *Accounting for Stock Issued to Employees*, and adopted the disclosure-only provisions under SFAS No. 123, *Accounting for Stock-Based Compensation*.

Recognition and Retention Plan ("RRP").

The purpose of the RRP is to promote the long-term interests of the Company and its stockholders by providing restricted stock as a means for attracting and retaining directors and key employees. The maximum number of shares that may be awarded under the RRP is 298,092. Restricted stock awards vest over a five-year period and, therefore, the fair value of these awards will be accrued ratably over a five-year period as compensation expense. As of March 31, 2006, restricted stock awards of 243,456 shares of common stock are outstanding. None of the 243,456 shares outstanding may be exercised as of March 31, 2006. The Company has an aggregate of 54,636 restricted shares available for future issuance under the RRP.

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Restricted stock activity is summarized in the following table:

| | Number of Shares | Weighted Average Fair Value at Date of Grant |
|--------------------------------------|---------------------|--|
| Outstanding at September 30, 2005 | - | \$ - |
| Granted | 255,380 | 12.70 |
| Forfeited | (11,924) | 12.70 |
| Exercised | - | - |
| Outstanding at March 31, 2006 | 243,456 | \$12.70 |

Stock Option and Incentive Plan ("SOP").

The Company implemented the SOP to promote the long-term interests of the Company and its stockholders by providing an incentive to directors and key employees who contribute to the operating success of the Company. The maximum number of stock options and stock appreciation rights that may be issued under the SOP is 745,229. The exercise price of each option equals the fair market value of the Company's stock on the date of grant. The options vest over five years and expire 10 years from the date of grant. The Company has an aggregate of 146,308 stock options available for future issuance under the SOP.

The fair value of each option award is estimated on the date of grant using the Black-Scholes option pricing model that uses the assumptions noted in the following table. The risk-free rate is based on the U.S. Treasury yield curve in

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effect at the time of grant. The expected life of options granted represents the period of time that options granted are expected to be outstanding. Expected volatilities are based on historical volatility of the Company's stock. Expected forfeiture rate is the estimated forfeiture rate based upon the employees in each separate group. Expected dividends represent the Company's estimated annual dividend rate over the expected life.

| | Risk Free Interest Rate | Expected Life (yrs) | Expected Volatility | Expected Forfeiture Rate | Expected Dividends |
|-------------------------|-------------------------------|------------------------|------------------------|--------------------------------|-----------------------|
| Options granted in 2005 | 3.98% | 5.50 | 14.96% | 3.03% | 2.00% |
| Options granted in 2006 | 4.58% | 7.50 | 15.51% | - % | 2.00% |

Stock option activity is summarized in the following table:

| | Number of Shares | Weighted Average Exercise Price | Weighted Average Fair Value |
|--------------------------------------|---------------------|--|-----------------------------------|
| Outstanding at September 30, 2005 | 581,278 | \$12.20 | \$2.08 |
| Granted | 40,000 | 12.85 | 2.86 |
| Forfeited | (22,357) | 12.20 | 2.08 |
| Exercised | - | - | - |
| Outstanding at March 31, 2006 | 598,921 | \$12.24 | \$2.13 |

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Options outstanding at March 31, 2006 were as follows:

| Range of Exercise Price | Weighted Ave. Remaining Contractual Life (years) | Options Outstanding | | | Options Exercisable | | |
|-------------------------------|--|-----------------------|--|---------------------------------|-----------------------|--|---------------------------------|
| | | Number Outstanding | Weighted Average Exercise Price | Aggregate Intrinsic Value | Number Exercisable | Weighted Average Exercise Price | Aggregate Intrinsic Value |
| \$12.20 | 9.3 | 558,921 | \$12.20 | \$822,000 | - | \$- | \$- |
| 12.85 | 9.9 | 40,000 | 12.85 | 33,000 | - | - | - |
| | | 598,921 | | \$855,000 | - | | \$- |

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The total fair value of options granted was approximately \$1.1 million. The fair value of the options granted is amortized ratably over the vesting period of the options. For the six months ended March 31, 2006, there were no cash proceeds received from the exercise of options. The following table illustrates the effect of the change, from applying the original provisions of SFAS No. 123, to the adoption of SFAS No. 123(R), on the Company's results of operations for the three months ended and six months ended March 31, 2006.

| | Three Months Ended March 31, 2006 | | | Six Months Ended March 31, 2006 | | |
|----------------------------------|---------------------------------------|-----------------------------|----------------|------------------------------------|-----------------------------|----------------|
| | Using Previous Accounting | Pro Forma Adjustments | As Reported | Using Previous Accounting | Pro Forma Adjustments | As Reported |
| | (in thousands, except per share data) | | | | | |
| Income before income taxes | \$2,035 | \$(53) | \$1,982 | \$4,935 | \$(105) | \$4,830 |
| Income taxes | 753 | (4) | 749 | 1,846 | (9) | 1,837 |
| Net income | \$1,282 | \$(49) | \$1,233 | \$3,089 | \$(96) | \$2,993 |
| Basic earnings per share | \$ 0.09 | \$ - | \$ 0.09 | \$ 0.21 | \$ - | \$ 0.21 |
| Diluted earnings per share | 0.09 | - | 0.09 | 0.21 | - | 0.21 |

As of March 31, 2005, no stock options had been granted by the Company.

The compensation expense yet to be recognized for stock-based awards that have been awarded but not vested is as follows:

| | Stock Options | Restricted Stock (in thousands) | Total Awards |
|-------------------------------|------------------|---------------------------------------|-----------------|
| Remainder of 2006 | \$ 114 | \$ 309 | \$ 423 |
| 2007 | 228 | 619 | 847 |
| 2008 | 228 | 619 | 847 |
| 2009 | 228 | 619 | 847 |
| 2010 | 228 | 619 | 847 |
| 2011 | 10 | 2 | 12 |
| Outstanding at March 31, 2006 | \$1,036 | \$2,787 | \$3,823 |

Note 6 - Earnings Per Share

Earnings per share ("EPS") is computed using the basic and diluted weighted average number of common shares outstanding during the period. Basic EPS is computed by dividing the Company's net income or loss by the weighted average number of common shares outstanding for the period. Diluted EPS is computed by dividing net income or loss by diluted weighted average shares outstanding, which include common stock equivalent shares outstanding using the treasury stock method, unless such shares are anti-dilutive. Common stock equivalents arise

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from assumed conversion of outstanding stock options and from assumed vesting of shares awarded but not released under the Company's RRP plan. There were no restricted stock awards or stock options granted as of March 31, 2005. Therefore, basic and diluted EPS are the same as of March 31, 2005. ESOP shares are not considered outstanding for earnings per share purposes until they are committed to be released.

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

| | Three Months Ended March 31, | | Six Months Ended March 31, | |
|---|---|------------|-------------------------------|------------|
| | 2006 | 2005 | 2006 | 2005 |
| | (in thousands, except share and per share data) | | | |
| Basic EPS: | | | | |
| Income available to common stockholders | \$ 1,233 | \$ 1,674 | \$ 2,993 | \$ 1,748 |
| Weighted-average common shares outstanding | 14,478,746 | 14,720,524 | 14,472,449 | 14,718,364 |
| Basic earnings per share | \$ 0.09 | \$ 0.11 | \$ 0.21 | \$ 0.12 |
| Diluted EPS: | | | | |
| Income available to common stockholders | \$ 1,233 | \$ 1,674 | \$ 2,993 | \$ 1,748 |
| Weighted-average common shares outstanding | 14,478,746 | 14,720,524 | 14,472,449 | 14,718,364 |
| Net effect of dilutive RRP awards | 18,604 | - | 11,542 | - |
| Weighted-average common shares outstanding and common stock equivalents | 14,497,350 | 14,720,524 | 14,483,991 | 14,718,364 |
| Diluted EPS | \$ 0.09 | \$ 0.11 | \$ 0.21 | \$ 0.12 |

Note 7 - Recently Issued Accounting Standards

In February 2006, the Financial Accounting Standards Board ("FASB") issued SFAS No. 155, *Accounting for Certain Hybrid Instruments*. The Statement provides entities with relief from having to separately determine the fair value of an embedded derivative that would otherwise be required to be bifurcated from its host contract in accordance with SFAS No. 133. Statement 155 allows an entity to make an irrevocable election to measure such a hybrid financial instrument at fair value in its entirety, with changes in fair value recognized in earnings. The Statement also (1) clarifies which interest-only strips and principal-only strips are not subject to Statement 133; (2) establishes a requirement for holders of securitized financial assets to evaluate whether the interest is a freestanding derivative or a hybrid financial instrument that contains an embedded derivative requiring bifurcation; (3) clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives; and (4) eliminates the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. The Statement is effective for all financial instruments acquired, issued or subject to a re-measurement event occurring after the beginning of an entity's first

fiscal year that begins after September 15, 2006 and is not expected to have a significant impact on the Company's consolidated financial condition or results of operations.

In March 2006, the FASB issued SFAS No. 156, *Accounting for Servicing of Financial Assets*. The Statement provides relief for loan servicers that use derivatives to economically hedge fluctuations in the fair value of their servicing rights. The Statement allows servicers to opt to measure their servicing rights at fair value, which is the same accounting basis used to measure derivatives. A servicer can also choose to continue applying the existing amortization method in SFAS No. 140. The Statement also requires additional disclosures regardless of which method is applied. The Statement is effective as of the beginning of the first fiscal year that begins after September 15, 2006 and is not expected to have a significant impact on the Company's consolidated financial condition or results of operations.

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Note 8 - Mortgage-Backed Securities

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

| | | March 31, 2006 | | |
|-----------------------------------|-------------------|------------------------------|-------------------------------|---------------|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| | | (in thousands) | | |
| Agency mortgage-backed securities | \$14,047 | \$- | \$(447) | \$13,600 |
| | | September 30, 2005 | | |
| Agency mortgage-backed securities | \$15,105 | \$- | \$(275) | \$14,830 |

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

| | March 31, 2006 | |
|--|-------------------|---------------|
| | Amortized Cost | Fair Value |
| | (in thousands) | |
| Due after five years through ten years | \$ 642 | \$ 609 |
| Due after ten years | 13,405 | 12,991 |
| Total | \$14,047 | \$13,600 |

The Company realized no gains or losses on sales of mortgage-backed securities available for sale for the three months ended March 31, 2006 and 2005.

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

| | Amortized Cost | March 31, 2006 | | Fair Value |
|---------------------------------------|-------------------|------------------------------|-------------------------------|---------------|
| | | Gross Unrealized Gains | Gross Unrealized Losses | |
| (in thousands) | | | | |
| Agency mortgage-backed securities | \$189,823 | \$120 | \$(6,242) | \$183,701 |
| Non-agency mortgage-backed securities | 3,579 | - | (133) | 3,446 |
| Total | \$193,402 | \$120 | \$(6,375) | \$187,147 |
| September 30, 2005 | | | | |
| Agency mortgage-backed securities | \$177,336 | \$323 | \$(2,607) | \$175,052 |
| Non-agency mortgage-backed securities | 3,638 | - | (77) | 3,561 |
| Total | \$180,974 | \$323 | \$(2,684) | \$178,613 |

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

| | March 31, 2006 | |
|--|-------------------|---------------|
| | Amortized Cost | Fair Value |
| (in thousands) | | |
| Due within one year | \$ 16 | \$ 16 |
| Due after one year through five years | 1,237 | 1,255 |
| Due after five years through ten years | 7,549 | 7,212 |
| Due after ten years | 184,600 | 178,664 |
| Total | \$193,402 | \$187,147 |

The fair value of temporarily impaired securities, the amount of unrealized losses and the length of time these unrealized losses existed as of March 31, 2006 are as follows:

| | Less than 12 months | | 12 months or longer | | Total | |
|---------------------------------------|---------------------|----------------------|---------------------|----------------------|---------------|----------------------|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| (in thousands) | | | | | | |
| Mortgage-backed securities, available | | | | | | |

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| | | | | | | |
|--|-----------|-----------|----------|-----------|-----------|-----------|
| for sale | \$ 6,439 | \$ (230) | \$ 7,161 | \$ (217) | \$ 13,600 | \$ (447) |
| Mortgage-backed securities, held to maturity | 128,384 | (3,712) | 50,119 | (2,663) | 178,503 | (6,375) |
| Total | \$134,823 | \$(3,942) | \$57,280 | \$(2,880) | \$192,103 | \$(6,822) |

Management has evaluated these securities and has determined that the decline in the value is temporary and not related to any company or industry specific event. The Company has the ability and intent to hold the securities for a reasonable period of time for a forecasted recovery of the amortized cost.

As of March 31, 2006, the Bank had pledged mortgage-backed securities with an amortized cost of \$113.1 million and a fair value of \$108.4 million as collateral for advances at the Federal Home Loan Bank of Seattle ("FHLB"). The Company has also pledged a mortgage-backed security with an amortized cost of \$3.3 million and a fair value of \$3.1 million as collateral for a \$1.5 million revolving line of credit from the Bank. As of March 31, 2006, there was no balance owed on the line of credit.

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Note 9 - Loans Receivable

Loans receivable are summarized as follows:

| | March 31, 2006 | | September 30, 2005 | |
|---------------------------------------|----------------|--|--------------------|------------------|
| | Balance | Percent of Total (dollars in thousands) | Balance | Percent of Total |
| Real Estate Loans | | | | |
| One-to four-family residential | \$293,579 | 61.11% | \$252,126 | 58.00% |
| Multi-family residential | 2,968 | 0.62 | 5,454 | 1.25 |
| Commercial | 128,231 | 26.70 | 116,432 | 26.78 |
| Total real estate loans | <u>424,778</u> | <u>88.43</u> | <u>374,012</u> | <u>86.03</u> |
| Real Estate Construction Loans | | | | |
| One-to four-family residential | 14,917 | 3.11 | 14,421 | 3.32 |
| Multi-family residential | - | - | 1,427 | 0.33 |
| Commercial and land development | 3,844 | 0.80 | 7,470 | 1.72 |
| Total real estate construction loans | <u>18,761</u> | <u>3.91</u> | <u>23,318</u> | <u>5.37</u> |
| Consumer Loans | | | | |
| Home equity lines of credit | 29,544 | 6.15 | 28,558 | 6.57 |
| Automobile and RV | 3,854 | 0.80 | 4,576 | 1.05 |
| Other consumer | 1,374 | 0.29 | 1,530 | 0.35 |
| Total consumer loans | <u>34,772</u> | <u>7.24</u> | <u>34,664</u> | <u>7.97</u> |

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| | | | | |
|---------------------------|-----------|---------|-----------|---------|
| Commercial/business loans | 2,034 | 0.42 | 2,759 | 0.63 |
| | | 100.00% | | 100.00% |
| | 480,345 | | 434,753 | |
| Less: | | | | |
| Deferred loan fees | 1,134 | | 927 | |
| Allowance for loan losses | 2,984 | | 2,882 | |
| Loans receivable, net | \$476,227 | | \$430,944 | |

Note 10 - Subsequent Events

On April 19, 2006, the State of Idaho Department of Finance issued a cease and desist order with respect to sales of unregistered securities in 2005 by a former investment representative of the Company. The Company is aware of approximately \$193,000 of unauthorized sales outstanding and is cooperating fully with the Department of Finance. At this time, the outcome of the action cannot be predicted and its financial impact, if any, cannot be assessed.

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

Forward-Looking Statements

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

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

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

- general economic conditions, either nationally or in our market area, that are worse than expected;
- changes in the interest rate environment that reduce our interest margins or reduce the fair value of financial instruments;
- increased competitive pressures among financial services companies;
- changes in consumer spending, borrowing and savings habits;
- legislative or regulatory changes that adversely affect our business;
- adverse changes in the securities markets; and
- changes in accounting policies and practices, as may be adopted by the bank regulatory agencies, the Public Company Accounting Oversight Board or the FASB.

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These factors should be considered in evaluating the forward-looking statements, and undue reliance should not be placed on such statements. The Company undertakes no obligation to publish revised forward-looking statements to reflect the occurrence of unanticipated events or circumstances after the date hereof.

Overview

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

The Bank was founded in 1920 as a building and loan association and reorganized as a federal mutual savings and loan association in 1936. The Bank is a community-oriented financial institution dedicated to serving the financial service needs of consumers and businesses within our market area. The Bank's primary business is attracting deposits from the general public and using these funds to originate loans. We emphasize the origination of loans secured by first mortgages on owner-occupied, residential real estate, residential development and construction, and commercial real estate. To a lesser extent, we originate other types of real estate loans, commercial business loans and consumer loans.

The Bank serves the Treasure Valley region of southwestern Idaho, that includes Ada, Canyon, Elmore and Gem Counties, through our 14 full-service banking offices and two loan centers. Nearly 40% of the state's population lives and works in the four counties served by Home Federal Bank. Ada County has the largest population and includes the city of Boise, the state capitol. Home Federal Bank maintains its largest branch presence in Ada County with eight locations, followed by Canyon County with four branches, including the Company's corporate headquarters in Nampa. The two remaining branches are located in Elmore and Gem Counties.

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

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Critical Accounting Policies

Allowance for Loan Losses.

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

Our methodology for analyzing the allowance for loan losses consists of three components: formula, specific and general allowances. The formula allowance is determined by applying an estimated loss percentage to various groups of loans based on historical measures such as the amount and type of classified loans, past due ratios and loss experience, which could affect the collectibility of the respective loan types. The specific allowance component is created when management believes that the collectibility of a specific large loan has been impaired and a loss is probable. The general allowance element relates to assets with no well-defined deficiency or weakness and takes into consideration loss that is inherent within the portfolio but has not been realized.

Mortgage Servicing Rights.

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

Deferred Income Taxes.

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

Comparison of Financial Condition at March 31, 2006 and September 30, 2005

General.

Total assets increased \$57.7 million, or 8.4%, to \$747.3 million at March 31, 2006 from \$689.6 million at September 30, 2005. Loans receivable increased \$45.3 million, or 10.5% to \$476.2 million to lead the overall asset growth. The demand for loans was funded with increased deposits of \$35.3 million and FHLB advances of \$20.6 million.

Assets.

For the six months ended March 31, 2006 total assets increased \$57.7 million. The increases and decreases were primarily concentrated in the following asset categories:

| | Balance at March 31, 2006 | Balance at September 30, 2005 (dollars in thousands) | Increase (decrease) | |
|---|---------------------------------|---|---------------------|---------|
| | | | Amount | Percent |
| Mortgage-backed securities, available for sale | \$ 13,600 | \$ 14,830 | \$(1,230) | (8.3)% |
| | 193,402 | 180,974 | 12,428 | 6.9 |

| | | | | |
|---|---------|---------|--------|------|
| Mortgage-backed securities, held to maturity | | | | |
| Loans receivable, net of allowance for loan losses | 476,227 | 430,944 | 45,283 | 10.5 |
| Property and equipment, net | 13,296 | 11,995 | 1,301 | 10.8 |

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Mortgage-backed securities increased \$11.2 million to \$207.0 million at March 31, 2006, from \$195.8 million at September 30, 2005. For the six months ended March 31, 2006, the Company purchased \$26.2 million of mortgage-backed securities that consisted primarily of hybrid adjustable and fixed rate securities with terms of 15 years or less. The Company purchases mortgage-backed securities to supplement loan originations during periods when the Company is not able to originate the desired type or volume of portfolio loans and to manage interest rate sensitivity.

Loans receivable, net, increased \$45.3 million to \$476.2 million at March 31, 2006, from \$430.9 million at September 30, 2005. Single-family residential loans and commercial real estate loans increased \$41.9 million and \$8.2 million, respectively, during the six months ended March 31, 2006. During the period, the Company purchased \$38.8 million of hybrid adjustable, one-to four-family mortgage loans. Purchased mortgage loans allow the Company to increase interest-earning assets, manage interest rate risk, and geographically diversify our mortgage loan portfolio at a relatively low overhead cost. As of March 31, 2006, over 90% of the Company's loan portfolio is secured by real estate, either as primary or secondary collateral.

Property and equipment, net increased \$1.3 million to \$13.3 million at March 31, 2006, from \$12.0 million at September 30, 2005. The Company completed the conversion of its core processing system during the quarter ended December 31, 2005. The majority of the increase in property and equipment is for software and hardware related to the conversion.

Deposits.

Deposits increased \$35.3 million, or 8.9%, to \$431.6 million at March 31, 2006, from \$396.3 million at September 30, 2005. Certificates of deposit accounted for the majority of the increase in total deposits with certificates of 12 to 23 month terms having the largest increase in balances. The following table details the changes in deposit accounts:

| | Balance at March 31, 2006 | Balance at September 30, 2005 (dollars in thousands) | Increase (decrease) | |
|-------------------------------------|---------------------------------|---|---------------------|-------------|
| | | | Amount | Percent |
| Noninterest-bearing demand deposits | \$ 49,068 | \$ 46,311 | \$ 2,757 | 6.0% |
| Interest-bearing demand deposits | 132,342 | 127,330 | 5,012 | 3.9 |
| Savings deposits | 25,583 | 25,219 | 364 | 1.4 |
| Certificates of deposit | 224,642 | 197,465 | 27,177 | 13.8 |
| Total deposit accounts | <u>\$431,635</u> | <u>\$396,325</u> | <u>\$35,310</u> | <u>8.9%</u> |

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Borrowings.

Advances from the FHLB increased \$20.6 million, or 11.7%, to \$196.5 million at March 31, 2006, from \$175.9 million at September 30, 2005. The Company uses advances from the FHLB as an alternative funding source to deposits in order to manage funding costs, reduce interest rate risk, and to leverage the balance sheet.

Equity.

Stockholders' equity increased \$3.0 million, or 3.0%, to \$104.4 million at March 31, 2006, from \$101.4 million at September 30, 2005. The increase was primarily a result of the \$3.0 million in net income and the allocation of ESOP shares and equity compensation totaling \$726,000, offset by \$595,000 of cash dividends paid to stockholders. On March 24, 2006, the Company paid \$0.055 per share in cash dividends to stockholders of record, excluding shares held by Home Federal MHC.

Comparison of Operating Results for the Three Months ended March 31, 2006 and March 31, 2005

General.

Net income for the three months ended March 31, 2006 was \$1.2 million, or \$0.09 per diluted share, compared to net income of \$1.7 million, or \$0.11 per diluted share, for the three months ended March 31, 2005. The results for the quarter ended March 31, 2005 include a \$386,000 pre-tax gain on the sale of a former branch. Excluding the gain on the sale of the branch, the Company had net income of \$1.4 million, or \$0.10 per diluted share, for the quarter ended March 31, 2005.

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The following table reconciles the Company's actual net income to pro forma net income for the three months ended March 31, 2006 and 2005, exclusive of the gain on the sale of the branch, as adjusted for federal and state taxes:

| | Three Months Ended March 31, | |
|-------------------------------------|---------------------------------------|----------------|
| | 2006 | 2005 |
| | (in thousands, except per share data) | |
| Pro forma disclosure | | |
| Net income, as reported | \$1,233 | \$1,674 |
| Gain on sale of branch | - | (386) |
| | - | 151 |
| Federal and state income tax effect | <u>\$1,233</u> | <u>\$1,439</u> |
| Pro forma net income | <u>\$1,233</u> | <u>\$1,439</u> |
| Earnings per share | | |
| Diluted as reported | \$0.09 | \$0.11 |
| Pro forma diluted | \$0.09 | \$0.10 |

Net Interest Income.

Net interest income increased \$140,000, or 2.5%, to \$5.6 million for the three months ended March 31, 2006, from \$5.5 million for the three months ended March 31, 2005. The increase in net interest income was primarily attributable to an increase in average interest-earning assets and interest-bearing liabilities of \$76.6 million and \$63.2 million, respectively, which offset the compression of the Company's net interest margin.

The Company's net interest margin decreased 34 basis points to 3.33% for the quarter ended March 31, 2006, from 3.67% for the same quarter last year. The cost of interest-bearing liabilities increased 47 basis points to 2.86% for the second quarter of fiscal 2006 compared to 2.39% for the second quarter of the prior year. The decline in the net interest margin reflects the relatively flat yield curve that currently exists, as the cost of shorter-term deposits and borrowed funds increased more rapidly than the yield on longer-term assets. Although the Company believes the repricing of existing and new loans over time will help counter the trend in net interest margin, pressure will likely continue in the near term as a result of the flat yield curve environment.

Interest and Dividend Income.

Total interest and dividend income for the three months ended March 31, 2006 increased \$1.2 million, or 13.9%, to \$9.6 million, from \$8.4 million for the three months ended March 31, 2005. The increase during the quarter was primarily attributable to the \$76.6 million increase in the average balance of interest-earning assets and an increase in the yield on interest-earning assets to 5.67% as a result of the general increase in interest rates.

The following table compares detailed average earning asset balances, associated yields, and resulting changes in interest and dividend income for the three months ended March 31, 2006 and 2005:

| Three Months Ended March 31, | | Increase/ (Decrease) in Interest and Dividend Income from 2005 |
|------------------------------|------|--|
| 2006 | 2005 | |
| Average Balance | | |
| Yield | | |
| Average Balance | | |
| Yield | | |

(dollars in thousands)

Loans receivable, net

\$456,732

| | |
|---|-----------|
| | 6.21% |
| | \$413,365 |
| | 6.09% |
| | \$ 797 |
| Loans held for sale | |
| | 2,358 |
| | 6.26 |
| | 1,471 |
| | 5.41 |
| | 17 |
| Investment securities, available for sale, including interest-bearing deposits in other banks | |
| | 5,526 |
| | 4.34 |
| | 2,982 |
| | 2.28 |
| | 24 |

| | |
|-------------------------------|-----------|
| | 43 |
| Mortgage-backed securities | |
| | 201,647 |
| | 4.73 |
| | 173,396 |
| | 4.72 |
| | 341 |
| FHLB stock | |
| | 9,591 |
| | - |
| | 8,044 |
| | 1.49 |
| | (30) |
| Total interest-earning assets | |
| | \$675,854 |

5.67%

\$599,258

5.61%

\$1,168

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On May 18, 2005, the FHLB indefinitely suspended dividends on all classes of its stock as part of its recapitalization plans. The suspension of FHLB dividends has not had a significant effect on our results of operations or financial condition.

Interest Expense.

Interest expense increased \$1.0 million, or 35.3%, to \$3.9 million for the three months ended March 31, 2006 from \$2.9 million for the three months ended March 31, 2005. The average balance of total interest-bearing liabilities increased \$63.2 million, or 13.0%, to \$550.7 million for the three months ended March 31, 2006 from \$487.5 million for the three months ended March 31, 2005. The increase was primarily a result of growth in certificates of deposits and additional advances from the FHLB. As a result of general market rate increases following Federal Reserve rate hikes during the past several quarters, the average cost of funds for total interest-bearing liabilities increased 47 basis points to 2.86% for the three months ended March 31, 2006 compared to 2.39% for the three months ended March 31, 2005.

The following table details average balances, cost of funds and the change in interest expense for the three months ended March 31, 2006 and 2005:

| | 2006 | | Three Months Ended March 31, 2005 | | Increase/ (Decrease) in Interest Expense from 2005 |
|-------------------------------------|--------------------|-------|--|-------|--|
| | Average Balance | Cost | Average Balance (dollars in thousands) | Cost | |
| Savings deposits | \$ 25,537 | 0.20% | \$ 25,358 | 0.21% | \$ - |
| Interest-bearing demand deposits | 98,914 | 0.41 | 95,453 | 0.27 | 37 |
| Money market deposits | 30,914 | 1.40 | 37,730 | 1.08 | 6 |
| Certificates of deposit | 214,727 | 3.49 | 176,139 | 2.92 | 589 |

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| | | | | | |
|------------------------------------|-----------|-------|-----------|-------|---------|
| FHLB advances | 180,586 | 4.08 | 152,786 | 3.79 | 396 |
| Total interest-bearing liabilities | \$550,678 | 2.86% | \$487,466 | 2.39% | \$1,028 |

Provision for Loan Losses

. The Company's Asset Liability Committee (the "Committee") assesses the adequacy of the allowance for loan losses on a quarterly basis. The quarterly assessment may include several factors, including changes in size and composition of the loan portfolio, delinquency rates, charge-off rates, the changing risk profile of the loan portfolio, as well as local economic conditions including unemployment rates, bankruptcies and vacancy rates of business and residential properties. The Committee's methodology for analyzing the allowance for loan losses consists of specific allocations on significant individual credits and a general allowance amount, including a range of losses. The specific allowance component is determined when management believes that the collectibility of a specific large loan has been impaired and a loss is probable. The general allowance component relates to assets with no well-defined deficiency or weakness and takes into consideration loss that is inherent within the portfolio but has not been realized. The general allowance is determined by applying a historical loss percentage to various types of loans with similar characteristics and classified loans that are not analyzed specifically. Due to the imprecision in calculating inherent and potential losses, a range is added to the general reserve to provide an allowance for loan losses that is adequate to cover losses that may arise as a result of changing economic conditions and other factors that may alter the bank's historical loss experience.

The provision for loan losses was \$90,000 for the three months ended March 31, 2006, compared to \$236,000 for the three months ended March 31, 2005. The \$146,000, or 61.9% decrease in the provision reflects the Company's current credit quality and reduction of classified assets, nonperforming loans and net charge-offs. The following table details selected activity associated with the allowance for loan losses for the three months ended March 31, 2006 and 2005:

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| | At or For the Three Months Ended March 31, | |
|--|---|-----------|
| | 2006 | 2005 |
| | (dollars in thousands) | |
| Provision for loan losses | \$ 90 | \$ 236 |
| Net charge-offs | 30 | 84 |
| Allowance for loan losses | 2,984 | 2,827 |
| Allowance for loan losses as a percentage of gross loans receivable and loans held for sale at the end of the period | 0.62% | 0.67% |
| Allowance for loan losses as a percentage of nonperforming loans at the end of the period | 29,840.00% | 1,197.88% |
| Nonperforming loans | \$10 | \$236 |
| Nonaccrual and 90 days or more past due loans as a percentage of loans receivable and loans held for sale at the end of the period | 0.002% | 0.06% |
| Loans receivable, net | \$476,227 | \$419,146 |

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Despite an increase in bankruptcy filings prior to the October 17, 2005 effective date of the new bankruptcy laws, the Company has not experienced a significant increase in loan losses as a result of charge-offs related to these additional filings. Management considers the allowance for loan losses at March 31, 2006 to be adequate to cover probable losses inherent in the loan portfolio based on the assessment of the above-mentioned factors affecting the loan portfolio.

Noninterest Income

. Noninterest income decreased \$152,000, or 5.8%, to \$2.5 million for the three months ended March 31, 2006 from \$2.6 million for the three months ended March 31, 2005. The decrease in noninterest income is primarily attributable to a \$386,000 gain on the sale of a former branch that occurred in the quarter ended March 31, 2005, offset by an increase in service charges and fees and gains on loan sales in the current quarter. The following table provides a detailed analysis of the changes in components of noninterest income:

| | Three Months Ended | | Increase (decrease) | |
|----------------------------------|--------------------|----------------|------------------------|---------------|
| | 2006 | 2005 | Amount | Percent |
| | | | (dollars in thousands) | |
| Service fees and charges | \$2,115 | \$1,952 | \$ 163 | 8.4% |
| Gain on sale of loans | 195 | 72 | 123 | 170.8 |
| Increase in cash surrender value | | | | |
| of bank owned life insurance | 108 | 87 | 21 | 24.1 |
| Loan servicing fees | 159 | 168 | (9) | (5.4) |
| Mortgage servicing rights, net | (64) | (58) | (6) | 10.3 |
| Other | (24) | 420 | (444) | (105.7) |
| Total noninterest income | \$2,489 | \$2,641 | \$(152) | (5.8)% |

The Company performs a quarterly review of mortgage servicing rights for potential declines in value. For the three months ended March 31, 2006, the Company determined there was no impairment of the mortgage servicing rights. For the current quarter, amortization of the servicing rights exceeded the servicing rights capitalized as the majority of loans were sold with the servicing rights released. The mortgage servicing right was 1.10% of mortgage loans serviced for others at March 31, 2006, compared to 1.18% at March 31, 2005. Mortgage servicing rights is an accounting estimate of the present value of the future servicing fees from the right to service mortgage loans for others. This estimate is affected by prepayment speeds of the underlying mortgages and interest rates. In general, during periods of falling interest rates, mortgage loans prepay faster and the value of the mortgage-servicing asset declines.

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Noninterest Expense

. Noninterest expense increased \$858,000, or 16.5%, to \$6.1 million for the three months ended March 31, 2006 from \$5.2 million for the three months ended March 31, 2005.

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

| | Three Months Ended March 31, | | Increase (decrease) | |
|----------------------------------|---------------------------------|--------------------------------|---------------------|--------------|
| | 2006 | 2005 (dollars in thousands) | Amount | Percent |
| Compensation and benefits | \$3,770 | \$3,096 | \$674 | 21.8% |
| Occupancy and equipment | 694 | 682 | 12 | 1.8 |
| Data processing | 520 | 376 | 144 | 38.3 |
| Advertising | 257 | 310 | (53) | (17.1) |
| Other | 810 | 729 | 81 | 11.1 |
| Total noninterest expense | \$6,051 | \$5,193 | \$858 | 16.5% |

Noninterest expense increased \$858,000, or 16.5%, to \$6.1 million for the three months ended March 31, 2006 from \$5.2 million for the three months ended March 31, 2005. Compensation and benefits increased \$674,000 to \$3.8 million for the quarter ended March 31, 2006 from \$3.1 million for the same quarter a year ago. The majority of the increase is attributable to the establishment of the equity compensation plans during various times of the prior fiscal year, annual merit increases, and an increase in employee commissions and incentive plans. The equity compensation plans include the Company's employee stock ownership plan, 2005 Recognition and Retention Plan and 2005 Stock Option and Incentive Plan. See Note 5 of the Notes to Consolidated Financial Statements contained herein for further information. As of March 31, 2006, the Company employed 231 full-time equivalent employees, compared to 240 at March 31, 2005. Data processing costs increased 38.3% as a result of the outsourcing of the Company's check processing function as part of the conversion of its core processing system in November 2005. Other operating expenses increased primarily as a result of the write-off of uncollectible accounts related to the conversion of the Company's internal check processing system and an increase in fraudulent debit card transactions.

The efficiency ratio, which is the percentage of noninterest expense to net interest income plus noninterest income, was 74.5% for the three months ended March 31, 2006 compared to 63.8% for the three months ended March 31, 2005. Excluding the non-recurring gain on the sale of a former branch, the efficiency ratio was 67.0% for the three months ended March 31, 2005. By definition, a lower efficiency ratio would be an indication that the Company is more efficiently utilizing resources to generate net interest income and other fee income.

Income Tax Expense.

Income tax expense decreased \$283,000, or 27.4%, to \$749,000 for the three months ended March 31, 2006 from \$1.0 million for the same period a year ago. Income before income taxes was \$2.0 million for the three months ended March 31, 2006 compared to \$2.7 million for the three months ended March 31, 2005. The Company's combined federal and state effective income tax rate for the current quarter was 37.8% compared to 38.1% for the same quarter of the prior fiscal year.

Comparison of Operating Results for the Six Months ended March 31, 2006 and March 31, 2005

General.

Net income for the six months ended March 31, 2006 was \$3.0 million, or \$0.21 per diluted share, compared to net income of \$1.7 million, or \$0.12 per diluted share, for the six months ended March 31, 2005. The results for the six months ended March 31, 2005 include a \$386,000 pre-tax gain on the sale of a former branch and a \$1.8 million pre-tax expense for establishing the Foundation. Excluding the gain on the sale of the branch and the expense for establishing the Foundation, the Company had net income of \$2.6 million, or \$0.18 per diluted share, for the six months ended March 31, 2005.

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The following table reconciles the Company's actual net income to pro forma net income for the six months ended March 31, 2006 and 2005, exclusive of the sale of the branch and the contribution to the Foundation, as adjusted for federal and state taxes:

| | Six Months Ended March 31, | |
|-------------------------------------|---------------------------------------|---------|
| | 2006 | 2005 |
| | (in thousands, except per share data) | |
| Pro forma disclosure | | |
| Net income, as reported | \$2,993 | \$1,748 |
| Gain on sale of branch | - | (386) |
| Contribution to Foundation | - | 1,825 |
| Federal and state income tax effect | - | (561) |
| | <hr/> | <hr/> |
| Pro forma net income | \$2,993 | \$2,626 |
| | <hr/> | <hr/> |
| Earnings per share | | |
| Diluted as reported | \$0.21 | \$0.12 |
| Pro forma diluted | \$0.21 | \$0.18 |

Net Interest Income.

Net interest income increased \$1.1 million, or 10.8%, to \$11.6 million for the six months ended March 31, 2006, from \$10.5 million for the six months ended March 31, 2005. Average total interest-earning assets increased \$80.6 million, or 13.8% to \$664.4 million for the six months ended March 31, 2006 from \$583.8 million for the same period last year. The increase in interest-earning assets was primarily a result of the purchase of mortgage-backed securities with the net proceeds of the minority stock offering in December 2004 and purchases of hybrid adjustable mortgage-backed securities and loans since then to achieve a desired level of interest-earning assets.

The Company's net interest margin decreased nine basis points to 3.50% for the six months ended March 31, 2006, from 3.59% for the same period last year. The cost of deposits was 2.04% for the first six months of fiscal 2006 compared to 1.65% for the first six months of the prior year. For the quarter ended December 31, 2005, the Company revised its estimate of accrued interest on an escalator certificate of deposit product, resulting in a \$310,000 reduction in interest expense for the quarter ended December 31, 2005. Excluding the revision, the net interest margin and cost of deposits for the first six months were 3.37% and 2.21%, respectively. The decline in net interest margin to 3.37% reflects the relatively flat yield curve that currently exists, as the cost of shorter-term deposits and borrowed funds increased more rapidly than the yield on longer-term assets. Although the Company believes the repricing of existing and new loans over time will help counter the trend in net interest margin, pressure will likely continue in the near term as a result of the flat yield curve environment.

Interest and Dividend Income.

Total interest and dividend income for the six months ended March 31, 2006 increased \$2.8 million, or 17.6%, to \$18.9 million, from \$16.1 million for the six months ended March 31, 2005. The increase was primarily attributable to the \$80.6 million increase in the average balance of interest-earning assets and an increase in the yield on interest-earning assets to 5.70% as a result of the general increase in interest rates.

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The following table compares detailed average earning asset balances, associated yields, and resulting changes in interest and dividend income for the six months ended March 31, 2006 and 2005:

| | 2006 | | Six Months Ended March 31, 2005 | | Increase/ (Decrease) in Interest and Dividend Income from 2005 |
|---|--------------------|--------------|--|--------------|---|
| | Average Balance | Yield | Average Balance (dollars in thousands) | Yield | |
| Loans receivable, net | \$446,441 | 6.20% | \$406,417 | 6.07% | \$1,499 |
| Loans held for sale | 3,852 | 6.07 | 1,953 | 5.58 | 180 |
| Investment securities, available for sale, including interest-bearing deposits in other banks | 3,596 | 3.95 | 26,717 | 1.95 | (189) |
| Mortgage-backed securities | 200,910 | 4.75 | 140,938 | 4.84 | 1,364 |
| FHLB stock | 9,591 | - | 7,735 | 0.78 | (30) |
| Total interest-earning assets | \$664,390 | 5.70% | \$583,760 | 5.51% | \$2,824 |

On May 18, 2005, the FHLB indefinitely suspended dividends on all classes of its stock as part of its recapitalization plans. The suspension of FHLB dividends has not had a significant effect on our results of operations or financial condition.

Interest Expense.

Interest expense increased \$1.7 million, or 30.2%, to \$7.3 million for the six months ended March 31, 2006 from \$5.6 million for the six months ended March 31, 2005. The average balance of total interest-bearing liabilities increased \$48.1 million, or 9.8%, to \$539.5 million for the six months ended March 31, 2006 from \$491.4 million for the six months ended March 31, 2005. The increase was primarily a result of growth in certificates of deposit and additional advances from the FHLB. As a result of general market rate increases following Federal Reserve rate hikes during the past several quarters, the average cost of funds for total interest-bearing liabilities increased 42 basis points to 2.70% for the six months ended March 31, 2006 compared to 2.28% for the six months ended March 31, 2005.

The following table details average balances, cost of funds and the change in interest expense for the six months ended March 31, 2006 and 2005:

| | 2006 | | Six Months Ended March 31, 2005 | | Increase/ (Decrease) in Interest Expense from 2005 |
|--|--------------------|------|--|------|--|
| | Average Balance | Cost | Average Balance (dollars in thousands) | Cost | |

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| | | | | | |
|------------------------------------|-----------------------------|-----------------------------|-----------------------------|-----------------------------|-----------------------------|
| Savings deposits | \$ 25,420 | 0.20% | \$ 25,446 | 0.20% | \$ - |
| Interest-bearing demand deposits | 97,688 | 0.39 | 113,861 | 0.26 | 43 |
| Money market deposits | 31,650 | 1.40 | 39,158 | 1.01 | 24 |
| Certificates of deposit | 207,446 | 3.14 | 172,067 | 2.93 | 737 |
| FHLB advances | 177,309 | 4.06 | 140,827 | 3.85 | 887 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Total interest-bearing liabilities | <u>\$539,513</u> | <u>2.70%</u> | <u>\$491,359</u> | <u>2.28%</u> | <u>\$1,691</u> |

Provision for Loan Losses.

The provision for loan losses was \$145,000 for the six months ended March 31, 2006, compared to \$295,000 for the six months ended March 31, 2005. The \$150,000, or 50.9% decrease in the provision reflects the Company's current credit quality and reduction of classified assets, nonperforming loans and net charge-offs. Management considers the allowance for loan losses at March 31, 2006 to be adequate to cover probable losses inherent in the loan portfolio. The following table details selected activity associated with the allowance for loan losses for the six months ended March 31, 2006 and 2005:

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| | At or For the Six Months Ended March 31, | |
|--|---|-----------|
| | 2006 | 2005 |
| | (dollars in thousands) | |
| Provision for loan losses | \$ 145 | \$ 295 |
| Net charge-offs | 43 | 105 |
| Allowance for loan losses | 2,984 | 2,827 |
| Allowance for loan losses as a percentage of gross loans receivable and loans held for sale at the end of the period | 0.62% | 0.67% |
| Allowance for loan losses as a percentage of nonperforming loans at the end of the period | 29,840.00% | 1,197.88% |
| Nonperforming loans | \$10 | \$236 |
| Nonaccrual and 90 days or more past due loans as a percentage of loans receivable and loans held for sale at the end of the period | 0.002% | 0.06% |
| Loans receivable, net | \$476,227 | \$419,146 |
| Noninterest Income | | |

. Noninterest income increased \$432,000, or 8.9%, to \$5.3 million for the six months ended March 31, 2006 from \$4.9 million for the six months ended March 31, 2005. The increase in noninterest income is primarily attributable to a \$590,000 increase in service charges as a result of enhancements to the retail checking program related to the core processing conversion in the prior quarter. Gains on sale of loans also increased \$366,000 from \$140,000 for the six months ended March 31, 2005 to \$506,000 for the comparable period in 2006 as loans sold to investors increased to \$37.2 million for the six months ended March 31, 2006 from \$24.3 million for the six months ended March 31, 2005. As a result of the Company's conversion of its core processing system during the quarter ended December 31, 2005, the Company retired fixed assets and

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software related to the prior system, resulting in an \$86,000 charge to gains and losses on fixed assets, included in other noninterest income for the six months ended March 31, 2006. Other noninterest income for the six months ended March 31, 2005 included a \$386,000 gain on the sale of a former branch.

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

| | Six Months Ended March 31, | | Increase (decrease) | |
|--|-------------------------------|----------------|------------------------|-------------|
| | 2006 | 2005 | Amount | Percent |
| | | | (dollars in thousands) | |
| Service fees and charges | \$4,501 | \$3,911 | \$590 | 15.1% |
| Gain on sale of loans | 506 | 140 | 366 | 261.4 |
| Increase in cash surrender value of bank owned life insurance | 190 | 162 | 28 | 17.3 |
| Loan servicing fees | 319 | 340 | (21) | (6.2) |
| Mortgage servicing rights, net | (160) | (154) | (6) | 3.9 |
| Other | (66) | 459 | (525) | (114.4) |
| Total noninterest income | \$5,290 | \$4,858 | \$432 | 8.9% |

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Noninterest Expense

. Noninterest expense decreased \$319,000, or 2.6%, to \$11.9 million for the six months ended March 31, 2006 from \$12.2 million for the six months ended March 31, 2005. The following table provides a detailed analysis of the changes in components of noninterest expense:

| | Six Months Ended March 31, | | Increase (decrease) | |
|----------------------------------|-------------------------------|-----------------|------------------------|---------------|
| | 2006 | 2005 | Amount | Percent |
| | | | (dollars in thousands) | |
| Compensation and benefits | \$ 7,576 | \$ 6,149 | \$ 1,427 | 23.2% |
| Occupancy and equipment | 1,422 | 1,401 | 21 | 1.5 |
| Data processing | 861 | 819 | 42 | 5.1 |
| Advertising | 471 | 650 | (179) | (27.5) |
| Contribution to Foundation | - | 1,825 | (1,825) | (100.0) |
| Other | 1,601 | 1,406 | 195 | 13.9 |
| Total noninterest expense | \$11,931 | \$12,250 | \$ (319) | (2.6)% |

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For the six months ended March 31, 2005, the Company established the Foundation by contributing \$1.8 million, consisting of 146,004 shares of its common stock and \$365,000 in cash. The Foundation was formed for the purpose of supporting charitable organizations and activities that enhance the quality of life for residents within the Company's market area.

Excluding the contribution to the Foundation, noninterest expense increased \$1.5 million for the six months ended March 31, 2006. Compensation and benefits accounted for \$1.4 million of the increase to \$7.6 million for the six months ended March 31, 2006 as compared to \$6.1 million for the same period a year ago. The majority of the increase in compensation and benefits is attributable to the establishment of the equity compensation plans during various times of the prior fiscal year, annual merit increases, and increases in employee commissions and incentive plans. See Note 5 of the Notes to Consolidated Financial Statements contained herein for further information. Other operating expenses increased primarily as a result of the write-off of uncollectible accounts related to the conversion of the Company's internal check processing system, an increase in fraudulent debit card transactions and an increase in monthly service charges by the Federal Reserve related to the conversion of the internal check processing system.

The efficiency ratio, which is the percentage of noninterest expense to net interest income plus noninterest income, was 70.6% for the six months ended March 31, 2006 compared to 79.9% for the six months ended March 31, 2005. Excluding the non-recurring contribution to the Foundation and the gain on the sale of a former branch, the efficiency ratio was 69.7% for the six months ended March 31, 2005.

Income Tax Expense.

Income tax expense increased \$789,000, or 75.3%, to \$1.8 million for the six months ended March 31, 2006 from \$1.0 million for the same period a year ago. Income before income taxes was \$4.8 million for the six months ended March 31, 2006 compared to \$2.8 million for the six months ended March 31, 2005. The Company's combined federal and state effective income tax rate for the current period was 38.0% compared to 37.5% for the same period of the prior fiscal year.

Liquidity, Commitments and Capital Resources

Liquidity.

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

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

At March 31, 2006, the Bank maintained a line of credit with the FHLB equal to 40% of total assets to the extent the Bank provides qualifying collateral and holds sufficient FHLB stock. At March 31, 2006, the Bank was in compliance with the collateral requirements and \$94.5 million of the line of credit was available. In addition, the Company holds readily saleable loans and mortgage-backed securities available for sale for liquidity purposes.

At March 31, 2006, certificates of deposits amounted to \$224.6 million, or 52.0% of total deposits, including \$143.0 million that are scheduled to mature by March 31, 2007. Historically, we have been able to retain a significant amount of our deposits as they mature. Management believes the Company has adequate resources to fund all loan commitments through deposits, advances from the FHLB, loan repayments, maturing investment securities, and the sale of mortgage loans in the secondary markets.

Off-Balance Sheet Arrangements.

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

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

The following is a summary of commitments and contingent liabilities with off-balance sheet risks as of March 31, 2006:

| | Contract or Notional Amount (in thousands) |
|-------------------------------------|--|
| Commitments to originate loans: | |
| Fixed rate | \$15,440 |
| Adjustable rate | 7,123 |
| Undisbursed balance of loans closed | 19,823 |
| Unused lines of credit | 29,747 |
| Commercial letters of credit | 69 |
| | <hr/> |
| Total | \$72,202 |
| | <hr/> |

Capital.

Consistent with our objective to operate a sound and profitable financial institution, the Company has maintained and will continue to focus on maintaining a "well capitalized" rating from regulatory authorities. In addition, the Company is subject to certain capital requirements set by our regulatory agencies. At March 31, 2006, the Company exceeded all regulatory capital requirements. Total equity of the Company was \$104.4 million at March 31, 2006, or 14.0% of total assets on that date.

The Bank's regulatory capital ratios at March 31, 2006 were as follows: Tier 1 capital of 11.5%; Tier 1 risk-based capital of 19.2%; and total risk-based capital of 19.9%. The regulatory capital requirements to be considered well

capitalized are 5%, 6%, and 10%, respectively.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

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

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One of our primary financial objectives is to generate ongoing profitability. The Company's profitability depends primarily on its net interest income, which is the difference between the income it receives on its loan and investment portfolio and its cost of funds, which consists of interest paid on deposits and borrowings. The rates we earn on assets and pay on liabilities generally are established contractually for a period of time. Market interest rates change over time. Our loans generally have longer maturities than our deposits. Accordingly, our results of operations, like those of other financial institutions, are affected by changes in interest rates and the interest rate sensitivity of our assets and liabilities. We measure our interest rate sensitivity on a monthly basis using an internal model.

Management employs various strategies to manage our interest rate sensitivity including: (1) selling long-term fixed-rate mortgage loans in the secondary market to Fannie Mae, Freddie Mac and other financial institutions; (2) borrowing intermediate to long-term funds at fixed rates from the FHLB; (3) originating consumer loans at shorter maturities or at variable rates; (4) originating adjustable rate mortgage loans; (5) appropriately modifying loan and deposit pricing to capitalize on the then current market opportunities; and (6) increasing lower cost core deposits, such as savings and checking accounts. At March 31, 2006, the Company had no off-balance sheet derivative financial instruments, and the Bank did not maintain a trading account for any class of financial instruments or engage in hedging activities or purchase high risk derivative instruments. Furthermore, the Company is not subject to foreign currency exchange rate risk or commodity price risk.

There has not been any material change in the market risk disclosures contained in the Company's 2005 Form 10-K.

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures.

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

(b) Changes in Internal Controls.

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There have been no changes in our internal control over financial reporting (as defined in 13a-15(f) of the Act) that occurred during the quarter ended March 31, 2006, that have materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. A number of internal control procedures were, however, modified during the quarter in conjunction with the Bank's internal control testing and conversion to a new core processing system. The Company also continued to implement suggestions from its internal auditor and independent auditors on ways to strengthen existing controls.

The Company intends to continually review and evaluate the design and effectiveness of its disclosure controls and procedures and to improve its controls and procedures over time and to correct any deficiencies that it may discover in the future. The goal is to ensure that senior management has timely access to all material non-financial information concerning the Company's business. While the Company believes the present design of its disclosure controls and procedures is effective to achieve its goal, future events affecting its business may cause the Company to modify its disclosure controls and procedures. The Company does not expect that its disclosure controls and procedures and internal control over financial reporting will prevent all error and fraud. A control procedure, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control procedure are met. Because of the inherent limitations in all control procedures, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns in controls or procedures can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management

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override of the control. The design of any control procedure is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control procedure, misstatements due to error or fraud may occur and not be detected.

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PART II - OTHER INFORMATION

Item 1. Legal Proceedings

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

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

Not applicable.

Stock Repurchases.

The Company did not repurchase any shares of its outstanding common stock during the three months ended March 31, 2006. In addition, the Company has no publicly announced plans to repurchase any shares of its common stock.

Item 3. Defaults Upon Senior Securities

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Not applicable.

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

The Company's Annual Meeting of Stockholders was held on January 23, 2006. The results of the vote on the two items presented at the meeting were as follows:

Proposal 1. Election of Directors

| | Term to Expire | FOR | | WITHHELD | |
|---------------------------|-------------------|--------------------|------------|--------------------|------------|
| | | Number of Votes | Percentage | Number of Votes | Percentage |
| Fred H. Helpenstell, M.D. | 2009 | 14,238,608 | 98.68% | 190,583 | 1.32% |
| Richard J. Navarro | 2009 | 14,391,084 | 99.74% | 38,107 | 0.26% |
| Daniel L. Stevens | 2009 | 14,290,865 | 99.04% | 138,326 | 0.96% |

Each of the following directors who were not up for re-election at the annual meeting of stockholders will continue in office: N. Charles Hedemark, Thomas W. Malson, James R. Stamey and Robert A. Tinstman.

Proposal 2. Ratification of the appointment of Independent Auditors

Stockholders ratified the appointment of Moss Adams LLP as the Company's independent auditors for the fiscal year ending September 30, 2006 by the following vote:

| | Number of Votes | Percentage |
|---------|--------------------|------------|
| FOR | 14,405,981 | 99.84% |
| AGAINST | 13,686 | 0.09% |
| ABSTAIN | 9,523 | 0.07% |

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

Item 5. Other Information

Not applicable.

Item 6. Exhibits

- 3.1 Articles of Incorporation of the Registrant (1)
- 3.2 Bylaws of the Registrant (1)
- 10.1 Form of Employment Agreement for President and Chief Executive Officer with Home Federal Bank (1)
- 10.2 Form of Employment Agreement for President and Chief Executive Officer with Home Federal Bancorp, Inc. (1)
- 10.3 Form of Severance Agreement for Executive Officers (1)
- 10.4 Form of Home Federal Savings and Loan Association of Nampa Employee Severance Compensation Plan (1)
- 10.5 Form of Director Indexed Retirement Agreement entered into by Home Federal Savings and Loan Association of Nampa with each of its Directors (1)
- 10.6 Form of Director Deferred Incentive Agreement entered into by Home Federal Savings and Loan Association of Nampa with each of its Directors (1)
- 10.7 Form of Split Dollar Agreement entered into by Home Federal Savings and Loan Association of Nampa with Daniel L. Stevens, N. Charles Hedemark, Fred H. Helpenstell, M.D., Richard J. Schrandt, James R. Stamey and Robert A. Tinstman (1)
- 10.8 Form of Executive Deferred Incentive Agreement, and amendment thereto, entered into by Home Federal Savings and Loan Association of Nampa with Daniel L. Stevens, Robert A. Schoelkoph, Roger D. Eisenbarth, Lynn A. Sander and Karen Wardwell (1)
- 10.9 Form of Amended and Restated Salary Continuation Agreement entered into by Home Federal Savings and Loan Association of Nampa with Daniel L. Stevens, Robert A. Schoelkoph, Roger D. Eisenbarth, Lynn A. Sander and Karen Wardwell (1)
- 10.10 2005 Stock Option and Incentive Plan approved by stockholders on June 23, 2005 and Form of Incentive Stock Option Agreement and Non-Qualified Stock Option Agreement (2)
- 10.11 2005 Recognition and Retention Plan approved by stockholders on June 23, 2005 and Form of Award Agreement (2)
- 10.12 Form of new Director Retirement Plan entered into by Home Federal Bank with each of its Directors (3)
- 14 Code of Ethics (4)
- 31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act
- 31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act
- 32 Certification Pursuant to Section 906 of the Sarbanes-Oxley Act

(1) Filed as an exhibit to the Registrant's Registration Statement on Form S-1 (333-35817).

(2) Filed as an exhibit to the Registrant's Registration Statement on Form S-8 (333-127858).

(3) Filed as an exhibit to the Registrant's Current Report on Form 8-K dated October 21, 2005.

(4) Filed as an exhibit to the Registrant's Annual Report on Form 10-K for the year ended September 30, 2004.

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SIGNATURES

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

Home Federal Bancorp, Inc.

Date: May 9, 2006

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

Date: May 9, 2006

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

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EXHIBIT INDEX

- 31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act
- 31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act
- 32 Certification Pursuant to Section 906 of the Sarbanes-Oxley Act

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EXHIBIT 31.1

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

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

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

over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

- (a) All significant deficiencies and material weakness in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial data information; and
- (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting

Date: May 9, 2006

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

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EXHIBIT 31.2

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

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

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

(b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fiscal fourth quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weakness in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial data information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting

Date: May 9, 2006

/s/ Robert A. Schoelkoph
Robert A. Schoelkoph
Senior Vice President and
Chief Financial Officer

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EXHIBIT 32

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

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

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

/s/ Daniel L. Stevens

Daniel L. Stevens
Chairman, President and
Chief Executive Officer

/s/ Robert A. Schoelkoph

Robert A. Schoelkoph
Senior Vice President and
Chief Financial Officer

Dated:

May 9, 2006

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