

MSB FINANCIAL CORP.  
Form 10-K  
September 29, 2008  
**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, DC 20549**

**FORM 10-K**

**ANNUAL REPORT**

**PURSUANT TO SECTIONS 13 OR 15(d)**

**OF THE SECURITIES EXCHANGE ACT OF 1934**

(Mark One)

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

For the fiscal year ended: June 30, 2008 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 No. **001-33246**

**MSB FINANCIAL CORP.**

(Exact name of Registrant as specified in its Charter)

**United States**

(State or other Jurisdiction of

Incorporation or Organization)

**34-1981437**

(I.R.S. Employer Identification No.)

**1902 Long Hill Road, Millington, New Jersey**

(Address of Principal Executive Offices)

**07946-0417**

(Zip Code)

Registrant's telephone number, including area code: **908-647-4000**

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Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
<b>Common Stock, \$0.10 par value</b>	<b>The Nasdaq Stock Market LLC</b>

Securities registered pursuant to Section 12(g) of the Act: **None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES  NO

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES  NO

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer <input type="radio"/>	Accelerated filer <input type="radio"/>
Non-accelerated filer <input type="radio"/>	Smaller reporting company <input checked="" type="radio"/>

(Do not check if a smaller reporting company)

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

The aggregate market value of the voting stock held by non-affiliates of the Registrant, based on the closing price of the Registrant's common stock as quoted on the Nasdaq Stock Market LLC on December 31, 2007, was approximately \$24.2 million.

As of September 22, 2008 there were 5,475,161 shares outstanding of the Registrant's common stock.

**DOCUMENTS INCORPORATED BY REFERENCE**

1. Portions of the Proxy Statement for the 2008 Annual Meeting of Shareholders. (Parts II and III)

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FOR THE FISCAL YEAR ENDED JUNE 30, 2008

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**PART IV**

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**PART I**

**Forward-Looking Statements**

MSB Financial Corp. (the “Company”) may from time to time make written or oral “forward-looking statements,” including statements contained in the Company’s filings with the Securities and Exchange Commission (including this Annual Report on Form 10-K and the exhibits thereto), in its reports to stockholders and in other communications by the Company, which are made in good faith by the Company pursuant to the “safe harbor” provisions of the private securities litigation reform act of 1995.

These forward-looking statements involve risks and uncertainties, such as statements of the Company’s plans, objectives, expectations, estimates and intentions, that are subject to change based on various important factors (some of which are beyond the Company’s control). The following factors, among others, could cause the Company’s financial performance to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward-looking statements: The strength of the United States economy in general and the strength of the local economies in which the Company conducts operations; the effects of, and changes in, trade, monetary and fiscal policies and laws, including interest rate policies of the board of governors of the federal reserve system, inflation, interest rate, market and monetary fluctuations; the timely development of and acceptance of new products and services of the Company and the perceived overall value of these products and services by users, including the features, pricing and quality compared to competitors’ products and services; the willingness of users to substitute competitors’ products and services for the Company’s products and services; the success of the Company in gaining regulatory approval of its products and services, when required; the impact of changes in financial services’ laws and regulations (including laws concerning taxes, banking, securities and insurance); technological changes, acquisitions; changes in consumer spending and saving habits; and the success of the Company at managing the risks involved in the foregoing.

The Company cautions that the foregoing list of important factors is not exclusive. The Company does not undertake to update any forward-looking statement, whether written or oral, that may be made from time to time by or on behalf of the Company.

**Item 1. Business**

**General**

The Company is a federally chartered corporation organized in 2004 for the purpose of acquiring all of the capital stock that Millington Savings Bank (the “Bank”) issued in its mutual holding company reorganization. During the fiscal year ended June 30, 2007, the Company conducted its initial public offering and sold 2,529,281 shares for net proceeds of approximately \$24.5 million. The Company’s principal executive offices are located at 1902 Long Hill Road, Millington, New Jersey 07946-0417 and its telephone number at that address is (908) 647-4000.

MSB Financial, MHC (the “MHC”) is a federally chartered mutual holding company that was formed in 2004 in connection with the mutual holding company reorganization. The MHC has not engaged in any significant business since its formation. So long as the MHC is in existence, it will at all times own a majority of the outstanding stock of the Company.



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The Bank is a New Jersey-chartered stock savings bank and its deposits are insured by the Federal Deposit Insurance Corporation. As of June 30, 2008, the Bank had 49 full time equivalent employees.

The Bank is regulated by the New Jersey Department of Banking and Insurance and the Federal Deposit Insurance Corporation. The OTS regulates the MHC and the Company as federally-chartered savings and loan holding companies.

Throughout this document, references to “we,” “us,” or “our” refer to the Bank or Company, or both, as the context indicates.

### **Competition**

We operate in a market area with a high concentration of banking and financial institutions, and we face substantial competition in attracting deposits and in originating loans. A number of our competitors are significantly larger institutions with greater financial and managerial resources and lending limits. Our ability to compete successfully is a significant factor affecting our growth potential and profitability.

Our competition for deposits and loans historically has come from other insured financial institutions such as local and regional commercial banks, savings institutions, and credit unions located in our primary market area. We also compete with mortgage banking and finance companies for real estate loans and with commercial banks and savings institutions for consumer loans, and we face competition for funds from investment products such as mutual funds, short-term money funds and corporate and government securities. There are large competitors operating throughout our total market area, and we also face strong competition from other community-based financial institutions.

### **Lending Activities**

We have traditionally focused on the origination of one-to-four family loans and home equity loans and lines of credit, which together comprise a substantial majority of the total loan portfolio. We also provide financing for commercial real estate, including multi-family dwellings/apartment buildings, service/retail and mixed-use properties, churches and non-profit properties, medical and dental facilities and other commercial real estate. In recent years, construction loans have grown as a component of our portfolio. We also originate commercial loans. Our consumer loans are comprised of auto loans, personal loans and account loans.

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**Loan Portfolio Composition.** The following tables analyze the composition of the Bank's portfolio by loan category at the dates indicated. Except as set forth below, there were no concentrations of loans exceeding 10% of total loans.

	<b>At June 30,</b>		<b>2007</b>		<b>2006</b>		<b>2005</b>		<b>2004</b>	
	<b>2008</b>		<b>Amount</b>	<b>Percent</b>	<b>Amount</b>	<b>Percent</b>	<b>Amount</b>	<b>Percent</b>	<b>Amount</b>	<b>Percent</b>
	<b>Amount</b>	<b>Percent</b>	<b>Amount</b>	<b>Percent</b>	<b>Amount</b>	<b>Percent</b>	<b>Amount</b>	<b>Percent</b>	<b>Amount</b>	<b>Percent</b>
	<b>(Dollars in thousands)</b>									
<b>Type of Loans:</b>										
One-to-four family real estate	\$ 145,868	56.31 %	\$ 123,601	50.94 %	\$ 120,921	53.89 %	\$ 113,488	58.50 %	\$ 109,781	62.73 %
Commercial real estate	30,068	11.61	28,989	11.95	23,587	10.51	17,971	9.26	17,162	9.81
Construction	17,771	6.86	23,822	9.82	23,276	10.37	18,398	9.48	13,668	7.81
Consumer	1,259	0.49	1,995	0.82	1,861	0.83	1,819	0.94	1,703	0.97
Home equity	54,778	21.15	55,896	23.04	49,257	21.95	38,291	19.74	29,710	16.98
Commercial	9,285	3.58	8,338	3.43	5,497	2.45	4,029	2.08	2,970	1.70
<b>Total loans receivable</b>	<b>259,029</b>	<b>100.00 %</b>	<b>242,641</b>	<b>100.00 %</b>	<b>224,399</b>	<b>100.00 %</b>	<b>193,996</b>	<b>100.00 %</b>	<b>174,994</b>	<b>100.00 %</b>
<b>Less:</b>										
Construction loans in process	(3,568)		(7,999 )		(4,968 )		(5,719 )		(5,371 )	
Allowance for loan losses	(1,025)		(926 )		(921 )		(874 )		(742 )	
Deferred loan fees	(146)		(218 )		(189 )		(211 )		(267 )	
<b>Total loans receivable, net</b>	<b>\$ 254,290</b>		<b>\$ 233,498</b>		<b>\$ 218,321</b>		<b>\$ 187,192</b>		<b>\$ 168,614</b>	



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**Loan Maturity Schedule.** The following table sets forth the maturity of the Bank's loan portfolio at June 30, 2008. Demand loans, loans having no stated maturity, and overdrafts are shown as due in one year or less. Undisbursed amounts on construction loans totaling \$3.6 million at June 30, 2008 are not shown in the table. The table shows contractual maturities and does not reflect repricing or the effect of prepayments. Actual maturities may differ.

**At June 30, 2008**

	<b>One-to-Four Family Real Estate</b>	<b>Commercial Real Estate</b>	<b>Construction</b>	<b>Consumer</b>	<b>Home Equity</b>	<b>Commercial</b>	<b>Total</b>
<b>(In thousands)</b>							
<u>Amounts Due:</u>							
Within 1 Year	\$ 10,780	\$ 2,854	\$ 14,156	\$ 650	\$ 65	\$ 166	\$ 28,671
After 1 year:							
1 to 5 years	37,419	8,662	47	588	2,193	7,366	56,275
5 to 10 years	16,620	8,521	-	21	15,845	461	41,468
After 10 years	81,049	10,031	-	-	36,675	1,292	129,047
Total due after one year	135,088	27,214	47	609	54,713	9,119	226,790
Total amount due	\$ 145,868	\$ 30,068	\$ 14,203	\$ 1,259	\$ 54,778	\$ 9,285	\$ 255,461

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The following table sets forth the dollar amount of all loans at June 30, 2008 due after June 30, 2009, which have fixed interest rates and which have floating or adjustable interest rates.

	<b>Fixed Rates</b> (In thousands)	<b>Floating or Adjustable Rates</b>	<b>Total</b>
One-to-four family real estate	\$ 132,106	\$ 2,982	\$ 135,088
Commercial real estate	27,214	-	27,214
Construction	47	-	47
Consumer	433	176	609
Home equity	35,548	19,165	54,713
Commercial	3,642	5,477	9,119
Total	\$ 198,990	\$ 27,800	\$ 226,790

**One-to-Four Family Real Estate Mortgages.** Our primary lending activity consists of the origination of one-to-four family first mortgage loans. Fixed rate, conventional mortgage loans are offered by the Bank with terms from 5 to 30 years. A bi-weekly payment option is available wherein a payment is made every fourteen days via automatic deduction from the borrower's Millington Savings Bank account.

We also originate fixed rate balloon mortgages with terms of 3 to 10 years and flexible amortizations. At the end of each term the mortgage may be paid off in full with no penalty or, provided that the loan is in good standing and there has been no negative change in value of the collateral, we may extend the existing mortgage on new terms, at a new interest rate. If the mortgage is extended, there may be additional charges at the time of each extension.

We originate adjustable rate mortgages, or ARM's, with up to 30 year terms at rates based upon the U.S. Treasury One Year Constant Maturity as an index. Our ARM's currently reset on an annual basis, beginning with the first year, and have a two percent annual increase cap and a six percent lifetime adjustment cap. We do not originate "teaser" rate or negative amortization loans.

Substantially all residential mortgages include "due on sale" clauses, which are provisions giving the lender the right to declare a loan immediately payable if the borrower sells or otherwise transfers an interest in the property to a third party. Property appraisals on real estate securing one-to-four family residential loans are made by state certified or licensed independent appraisers and are performed in accordance with applicable regulations and policies. We require title insurance policies on all first lien one-to-four family residential loans. Homeowners, liability, fire and, if applicable, flood insurance policies are also required.

We provide financing on residential investment properties with either 3 to 10 year balloon mortgages or 5 to 30 year fixed duration mortgages. At the end of each term a balloon mortgage on an investment property may be paid off in full with no penalty or, provided that the loan is in good standing and there has been no negative change in value of the collateral, we may extend the existing mortgage on new terms, at a new interest rate. If the mortgage is extended, there may be additional charges at the time of each extension. Our investment property lending is available to individuals or proprietorships, partnerships, limited liability corporations, and corporations with personal guarantees. All investment property is underwritten on its ability substantially to carry itself, unless the property is a two-family residence with the mortgagor living in one of the units. Preference is given to those loans where rental



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income covers all operating expenses, including but not limited to principal and interest, real estate tax, hazard insurance, utilities, maintenance, and reserve. Operating expenses generally may not exceed rental income by more than 10%. Any negative cash flow will be included in the limit on the borrower's total debt ratio.

We generally originate one-to-four family first mortgage loans, for primary residence or investment, for up to 80% loan-to-value. Although not our normal practice, our lending policy permits us to exceed this limit. Our president and executive vice president are both authorized to approve a loan-to-value ratio of up to 90%. Loans in excess of 90% loan-to-value must have private mortgage insurance and must be approved by the Board of Directors.

**Commercial Real Estate Mortgages.** Our commercial real estate lending includes multi-family dwellings/apartment buildings, service/retail and mixed-use properties, churches and non-profit properties, medical and dental facilities and other commercial real estate. Our commercial real estate mortgage loans are either 3 to 10 year balloon mortgages (with a maximum amortization period of 25 years) or 15 year fixed duration mortgages. This type of lending is made available to proprietorships, partnerships, and corporations with personal guarantees. All commercial property is underwritten on its ability substantially to carry itself. A cash flow and lease analysis is performed for each property. Preference is given to those loans where rental income covers all operating expenses, including but not limited to principal and interest, real estate tax, hazard insurance, utilities, maintenance, and reserve. Operating expenses may exceed rental income by not more than 10%. Any negative cash flow will be included in the limit on the borrower's total debt ratio. Cash from other assets of the borrower, who may own multiple properties and generate a surplus, can be made available to cover debt-service shortages of the financed property.

The maximum loan-to-value ratio on most commercial real estate loans we originate is 80%. Although not our normal practice, our lending policy permits us to originate these loans in excess of an 80% loan-to-value. Our President and Executive Vice President are authorized to approve a loan-to-value ratio of up to 90% on commercial real estate loans.

The management skills of the borrower are judged on the basis of his/her professional experience and must be documented to meet the Bank's satisfaction in relation to the desired project. The assets of the borrower must indicate his/her ability to support the proposed investment, both in terms of liquidity and net worth, and tangible history of the borrower's capability and experience must be evident.

Unlike single-family residential mortgage loans, which generally are made on the basis of the borrower's ability to make repayment from his or her employment and other income, and which are secured by real property whose value tends to be more easily ascertainable, multi-family and commercial real estate loans typically are made on the basis of the borrower's ability to make repayment from the cash flow of the borrower's business or rental income. As a result, the availability of funds for the repayment of commercial real estate and multi-family loans may be substantially dependent on the success of the business itself and the general economic environment. Commercial real estate and multi-family loans, therefore, have greater credit risk than one-to-four family residential mortgages or consumer loans. In addition, commercial real estate and multi-family loans generally result in larger balances to single borrowers, or related groups of borrowers and also generally require substantially greater evaluation and oversight efforts.

**Construction Loans.** We originate construction and land acquisition loans for an owner-occupied residence or to a builder with a valid contract of sale. With prior Board of Director approval, we also provide financing for speculative residential or commercial construction and development. Individual consideration is given to builders based on their past performance, workmanship, and financial worth.



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Our construction lending includes loans for construction or major renovations or improvements of owner-occupied residences; however, the majority of this portfolio consists of real estate developers.

Construction loans are mortgages with a one-year duration. Funds are disbursed periodically upon inspections made by our inspectors on the completion of each phase, as per the approved draw schedule. Funds disbursed may not exceed 90% loan-to-value of land and improvements at any time during construction. Interest rates on disbursed funds are based on the rate and terms set at the time of closing. The majority of our construction lending is variable rate loans with rates tied to the prime rate published in *The Wall Street Journal*, plus a premium. Payments on disbursed funds must be made on a monthly basis. The loan-to-value limitation on land acquisition loans is 75%.

Construction lending is generally considered to involve a higher degree of credit risk than residential mortgage lending. If the estimate of construction cost proves to be inaccurate, we may be compelled to advance additional funds to complete the construction with repayment dependent, in part, on the success of the ultimate project rather than the ability of a borrower or guarantor to repay the loan. If we are forced to foreclose on a project prior to completion, there is no assurance that we will be able to recover the entire unpaid portion of the loan. In addition, we may be required to fund additional amounts to complete a project and may have to hold the property for an indeterminate period of time.

**Consumer Loans.** Our consumer lending products consist of new and used auto loans, secured and unsecured personal loans, account loans and overdraft lines of credit. The maximum term for a loan on a new or used automobile is six years or four years, respectively. We will lend up to 80% of retail value or dealer invoice on a car loan. We offer a deduction on the interest rate for car loans with payments automatically deducted from the borrower's checking or statement savings account with us.

Our personal loans have terms of up to four years with a minimum and maximum balance of \$1,000 and \$5,000, respectively. A deduction to the interest rate is offered for loans with automatic debit repayment from a checking or statement savings account with us. Our account loans permit a depositor to borrow up to 90% of his or her funds on deposit with us in certificate of deposit accounts. The interest rate is the current rate paid to the depositor, plus a premium. A minimum payment of interest only is required. We offer an overdraft line of credit with a minimum of \$500 and up to a maximum of \$5,000 and an interest rate tied to the prime rate published in *The Wall Street Journal*, plus a premium.

Consumer lending is generally considered to involve a higher degree of credit risk than residential mortgage lending. Consumer loan repayment is dependent on the borrower's continuing financial stability and can be adversely affected by job loss, divorce, illness or personal bankruptcy. The application of various federal laws, including federal and state bankruptcy and insolvency laws, may limit the amount which can be recovered on consumer loans in the event of a default. Account loans are fully secured.

**Home Equity Loans and Lines of Credit.** We offer fixed rate home equity loans and variable rate home equity lines of credit with a minimum credit limit of \$5,000. Collateral valuation is established through a variety of methods, including an on-line appraisal valuation estimator, drive by appraisals, recent assessed tax value, purchase price or consideration value as evidenced by a deed or property search report or a report of real estate comparables from a licensed realtor. Loan requests over \$250,000, however, require full appraisals, and requests over \$450,000 require Board approval. The loan-to-value limit on home equity lending is 80% on owner occupied property and 75% on investment property. The variable rate on home equity lines of credit is adjusted monthly and is currently set at prime for owner occupied properties and prime plus a premium for investment properties. The fixed rate loans on investment property are also higher than fixed rate owner occupied home equity loans. We generally provide home equity financing only for a first or second lien position.



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Our fixed rate home equity loans have terms of 5 to 30 years. Our variable rate home equity lines of credit have terms of 15 years, and we also offer an interest only home equity line of credit based on a 10 year term. The loan-to-value limit on interest only home equity financing is 70% on owner occupied property and 60% on investment property. We also offer bridge loans with a variable rate and a 70% loan-to-value limit on owner occupied property and 60% on investment property.

**Commercial Loans.** We offer revolving lines of credit to businesses to finance short-term working capital needs like accounts receivable and inventory. These lines of credit may be unsecured or secured by accounts receivable and inventory or real estate. We generally provide such financing for no more than a 3 year term and with a variable rate.

We also originate commercial term loans to fund longer-term borrowing needs such as purchasing equipment, property improvements or other fixed asset needs. These loans are secured by new and used machinery, equipment, fixtures, furniture or other long-term fixed assets and have terms of 1 to 7 years. We originate commercial term loans for other general long-term business purposes, and these loans are secured by real estate. Interest on commercial term loans is payable monthly and principal may be payable monthly or quarterly.

The normal minimum amount for our commercial term loans and lines of credit is \$5,000. We generally will not lend more than \$100,000 on a commercial line of credit or \$500,000 on a commercial term loan. We typically do not provide working capital loans to businesses outside our normal market area or to new businesses where repayment is dependent solely on future profitable operation of the business. We avoid originating loans for which the primary source of repayment could be liquidation of the collateral securing the loan in light of poor repayment prospects. We typically require personal guarantees on all commercial loans, regardless of other collateral securing the loan.

The loan-to-value limits related to commercial lending vary according to the collateral. Loans secured by real estate may be originated for up to 80% loan-to-value. Other limits are as follows. Savings accounts: 90% of the deposit amount; accounts receivable: 80% of eligible amounts receivable 60 days or less past due or 90 days from invoice, whichever is less; inventory: 50% of raw materials and 60% of finished goods; stocks: 50% to 75% depending on exchange or market listing; bonds: 'A' rated or better, 90% of market value, less than 'A' rated, 60% of market value; new equipment: 75% of purchase price; and used equipment: lesser of 75% of purchase price or 75% of current market value.

**Loans to One Borrower.** Under federal law, savings institutions have, subject to certain exemptions, lending limits to one borrower in an amount equal to the greater of \$500,000 or 15% of the institution's unimpaired capital and surplus. Accordingly, as of June 30, 2008, our loans to one borrower legal limit was approximately \$5.0million.

Loans that approach the loans to one borrower limit are reviewed by the Board of Directors before being approved. The Bank's lending policies require Board approval before any borrower's existing and/or committed borrowings from the Bank may exceed \$1.0 million in aggregate. Any single loan in excess of \$1.0 million also requires prior Board approval.

**Loan Originations, Purchases, Sales, Solicitation and Processing.** Our customary sources of loan applications include repeat customers, referrals from realtors and other professionals and "walk-in" customers. Our residential loan originations are driven by the Bank's reputation, as opposed to being advertising driven.

We normally do not sell loans into the secondary mortgage market and did not sell any loans in the five year period ended June 30, 2008. Because it has been our policy to retain the loans we originate





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in our portfolio, we have not uniformly originated our real estate mortgage loans to meet the documentation standards to sell loans in the secondary mortgage market. We may do so, however, in the future if we find it desirable in connection with interest rate risk management to sell longer term fixed rate mortgages into the secondary mortgage market.

We did not purchase any whole loans in the five-year period ended June 30, 2008. We did, however, purchase a few participation interests in loans originated by other banks during this period.

***Loan Approval Procedures and Authority.*** Lending policies and loan approval limits are approved and adopted by the Board of Directors. Lending authority is vested primarily in President and Chief Executive Officer Gary Jolliffe, Executive Vice President and Chief Operating Officer Michael Shriner and Vice President and Chief Lending Officer Nancy Schmitz. Each of these officers may approve loans within the following limits: first mortgage real estate and construction loans up to \$500,000; home equity loans up to \$150,000; consumer loans up to \$150,000; and commercial loans up to \$150,000. These officers may combine their authorities to make home equity, consumer and commercial loans up to \$450,000 and first mortgage real estate and construction loans up to \$1.0 million. Prior Board approval is required for home equity, consumer and commercial loans in excess of \$450,000 and for first mortgage real estate and construction loans in excess of \$1.0 million. The Board also must give prior approval for any aggregation of existing and/or committed loans to one borrower that exceed \$1.0 million. Certain other Bank employees also have limited lending authority.

### **Asset Quality**

***Loan Delinquencies and Collection Procedures.*** The Bank's procedures for delinquent loans are as follows:

15 days delinquent:	late charge added, first delinquent notice mailed
30 days delinquent:	second delinquent notice mailed
45 days delinquent:	additional late charge, third delinquent notice mailed, telephone contact made
60 days delinquent:	telephone contact made, separate letter mailed
90 days delinquent:	decision made to foreclose or workout

When a loan is 90 days delinquent, the Board may determine to refer it to an attorney for repossession or foreclosure. All reasonable attempts are made to collect from borrowers prior to referral to an attorney for collection. In certain instances, we may modify the loan or grant a limited moratorium on loan payments to enable the borrower to reorganize his or her financial affairs, and we attempt to work with the borrower to establish a repayment schedule to cure the delinquency.

As to mortgage loans, if a foreclosure action is taken and the loan is not reinstated, paid in full or refinanced, the property is sold at judicial sale at which we may be the buyer if there are no adequate offers to satisfy the debt. Any property acquired as the result of foreclosure or by deed in lieu of foreclosure is classified as real estate owned until it is sold or otherwise disposed of. When real estate owned is acquired, it is recorded at its fair market value less estimated selling costs. The initial writedown of the property is charged to the allowance for loan losses. Adjustments to the carrying value of the property that result from subsequent declines in value are charged to operations in the period in which the declines occur. At June 30, 2008, we held no real estate owned.

As to commercial loans, the Bank requires updated financial statements when the loan becomes 90 days delinquent. As to account loans, the outstanding balance is collected from the related account along with accrued interest when the loan is 180 days delinquent.



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Loans are reviewed on a regular basis, and all delinquencies of 60 days or more are reported to the Board of Directors. Loans are placed on non-accrual status when they are more than 90 days delinquent, with the exception of loans that may be placed on a non-accrual status at any time if, in the opinion of management, the collection of additional interest is doubtful. Loans with a loan-to-value ratio of 60% or less, however, are not automatically placed on non-accrual status if more than 90 days delinquent. Interest accrued and unpaid at the time a loan is placed on non-accrual status is charged against interest income. Subsequent payments are either applied to the outstanding principal balance or recorded as interest income, depending on the assessment of the ultimate collectibility of the loan. At June 30, 2008, we had approximately \$2.9 million of loans that were held on a non-accrual basis. \$2.7 million of the non-accrual loans were classified as impaired as of June 30, 2008, and were subject to specific loss allowances totaling \$114,000.

**Non-Performing Assets.** The following table provides information regarding our non-performing loans and other non-performing assets as of the dates indicated.

	<b>At June 30,</b>				
	<b>2008</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
<u>Loans accounted for on a non-accrual basis:</u>					
One-to-four family real estate	\$ 1,234	\$ 116	\$ -	\$ 1,662	\$ 951
Commercial real estate	410	-	-	-	216
Construction	-	666	-	-	55
Consumer	-	-	1	13	-
Home equity	634	634	325	554	549
Commercial	658	166	98	99	124
Total	2,936	1,582	424	2,328	1,895
<u>Accruing loans contractually past due</u>					
<u>90 days or more:</u>					
One-to-four family real estate	1,615	740	252	39	74
Commercial real estate	378	-	-	-	-
Construction	-	-	47	-	-
Consumer	16	-	-	2	13
Home equity	234	27	-	38	-
Commercial	-	-	-	-	-
Total	2,243	767	299	79	87
Total non-performing loans	\$ 5,179	\$ 2,349	\$ 723	\$ 2,407	\$ 1,982
Total non-performing assets	\$ 5,179	\$ 2,349	\$ 723	\$ 2,407	\$ 1,982
Total non-performing loans to total loans	2.00 %	0.97 %	0.32 %	1.24 %	1.13 %
Total non-performing loans to total assets	1.68 %	0.83 %	0.27 %	1.01 %	0.92 %
Total non-performing assets to total assets	1.68 %	0.83 %	0.27 %	1.01 %	0.92 %

During the year ended June 30, 2008, gross interest income of \$186,000 would have been recorded on loans accounted for on a non-accrual basis if those loans had been current, and \$169,000 of interest on a cash basis as collected was included in income. At June 30, 2008, there were \$516,000 in loans that were not classified as nonaccrual, 90 days past due or restructured but where known information about possible credit problems of borrowers caused management to have serious concerns as to the ability of the borrowers to comply with present loan repayment terms and may result in future disclosure as nonaccrual, 90 days past due or restructured.



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**Classified Assets.** Management, in compliance with the Uniform Credit Classification and Account Management Policy adopted by the Federal Deposit Insurance Corporation, has instituted an internal loan review program, whereby non-performing loans are classified as special mention, substandard, doubtful or loss. It is our policy to review the loan portfolio, in accordance with regulatory classification procedures, on at least a quarterly basis. When a loan is classified as substandard or doubtful, management is required to evaluate the loan for impairment. When management classifies a portion of a loan as loss, a reserve equal to 100% of the loss amount is required to be established or the loan is to be charged-off.

An asset that does not currently expose the Bank to a sufficient degree of risk to warrant an adverse classification, but which possesses credit deficiencies or potential weaknesses that deserve management's close attention is classified as "special mention."

An asset classified as "substandard" is inadequately protected by the current net worth and paying capacity of the obligor or the collateral pledged, if any. Assets so classified have well-defined weaknesses and are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

An asset classified as "doubtful" has all the weaknesses inherent in a "substandard" asset with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The possibility of a loss on a doubtful asset is high.

That portion of an asset classified as "loss" is considered uncollectible and of such little value that its continuance as an asset, without establishment of a specific valuation or charge-off, is not warranted. This classification does not necessarily mean that an asset has absolutely no recovery or salvage value; but rather, it is not practical or desirable to defer writing off a basically worthless asset even though partial recovery may be effected in the future.

Management's classification of assets is reviewed by the Board on a regular basis and by the regulatory agencies as part of their examination process. An independent loan review firm performs periodic reviews of our loan portfolio.

The following table discloses the Bank's classification of assets as of June 30, 2008.

	<b>At June 30, 2008</b>
	(In thousands)
Special Mention	\$ 2,483
Substandard	3,761
Doubtful	-
Loss	22
Total	\$ 6,266

At June 30, 2008, fourteen out of twenty loans classified as "special mention," totaling \$1.9 million; ten out of twelve loans classified as "substandard" totaling \$3.3 million; and the single loan classified as "loss" for \$22,000 are included as non-performing assets in the non-performing assets table.



**Allowance for Loan Losses.** The allowance for loan losses is a valuation account that reflects our estimation of the losses in our loan portfolio to the extent they are both probable and reasonable to estimate. The allowance is established through provisions for loan losses that are charged to income in the period they are established. We charge losses on loans against the allowance for loan losses when we believe the collection of loan principal is unlikely. Recoveries on loans previously charged-off are added back to the allowance.

Management, in determining the allowance for loan losses, considers the losses inherent in the loan portfolio and changes in the nature and volume of our loan activities, along with general economic and real estate market conditions. We establish a specific allowance for loans classified as "loss" or that are determined to be impaired. We make provisions for loan losses to a general allowance according to (i) the type of loan, one-to-four family real estate mortgages, commercial real estate mortgages, construction loans, commercial term loans and lines of credit, consumer loans and home equity loans and lines of credit, with commercial, construction and consumer loans receiving a higher allowance than other loan types, and (ii) whether the loan is current and performing or delinquent, with higher allowances made according to the number of days a loan is delinquent. However, for purposes of establishing the general valuation allowance loans that are delinquent 90 days or more are treated as current if they have a loan-to-value ratio of less than 60%.

We maintain a loan review system which provides for a systematic review of the loan portfolios and the early identification of potential impaired loans. We generally review a loan for impairment as soon as the loan is 60 or more days delinquent. A loan evaluated for impairment is deemed to be impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. All loans identified as impaired are evaluated independently. We do not aggregate such loans for evaluation purposes. Payments received on impaired loans are applied first to unpaid interest, escrow and late charges and then to principal.

Specific loan loss allowances are established for impaired loans based on a review of such information and/or appraisals of the underlying collateral. General loan loss allowances are based upon a combination of factors including, but not limited to, actual loan loss experience, composition of the loan portfolio, current economic conditions and management's judgment. The estimation of the allowance for loan losses is inherently subjective as it requires estimates and assumptions that are susceptible to significant revisions as more information becomes available or as future events change. Future additions to the allowance for loan losses may be necessary if economic and other conditions in the future differ substantially from the current operating environment. In addition, the New Jersey Department of Banking and Insurance and the Federal Deposit Insurance Corporation, as an integral part of their examination process, periodically review our loan and foreclosed real estate portfolios and the related allowance for loan losses and valuation allowance for foreclosed real estate. They may require the allowance for loan losses or the valuation allowance for foreclosed real estate to be increased based on their review of information available at the time of the examination, which would negatively affect our earnings.



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The following table sets forth information with respect to the Bank's allowance for loan losses for the periods indicated:

	Year Ended June 30,				
	2008	2007	2006	2005	2004
	(Dollars in thousands)				
Allowance balance at beginning of period	\$ 926	\$ 921	\$ 874	\$ 742	\$ 651
Provision for loan losses	135	5	60	135	134
<u>Charge-offs:</u>					
Consumer	42	3	17	3	45
Total charge-offs	42	3	17	3	45
<u>Recoveries:</u>					
Consumer	6	3	4	-	2
Total recoveries	6	3	4	-	2
Net charge-offs	\$ 36	\$ -	\$ 13	\$ 3	\$ 43
Allowance balance at end of period	\$ 1,025	\$ 926	\$ 921	\$ 874	\$ 742
Total loans outstanding at end of period	\$ 259,029	\$ 242,641	\$ 224,399	\$ 193,996	\$ 174,994
Average loans outstanding during period	\$ 243,879	\$ 228,069	\$ 205,905	\$ 179,837	\$ 151,736
Allowance for loan losses as a percentage of non-performing loans	19.79 %	39.42 %	127.39 %	36.31 %	37.44 %
Allowance for loan losses as a percentage of total loans	0.40 %	0.38 %	0.41 %	0.45 %	0.42 %
Net loans charge-offs as a percentage of average loans	0.01 %	- %	0.01 %	- %	0.03 %

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**Allocation of Allowance for Loan Losses.** The following table sets forth the allocation of the Bank's allowance for loan losses by loan category and the percent of loans in each category to total loans receivable at the dates indicated. The portion of the loan loss allowance allocated to each loan category does not represent the total available for future losses that may occur within the loan category since the total loan loss allowance is a valuation allocation applicable to the entire loan portfolio.

	<b>At June 30,</b>		<b>2007</b>		<b>2006</b>		<b>2005</b>		<b>2004</b>	
	<b>2008</b>									
	Percent		Percent		Percent		Percent		Percent	
	of Loans		of Loans		of Loans		of Loans		of Loans	
	to Total		to Total		to Total		to Total		to Total	
	Amount	Loans	Amount	Loans	Amount	Loans	Amount	Loans	Amount	Loans
	(Dollars in thousands)									
<u>At end of period</u>										
<u>allocated to:</u>										
One-to-four family real estate	\$ 471	56.31 %	\$ 389	50.94 %	\$ 436	53.89 %	\$ 467	58.50 %	\$ 418	62.73 %
Commercial real estate	116	11.61	105	11.95	108	10.51	72	9.26	85	9.81
Construction	74	6.86	83	9.82	125	10.37	72	9.48	47	7.81
Consumer	7	0.49	9	0.82	9	0.83	19	0.94	8	0.97
Home equity	238	21.45	236	23.04	178	21.95	202	19.24	157	16.98
Commercial	119	3.58	104	3.43	65	2.45	42	2.08	27	1.70
Total allowance	\$ 1,025	100.00 %	\$ 926	100.00 %	\$ 921	100.00 %	\$ 874	100.00 %	\$ 742	100.00 %

## Securities Portfolio

Our investment policy is designed to manage cash flows and foster earnings within prudent interest rate risk and credit risk guidelines. The portfolio mix is governed by our short term and long term liquidity needs. Rate-of-return, cash flow, rating and guarantor-backing are also considered when making investment decisions. The purchase of principal only and stripped coupon interest only security instruments is specifically not authorized by our investment policy. Furthermore, other than government related securities which may not be rated, we only purchase securities with a rating of AAA or AA. We invest primarily in mortgage-backed securities, U.S. government obligations and U.S. government agency issued securities.

Mortgage-backed securities represent a participation interest in a pool of mortgages issued by U.S. government agencies or government-sponsored entities, such as Federal Home Loan Mortgage Corporation (“Freddie Mac”), the Government National Mortgage Association (“Ginnie Mae”), and the Federal National Mortgage Association (“Fannie Mae”), as well as non-government, private corporate issuers. Mortgage-backed securities are pass-through securities and generally yield less than the mortgage loans underlying the securities. The characteristics of the underlying pool of mortgages, *i.e.*, fixed-rate or adjustable-rate, as well as prepayment risk, are passed on to the certificate holder.

Mortgage-backed securities issued or sponsored by U.S. government agencies and government-sponsored entities are guaranteed as to the payment of principal and interest to investors. Private corporate issuers’ mortgage-backed securities typically offer rates above those paid on government agency issued or sponsored securities, but lack the guaranty of those agencies.

Statement of Financial Accounting Standards No. 115, “Accounting for Certain Investments in Debt and Equity Securities,” requires that securities be categorized as “held to maturity,” “trading securities” or “available for sale,” based on management’s intent as to the ultimate disposition of each security. Statement No. 115 allows debt securities to be classified as “held to maturity” and reported in financial statements at amortized cost if the reporting entity has the positive intent and ability to hold these securities to maturity. Securities that might be sold in response to changes in market interest rates, changes in the security’s prepayment risk, increases in loan demand, or other similar factors cannot be classified as “held to maturity.”

At the present time, nearly our entire securities portfolio is purchased with the intent to hold the security until maturity. At June 30, 2008, we maintained a small trading account totaling \$82,000 and the rest of our securities portfolio was classified as held to maturity. Securities not classified as “held to maturity” or as “trading securities” are classified as “available for sale” and are reported at fair value with unrealized gains and losses on the securities impacting equity.

Individual securities are considered impaired when fair value is less than amortized cost. Management evaluates on a quarterly basis whether any securities are other-than-temporarily impaired. In making this determination, we consider the extent and duration of the impairment, the nature and financial health of the issuer, other factors relevant to specific securities, and our ability and intent to hold securities for a period of time sufficient to allow for any anticipated recovery in market value. If a security is determined to be other-than-temporarily impaired, an impairment loss is charged to operations.

At June 30, 2008, our securities portfolio did not contain securities of any issuer, other than the U.S. government or its agencies, having an aggregate book value in excess of 10% of our equity. We do not currently participate in hedging programs, interest rate caps, floors or swaps, or other activities involving the use of off-balance sheet derivative financial instruments, however, we may in the future utilize such instruments if we believe it would be beneficial for managing our interest rate risk.



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The following table sets forth certain information regarding the carrying values, weighted average yields and maturities of our held to maturity securities portfolio at June 30, 2008. This table shows contractual maturities and does not reflect repricing or the effect of prepayments. Actual maturities of the securities held by us may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without prepayment penalties. Callable securities pose reinvestment risk because we may not be able to reinvest the proceeds from called securities at an equivalent or higher interest rate.

	At June 30, 2008											
	One Year or Less		One to Five Years		Five to Ten Years		More than Ten Years		Total Investment Securities			
	Carrying Value	Average Yield	Carrying Value	Average Yield	Carrying Value	Average Yield	Carrying Value	Average Yield	Carrying Value	Average Yield	Market Value	
	(Dollars in thousands)											
U.S. Government Agency Obligations	\$ -	- %	\$ -	- %	\$ 2,000	5.00 %	\$ 22,023	5.37 %	\$ 24,023	5.34 %	\$ 23,440	
<u>Mortgage-Backed Securities:</u>												
Government National Mortgage Association	-	-	-	-	-	-	41	5.77	41	5.77	43	
Federal Home Loan Mortgage Corporation	-	-	-	-	128	6.52	524	6.08	652	6.16	660	
Federal National Mortgage Association	-	-	861	6.13	987	4.82	2,179	6.02	4,027	5.75	4,052	
Total	\$ -	- %	\$ 861	6.13 %	\$ 3,115	5.01 %	\$ 24,767	5.44 %	\$ 28,743	5.42 %	\$ 28,195	

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The following table sets forth the carrying value of our held to maturity securities portfolio at the dates indicated. Securities classified as held to maturity are shown at our amortized cost.

	<b>At June 30</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
	(In thousands)		
U.S. Government Agency Obligations	\$ 24,023	\$ 24,120	\$ 24,127
Government National Mortgage Association	41	55	69
Federal Home Loan Mortgage Corporation	652	758	923
Federal National Mortgage Association	4,027	4,403	2,588
Total securities held to maturity	\$ 28,743	\$ 29,336	\$ 27,707

### Sources of Funds

**General.** Deposits are our major source of funds for lending and other investment purposes. To the extent that our loan originations have exceeded the funding available from deposits, we have borrowed funds from the Federal Home Loan Bank to supplement the amount of funds for lending and funding daily operations.

In addition, we derive funds from loan and mortgage-backed securities principal repayments, and proceeds from the maturity and call of investment securities. Loan and securities payments are a relatively stable source of funds, while deposit inflows and outflows are significantly influenced by pricing strategies and money market conditions.

**Deposits.** Our current deposit products include checking and savings accounts, certificates of deposit and fixed or variable rate individual retirement accounts (IRA's). Deposit account terms vary, primarily as to the required minimum balance amount, the amount of time, if any, that the funds must remain on deposit and the applicable interest rate. Our savings account menu includes regular passbook, statement, money market and club accounts. We also offer a six-level tiered savings account. Our certificates of deposit currently range in terms from 6 months to 10 years. Our IRA's are available with the same maturities as certificates of deposit accounts, with the exception of the 30 month term. We offer a two year certificate of deposit that permits the depositor to increase the interest rate to the current two year rate once during the term.

Deposits are obtained primarily from within New Jersey. The Bank utilizes brokered deposits as a funding source. Brokered deposits at June 30, 2008 totaled \$720,000. Premiums or incentives for opening accounts are sometimes offered. We periodically select particular certificate of deposit maturities for promotion in connection with asset/liability management and interest rate risk concerns.

The determination of deposit and certificate interest rates is based upon a number of factors, including: (1) need for funds based on loan demand, current maturities of deposits and other cash flow needs; (2) a current survey of a selected group of competitors' rates for similar products; (3) economic conditions; and (4) business plan projections.

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A large percentage of our deposits are in certificates of deposit. The inflow of certificates of deposit and the retention of such deposits upon maturity are significantly influenced by general interest rates and money market conditions, making certificates of deposit traditionally a more volatile source of funding than core deposits. Our liquidity could be reduced if a significant amount of certificates of deposit maturing within a short period of time were not renewed. To the extent that such deposits do not remain with us, they may need to be replaced with borrowings which could increase our cost of funds and negatively impact our net interest rate spread and our financial condition.

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The following tables set forth the distribution of average deposits for the periods indicated and the weighted average nominal interest rates for each period on each category of deposits presented.

	For the Year Ended June 30, 2008			2007			2006							
	Average Balance	Percent of Total Deposits	Weighted Average Nominal Rate	Average Balance	Percent of Total Deposits	Weighted Average Nominal Rate	Average Balance	Percent of Total Deposits	Weighted Average Nominal Rate					
	(Dollars in thousands)													
Non-interest-bearing demand	\$8,540	3.95 %	0.00 %	\$9,804	4.75 %	0.00 %	\$8,294	4.21 %	0.00 %					
Interest-bearing demand	26,906	12.46	0.90	29,056	14.07	0.96	34,117	17.32	0.96					
Savings and club	51,048	23.63	2.48	48,248	23.37	1.86	44,839	22.76	1.27					
Certificates of deposit	129,506	59.96	4.76	119,364	57.81	4.65	109,755	55.71	3.73					
Total deposits	\$216,000	100.00 %	3.55 %	\$206,472	100.00 %	3.26 %	\$197,005	100.00 %	2.53 %					



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The following table sets forth certificates of deposit classified by interest rate as of the dates indicated.

	<b>At June 30, 2008</b>		<b>2007</b>		<b>2006</b>	
	<b>Amount</b>	<b>Percent of Total</b>	<b>Amount</b>	<b>Percent of Total</b>	<b>Amount</b>	<b>Percent of Total</b>
<b>(Dollars in thousands)</b>						
<u>Interest Rate:</u>						
1.00% - 1.99%	\$ 1	- %	\$ 7	0.01 %	\$ 8	0.01 %
2.00% - 2.99%	22,434	18.46	1	-	2,375	2.12
3.00% - 3.99%	13,639	11.22	4,997	3.89	28,049	25.04
4.00% - 4.99%	44,128	36.32	47,472	36.98	68,182	60.86
5.00% - 5.99%	41,307	34.00	75,857	59.08	13,400	11.96
6.00% - 6.99%	-	0.00	48	0.04	14	0.01
<b>Total</b>	<b>\$ 121,509</b>	<b>100.00 %</b>	<b>\$ 128,382</b>	<b>100.00 %</b>	<b>\$ 112,028</b>	<b>100.00 %</b>

The following table sets forth the amount and maturities of certificates of deposit at the Bank at June 30, 2008.

	<b>Amount Due Year Ending June 30,</b>					<b>After June 30, 2013</b>
	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	
<b>(In thousands)</b>						
<u>Interest Rate:</u>						
1.00% - 1.99%	\$ 1	\$ -	\$ -	\$ -	\$ -	\$ -
2.00% - 2.99%	20,202	2,059	168	5	-	-
3.00% - 3.99%	9,035	3,852	413	11	230	98
4.00% - 4.99%	35,472	3,960	1,694	144	1,672	1,186
5.00% - 5.99%	31,996	-	-	1,835	1,386	6,090
6.00% - 6.99%	-	-	-	-	-	-
<b>Total</b>	<b>\$ 96,706</b>	<b>\$ 9,871</b>	<b>\$ 2,275</b>	<b>\$ 1,995</b>	<b>\$ 3,288</b>	<b>\$ 7,374</b>

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The following table shows the amount of the Bank's certificates of deposit of \$100,000 or more by time remaining until maturity as of June 30, 2008.

	<b>Certificates of Deposit</b>
	(In thousands)
<u>Remaining Time Until Maturity:</u>	
Within three months	\$ 15,963
Three through six months	10,768
Six through twelve months	6,439
Over twelve months	9,349
Total	\$ 42,519

**Borrowings.** To supplement our deposits as a source of funds for lending or investment, we have borrowed funds in the form of advances from the Federal Home Loan Bank. At June 30, 2008, our collateralized borrowing limit with the Federal Home Loan Bank was \$104.7 million and our outstanding borrowings with the Federal Home Loan Bank totaled \$37.1 million. Information regarding our total borrowings as of June 30, 2008 are set forth in the following table.

	<b>At June 30, 2008</b>		
	<b>Balance</b>	<b>Rate</b>	<b>Maturity</b>
	(Dollars in thousands)		
<u>Total Borrowings:</u>			
Overnight Line of Credit	\$ -	daily adjustable rate	Next day
Five Year Amortizing Fixed Rate Advance	\$ 1,068	3.600%	August 2009
Two Year Fixed Rate Convertible Advance	\$ 6,000	4.641%	August 2009
Five Year Fixed Rate Advance	\$ 5,000	4.250%	December 2009
Five Year Fixed Rate Advance	\$ 5,000	4.280%	June 2010
Ten Year Fixed Rate Convertible Advance	\$ 10,000	3.272%	November 2017
Ten Year Fixed Rate Convertible Advance	\$ 10,000	3.460%	March 2018

Short-term Federal Home Loan Bank advances generally have original maturities of less than one year. Information regarding our short-term advances for the dates and periods indicated are set forth in the following table.

	<b>At or For the Year Ended June 30,</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
	(Dollars in thousands)		
<u>Short-Term Borrowings:</u>			
Average balance outstanding	\$ 6,878	\$ 29,040	\$ 24,602
Maximum amount outstanding			
at any month-end during the period	14,500	26,000	41,500
Balance outstanding at end of period	-	16,000	41,500
Weighted average interest rate during the period	4.55	%	5.44
			%
			4.59
			%

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Weighted average interest rate at end of period	-	%	5.49	%	5.41	%
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Advances from the Federal Home Loan Bank are typically secured by the Federal Home Loan Bank stock and a portion of our residential mortgage loans and by other assets, mainly securities which are obligations of or guaranteed by the U.S. government. Additional information regarding our borrowings is included under Note 8 to our consolidated financial statements beginning on page F-1.

### Subsidiary Activity

MSB Financial Corp. has no direct subsidiaries other than Millington Savings Bank. The Bank has one wholly owned subsidiary, Millington Savings Services Corp., formed in 1984. The service corporation is currently inactive.

### Regulation And Supervision

The Bank and the Company operate in a highly regulated industry. This regulation establishes a comprehensive framework of activities in which they may engage and is intended primarily for the protection of the Deposit Insurance Fund and depositors. Set forth below is a brief description of certain laws that relate to the regulation of the Bank and the Company. The description does not purport to be complete and is qualified in its entirety by reference to applicable laws and regulations.

Regulatory authorities have extensive discretion in connection with their supervisory and enforcement activities, including the imposition of restrictions on operations, the classification of assets and the adequacy of the allowance for loan losses. Any change in such regulation and oversight, whether in the form of regulatory policy, regulations, or legislation, including changes in the regulations governing mutual holding companies, could have a material adverse impact on the Company and the Bank. The adoption of regulations or the enactment of laws that restrict the operations of the Bank and/or the Company or impose burdensome requirements upon one or both of them could reduce their profitability and could impair the value of the Bank's franchise, resulting in negative effects on the trading price of the Company's common stock.

### Regulation of the Bank

**General.** As a New Jersey chartered, Federal Deposit Insurance Corporation-insured savings bank, the Bank is regulated by the New Jersey Department of Banking and Insurance and the Federal Deposit Insurance Corporation. The Bank's operations are subject to extensive regulation, including restrictions or requirements with respect to loans to one borrower, the percentage of non-mortgage loans or investments to total assets, capital distributions, permissible investments and lending activities, liquidity, transactions with affiliates and community reinvestment. The Bank must file regulatory reports concerning its activities and financial condition, and must obtain regulatory approvals prior to entering into certain transactions, such as mergers with or acquisitions of other financial institutions. The New Jersey Department of Banking and Insurance and the Federal Deposit Insurance Corporation regularly examine the Bank and prepare reports to the Bank's Board of Directors on deficiencies, if any, found in its operations. The regulatory authorities have substantial discretion to impose enforcement action on an institution that fails to comply with applicable regulatory requirements, particularly with respect to its capital requirements.

**Insurance of Deposit Accounts.** The Bank's deposits are insured to applicable limits by the Federal Deposit Insurance Corporation ("FDIC"). Although the FDIC is authorized to assess premiums under a risk-based system for such deposit insurance, most insured depository institutions have not been required to pay premiums for the last ten years. The Federal Deposit Insurance Reform Act of 2005 (the "Reform Act") resulted in significant changes to the federal deposit insurance program: (i) effective March 31, 2006, the Bank Insurance Fund and the Savings Association Insurance Fund were merged into



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a new combined fund, called the Deposit Insurance Fund; (ii) the current \$100,000 deposit insurance coverage will be indexed for inflation (with adjustments every five years, commencing January 1, 2011); and (iii) deposit insurance coverage for retirement accounts was increased to \$250,000 per participant subject to adjustment for inflation. In addition, the Reform Act gave the FDIC greater latitude in setting the assessment rates for insured depository institutions, which could be used to impose minimum assessments.

The FDIC is authorized to set the reserve ratio for the Deposit Insurance Fund annually at between 1.15% and 1.5% of estimated insured deposits. If the Deposit Insurance Fund's reserves exceed the designated reserve ratio, the FDIC is required to pay out all or, if the reserve ratio is less than 1.5%, a portion of the excess as a dividend to insured depository institutions based on the percentage of insured deposits held on December 31, 1996 adjusted for subsequently paid premiums.

Pursuant to the Reform Act, the FDIC has determined to maintain the designated reserve ratio at 1.25%. The FDIC has also adopted a new risk-based premium system that provides for quarterly assessments based on an insured institution's ranking in one of four risk categories based on their examination ratings and capital ratios. Well-capitalized institutions with the CAMELS ratings of 1 or 2 are grouped in Risk Category I and assessed for deposit insurance at an annual rate of between five and seven basis points, with the assessment rate for an individual institution determined according to a formula based on a weighted average of the institution's individual CAMELS component ratings plus either five financial ratios or the average ratings of its long-term debt. Institutions in Risk Categories II, III and IV are assessed at annual rates of 10, 28 and 43 basis points, respectively.

In addition, all FDIC-insured institutions are required to pay assessments to the FDIC to fund interest payments on bonds issued by the Financing Corporation ("FICO"), an agency of the Federal government established to recapitalize the predecessor to the SAIF. The FICO assessment rates, which are determined quarterly, averaged .00113% of insured deposits in fiscal 2008. These assessments will continue until the FICO bonds mature in 2017.

**Regulatory Capital Requirements.** Federal Deposit Insurance Corporation capital regulations require savings institutions to meet three minimum capital standards: (1) tangible capital equal to 1.5% of total adjusted assets, (2) "Tier 1" or "core" capital equal to at least 4% (3% if the institution has received the highest possible rating on its most recent examination) of total adjusted assets, and (3) risk-based capital equal to 8% of total risk-weighted assets. At June 30, 2008, the Bank was in compliance with the minimum capital standards and qualified as "well capitalized." For the Bank's compliance with these regulatory capital standards, see Note 12 to the consolidated financial statements. In assessing an institution's capital adequacy, the Federal Deposit Insurance Corporation takes into consideration not only these numeric factors but also qualitative factors, and has the authority to establish higher capital requirements for individual institutions where necessary.

The Federal Deposit Insurance Corporation may require any savings institution that has a risk-based capital ratio of less than 8%, a ratio of Tier 1 capital to risk-weighted assets of less than 4% or a ratio of Tier 1 capital to total adjusted assets of less than 4% (3% if the institution has received the highest rating on its most recent examination) to take certain action to increase its capital ratios. If the savings institution's capital is significantly below the minimum required levels of capital or if it is unsuccessful in increasing its capital ratios, the institution's activities may be restricted.

For purposes of the capital regulations, tangible capital is defined as core capital less all intangible assets except for certain mortgage servicing rights. Tier 1 or core capital is defined as common stockholders' equity, non-cumulative perpetual preferred stock and related surplus, minority interests in the equity accounts of consolidated subsidiaries, and certain non-withdrawable accounts and pledged



deposits of mutual savings banks. The Bank does not have any non-withdrawable accounts or pledged deposits. Tier 1 and core capital are reduced by an institution's intangible assets, with limited exceptions for certain mortgage and non-mortgage servicing rights and purchased credit card relationships. Both core and tangible capital are further reduced by an amount equal to the savings institution's debt and equity investments in "non-includable" subsidiaries engaged in activities not permissible for national banks other than subsidiaries engaged in activities undertaken as agent for customers or in mortgage banking activities and subsidiary depository institutions or their holding companies.

The risk-based capital standard for savings institutions requires the maintenance of total capital of 8% of risk-weighted assets. Total capital equals the sum of core and supplementary capital. The components of supplementary capital include, among other items, cumulative perpetual preferred stock, perpetual subordinated debt, mandatory convertible subordinated debt, intermediate-term preferred stock, the portion of the allowance for loan losses not designated for specific loan losses and up to 45% of unrealized gains on equity securities. The portion of the allowance for loan and lease losses includable in supplementary capital is limited to a maximum of 1.25% of risk-weighted assets. Overall, supplementary capital is limited to 100% of core capital. For purposes of determining total capital, a savings institution's assets are reduced by the amount of capital instruments held by other depository institutions pursuant to reciprocal arrangements and by the amount of the institution's equity investments (other than those deducted from core and tangible capital) and its high loan-to-value ratio land loans and non-residential construction loans.

A savings institution's risk-based capital requirement is measured against risk-weighted assets, which equal the sum of each on-balance-sheet asset and the credit-equivalent amount of each off-balance-sheet item after being multiplied by an assigned risk weight. These risk weights range from 0% for cash to 100% for delinquent loans, property acquired through foreclosure, commercial loans, and certain other assets.

**Qualified Thrift Lender Test.** Savings institutions must meet a qualified thrift lender test or they become subject to the business activity restrictions and branching rules applicable to national banks. To qualify as a qualified thrift lender, a savings institution must either (i) be deemed a "domestic building and loan association" under the Internal Revenue Code by maintaining at least 60% of its total assets in specified types of assets, including cash, certain government securities, loans secured by and other assets related to residential real property, educational loans and investments in premises of the institution or (ii) satisfy the statutory qualified thrift lender test set forth in the Home Owners' Loan Act by maintaining at least 65% of its portfolio assets in qualified thrift investments (defined to include residential mortgages and related equity investments, certain mortgage-related securities, small business loans, student loans and credit card loans). For purposes of the statutory qualified thrift lender test, portfolio assets are defined as total assets minus goodwill and other intangible assets, the value of property used by the institution in conducting its business, and specified liquid assets up to 20% of total assets. A savings institution must maintain its status as a qualified thrift lender on a monthly basis in at least nine out of every twelve months. The Bank met the qualified thrift lender test as of June 30, 2008 and in each of the last twelve months and, therefore, qualifies as a qualified thrift lender.

A savings bank that fails the qualified thrift lender test and does not convert to a bank charter generally will be prohibited from: (1) engaging in any new activity not permissible for a national bank, (2) paying dividends not permissible under national bank regulations, and (3) establishing any new branch office in a location not permissible for a national bank in the institution's home state. In addition, if the institution does not requalify under the qualified thrift lender test within three years after failing the test, the institution would be prohibited from engaging in any activity not permissible for a national bank and would have to repay any outstanding advances from the Federal Home Loan Bank as promptly as possible.



**Community Reinvestment Act.** Under the Community Reinvestment Act, every insured depository institution, including the Bank, has a continuing and affirmative obligation consistent with its safe and sound operation to help meet the credit needs of its entire community, including low and moderate income neighborhoods. The Community Reinvestment Act does not establish specific lending requirements or programs for financial institutions nor does it limit an institution's discretion to develop the types of products and services that it believes are best suited to its particular community. The Community Reinvestment Act requires the depository institution's record of meeting the credit needs of its community to be assessed and taken into account in the evaluation of certain applications by such institution, such as a merger or the establishment of a branch office by the Bank. An unsatisfactory Community Reinvestment Act examination rating may be used as the basis for the denial of an application. The Bank received a "satisfactory" rating in its most recent Community Reinvestment Act examination.

**Federal Home Loan Bank System.** The Bank is a member of the Federal Home Loan Bank of New York, which is one of twelve regional federal home loan banks. Each Federal Home Loan Bank serves as a reserve or central bank for its members within its assigned region. It is funded primarily from funds deposited by financial institutions and proceeds derived from the sale of consolidated obligations of the Federal Home Loan Bank System. It makes loans to members pursuant to policies and procedures established by its board of directors.

As a member, the Bank is required to purchase and maintain stock in the Federal Home Loan Bank of New York in an amount equal to the greater of 1% of its aggregate unpaid residential mortgage loans, home purchase contracts or similar obligations at the beginning of each year or 5% of its outstanding Federal Home Loan Bank advances.

The Federal Home Loan Banks are required to provide funds for the resolution of troubled savings institutions and to contribute to affordable housing programs through direct loans or interest subsidies on advances targeted for community investment and low- and moderate-income housing projects. These contributions have adversely affected the level of Federal Home Loan Bank dividends paid and could continue to do so in the future. In addition, these requirements could result in the Federal Home Loan Banks imposing a higher rate of interest on advances to their members.

**The USA Patriot Act.** The Bank is subject to regulations implementing the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, or the USA Patriot Act. The USA Patriot Act gives the federal government powers to address terrorist threats through enhanced domestic security measures, expanded surveillance powers, increased information sharing and broadened anti-money laundering requirements. By way of amendments to the Bank Secrecy Act, Title III of the USA Patriot Act takes measures intended to encourage information sharing among bank regulatory agencies and law enforcement bodies. Further, certain provisions of Title III impose affirmative obligations on a broad range of financial institutions, including banks, thrifts, brokers, dealers, credit unions, money transfer agents and parties registered under the Commodity Exchange Act.

Among other requirements, Title III of the USA Patriot Act and the related regulations impose the following requirements with respect to financial institutions:

- Establishment of anti-money laundering programs that include, at minimum: (i) internal policies, procedures, and controls; (ii) specific designation of an anti-money laundering compliance officer; (iii) ongoing employee training programs; and (iv) an independent audit function to test the anti-money laundering program.



- Establishment of a program specifying procedures for obtaining identifying information from customers seeking to open new accounts, including verifying the identity of customers within a reasonable period of time.
- Establishment of appropriate, specific, and, where necessary, enhanced due diligence policies, procedures, and controls designed to detect and report money laundering.
- Prohibitions on establishing, maintaining, administering or managing correspondent accounts for foreign shell banks (foreign banks that do not have a physical presence in any country), and compliance with certain record keeping obligations with respect to correspondent accounts of foreign banks.

Bank regulators are directed to consider a holding company's effectiveness in combating money laundering when ruling on applications under the Federal Reserve Act and the Bank Merger Act.

#### **Regulation of the Company**

**General.** The Company is a savings and loan holding company within the meaning of Section 10 of the Home Owners' Loan Act. It is required to file reports with the Office of Thrift Supervision and is subject to regulation and examination by the Office of Thrift Supervision. The Company must also obtain regulatory approval from the Office of Thrift Supervision before engaging in certain transactions, such as mergers with or acquisitions of other financial institutions.

**Activities Restrictions.** As a savings and loan holding company and as a subsidiary holding company of a mutual holding company, the Company is subject to statutory and regulatory restrictions on its business activities. The non-banking activities of the Company and its non-savings institution subsidiaries are restricted to certain activities specified by Office of Thrift Supervision regulation, which include performing services and holding properties used by a savings institution subsidiary, activities authorized for savings and loan holding companies as of March 5, 1987, and non-banking activities permissible for bank holding companies pursuant to the Bank Holding Company Act of 1956 or authorized for financial holding companies pursuant to the Gramm-Leach-Bliley Act. Before engaging in any non-banking activity or acquiring a company engaged in any such activities, the Company must file with the Office of Thrift Supervision either a prior notice or (in the case of non-banking activities permissible for bank holding companies) an application regarding its planned activity or acquisition.

**Mergers and Acquisitions.** The Company must obtain approval from the Office of Thrift Supervision before acquiring, directly or indirectly, more than 5% of the voting stock of another savings institution or savings and loan holding company or acquiring such an institution or holding company by merger, consolidation or purchase of its assets. Federal law also prohibits a savings and loan holding company from acquiring more than 5% of a company engaged in activities other than those authorized for savings and loan holding companies by federal law or acquiring or retaining control of a depository institution that is not insured by the Federal Deposit Insurance Corporation. In evaluating an application for the Company to acquire control of a savings institution, the Office of Thrift Supervision would consider the financial and managerial resources and future prospects of the Company and the target institution, the effect of the acquisition on the risk to the insurance funds, the convenience and the needs of the community and competitive factors.

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***Waivers of Dividends by the MHC.*** Office of Thrift Supervision regulations require the MHC to notify the Office of Thrift Supervision of any proposed waiver of its receipt of dividends from the Company. The Office of Thrift Supervision reviews dividend waiver notices on a case-by-case basis, and,

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in general, does not object to any such waiver if: (i) the waiver would not be detrimental to the safe and sound operations of the subsidiary savings association and (ii) the mutual holding company's board of directors determines that such waiver is consistent with such directors' fiduciary duties to the mutual holding company's members. During the year ended June 30, 2008, the MHC waived its right to receive dividends declared by the Company totaling \$278,000.

**Conversion of the MHC to Stock Form.** Office of Thrift Supervision regulations permit the MHC to convert from the mutual form of organization to the capital stock form of organization, commonly referred to as a second step conversion. In a second step conversion a new holding company would be formed as the successor to the Company, the MHC's corporate existence would end, and certain depositors of the Bank would receive the right to subscribe for shares of the new holding company. In a second step conversion, each share of common stock held by stockholders other than the MHC would be automatically converted into shares of common stock of the new holding company.

**Acquisition of Control.** Under the federal Change in Bank Control Act, a notice must be submitted to the Office of Thrift Supervision if any person (including a company), or group acting in concert, seeks to acquire "control" of a savings and loan holding company or savings association. An acquisition of "control" can occur upon the acquisition of 10% or more of the voting stock of a savings and loan holding company or savings institution or as otherwise defined by the Office of Thrift Supervision. Under the Change in Bank Control Act, the Office of Thrift Supervision has 60 days from the filing of a complete notice to act, taking into consideration certain factors, including the financial and managerial resources of the acquirer and the anti-trust effects of the acquisition. Any company that so acquires control would then be subject to regulation as a savings and loan holding company.

### **Item 1A. Risk Factors**

Not applicable as the Company is a "smaller reporting company."

### **Item 1B. Unresolved Staff Comments**

Not applicable.

**Item 2. Properties**

At June 30, 2008, our investment in property and equipment, net of depreciation and amortization, totaled \$10.8 million, including leasehold improvements and construction in progress. The following table lists our offices.

<b>Office Location</b>	<b>Year Facility Opened</b>		<b>Leased or Owned</b>
<u>Millington Main Office</u> 1902 Long Hill Road Millington, NJ	1994	(1)	Owned
<u>Dewy Meadow Branch Office</u> 415 King George Road Basking Ridge, NJ	2002		Leased
<u>RiverWalk Branch Office</u> 675 Martinsville Road Basking Ridge, NJ	2005	(2)	Leased
<u>Martinsville Branch Office</u> 1924 Washington Valley Road Martinsville, NJ	2006		Leased
<u>Bearnaville Branch Office</u> 122 Morristown Road Bernardsville, NJ	2008	(3)	Owned

(1) The Bank's main office opened in 1911 in Millington, New Jersey. The Bank moved into its current main office in 1994.

(2) The Bank's first branch office opened in 1998 in Liberty Corner, New Jersey. This office was relocated in 2005.

(3) The Bank's Bernardsville branch office opened in August 2008.

**Item 3. Legal Proceedings**

The Bank, from time to time, is a party to routine litigation which arises in the normal course of business, such as claims to enforce liens, condemnation proceedings on properties in which we hold security interests, claims involving the making and servicing of real property loans, and other issues incident to our business. There were no lawsuits pending or known to be contemplated against the Company or the Bank at June 30, 2008 that would have a material effect on operations or income.

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

No matters were submitted to a vote of security holders during the fourth quarter of the fiscal year ended June 30, 2008.

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## PART II

**Item 5. Market for Common Equity and Related Stockholder Matters and Purchases of Equity Securities**

(a) **Market Information.** Upon completion of the Company's initial public offering in January 2007, the Company's common stock commenced trading on The NASDAQ Stock Market under the symbol "MSBF". The table below shows the reported high and low closing prices of common stock during the periods indicated.

	<b>High</b>	<b>Low</b>
<u>2007</u>		
Quarter ended March 31, 2007 <sup>(1)</sup>	\$ 12.50	\$ 11.02
Quarter ended June 30, 2007	\$ 11.70	\$ 11.25
<u>2008</u>		
Quarter ended September 30, 2007	\$ 11.25	\$ 9.71
Quarter ended December 31, 2007	10.31	9.40
Quarter ended March 31, 2008	11.20	9.16
Quarter ended June 30, 2008	10.95	10.52

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(1) Stock offering was completed on January 4, 2007, and trading commenced on January 5, 2007.

**Dividends.** Declarations of dividends by the Board of Directors depend on a number of factors, including investment opportunities, growth objectives, financial condition, profitability, tax considerations, minimum capital requirements, regulatory limitations, and general economic as well as stock market conditions. The timing, frequency and amount of dividends is determined by the Board. To date, the Company has not yet paid any dividends.

**Stockholders.** As of September 15, 2008, there were approximately 664 registered shareholders of record of the Company's common stock. This number does not include brokerage firms, banks and registered clearing agents acting as nominees for an indeterminate number of beneficial ("street name") owners.

(b) Not applicable

(c) **Issuer Purchases of Equity Securities.**





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Treasury stock repurchases during the fourth quarter of fiscal year 2008 for the Company were as follows:

Period	Total number of shares purchased	Average price paid per share	Total number of shares Purchased as part of Publicly announced plans or programs	Maximum number of Shares that may be Purchased under the plans or programs
April, 2008	-	\$ -	-	70,472
May, 2008	24,500	10.86	24,500	45,972
June, 2008	29,602	10.94	29,602	16,370
Total	54,102	\$ 10.91	54,102	

### **Item 6. Selected Financial Data**

Not applicable as the Company is a smaller reporting company.

### **Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

This discussion and analysis reflects the Company's consolidated financial statements and other relevant statistical data and is intended to enhance your understanding of our financial condition and results of operations. You should read the information in this section in conjunction with the Company's consolidated financial statements and accompanying notes thereto beginning on page F-1 following Item 15 of this Form 10-K.

#### **Overview**

Our primary business is attracting retail deposits from the general public and using those deposits, together with funds generated from operations, principal repayments on securities and loans and borrowed funds, for our lending and investing activities. Our loan portfolio consists of one- to four-family residential real estate mortgages, commercial real estate mortgages, construction loans, commercial loans, home equity loans and lines of credit, and other consumer loans. We also invest in U.S. government obligations and mortgage-backed securities.

We reported net income of \$612,000 for the fiscal year ended June 30, 2008 as compared to net income of \$1.3 million for fiscal 2007. The results for fiscal 2007 included a \$974,000 gain on the sale of a real estate investment (approximately \$603,000 net of income taxes).

Net interest income for fiscal 2008 was up approximately 3.6% as compared to fiscal 2007 while non-interest expense was up approximately 5.2%. The interest rate spread declined in fiscal 2008 to 2.21%, compared to 2.40% for fiscal 2007, mainly as a result of the continuing flat or inverted yield curve environment. Our net interest margin has been compressed by this rate environment. For the year ended June 30, 2008,

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interest income increased by \$495,000 or 3.1% while interest expense increased by \$229,000 or 2.6% as compared to 2007.

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Total assets were \$308.1 million at June 30, 2008, a 8.3% increase compared to \$284.6 million at June 30, 2007. The increase in assets occurred primarily as the result of a \$20.8 million increase in loans receivable, net. Deposits were \$225.4 million at June 30, 2008, compared to \$211.1 million at June 30, 2007. Increased loan demand was responsible for the increase in borrowed funds; FHLB advances were \$37.1 million at June 30, 2008, up from \$27.9 million at June 30, 2007.

Stockholders' equity at June 30, 2008 of \$43.4 million compared to our stockholders' equity at the prior year-end of \$43.3 million. Our return on average equity for fiscal 2008 was 1.39%, compared to 4.27% for fiscal 2007. The decrease in return on average equity for 2008 reflects a reduction in net income for the fiscal year ended June 30, 2008 as compared the year ended June 30, 2007.

While deposits continue to be our primary source of funds to support our lending activities, our loan originations in recent years have exceeded our deposits. Over the last five years we experienced loan growth of \$115.8 million or 83.6% while our deposits have grown by \$45.0 million, a 25.0% increase. Our loans to deposits ratio has gone from 76.8% to 112.8%. This has caused us to use Federal Home Loan Bank borrowings to fund loans, and borrowings are usually a higher cost source of funds than deposits, which means our net interest rate spread and profitability are lower than if we did not have to borrow funds. As of five years ago, we had zero borrowings while at June 30, 2008 our Federal Home Loan Bank advances had grown to \$37.1 million. To lessen our dependency on borrowings as a funding source we are striving to grow deposits and have expanded our branch network as part of that effort. Since 2002 we have opened two new offices and relocated our first branch office (opened in 1998) to a larger facility. Our fifth branch opened in August 2008.

### Critical Accounting Policies

Our accounting policies are integral to understanding the results reported and are described in Note 1 to our consolidated financial statements beginning on page F-1. In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the dates of the consolidated statements of financial condition and revenues and expenses for the periods then ended. Actual results could differ significantly from those estimates. A material estimate that is particularly susceptible to significant change relates to the determination of the allowance for loan losses.

The allowance for loan losses is established through provisions for loan losses charged against income. Loans deemed to be uncollectible are charged against the allowance for loan losses, and subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is maintained at a level by management which represents the evaluation of known and inherent risks in the loan portfolio at the consolidated balance sheet date that are both probable and reasonable to estimate. Management's periodic evaluation of the adequacy of the allowance is based on the Bank's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions, and other relevant factors. This evaluation is inherently subjective, as it requires material estimates that may be susceptible to significant change, including the amounts and timing of future cash flows expected to be received on impaired loans.

The allowance consists of specific and general components. The specific component related to loans that are classified as doubtful, substandard, or special mention. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general



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component covers nonclassified loans and is based on historical loss experience adjusted for qualitative factors.

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis for commercial and construction loans by the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Bank does not separately identify individual consumer and residential mortgage loans for impairment disclosures.

Although specific and general loan loss allowances are established in accordance with management's best estimate, actual losses are dependent upon future events and, as such, further provisions for loan losses may be necessary in order to increase the level of the allowance for loan losses. For example, our evaluation of the allowance includes consideration of current economic conditions, and a change in economic conditions could reduce the ability of our borrowers to make timely repayments of their loans. This could result in increased delinquencies and increased non-performing loans, and thus a need to make increased provisions to the allowance for loan losses, which would be a charge to income during the period the provision is made, resulting in a reduction to our earnings. A change in economic conditions could also adversely affect the value of the properties collateralizing our real estate loans, resulting in increased charge-offs against the allowance and reduced recoveries, and thus a need to make increased provisions to the allowance for loan losses. Furthermore, a change in the composition of our loan portfolio or growth of our loan portfolio could result in the need for additional provisions.

### **Comparison of Financial Condition at June 30, 2008 and 2007**

**General.** Total assets reached \$308.1 million at June 30, 2008, compared to \$284.6 million at June 30, 2007. The increase was fueled by loan originations, the funding for which was provided primarily by a \$14.3 million or 6.8% increase in deposits, to \$225.4 million at June 30, 2008, compared to \$211.1 million at June 30, 2007, and a \$9.2 million increase in borrowings from the Federal Home Loan Bank.

Total assets grew \$23.5 million or 8.3% between years while total liabilities increased by \$23.4 million or 9.7%, and the ratio of average interest-earning assets to average-interest bearing liabilities grew to 115.72% for fiscal 2008 as compared to 111.07% for fiscal 2007.

**Loans.** Loans receivable, net, rose to \$254.3 million at June 30, 2008 from \$233.5 million at June 30, 2007, an increase of \$20.8 million, or 8.9%. As a percentage of assets, loans increased to 82.5% from 82.1%. The Bank experienced strong demand for its one-to-four family residential loans in its market area; the one-to-four family portfolio grew by \$22.3 million or 18.0% during the year. Commercial real estate loans grew by \$1.1 million, a 3.7% increase, while commercial business loans increased \$947,000, representing a 11.4% change from June 30, 2007. The home equity loan portfolio decreased by \$1.1



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million or 2.0%, as did construction loans by \$1.6 million or 10.2% and consumer loans by \$736,000 or 36.9%, between June 30, 2007 and June 30, 2008.

**Securities.** Our portfolio of securities held to maturity was at \$28.7 million at June 30, 2008 as compared to \$29.3 million at June 30, 2007. Maturities, calls and principal repayments during the year totaled \$20.6 million as compared to \$2.4 million during the prior year. We purchased \$20.0 million of new securities during the year ended June 30, 2008 compared to \$4.0 million during the year ended June 30, 2007.

**Premises and equipment, net.** Total premises and equipment, net at June 30, 2008 was \$10.8 million, compared to \$8.9 million at June 30, 2007, an increase of \$1.9 million or 20.8%. The increase was primarily attributed to the ongoing construction of the Bank's new Bernardsville branch location opened in August 2008.

**Deposits.** Total deposits at June 30, 2008 were \$225.4 million, compared to \$211.1 million at June 30, 2007. Savings and club accounts increased by \$19.7 million; non-interest bearing demand accounts by \$1.8 million, and super NOW accounts by \$163,000. Certificates of deposit decreased by \$6.9 million, as did NOW accounts by \$364,000, and money market demand accounts by \$203,000.

**Borrowings.** Total borrowings at June 30, 2008 amounted to \$37.1 million, compared to \$27.9 million at June 30, 2007. The Bank borrowed \$26.0 million in long term borrowings during the year to fund continued loan demand. The Bank did not have short-term borrowings at June 30, 2008 as compared to \$16.0 million at June 30, 2007.

Our investment in Federal Home Loan Bank of New York stock was \$2.1 million at June 30, 2008 compared to \$1.7 million at June 30, 2007. The increased ownership of Federal Home Loan Bank stock resulted from the increase in borrowings during the year ended June 30, 2008.

**Equity.** Stockholders' equity was \$43.4 million at June 30, 2008 as compared to \$43.3 million at June 30, 2007, reflecting an increase of \$50,000 for the period ended June 30, 2008. The increase in equity was primarily attributed to net income of \$612,000, along with \$176,000 in ESOP shares earned and \$52,000 in other comprehensive income, offset in part by the repurchase of \$609,000 in treasury stock and the declaration of \$209,000 in cash dividends on our common stock.

### Comparison of Operating Results for the Two Years Ended June 30, 2008

**General.** Our results of operations depend primarily on our net interest income. Net interest income is the difference between the interest income we earn on our interest-earning assets and the interest we pay on our interest-bearing liabilities. It is a function of the average balances of loans and investments versus deposits and borrowed funds outstanding in any one period and the yields earned on those loans and investments and the cost of those deposits and borrowed funds. Our results of operations are also affected by our provision for loan losses, non-interest income and non-interest expense. Non-interest income includes service fees and charges, including income on bank owned life insurance. Non-interest expense includes salaries and employee benefits, occupancy and equipment expense and other general and administrative expenses such as service bureau fees and advertising costs.



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Our net income for the year ended June 30, 2008 was \$612,000, a 54.1% decrease compared to net income of \$1.3 million for the year ended June 30, 2007. A \$266,000 or 3.6% increase in net interest income and a \$505,000 decrease in income tax expense were offset by an increase of \$130,000 in the provision for loan losses, a decrease of \$1.0 million or 64.0% reduction in other non-interest income, and a \$350,000 or 5.2% increase in non-interest expense for the year ended June 30, 2008. The decrease of

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\$1.0 million in other non-interest income from the prior year was attributable to the sale of the Bank's former main office site in February 2007 which generated \$974,000 in pre-taxable income for the Company.

**Net Interest Income.** Net interest income for the year ended June 30, 2008 amounted to \$7.6 million, 3.6% higher than net interest income for the year ended June 30, 2007 of \$7.3 million. A \$495,000 or 3.1% increase in interest income for the year ended June 30, 2008 was partially offset by a \$229,000 or 2.6% increase in interest expense.

The increase in interest income for the year ended June 30, 2008 resulted from a 5.3% increase in the average balance of interest-earning assets partially offset by a 13 basis points decrease in the average yield thereon. The increase in the average loans receivable balance of \$15.8 million, partially offset by a 23 basis point decrease in average yield from 6.37% at June 30, 2007 to 6.14% at June 30, 2008, was primarily responsible for the increase in interest income for the year ended June 30, 2008 compared to the year ended June 30, 2007.

The increase in interest expense for the year ended June 30, 2008 is largely attributable to the higher average balance of deposits and higher average cost of deposits during the year. The Bank's average cost of interest-bearing deposits for the year ended June 30, 2008 was 3.70%, 28 basis points higher than the prior year. The average balance of interest-bearing deposits rose by 5.5% between years. The average balance of Federal Home Loan Bank advances for the year ended June 30, 2008 was \$33.0 million and the average cost thereof was 4.13%. This represents a \$8.3 million or 20.0% decrease from the average balance of \$41.3 million for the year ended June 30, 2007 and a 92 basis point decrease in the average cost of advances for the year ended June 30, 2007.

Our net interest rate spread was 2.21% for the year ended June 30, 2008 and 2.40% for the year ended June 30, 2007. The spread decreased during the year ended June 30, 2008 as our average cost of interest-bearing liabilities increased by 6 basis points to 3.76% from 3.70% during the year ended June 30, 2007. Correspondingly, the average yield on interest-earning assets decreased 13 basis points from 6.10% for the year ended June 30, 2007 to 5.97% for the year ended June 30, 2008.

**Provision for Loan Losses.** The allowance for loan losses is a valuation account that reflects our estimation of the losses inherent in our loan portfolio to the extent they are both probable and reasonable to estimate. The allowance is established through provisions for loan losses that are charged to income in the period they are established. We charge losses on loans against the allowance for loan losses when we believe the collection of loan principal is unlikely. Recoveries on loans previously charged-off are added back to the allowance. The provision for the year ended June 30, 2008 was \$135,000 as compared to \$5,000 for the year before. The allowance for loan losses as a percentage of non-performing loans was 19.79% at June 30, 2008 compared to 39.42% at June 30, 2007 and the allowance for loan losses as a percentage of total loans was 0.40% at June 30, 2008 compared to 0.38% at June 30, 2007. While non-performing loans have increased, most of these loans are adequately collateralized by real estate. Of the \$5.2 million in non-performing loans at June 30, 2008, only \$936,000 required specific loss allowances totaling \$114,000.

**Non-Interest Income.** This category includes fees derived from checking accounts, ATM transactions and debit card use and mortgage related fees. It also includes increases in the cash-surrender value of our bank owned life insurance. Overall, non-interest income decreased to \$568,000 for the year ended June 30, 2008 compared to \$1.6 million for the year ended June 30, 2007. The \$1.0 million decrease was attributable to the sale of the Bank's former main office site in February 2007, which generated \$974,000 in pre-tax income.



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Income from fees and service charges is the largest regular component of non-interest income and totaled \$353,000 and \$333,000 for the years ended June 30, 2008 and 2007, respectively.

Income on bank owned life insurance was \$158,000 and \$150,000 for the years ended June 30, 2008 and 2007, respectively.

**Non-Interest Expenses.** Total non-interest expenses grew by 5.2% during the year ended June 30, 2008 and amounted to \$7.1 million and \$6.7 million for the years ended June 30, 2008 and 2007, respectively.

Salaries and employee benefits expense totaled \$3.4 million for the year ended June 30, 2008 and was \$90,000 or 2.7% higher than the prior year. The increase in expense for the period reflects normal salary increases, including an increase of \$28,000 in stock option expense, offset by a reduction of \$122,000 in the Bank's 401-k pension plan expense, as a result of the plan being amended. Salaries and employee benefits are our main non-interest expense and represented 47.5% and 48.7% of non-interest expenses for the years ended June 30, 2008 and 2007, respectively. Occupancy and equipment expense rose by \$41,000 to \$1.3 million, a 3.3% increase over last year, while other miscellaneous expenses rose by \$353,000 to \$1.5 million, a 31.5% increase over last year. The increase in other miscellaneous expenses was primarily the result of increased expenses related to being a public company and Sarbanes-Oxley Section 404 compliance expense. These increases were partially offset by decreases of \$87,000, or 15.6% in service bureau fees and \$67,000, or 24.5% in advertising expenses, respectively. The decrease in service bureau fees was due to the negotiation of a new service contract, whereas the decrease in advertising expense was attributed to a planned reduction in spending.

**Income Taxes.** Income tax expense for the year ended June 30, 2008 was \$315,000 as compared to \$820,000 for the year ended June 30, 2007. The reduction for the year ended June 30, 2008 reflects lower pre-tax income as well as a decrease in the effective tax rate to 34.0% from 38.1%. The decrease in the effective tax rate was due to an increase in income from bank owned life insurance, which is tax exempt, as a percentage of pre-tax income.

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**Average Balance Sheet.** The following tables set forth certain information for the years ended June 30, 2008, 2007 and 2006. The average yields and costs are derived by dividing income or expense by the average daily balance of assets or liabilities, respectively, for the periods presented.

	Year Ended June 30, 2008			2007			2006		
	Average Balance	Interest Earned/Paid	Average Yield/ Cost	Average Balance	Interest Earned/ Paid	Average Yield/ Cost	Average Balance	Interest Earned/ Paid	Average Yield/ Cost
(Dollars in thousands)									
<u>Interest-earning assets:</u>									
Loans <sup>(1)</sup>	\$ 243,879	\$ 14,974	6.14 %	\$ 228,069	\$ 14,527	6.37 %	\$ 205,905	\$ 12,773	6.20 %
Securities	28,178	1,383	4.91 %	27,690	1,214	4.38 %	27,959	1,177	4.21 %
Other interest-earning assets <sup>(2)</sup>	6,260	269	4.30 %	8,539	390	4.57 %	5,008	167	3.33 %
Total interest-earning assets	278,317	16,626	5.97 %	264,298	16,131	6.10 %	238,872	14,117	5.91 %
Non-interest-earning assets	17,978			16,555			16,719		
Total assets	\$ 295,325			\$ 280,853			\$ 255,591		
<u>Interest-bearing liabilities:</u>									
NOW & money market	\$ 26,906	241	0.90 %	\$ 29,056	279	0.96 %	\$ 34,117	329	0.96 %
Savings and club deposits	51,048	1,267	2.48 %	48,248	896	1.86 %	44,839	568	1.27 %
Certificates of deposit	129,506	6,170	4.76 %	119,364	5,552	4.65 %	109,755	4,098	3.73 %
Total interest-bearing deposits	207,460	7,678	3.70 %	196,668	6,727	3.42 %	188,711	4,995	2.65 %
Federal Home Loan Bank advances	33,035	1,364	4.13 %	41,297	2,086	5.05 %	37,637	1,666	4.43 %
Total interest-bearing liabilities	240,519	9,042	3.76 %	237,965	8,813	3.70 %	226,348	6,661	2.94 %
Non-interest-bearing deposits	8,540			9,804			8,294		
Other non-interest-bearing liabilities	2,300			1,879			1,782		
Total liabilities	251,335			249,648			236,424		
Stockholder's equity	43,990			31,205			19,167		
Total liabilities and stockholder's equity	\$ 295,325			\$ 280,853			\$ 255,591		
Net interest rate spread <sup>(3)</sup>		\$ 7,584	2.21 %		\$ 7,318	2.40 %		\$ 7,456	2.97 %
Net interest margin <sup>(4)</sup>			2.72 %			2.77 %			3.12 %
Ratio of interest-earning assets to									
Interest-bearing liabilities	115.72			111.07 %			105.53 %		

- (1) Non-accruing loans have been included, and the effect of such inclusion was not material. The allowance for loan losses is excluded, while construction loans in process and deferred fees are included.
- (2) Includes Federal Home Loan Bank stock at cost and term deposits with other financial institutions.
- (3) Net interest rate spread represents the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities.
- (4) Net interest margin represents net interest income as a percentage of average interest-earning assets.



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**Rate/Volume Analysis.** The following table reflects the sensitivity of our interest income and interest expense to changes in volume and in prevailing interest rates during the periods indicated. Each category reflects the: (1) changes in volume (changes in volume multiplied by old rate); (2) changes in rate (changes in rate multiplied by old volume); and (3) net change. The net change attributable to the combined impact of volume and rate has been allocated proportionally to the absolute dollar amounts of change in each.

	<b>Year Ended June 30, 2008 vs. 2007</b>			<b>Year Ended June 30, 2007 vs. 2006</b>		
	<b>Increase (Decrease)</b>			<b>Increase (Decrease)</b>		
	<b>Due to</b>			<b>Due to</b>		
	<b>Volume</b>	<b>Rate</b>	<b>Net</b>	<b>Volume</b>	<b>Rate</b>	<b>Net</b>
	(In thousands)					
<b><u>Interest and dividend income:</u></b>						
Loans	\$ 984	\$ (537 )	\$ 447	\$ 1,398	\$ 356	\$ 1,754
Securities	21	148	169	(11 )	48	37
Other interest-earning assets	(99 )	(22 )	(121 )	146	77	223
Increase (decrease) in total interest income	906	(411 )	495	1,533	481	2,014
<b><u>Interest expense:</u></b>						
NOW and money market accounts	(20 )	(18 )	(38 )	(50 )	—	(50 )
Savings and club	55	316	371	46	282	328
Certificates of deposit	483	135	618	381	1,073	1,454
Total interest-bearing deposits	518	433	951	377	1,355	1,732
Federal Home Loan Bank advances	(378 )	(344 )	(722 )	172	248	420
Increase in total interest expense	140	89	229	549	1,603	2,152
Change in net interest income	\$ 766	\$ (500 )	\$ 266	\$ 983	\$ (1,122 )	\$ (138 )

### **Liquidity, Commitments and Capital Resources**

The Bank must be capable of meeting its customer obligations at all times. Potential liquidity demands include funding loan commitments, cash withdrawals from deposit accounts and other funding needs as they present themselves. Accordingly, liquidity is measured by our ability to have sufficient cash reserves on hand, at a reasonable cost and/or with minimum losses.

Senior management is responsible for managing our overall liquidity position and risk and is responsible for ensuring that our liquidity needs are being met on both a daily and long term basis. The Financial Review Committee, comprised of senior management and chaired by President and Chief Executive Officer Gary Jolliffe, is responsible for establishing and reviewing our liquidity procedures, guidelines, and strategy on a periodic basis.

Our approach to managing day-to-day liquidity is measured through our daily calculation of investable funds and/or borrowing needs to ensure adequate liquidity. In addition, senior management constantly evaluates our short-term and long-term liquidity risk and strategy based on current market conditions, outside investment and/or borrowing opportunities, short and long-term economic trends, and anticipated short and long-term liquidity requirements. The Bank's loan and deposit rates may be adjusted as another means of managing short and long-term liquidity needs. We do not at present participate in derivatives or other types of hedging instruments to meet liquidity demands, as we take a conservative approach in managing liquidity.





At June 30, 2008, the Bank had outstanding commitments to originate loans of \$7.4 million, construction loans in process of \$3.6 million, unused lines of credit of \$28.4 million (including \$24.1 million for home equity lines of credit), and standby letters of credit of \$268,000. Certificates of deposit scheduled to mature in one year or less at June 30, 2008, totaled \$96.7 million.

As of June 30, 2008, the Bank had approximately \$2.4 million in contractual obligations related to building improvements for its Bernardsville branch. The Bank also had contractual obligations related to the long-term operating leases for the three branch locations that it leases (Dewey Meadow, RiverWalk and Martinsville). For additional information regarding the Bank's lease commitments as of June 30, 2008, see Note 9 to our consolidated financial statements beginning on page F-1.

The Bank generates cash through borrowings from the Federal Home Loan Bank to meet its day-to-day funding obligations. At June 30, 2008, its total loans to deposits ratio was 112.8%. At June 30, 2008, the Bank's collateralized borrowing limit with the Federal Home Loan Bank was \$104.7 million, of which \$37.1 million was outstanding. As of June 30, 2008, the Bank also had a \$20.0 million line of credit with a financial institution for reverse repurchase agreements (which is a form of borrowing) that it could access if necessary.

Consistent with its goals to operate a sound and profitable financial organization, the Bank actively seeks to maintain its status as a well-capitalized institution in accordance with regulatory standards. As of June 30, 2008, the Bank exceeded all applicable regulatory capital requirements. See Note 13 to our consolidated financial statements beginning at page F-1 for more information about the Bank's regulatory capital compliance.

#### **Off-Balance Sheet Arrangements**

We are a party to financial instruments with off-balance-sheet risk in the normal course of our business of investing in loans and securities as well as in the normal course of maintaining and improving Millington Savings Bank's facilities. These financial instruments include significant purchase commitments, such as commitments related to capital expenditure plans and commitments to purchase investment securities or mortgage-backed securities, and commitments to extend credit to meet the financing needs of our customers. At June 30, 2008, our significant off-balance sheet commitments consisted of commitments to originate loans of \$7.4 million, construction loans in process of \$3.6 million, unused lines of credit of \$28.4 million (including \$24.1 million for home equity lines of credit), standby letters of credit of \$268,000, and approximately \$2.4 million in contractual obligations related to building improvements for its Bernardsville branch.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Our exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit is represented by the contractual amount of those instruments. We use the same credit policies in making commitments and conditional obligations as we do for on-balance-sheet instruments. Since a number of commitments typically expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. For additional information regarding our outstanding lending commitments at June 30, 2008, see Note 14 to our consolidated financial statements beginning on page F-1.



### **Impact of Inflation**

The Company's financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. These principles require the measurement of financial position and operating results in terms of historical dollars, without considering changes in the relative purchasing power of money over time due to inflation.

Our primary assets and liabilities are monetary in nature. As a result, interest rates have a more significant impact on our performance than the effects of general levels of inflation. Interest rates, however, do not necessarily move in the same direction or with the same magnitude as the price of goods and services, since such prices are affected by inflation. In a period of rapidly rising interest rates, the liquidity and maturities of our assets and liabilities are critical to the maintenance of acceptable performance levels.

The principal effect of inflation on earnings, as distinct from levels of interest rates, is in the area of non-interest expense. Expense items such as employee compensation, employee benefits and occupancy and equipment costs may be subject to increases as a result of inflation. An additional effect of inflation is the possible increase in the dollar value of the collateral securing loans that we have made. We are unable to determine the extent, if any, to which properties securing our loans have appreciated in dollar value due to inflation.

### **Recent Accounting Pronouncements**

Note 18 to the consolidated financial statements is incorporated herein by reference.

### **Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

#### **Management of Interest Rate Risk and Market Risk**

*Qualitative Analysis.* Because the majority of our assets and liabilities are sensitive to changes in interest rates, a significant form of market risk for us is interest rate risk, or changes in interest rates.

We derive our income mainly from the difference or "spread" between the interest earned on loans, securities and other interest-earning assets, and interest paid on deposits, borrowings and other interest-bearing liabilities. In general, the larger the spread, the more we earn. When market rates of interest change, the interest we receive on our assets and the interest we pay on our liabilities will fluctuate. This can cause decreases in our spread and can adversely affect our income.

Several years ago market interest rates were at historically low levels. Beginning in June 2004 through June 2007, the U.S. Federal Reserve increased its target federal funds rate, raising it 17 times, from 1.00% to 5.25% during this period. The Federal Reserve subsequently reduced its target federal fund rate 7 times over the past year to 2.00% as of June 30, 2008. A normalization of the last year's inverted yield occurred during

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the past year as a result of the Federal Reserves policy. The federal funds rate and other short-term market interest rates, which we use as a guide to our deposit pricing, have decreased, while intermediate-and long-term market interest rates have remained stable, which we use as a guide to our loan pricing, have not decreased nor increased proportionately. The Bank has begun to realize a reduction in its deposit portfolio average rate more recently.

***Quantitative Analysis.*** The following table presents Millington Savings Bank's net portfolio value as of June 30, 2008. The Bank outsources its interest rate risk modeling and the net portfolio values

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shown in this table were calculated by an outside consultant, based on information provided by Millington Savings Bank.

<b>At June 30, 2008</b>		<b>Net Portfolio Value</b>			
<b>Net Portfolio Value</b>		<b>as % of Present Value of Assets</b>			
<b>Changes in Rates</b>	<b>\$ Amount</b>	<b>\$ Change</b>	<b>% Change</b>	<b>Net Portfolio Value Ratio</b>	<b>Basis Point Change</b>
	(In thousands)				
+300 bp	24,861	(11,959)	(32.48%)	8.78%	(320)bp
+200 bp	29,704	(7,116)	(19.33%)	10.18%	(180)bp
+100 bp	34,126	(2,694)	(7.32%)	11.37%	(61)bp
0 bp	36,820	0	0.00%	11.98%	0 bp
- 100 bp	35,242	(1,578)	(4.29%)	11.32%	(66)bp
- 200 bp	31,540	(5,281)	(14.34%)	10.06%	(192)bp

Future interest rates or their effect on net portfolio value or net interest income are not predictable. Computations of prospective effects of hypothetical interest rate changes are based on numerous assumptions, including relative levels of market interest rates, prepayments, and deposit run-offs, and should not be relied upon as indicative of actual results. Certain shortcomings are inherent in this type of computation. Although certain assets and liabilities may have similar maturity or periods of repricing, they may react at different times and in different degrees to changes in the market interest rates. The interest rate on certain types of assets and liabilities, such as demand deposits and savings accounts, may fluctuate in advance of changes in market interest rates, while rates on other types of assets and liabilities may lag behind changes in market interest rates. Certain assets, such as adjustable rate mortgages, generally have features that restrict changes in interest rates on a short-term basis and over the life of the asset. In the event of a change in interest rates, prepayments and early withdrawal levels could deviate significantly from those assumed in making calculations set forth above. Additionally, an increased credit risk may result as the ability of many borrowers to service their debt may decrease in the event of an interest rate increase.

Notwithstanding the discussion above, the quantitative interest rate analysis presented above indicates that a rapid increase or decrease in interest rates would adversely affect our net interest margin and earnings.

### **Item 8. Financial Statements and Supplementary Data**

The Company's financial statements are contained in this Annual Report on Form 10-K immediately following Item 15.

### **Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

Not applicable.



**Item 9A(T). Controls and Procedures**

(a) **Disclosure Controls and Procedures**

An evaluation was performed under the supervision and with the participation of the Company's management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended) as of June 30, 2008. Based on such evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures are effective as of June 30, 2008.

(b) **Internal Control Over Financial Reporting**

**1. Management's Annual Report on Internal Control Over Financial Reporting.**

Management's report on the Company's internal control over financial reporting appears immediately preceding the Company's consolidated financial statements which are found following Item 15.

**2. Report of Independent Registered Public Accounting Firm**

This annual report does not include an attestation report of the Company's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permit the Company to provide only management's report in this annual report.

**3. Changes in Internal Control over Financial Reporting**

No change in the Company's internal controls over financial reporting (as defined in Rule 13a-15(f) promulgated under the Securities Exchange Act of 1934, as amended) occurred during the most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

**Item 9B. Other Information**

None.

**PART III**

**Item 10. Directors, Executive Officers and Corporate Governance**

The information that appears under the headings “Proposal I – Election of Directors,” “Section 16(a) Beneficial Reporting Compliance” and “Corporate Governance” in the Registrant’s definitive proxy statement for the Registrant’s 2008 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission (the “Proxy Statement”) is incorporated herein by reference.

**Item 11. Executive Compensation**

The information that appears under the headings “Executive Compensation” and “Director Compensation” in the Proxy Statement is incorporated herein by reference.

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**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

- (a) **Security Ownership of Certain Beneficial Owners.** Information required by this item is incorporated herein by reference to the section captioned “Principal Holders of our Common Stock” in the Proxy Statement.
- (b) **Security Ownership of Management.** Information required by this item is incorporated herein by reference to the section captioned “Principal Holders of our Common Stock” and “Proposal I – Election of Directors” in the Proxy Statement.
- (c) **Changes in Control.** Management of the Company knows of no arrangements, including any pledge by any person of securities of the Company, the operation of which may at a subsequent date result in a change in control of the registrant.
- (d) **Securities Authorized for Issuance Under Equity Compensation Plans.** Set forth below is information as of June 30, 2008 with respect to compensation plans under which equity securities of the Registrant are authorized for issuance.

**Equity Compensation Plan Information**

	(A)	(B)	(C)
	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	Weighted-average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (A))
<b>Equity compensation plans</b>			
<b>approved by shareholders:</b>			
2008 Stock Compensation			
and Incentive Plan	275,410	\$10.75	-
Total	275,410	10.75	-

**Item 13. Certain Relationships and Related Transactions, and Director Independence**

No directors, executive officers or their immediate family members were engaged, directly or indirectly, in transactions with the Company or any subsidiary during any of the three years ended June 30, 2008 that exceeded \$120,000 (excluding loans with Millington Savings Bank).

Millington Savings Bank makes loans to its officers, directors and employees in the ordinary course of business. All directors and employees are offered a 50 basis point reduction on interest rates for consumer loans or primary residence mortgage loans. Such loans do not include more than the normal risk of collectibility or present other unfavorable features.

Other than Mr. Jolliffe and Mr. Shriner, who are employees of the Bank, all of the directors are independent directors.

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**Item 14. Principal Accountant Fees and Services**

The information relating to this item is incorporated herein by reference to the information contained under the section captioned "Proposal II – Ratification of Appointment of Auditors" in the Proxy Statement.

**PART IV**

**Item 15. Exhibits and Financial Statement Schedules**

(1) The following financial statements and the independent auditors' report appear in this Annual Report on Form 10-K immediately after this Item 15:

Management's Report on Internal Controls  
Report of Independent Registered Public Accounting Firm  
Consolidated Statements of Financial Condition as of June 30, 2008 and 2007  
Consolidated Statements of Income For the Years Ended June 30, 2008 and 2007  
Consolidated Statements of Changes in Stockholders' Equity for the Years Ended June 30, 2008 and 2007  
Consolidated Statements of Cash Flows for the Years Ended June 30, 2008 and 2007  
Notes to Consolidated Financial Statements

(2) All schedules are omitted because they are not required or applicable, or the required information is shown in the consolidated financial statements or the notes thereto.

(3) The following exhibits are filed as part of this report:

- 3.1 Charter of MSB Financial Corp. \*
- 3.2 Bylaws of MSB Financial Corp. \*
- 4 Stock Certificate of MSB Financial Corp.\*
- 10.1 Employment Agreement with Gary T. Jolliffe\*
- 10.2 Employment Agreement with Michael A. Shriner\*
- 10.3 Employment Agreement with Jeffrey E. Smith\*
- 10.4 Form of Executive Life Insurance Agreement\*
- 10.5 Millington Savings Bank Executive Incentive Retirement Plan Agreement for President and Chief Executive Officer\*
- 10.6 Millington Savings Bank Executive Incentive Retirement Plan Agreement for the Benefit of Senior Officers\*
- 10.7 Millington Savings Bank Directors Consultation and Retirement Plan\*
- 10.8 MSB Financial Corp. 2008 Stock Compensation and Incentive Plan\*\*
- 21 Subsidiaries of the Registrant
- 23 Consent of Beard Miller Company LLP

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- 31 Certifications pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
  - 32 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
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- \* Incorporated by reference to the Registrant's Form S-1 Registration Statement No. 333-137294
- \*\* Incorporated by reference to the Registrant's Form S-8 Registration Statement No. 333-150968

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## MANAGEMENT'S REPORT ON INTERNAL CONTROL

### OVER FINANCIAL REPORTING

Management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). The Company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorization of management and directors of the Company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the financial statements.

Internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements prepared for external purposes in accordance with generally accepted accounting principles. Because of inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

Under supervision and with the participation of management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework in *Internal Control-Integrated Framework*, management concluded that our internal control over financial reporting was effective as of June 30, 2008.

This annual report does not include an attestation report of the Company's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permit the company to provide only management's report in this annual report.

/s/Gary T. Jolliffe  
Gary T. Jolliffe

President and Chief Executive Officer

/s/Jeffrey E. Smith  
Jeffrey E. Smith

Vice President and Chief Financial Officer



**[Letterhead of Beard Miller Company LLP]**

**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Stockholders

MSB Financial Corp. and Subsidiaries

Millington, New Jersey

We have audited the accompanying consolidated statements of financial condition of MSB Financial Corp. and subsidiaries (the "Company") as of June 30, 2008 and 2007, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended. The Company's management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of MSB Financial Corp. and subsidiaries as of June 30, 2008 and 2007, and the consolidated results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1, the Company changed its method of accounting for Defined Benefit Pension Plans in 2007.

/s/ Beard Miller Company LLP

Beard Miller Company LLP

Clark, New Jersey

September 25, 2008





**MSB Financial Corp. and Subsidiaries****Consolidated Statements of Financial Condition**

	<b>June 30,</b>	
	<b>2008</b>	<b>2007</b>
	<b>(Dollars in Thousands, except Per Share Amount)</b>	
<b>Assets</b>		
Cash and due from banks	\$ 1,480	\$ 1,460
Interest-earning demand deposits with banks	3,215	2,809
Cash and Cash Equivalents	4,695	4,269
Trading securities	82	114
Securities held to maturity (fair value of \$28,195 and \$28,684, respectively)	28,743	29,336
Loans receivable, net of allowance for loan losses of \$1,025 and \$926, respectively	254,290	233,498
Premises and equipment	10,759	8,907
Federal Home Loan Bank of New York stock, at cost	2,112	1,669
Bank owned life insurance	4,088	3,929
Accrued interest receivable	1,680	1,513
Deferred income taxes	1,111	954
Other assets	498	389
<b>Total Assets</b>	<b>\$ 308,058</b>	<b>\$ 284,578</b>
<b>Liabilities and Stockholders' Equity</b>		
<b>Liabilities</b>		
Deposits:		
Non-interest bearing	\$ 10,027	\$ 8,217
Interest bearing	215,344	202,901
Total Deposits	225,371	211,118
Advances from Federal Home Loan Bank of New York	37,068	27,889
Advance payments by borrowers for taxes and insurance	480	505
Other liabilities	1,743	1,720
<b>Total Liabilities</b>	<b>264,662</b>	<b>241,232</b>
<b>Commitments and Contingencies</b>		
	—	—
<b>Stockholders' Equity</b>		
Common stock, par value \$0.10; 10,000,000 shares authorized; 5,620,625 issued; 5,564,633 and 5,620,625 shares outstanding	562	562
Paid-in capital	24,188	24,153

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Retained earnings	21,026	20,623
Unearned ESOP shares	(1,770 )	(1,939 )
Treasury stock, at cost, 55,992 and 0 shares, respectively	(609 )	—
Accumulated other comprehensive loss	(1 )	(53 )
<b>Total Stockholders' Equity</b>	43,396	43,346
<b>Total Liabilities and Stockholders' Equity</b>	\$ 308,058	\$ 284,578

*See notes to consolidated financial statements.*

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***MSB Financial Corp. and Subsidiaries*****Consolidated Statements of Income**

	<b>Years Ended June 30,</b>	
	<b>2008</b>	<b>2007</b>
	<b>(In Thousands, Except Per Share Amounts)</b>	
<b>Interest Income</b>		
Loans receivable, including fees	\$ 14,974	\$ 14,527
Securities held to maturity	1,383	1,214
Other	269	390
<b>Total Interest Income</b>	<b>16,626</b>	<b>16,131</b>
<b>Interest Expense</b>		
Deposits	7,678	6,727
Borrowings	1,364	2,086
<b>Total Interest Expense</b>	<b>9,042</b>	<b>8,813</b>
<b>Net Interest Income</b>	<b>7,584</b>	<b>7,318</b>
<b>Provision for Loan Losses</b>	<b>135</b>	<b>5</b>
<b>Net Interest Income after Provision for Loan Losses</b>	<b>7,449</b>	<b>7,313</b>
<b>Non-Interest Income</b>		
Fees and service charges	353	333
Income from Bank Owned Life Insurance	158	150
Unrealized (loss) gain on trading securities	(32 )	5
Income from investment in real estate	—	1,007
Other	89	84
<b>Total Non-Interest Income</b>	<b>568</b>	<b>1,579</b>
<b>Non-Interest Expenses</b>		
Salaries and employee benefits	3,370	3,280
Directors compensation	289	269
Occupancy and equipment	1,280	1,239
Service bureau fees	472	559
Advertising	206	273
Other	1,473	1,120
<b>Total Non-Interest Expenses</b>	<b>7,090</b>	<b>6,740</b>
<b>Income before Income Taxes</b>	<b>927</b>	<b>2,152</b>

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<b>Income Taxes</b>	315	820
<b>Net Income</b>	\$ 612	\$ 1,332
<b>Weighted average number of shares of common stock outstanding, basic and diluted</b>	5,430	4,215
<b>Earnings per share - basic and diluted</b>	\$ .11	\$ .32

*See notes to consolidated financial statements.*

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**MSB Financial Corp. and Subsidiaries****Consolidated Statements of Changes in Stockholders' Equity**

	Common Stock	Paid-In Capital	Retained Earnings	Unearned ESOP Shares	Treasury Stock	Accumulated Other Comprehensive Loss	Total Stockholders' Equity
<b>Balance – June 30, 2006</b>							
	\$ 1	\$ 199	\$ 19,291	\$ —	\$ —	\$ —	\$ 19,491
Net income	—	—	1,332	—	—	—	1,332
Issuance of common stock, net of expenses (5,620,625 shares)	561	23,941	—	—	—	—	24,502
Adjustment to initially apply FASB Statement No. 158, net of deferred income tax of \$35	—	—	—	—	—	(53)	(53)
Common stock acquired by ESOP	—	—	—	(2,023)	—	—	(2,023)
ESOP shares earned	—	13	—	84	—	—	97
<b>Balance - June 30, 2007</b>	562	24,153	20,623	(1,939)	—	(53)	43,346
Net income	—	—	612	—	—	—	612
Other comprehensive income, net of tax:							
Pension cost, net of income taxes of \$34	—	—	—	—	—	52	52
Comprehensive Income							664
Dividends declared (\$0.09 per share)	—	—	(209)	—	—	—	(209)
ESOP shares earned	—	7	—	169	—	—	176
Treasury stock repurchased (55,992 Shares)	—	—	—	—	(609)	—	(609)
Stock-based compensation	—	28	—	—	—	—	28
<b>Balance - June 30, 2008</b>	\$ 562	\$ 24,188	\$ 21,026	\$ (1,770)	\$ (609)	\$ (1)	\$ 43,396

See notes to consolidated financial statements.



**MSB Financial Corp. and Subsidiaries****Consolidated Statements of Cash Flows**

	<b>Years Ended June 30,</b>	
	<b>2008</b>	<b>2007</b>
	<b>(In Thousands)</b>	
<b>Cash Flows from Operating Activities</b>		
Net income	\$ 612	\$ 1,332
Adjustments to reconcile net income to net cash provided by operating activities:		
Net (accretion) of securities premiums and discounts and deferred loan fees and costs	(144 )	(136 )
Depreciation and amortization expense	529	527
Amortization component of net periodic pension cost	86	—
ESOP compensation	176	97
Stock based compensation	28	—
Provision for loan losses	135	5
Earnings on bank owned life insurance	(158 )	(150 )
Unrealized loss (gain) trading securities	32	(5 )
(Gain) on sale of investment in real estate	—	(974 )
Gain on sale of equipment	—	(2 )
(Increase) in accrued interest receivable	(167 )	(163 )
Deferred income taxes	(191 )	(167 )
(Increase) in other assets	(110 )	(146 )
(Decrease) increase in other liabilities	(106 )	402
Increase in interest payable	60	2
<b>Net Cash Provided by Operating Activities</b>	<b>782</b>	<b>622</b>
<b>Cash Flows from Investing Activities</b>		
Activity in held to maturity securities:		
Purchases	(20,000 )	(3,988 )
Maturities, calls and principal repayments	20,590	2,359
Net increase in loans receivable	(20,780 )	(15,046 )
Proceeds from sales of investment in real estate	—	1,061
Proceeds from sale of equipment	—	2
Purchase of bank premises and equipment	(2,381 )	(526 )
Redemption of bank owned life insurance	—	225
Purchase of Federal Home Loan Bank of New York stock	(3,629 )	(5,051 )
Redemptions of Federal Home Loan Bank of New York stock	3,186	6,203
<b>Net Cash Used in Investing Activities</b>	<b>(23,014 )</b>	<b>(14,761 )</b>
<b>Cash Flows from Financing Activities</b>		
Net increase in deposits	14,253	16,363
Net (decrease) in short-term borrowings	(16,000 )	(25,500 )

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Proceeds from long-term borrowings	26,000	—
Repayments of long-term borrowings	(821 )	(791 )
(Decrease) in advance payments by borrowers for taxes and insurance	(25 )	(24 )
Proceeds of initial public stock offering	—	24,502
Cash dividends paid to minority shareholders	(140 )	—
Stock acquired for ESOP plan	(609 )	(2,023 )
<b>Net Cash Provided by Financing Activities</b>	<b>22,658</b>	<b>12,527</b>
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	<b>426</b>	<b>(1,612 )</b>
<b>Cash and Cash Equivalents – Beginning</b>	<b>4,269</b>	<b>5,881</b>
<b>Cash and Cash Equivalents – Ending</b>	<b>\$ 4,695</b>	<b>\$ 4,269</b>

*See notes to consolidated financial statements.*

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***MSB Financial Corp. and Subsidiaries***

**Consolidated Statements of Cash Flows**

	<b>Years Ended June 30,</b>	
	<b>2008</b>	<b>2007</b>
	<b>(In Thousands)</b>	
<b>Supplementary Cash Flows Information</b>		
Interest paid	\$ 8,982	\$ 8,811
Income taxes paid	\$ 634	\$ 909
Dividends declared, not yet paid	\$ 69	\$ —

*See notes to consolidated financial statements.*

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## ***MSB Financial Corp. and Subsidiaries***

### **Note 1 - Summary of Significant Accounting Policies**

#### **Basis of Consolidated Financial Statement Presentation**

The consolidated financial statements include the accounts of MSB Financial Corp. (the “Company”) and its wholly-owned subsidiaries, Millington Savings Bank (the “Savings Bank”) and Millington Savings Service Corp. (the “Service Corp.”). All significant intercompany accounts and transactions have been eliminated in consolidation.

The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (“GAAP”). In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the dates of the consolidated statements of financial condition and revenues and expenses for the periods then ended. Actual results could differ significantly from those estimates.

A material estimate that is particularly susceptible to significant changes relates to the determination of the allowance for loan losses. Management believes that the allowance for loan losses is adequate. While management uses available information to recognize losses on loans, future additions to the allowance for loan losses may be necessary based on changes in economic conditions in the Savings Bank’s market area.

In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Savings Bank’s allowance for loan losses. Such agencies may require the Savings Bank to recognize additions to the allowance for loan losses based on their judgments about information available to them at the time of their examination.

#### **Organization and Business**

The Company is a federally-chartered corporation organized in 2004 for the purpose of acquiring all of the capital stock that the Savings Bank issued in its mutual holding company reorganization. The Company’s principal business is the ownership and operation of the Savings Bank.

MSB Financial, MHC (the “MHC”) is a federally-chartered mutual holding company that was formed in 2004 in connection with the mutual holding company reorganization. The MHC has not engaged in any significant business other than its ownership interest in the Company since its formation. So long as the MHC is in existence, it will at all times own a majority of the outstanding stock of the Company. At June 30, 2008, the MHC owned 55.6% of the Company’s outstanding common shares.

The Savings Bank is a New Jersey chartered stock savings bank and its deposits are insured by the Federal Deposit Insurance Corporation. The primary business of the Savings Bank is attracting retail deposits from the general public and using those deposits together with funds generated from operations, principal repayments on securities and loans and borrowed funds, for its lending and investing activities. Our loan portfolio consists of one-to-four family residential loans, commercial loans, and consumer loans. We also invest in U.S. government obligations and mortgage-backed securities. The Savings Bank is regulated by the New Jersey Department of Banking and Insurance and the Federal Deposit Insurance Corporation. The Office of Thrift Supervision regulates the MHC and the Company as savings and loan holding companies.

The primary business of the Service Corp. was the ownership and operation of a single commercial rental property. This property was sold during the year ended June 30, 2007. Currently the Service Corp. is inactive.

## ***MSB Financial Corp. and Subsidiaries***

### **Note 1 - Summary of Significant Accounting Policies (Continued)**

#### **Cash and Cash Equivalents**

Cash and cash equivalents include cash and amounts due from depository institutions and interest-bearing deposits with original maturities of three months or less.

#### **Securities**

Investments in debt securities that we have the positive intent and ability to hold to maturity are classified as held-to-maturity securities and reported at amortized cost. Debt and equity securities that are bought and held principally for the purpose of selling them in the near term are classified as trading securities and reported at fair value, with unrealized holding gains and losses included in earnings. Debt and equity securities not classified as trading securities or as held-to-maturity securities are classified as available for sale securities and reported at fair value, with unrealized holding gains or losses, net of applicable income taxes, reported in a separate component of stockholder's equity.

Individual securities are considered impaired when fair value is less than amortized cost. Management evaluates on a quarterly basis whether any securities are other-than-temporarily impaired. In making this determination, we consider the extent and duration of the impairment, the nature and financial health of the issuer, other factors relevant to specific securities, and our ability and intent to hold securities for a period of time sufficient to allow for any anticipated recovery in market value. If a security is determined to be other-than-temporarily impaired, an impairment loss is charged to operations.

Discounts and premiums on securities are accreted/amortized to maturity by use of the level-yield method. Gain or loss on sales of securities is based on the specific identification method.

#### **Concentration of Risk**

The Savings Bank's lending activities are concentrated in loans secured by real estate located primarily in the State of New Jersey.

#### **Loans Receivable**

Loans receivable are stated at unpaid principal balances less the allowance for loan losses and deferred loan fees. Loan origination fees and certain direct loan origination costs are deferred and accreted/amortized as an adjustment of yield over the contractual lives of the related loans.

The Savings Bank provides an allowance for uncollected interest on loans that are contractually delinquent ninety days or more. The allowance is established by a charge to interest income equal to all interest previously accrued. Income is subsequently recognized only to the extent that cash payments are received until such collections result in the reduction of the loan's delinquent status to less than ninety days, at which time the loan is returned to accrual status.

#### **Allowance for Loan Losses**

An allowance for loan losses is maintained at a level that represents management's best estimate of losses known and inherent in the loan portfolio that are both probable and estimable. The allowance for loan losses is established through a provision for loan losses charged to operations. The allowance is reduced by loans charged off and increased by recoveries, if any, of amounts previously charged off. Management of the Savings Bank, in determining the allowance for loan losses, considers the risks inherent in its loan portfolio and changes in the nature and volume of its loan activities, along with the general economic and real estate



***MSB Financial Corp. and Subsidiaries*****Note 1 - Summary of Significant Accounting Policies (Continued)**

market conditions. The Savings Bank utilizes a two tier approach: (1) identification of impaired loans and establishment of specific loss allowances on such loans; and (2) establishment of general valuation allowances on the remainder of its loan portfolio. The Savings Bank maintains a loan review system which allows for a periodic review of its loan portfolio and the early identification of potential impaired loans. Such system takes into consideration, among other things, delinquency status, size of loans, and type of collateral and financial condition of the borrowers. Specific loan loss allowances are established for identified loans based on a review of such information and/or appraisals of the underlying collateral. General loan loss allowances are based upon a combination of factors including, but not limited to, actual loan loss experience, composition of the loan portfolio, current economic conditions and management's judgment. Although management believes that adequate specific and general loan loss allowances are established, actual losses are dependent upon future events and, as such, further additions to the level of the loan loss allowance may be necessary.

A loan evaluated for impairment is deemed to be impaired when, based on current information and events, it is probable that the Savings Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement. All loans identified as impaired are evaluated independently. The Savings Bank does not aggregate such loans for evaluation purposes. Payments received on impaired loans are applied first to accrued interest receivable and then to principal.

**Investment in Real Estate**

Investment in real estate consisted of real property originally acquired for banking operations and subsequently used as rental property. Net income from operations is recorded in operations as earned. Depreciation charges are computed on the straight line method over the estimated useful life of the property. The property was sold during the year ended June 30, 2007.

**Premises and Equipment**

Premises and equipment are comprised of land, at cost, and buildings, building improvements, furnishings and equipment and leasehold improvements, at cost, less accumulated depreciation and amortization. Depreciation and amortization charges are computed on the straight-line method over the following estimated useful lives:

	<b>Years</b>
Building and improvements	5 - 50
Furnishings and equipment	3 - 7
Leasehold improvements	Shorter of useful life or term of lease

Significant renewals and betterments are charged to the property and equipment account. Maintenance and repairs are charged to operations in the year incurred. Rental income is netted against occupancy costs in the consolidated statements of income.

**Federal Home Loan Bank Stock**

Federal law requires a member institution of the Federal Home Loan Bank system to hold restricted stock of its district Federal Home Loan Bank according to a predetermined formula. The restricted stock is carried at cost.

**Bank Owned Life Insurance**

Bank owned life insurance is carried at net cash surrender value. The change in the net asset value is recorded as a component of non-interest income.



**Note 1 - Summary of Significant Accounting Policies (Continued)**

**Defined Benefit Plans**

In September 2006, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standard (“SFAS”) No. 158, “Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans” – an Amendment of FASB Nos. 87, 88, 106 and 132(R). SFAS No. 158 requires two major changes to accounting for defined benefit and postretirement plans, with two different effective dates. The first requirement of SFAS No. 158, which the Company adopted as of June 30, 2007, requires the recognition of the over-funded and under-funded status of a defined benefit postretirement plan as an asset or liability in the consolidated statement of financial condition, with changes in the funded status recorded through other comprehensive income in the year in which those changes occur.

The second requirement of SFAS No.158, which was effective for the Company as of July 1, 2008, requires that the funded status be measured as of the entity’s fiscal year-end rather than as of an earlier date currently permitted. The Company currently uses a measurement date of April 1 for its defined benefit pension plans. The Company does not expect the adoption of the second requirement of SFAS No. 158 to have a material impact on our consolidated financial position, results of operations or cash flows.

**Stock-based Compensation Plans**

The Company adopted SFAS No. 123(R) upon approval of the MBS Financial Corp. 2008 Stock Compensation and Incentive Plan on March 10, 2008, and, accordingly, expenses the fair value of all options granted over their vesting periods and the fair value of all share-based compensation granted over the requisite service periods.

**Advertising**

The Company expenses advertising and marketing costs as incurred.

**Income Taxes**

The Company and its subsidiaries file a consolidated federal income tax return with the MHC. Federal income taxes are allocated based on the contribution of their respective income or loss to the consolidated income tax return. Separate state income tax returns are filed.

Federal and state income taxes have been provided on the basis of reported income. The amounts reflected on the income tax returns differ from these provisions due principally to temporary differences in the reporting of certain items of income and expense for financial reporting and income tax reporting purposes. Deferred income taxes are recorded to recognize such temporary differences.

Effective June 1, 2007, the Company adopted the provisions of FASB Interpretation No. 48, “Accounting for Uncertainty in Income Taxes (“FIN48”). The Interpretation provides clarification on accounting for uncertainty in income taxes recognized in an enterprise’s financial statements in accordance with SFAS No. 109, “Accounting for Income Taxes.” The Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return, and also provides guidance on derecognizing, classification, interest and penalties, accounting in interim periods, disclosure and transition. As a result of the Company’s evaluation of the implementation of FIN 48, no significant income tax uncertainties were identified. Therefore, the Company recognized no adjustment for unrecognized income tax benefits for the year ended June 30, 2008. The Company’s policy is to recognize interest and penalties on unrecognized tax benefits in income taxes expense in the consolidated statement of income. The Company did not recognize any interest and penalties for the years ended June 30, 2008 and 2007. The tax years subject to examination by the taxing authorities are the years ended June 30, 2007, 2006, and 2005.





**Note 1 – Summary of Significant Accounting Policies (Continued)**

**Off-Balance Sheet Credit-Related Financial Instruments**

In the ordinary course of business, the Company enters into commitments to extend credit, including commitments under lines of credit. Such financial instruments are recorded when they are funded.

**Earnings per Share**

Basic earnings per share is computed by dividing net income by the weighted average number of common shares outstanding, exclusive of the Employee Stock Ownership Plan (“ESOP”) shares not yet committed to be released. The 10,000 shares issued to MSB Financial, MHC in connection with the formation of the mutual holding company structure in 2004 were “replaced” with 3,091,344 shares, or 55% of the shares issued in the Company’s initial public offering, upon completion of the offering on January 4, 2007. This transaction is analogous to a stock split or significant stock dividend. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock, such as outstanding stock options, were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the Company. Diluted earnings per share is calculated by adjusting the weighted average number of shares of common stock outstanding to include the effect of contracts or securities exercisable (such as stock options) or which could be converted into common stock, if dilutive, using the treasury stock method. Diluted earnings per share did not differ from basic earnings per share for the year ended June 30, 2008, as the 39,879 weighted average number of outstanding stock options were all anti-dilutive. Diluted earnings per share did not differ from basic earnings per share for the year ended June 30, 2007 as there were no contracts or securities exercisable or which could be converted into common stock during the period.

**Other Comprehensive Income**

Other comprehensive income includes benefit plans amounts recognized under SFAS No. 158. This adjustment to other comprehensive income reflects, net of tax, transition obligations, prior service costs and unrealized net losses that had not been recognized in the consolidated financial statements prior to the implementation of SFAS No. 158. The Company has elected to report the effects of other comprehensive income in the consolidated statements of changes in stockholders’ equity.

**Interest Rate Risk**

The Savings Bank is principally engaged in the business of attracting deposits from the general public and using these deposits, together with other funds, to purchase securities and to make loans secured by real estate. The potential for interest-rate risk exists as a result of the generally shorter duration of the Savings Bank’s interest-sensitive liabilities compared to the generally longer duration of its interest-sensitive assets. In a rising rate environment, liabilities will reprice faster than assets, thereby reducing net interest income. For this reason, management regularly monitors the maturity structure of the Savings Bank’s assets and liabilities in order to measure its level of interest-rate risk and to plan for future volatility.

**Reclassification**

Certain prior year amounts have been reclassified to conform to the current year’s presentation.



**Note 2 - Stock Offering and Stock Repurchase Program**

A registration Statement on Form S-1 (File No. 333-137294), as amended, was filed by the Company with the Securities and Exchange Commission pursuant to the Securities Act of 1933, as amended, relating to the offer for sale of up to 2,199,375 shares (subject to increase to 2,529,281 shares) of its common stock at \$10.00 per share. The offering closed on January 4, 2007 and 2,529,281 shares were sold for gross proceeds of \$25,292,810, including 202,342 shares sold to the Savings Bank's newly established Employee Stock Ownership Plan ("ESOP"). Net proceeds of the offering totaled approximately \$24.5 million. Concurrent with the closing of the offering, the MHC received 3,091,344 shares of company stock in exchange for the 10,000 shares previously owned. At June 30, 2008, the MHC is the majority stockholder of the Company owning 55.6% of the Company's outstanding common stock. Prior to January 4, 2007, the MHC owned 100% of the Company's outstanding common stock.

On January 29, 2008, the Board of Directors authorized a stock repurchase program pursuant to which the Company intends to repurchase up to 5% of its outstanding shares (excluding shares held by the MHC), representing up to 126,464 shares. The timing of the repurchases will depend on certain factors, including but not limited to, market conditions and prices, the Company's liquidity requirements and alternative uses of capital. Repurchased shares are held as treasury stock and are available for general corporate purposes. During the year ended June 30, 2008, the Company purchased 55,992 shares at a cost of \$609,000 or approximately \$10.88 per share. The remaining 70,472 shares were repurchased during the period July 1, 2008 through August 11, 2008, inclusive.

On August 21, 2008, the Company announced the Board of Directors had authorized a second stock repurchase program pursuant to which the Company intends to repurchase up to an additional 5%, or 120,140 shares. The timing of the repurchases will depend on certain factors, including but not limited to, market conditions and prices, the Company's liquidity requirements and alternative uses of capital. Repurchased shares are held as treasury stock and are available for general corporate purposes.

**Note 3 - Securities Held to Maturity**

The amortized cost of securities held to maturity and their approximate fair values are summarized as follows:

	<b>Amortized Cost (In thousands)</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b>Fair Value</b>
<b>June 30, 2008:</b>				
U.S. Government agencies	\$ 24,023	\$ 2	\$ 585	\$ 23,440
Mortgage-backed securities	4,720	47	12	4,755
	\$ 28,743	\$ 49	\$ 597	\$ 28,195
<b>June 30, 2007:</b>				
U.S. Government agencies	\$ 24,120	\$ —	\$ 637	\$ 23,483
Mortgage-backed securities	5,216	36	51	5,201
	\$ 29,336	\$ 36	\$ 688	\$ 28,684

All mortgage-backed securities at June 30, 2008 and 2007 have been issued by FNMA, FHLMC or GNMA.

The amortized cost and estimated fair value of securities held to maturity at June 30, 2008, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	<b>Amortized Cost (In Thousands)</b>	<b>Fair Value</b>
U.S. Government agencies:		
Due within one year	\$ —	\$ —
Due after one year through five years	—	—
Due after five years through ten years	2,000	2,001
Due thereafter	22,023	21,439
	24,023	23,440
Mortgage-backed securities		
	4,720	4,755
	\$ 28,743	\$ 28,195



**Note 3 - Securities Held to Maturity (Continued)**

There were no sales of securities held to maturity during the years ended June 30, 2008 and 2007. At June 30, 2008 and 2007, securities held to maturity with a carrying value of approximately \$467,000 and \$474,000, respectively, were pledged to secure public funds on deposit.

The following table shows the gross unrealized losses and fair value of securities in an unrealized loss position, and the length of time that such securities have been in a continuous unrealized loss position:

	Less than 12 Months		More than 12 Months		Total	Gross Unrealized Losses
	Fair Value (In Thousands)	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses		
<b>June 30, 2008:</b>						
U.S. Government agencies	\$ 17,996	\$ 585	\$ 4,000	\$ —	\$ 21,996	\$ 585
Mortgage-backed securities	—	—	1,120	12	1,120	12
	\$ 17,996	\$ 585	\$ 5,120	\$ 12	\$ 23,116	\$ 597
<b>June 30, 2007:</b>						
U.S. Government agencies	\$ 1,977	\$ 23	\$ 21,477	\$ 614	\$ 23,454	\$ 637
Mortgage-backed securities	194	3	1,030	48	1,224	51
	\$ 2,171	\$ 26	\$ 22,507	\$ 662	\$ 24,678	\$ 688

At June 30, 2008, management concluded that the unrealized losses above (which related to 8 U.S. Government Agency bonds and 2 mortgage-backed securities compared to 13 and 4 respectively, as of June 30, 2007) are temporary in nature since they are not related to the underlying credit quality of the issuers and the Company has the ability and intent to hold these securities for a time necessary to recover their cost. The losses above are primarily related to market interest rates.

**Note 4 - Loans Receivable**

The composition of loans receivable at June 30, 2008 and 2007 is as follows:

	<b>2008</b>		<b>2007</b>
	<b>(In Thousands)</b>		
Real estate mortgage:			
One-to-four family	\$ 145,868		\$ 123,601
Commercial	30,068		28,989
	175,936		152,590
Real estate construction	17,771		23,822
Consumer:			
Deposit accounts	518		1,140
Equity	54,778		55,896
Automobile	485		596
Personal	80		99
Overdraft protection	176		160
	56,037		57,891
Commercial	9,285		8,338
<b>Total Loans</b>	<b>259,029</b>		<b>242,641</b>
Loans in process	(3,568 )		(7,999 )
Allowance for loan losses	(1,025 )		(926 )
Deferred loan fees	(146 )		(218 )
	<b>\$ 254,290</b>		<b>\$ 233,498</b>

The following table presents changes in the allowance for loan losses for the years ended June 30, 2008 and 2007:

	<b>2008</b>		<b>2007</b>
	<b>(In Thousands)</b>		
Balance, beginning	\$ 926		\$ 921
Provision charged to operations	135		5
Loans charged off	(42 )		(3 )
Recoveries of loans previously charged off	6		3
Balance, ending	<b>\$ 1,025</b>		<b>\$ 926</b>





**Note 4 - Loans Receivable (Continued)**

At June 30, 2008 and 2007, the Savings Bank had loans in the amount of \$2.7 million and \$634,000, respectively, that were considered to be impaired. At June 30, 2008, \$936,000 of the loans deemed impaired were subject to specific loss reserves totaling \$114,000. There were no specific loss reserves on impaired loans at June 30, 2007. The average balances of impaired loans outstanding during the years ended June 30, 2008 and 2007, were \$1.7 million and \$634,000, respectively. Interest income recorded on impaired loans during the year ended June 30, 2008, was \$161,000 and not significant during the year ended June 30, 2007. Loans on which the accrual of interest has been discontinued amounted to \$2,936,000 and \$1,582,000 at June 30, 2008 and 2007, respectively. During the years ended June 30, 2008 and 2007, \$169,000 and \$94,000, respectively, in interest was collected and recognized on these loans. During the years ended June 30, 2008 and 2007, had all such loans been performing in accordance with their original terms, interest income of \$186,000 and \$132,000, respectively, would have been recognized. The Savings Bank is not committed to lend additional funds on these non-accrual loans. At June 30, 2008 and 2007, the Savings Bank had loans which were ninety days or more delinquent and still accruing interest of \$2.2 million and \$767,000, respectively. Such loans were considered to be well collateralized.

**Note 5 - Premises and Equipment**

The components of premises and equipment at June 30, 2008 and 2007 are as follows:

	<b>2008</b>		<b>2007</b>
	<b>(In Thousands)</b>		
Land	\$ 671		\$ 671
Buildings and improvements	3,180		3,169
Leasehold improvements	1,768		1,768
Furnishings and equipment	2,676		2,612
Assets being developed for future use	6,377		4,071
	14,672		12,291
Accumulated depreciation and amortization	(3,913	)	(3,384
	\$ 10,759		\$ 8,907

Depreciation and amortization expense on premises and equipment totaled \$529,000 and \$518,000 during the years ended June 30, 2008 and 2007, respectively.

Assets being developed for future use include \$3,725,000 in property purchased and \$2.4 million in renovation costs related to a facility that was placed in service in August 2008.

**Note 6 - Accrued Interest Receivable**

The components of interest receivable at June 30, 2008 and 2007 are as follows:

	<b>2008</b>		<b>2007</b>
	<b>(In Thousands)</b>		
Loans	\$ 1,238		\$ 1,170
Securities held to maturity	442		343

\$ 1,680

\$ 1,513

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**Note 7 - Deposits**

Deposits at June 30, 2008 and 2007 consist of the following major classifications:

	2008			2007		
	Amount	Average Rate		Amount	Average Rate	
	(Dollars in Thousands)					
Non-interest bearing demand NOW	\$ 10,027	—	%	\$ 8,217	—	%
Super NOW	24,860	.72		25,224	1.02	
Savings and club	1,377	.80		1,214	1.00	
Money market demand	66,219	2.52		46,499	2.37	
Certificates of deposit	1,379	.95		1,582	1.15	
	121,509	4.28		128,382	4.88	
	\$ 225,371	3.14	%	\$ 211,118	3.62	%

A summary of certificates of deposit by maturity at June 30, 2008 is as follows (in thousands):

Year ended June 30:	
2009	\$ 96,706
2010	9,871
2011	2,275
2012	1,995
2013	3,288
Thereafter	7,374
	\$ 121,509

The aggregate amount of certificates of deposit with a minimum denomination of \$100,000 was \$42,519,000 and \$44,708,000 at June 30, 2008 and 2007, respectively. Generally, deposits in excess of \$100,000 are not insured by the FDIC.

A summary of interest expense for the years ended June 30, 2008 and 2007 is as follows:

	2008	2007
	(In Thousands)	
Demand	\$ 241	\$ 279
Savings and club	1,267	896
Certificates of deposit	6,170	5,552
	\$ 7,678	\$ 6,727

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**Note 8 - Advances from Federal Home Loan Bank of New York**

The Savings Bank has various credit facilities with the Federal Home Loan Bank, which expire on July 31, 2008, and provide borrowings up to \$66,538,000. The Savings Bank has subsequently renewed its borrowing agreement with the Federal Home Loan Bank through the period ending July 31, 2009, with borrowings up to \$54,000,000. Short-term borrowings against this facility totaled \$0 and \$16,000,000 as of June 30, 2008 and 2007, respectively. The interest rate on short-term borrowings at June 30, 2007 was 5.49%. Long-term debt due to the Federal Home Loan Bank at June 30, 2008 and 2007 consisted of the following:

Maturity	Fixed Interest Rate	2008 (In Thousands)	2007
August 10, 2009	4.641 %	\$ 6,000	\$ —
August 11, 2009	3.600	1,068	1,889
December 30, 2009	4.250	5,000	5,000
June 1, 2010	4.280	5,000	5,000
November 27, 2017	3.272	10,000	—
March 15, 2018	3.460	10,000	—
	3.822 %	\$ 37,068	\$ 11,889

The advances are secured by a blanket assignment of unpledged and qualifying mortgage loans.

**Note 9 - Lease Commitments and Total Rental Expense**

The Savings Bank leases three branch locations under long-term operating leases. Future minimum lease payments by year and in the aggregate, under noncancellable operating leases with initial or remaining terms of one year or more, consisted of the following at June 30, 2008 (in thousands):

Year Ended June 30:	
2009	\$ 350
2010	361
2011	361
2012	375
2013	286
Thereafter	1,196
	\$ 2,929

The minimum payments have not been reduced by minimum sublease rentals of \$435,000 due in the future under noncancellable subleases.

The total rental expense for all leases for the years ended June 30, 2008 and 2007 was approximately \$344,000 and \$420,000, respectively.



**Note 10 - Income Taxes**

The income tax provision consists of the following for the years ended June 30, 2008 and 2007:

	<b>2008</b>		<b>2007</b>
	<b>(In Thousands)</b>		
Current:			
Federal	\$ 383		\$ 755
State	123		232
	506		987
Deferred:			
Federal	(143 )		(131 )
State	(48 )		(36 )
	(191 )		(167 )
	\$ 315		\$ 820

A reconciliation of the statutory federal income tax at a rate of 34% to the income tax expense included in the statements of income at June 30, 2008 and 2007, is as follows:

	<b>2008</b>			<b>2007</b>		
	<b>Amount</b>	<b>% of Pretax Income</b>		<b>Amount</b>	<b>% of Pretax Income</b>	
	<b>(Dollars in Thousands)</b>					
Federal income tax at statutory rate	\$ 315	34.0	%	\$ 732	34.0	%
State tax, net of federal benefit	50	5.4		129	6.0	
Bank Owned Life Insurance	(54 )	(5.8 )		(52 )	(2.4 )	
Other	4	0.4		11	0.5	
	\$ 315	34.0	%	\$ 820	38.1	%

**Note 10 - Income Taxes (Continued)**

The components of the net deferred tax asset at June 30, 2008 and 2007 are as follows:

	<b>2008</b>	<b>2007</b>
	<b>(In Thousands)</b>	
Deferred tax assets:		
Depreciation	\$ 160	\$ 84
Allowances for losses on loans and commitments	423	385
Uncollected interest	30	21
Benefit plans	462	410
Accumulated other comprehensive income-benefit plans	1	35
Other	35	21
	1,111	956
Deferred tax liabilities – Other	—	2
<b>Net Deferred Tax Asset</b>	<b>\$ 1,111</b>	<b>\$ 954</b>

Retained earnings include \$1,466,000 at June 30, 2008 and 2007, for which no provision for income tax has been made. These amounts represent deductions for bad debt reserves for tax purposes which were only allowed to savings institutions which met certain definitional tests prescribed by the Internal Revenue Code of 1986, as amended. The Small Business Job Protection Act of 1996 eliminated the special bad debt deduction granted solely to thrifts. Under the terms of the Act, there would be no recapture of the pre-1988 (base year) reserves. However, these pre-1988 reserves would be subject to recapture under the rules of the Internal Revenue Code if the Savings Bank itself pays a cash dividend in excess of earnings and profits, or liquidates. The Act also provides for the recapture of deductions arising from “applicable excess reserve” defined as the total amount of reserve over the base year reserve. The Savings Bank’s total reserve exceeds the base year reserve and deferred taxes have been provided for this excess.



**Note 11 - Benefit Plans****Directors' Retirement Plan**

The Savings Bank has a Directors' Retirement Plan, which provides that any Director meeting specified age and service requirements may retire and continue to be paid. This plan is unfunded.

The following table sets forth the plan's funded status and activity for the years ended June 30, 2008 and 2007:

	<b>2008</b>		<b>2007</b>
	<b>(Dollars In Thousands)</b>		
Actuarial present value of benefit obligations	\$ 685		\$ 621
Projected benefit obligation – beginning	\$ 743		\$ 634
Service cost	26		23
Interest cost	46		39
Actuarial (gain) loss	(10	)	71
Annuity payment	(24	)	(24
			)
Projected benefit obligation – ending	\$ 781		\$ 743
Plan assets at fair value – beginning	\$ —		\$ —
Employer contribution	24		24
Settlements/payments	(24	)	(24
			)
Plan assets at fair value – ending	\$ —		\$ —
Projected benefit obligation in excess of assets at fair value	\$ 781		\$ 743
Amount contributed in the fourth quarter	(6	)	(6
			)
Accrued pension cost included in other liabilities	\$ 775		\$ 737
Assumptions:			
Discount rate	6.75	%	6.38
Fee increase	4.00	%	3.75
			%

**Note 11 - Benefit Plans (Continued)**

**Directors' Retirement Plan (Continued)**

Net periodic pension cost for the years ended June 30, 2008 and 2007, included the following:

	<b>2008</b>		<b>2007</b>	
	<b>(Dollars In Thousands)</b>			
Service cost	\$ 26		\$ 23	
Interest cost	46		39	
Amortization of unrecognized past service liability	11		13	
 Net periodic plan cost	 \$ 83		 \$ 75	
 Assumptions:				
Discount rate	6.38	%	6.25	%
Fee increase	3.75	%	3.25	%

For the year ended June 30, 2009, the Savings Bank expects to contribute \$37,000 to the plan.

Estimated future benefit payments for years ending June 30, which reflect expected future service, as appropriate, are as follows (in thousands):

2009	\$	37
2010		38
2011		64
2012		73
2013		80
2014 - 2018	\$	532

As of June 30, 2008 and 2007, unrecognized past service liabilities and actuarial losses aggregating \$120,000 and \$142,000, respectively, were included, net of income taxes of \$48,000 and \$57,000, respectively, in accumulated other comprehensive income. Approximately \$11,000 of this amount is expected to be recognized as a component of net periodic plan cost during the year ending June 30, 2009.

**Note 11 - Benefit Plans (Continued)**

**Executive Incentive Retirement Plan**

The Savings Bank has an unfunded, non-qualified executive incentive retirement plan covering all eligible executives. The plan provides for either a lump sum payment or equal annual installments for a period of fifteen years commencing on the first day of the calendar month following the termination of employment due to retirement, resignation, disability or death. The amount payable is based on the vested balance of the executive's accumulated awards plus interest. The annual awards are based upon the executive's base salary in effect at the beginning of the plan year and the Savings Bank's net income for the prior fiscal year. The percentage vested is based on the sum of the executive's age and years of service.

The following table sets forth the plan's funded status and activity for the years ended June 30, 2008 and 2007:

	<b>2008</b>		<b>2007</b>
	<b>(Dollars In Thousands)</b>		
Actuarial present value of benefit obligations	\$ 267		\$ 234
Projected benefit obligation – beginning	\$ 234		\$ 216
Service cost	87		79
Interest cost	15		14
Actuarial (gain) loss	(69 )		(75 )
Projected benefit obligation – ending (accrued pension cost included in other liabilities)	\$ 267		\$ 234
Assumptions:			
Discount rate	6.75 %		6.38 %
Fee increase	4.00 %		3.75 %

Net periodic plan cost for the years ended June 30, 2008 and 2007, included the following:

	<b>2008</b>		<b>2007</b>
	<b>(Dollars In Thousands)</b>		
Service Cost	\$ 87		\$ 79
Interest Cost	15		14
Amortization of unrecognized (gain)	(4 )		—
Net periodic plan cost	\$ 98		\$ 93
Assumptions:			
Discount rate	6.38 %		6.25 %
Salary increase rate	3.75 %		3.25 %



**Note 11 - Benefit Plans (Continued)**

**Executive Incentive Retirement Plan (Continued)**

For the year ending June 30, 2009, the Savings Bank expects to contribute \$14,000 to the plan. There were no contributions made to the plan for the years ended June 30, 2008 and June 30 2007, respectively.

Estimated future benefit payments for the years ending June 30, which reflect expected future service, as appropriate, are as follows:

2009	\$	14
2010		222
2011		5
2012		9
2013		9
2014 – 2018		172

As of June 30, 2008 and 2007, actuarial gains of \$119,000 and \$54,000, respectively, were included, net of income taxes of \$47,000 and \$22,000, respectively, in accumulated other comprehensive income. Approximately \$13,000 of this amount is expected to be recognized as a component of net periodic plan cost during the year ending June 30, 2009.

**401(k) Savings and Profit Sharing Plan**

The Savings Bank sponsors a savings and profit sharing plan, pursuant to Section 401(k) of the Internal Revenue Code (“IRC”), for all eligible employees. The plan has a profit sharing component paid annually by the Savings Bank of 5% (11% for the calendar year 2006) of each eligible employee’s compensation. Employees may also elect to defer up to 80% of their compensation, subject to IRC limitations. The Savings Bank will match 50% of the first 6% of the employee’s salary deferral up to a maximum of 3% of each employee’s compensation. The Plan expense amounted to approximately \$69,000 and \$273,000 for the years ended June 30, 2008 and 2007, respectively.

**Employee Stock Ownership Plan**

Effective upon completion of the Company’s initial public stock offering in January 2007, the Savings Bank established an Employee Stock Ownership Plan (“ESOP”) for all eligible employees who complete a twelve-month period of employment with the Savings Bank, have attained the age of 21 and have completed at least 1,000 hours of service in a plan year. The ESOP used \$2,023,420 in proceeds from a term loan obtained from the Company to purchase 202,342 shares of Company common stock. The term loan principal is payable over 48 equal quarterly installments through December 31, 2018. The interest rate on the term loan is 8.25%. Each quarter, the Savings Bank intends to make discretionary contributions to the ESOP, which will be equal to principal and interest payments required on the term loan. The ESOP may further pay down the loan with dividends paid, if any, on the Company common stock owned by the ESOP.

Shares purchased with the loan proceeds provide collateral for the term loan and are held in a suspense account for future allocations among participants. Base compensation is the basis for allocation to participants of contributions to the ESOP and shares released from the suspense account, as described by the Plan, in the year of allocation.



**Note 11 - Benefit Plans (Continued)**

The ESOP is accounted for in accordance with Statement of Position 93-6, "Accounting for Employee Stock Ownership Plans," which was issued by the American Institute of Certified Public Accountants. Accordingly, ESOP shares pledged as collateral were initially recorded as unearned ESOP shares in the consolidated statements of financial condition. Thereafter, on a monthly basis, 1,405 shares are committed to be released, compensation expense is recorded equal to the number of shares committed to be released times the monthly average market price of the shares, and the committed shares become outstanding for basic earnings per common share computations. ESOP compensation expense was approximately \$175,000 and \$97,000 for the years ended June 30, 2008 and 2007, respectively.

ESOP shares at June 30 are summarized as follows:

	2008	2007
Allocated shares	16,862	—
Shares committed to be released	8,431	8,431
Unearned shares	177,049	193,911
<b>Total ESOP Shares</b>	<b>202,342</b>	<b>202,342</b>
Fair value of unearned shares	\$ 1,928,066	\$ 2,181,500

**Stock-Based Compensation**

At the Company's annual stockholders' meeting held on March 10, 2008, stockholders of the Company approved the MSB Financial Corp. 2008 Stock Compensation and Incentive Plan. Under this plan, the Company may grant options to purchase up to 275,410 shares of Company common stock. At June 30, 2008, there were no shares remaining for future option grants under the plan.

On May 9, 2008, options to purchase 275,410 shares of common stock at \$10.75 per share were awarded and will expire no later than ten years following the grant date. The options granted vest over a five-year service period, with 20% of the awards vesting on each anniversary date of grant. The fair value of the options granted, as computed using the Black-Scholes option-pricing model, was determined to be \$2.99 per option based upon the following underlying assumptions: a risk-free interest rate, expected option life, expected stock price volatility, and dividend yield of 3.33%, 6.5 years, 24.23%, and 1.11%, respectively.

The risk-free interest rate was based on the U.S. Treasury yield at the option grant date for securities with a term matching the expected life of the options granted. The expected life was calculated using the "simplified" method provided for under Staff Accounting Bulletin No. 110 as the Company has no prior option experience to draw upon. Expected volatility was calculated based upon the actual price history of the Company's common stock up until the date of the option grants. The dividend yield was calculated based upon the most recent annualized cash dividend declared by the Company and the market value of the Company's common stock at the grant date.

Management recognizes compensation expense for the fair value of the options, which have graded vesting, on a straight-line basis over the requisite service period of the awards. During the year ended June 30, 2008, approximately \$27,000 in stock option expense was recorded along with income tax benefits of \$4,000.

**Note 11 - Benefit Plans (Continued)**

A summary of stock option activity follows:

	<b>Options</b>	<b>Weighted Average Exercise Price</b>	<b>Weighted Average Remaining Contractual Term</b>	<b>Aggregate Intrinsic Value</b>
Outstanding at June 30, 2007	—			
Granted	<b>275,410</b>	<b>\$ 10.75</b>		
Outstanding at June 30, 2008	<b>275,410</b>	<b>10.75</b>	<b>9.8 years</b>	<b>\$ 33,049</b>
Exercisable at June 30, 2008	—			

Shares issued upon the exercise of stock options are planned to be issued from treasury stock. Expected future compensation expense relating to the 275,410 non-vested options outstanding at June 30, 2008 is \$796,000 over a weighted average period of 4.8 years.

**Note 12 - Transactions with Officers and Directors**

The Savings Bank has had, and may be expected to have in the future, banking transactions in the ordinary course of business with its officers, directors, their immediate families, and affiliated companies (commonly referred to as related parties), on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with others. These persons were indebted to the Savings Bank for loans totaling \$8,819,000 and \$8,016,000 at June 30, 2008 and 2007, respectively. During the year ended June 30, 2008, \$4,605,000 of new loans and \$3,802,000 of repayments were made.

**Note 13 - Regulatory Capital**

The Savings Bank is subject to various regulatory capital requirements administered by Federal and State banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Savings Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Savings Bank must meet specific capital guidelines that involve quantitative measures of the Savings Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Savings Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weighting, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Savings Bank to maintain minimum amounts and ratios (set forth in the table below) of tangible, core and risk-based capital as defined in the regulations. Management believes, as of June 30, 2008 and 2007, that the Savings Bank met all capital adequacy requirements to which it is subject.

As of January 18, 2006, the most recent notification from the regulators categorized the Savings Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Savings Bank must maintain minimum core, Tier 1 risk-based and total risk-based ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed the institution's category.





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**Note 13 - Regulatory Capital (Continued)**

The following tables present a reconciliation of capital per GAAP and regulatory capital and information as to the Savings Bank's capital levels at the dates presented:

	<b>June 30, 2008</b>	<b>2007</b>
	<b>(In Thousands)</b>	
GAAP capital	\$ 31,802	\$ 30,889
Investment in subsidiary	(641 )	(641 )
Accumulated other comprehensive loss	1	53
Core and tangible capital	31,162	30,301
Allowance for loan loss	1,025	926
Allowance for loan commitments	34	37
Total Capital	\$ 32,221	\$ 31,264

	<b>Actual</b>		<b>For Capital Adequacy Purposes</b>		<b>To be Well Capitalized under Prompt Corrective Action Provisions</b>	
					<b>Amount</b>	<b>Ratio</b>
	<b>Amount</b>	<b>Ratio</b>	<b>Amount</b>	<b>Ratio</b>	<b>Amount</b>	<b>Ratio</b>
	(Dollars In Thousands)					
<b>June 30, 2008:</b>						
Tangible	\$ 31,162	10.06%	\$ ≥ 4,647	≥1.50%	N/A	N/A
Core (leverage)	31,162	10.06	≥12,391	≥4.00	\$ ≥15,489	≥ 5.00%
Tier 1 risk-based	31,162	15.01	N/A	N/A	≥12,458	≥ 6.00
Total risk-based	32,221	15.52	≥16,610	≥8.00	≥20,763	≥10.00
<b>June 30, 2007:</b>						
Tangible	\$ 30,301	10.68%	\$ ≥ 4,257	≥1.50%	N/A	N/A
Core (leverage)	30,301	10.68	≥11,352	≥4.00	\$ ≥14,190	≥ 5.00%
Tier 1 risk-based	30,301	15.67	N/A	N/A	≥11,601	≥ 6.00
Total risk-based	31,264	16.17	≥15,468	≥8.00	≥19,336	≥10.00

**Note 14 - Commitments and Contingencies**

The Savings Bank 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 include commitments to extend credit and letters of credit. Such commitments involve, to varying degrees, elements of credit, and interest rate risk in excess of the amount recognized in the statements of financial condition.

The Savings Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and letters of credit is represented by the contractual amount of those instruments. The Savings Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.



**Note 14 - Commitments and Contingencies (Continued)**

At June 30, 2008 and 2007, the following financial instruments were outstanding whose contract amounts represent credit risk:

	<b>2008</b>	<b>2007</b>
	<b>(In Thousands)</b>	
Commitments to grant loans	\$ 7,401	\$ 2,475
Unfunded commitments under lines of credit	28,361	25,876
Standby letters of credit	268	298
	\$ 36,030	\$ 28,649

At June 30, 2008, the commitments to grant loans included \$2,821,000 of fixed rate mortgage loans with interest rates ranging from 5.25% to 6.75% and \$4,580,000 of variable rate construction loans with an initial interest rate ranging from 5.00% to 6.00%. Of the unfunded commitments under lines of credit at June 30, 2008, \$24,139,000 was available under a homeowner's equity lending program, \$466,000 was available under an overdraft protection lending program and \$3,756,000 was available under commercial lines of credit. Amounts outstanding under these programs were assessed interest ranging from 1.00% below the prime rate to 4.00% over the prime rate. At June 30, 2008, amounts issued on standby performance letters of credit were assessed an issuance fee equal to 1.00% of the face amount of such letter of credit.

At June 30, 2007, the commitments to grant loans included \$1,475,000 of fixed rate mortgage loans with interest rates ranging from 6.00% to 8.25% and \$1,000,000 of variable rate construction loans with an initial interest rate of 8.25%. Of the unfunded commitments under lines of credit at June 30, 2007, \$20,979,000 was available under a homeowner's equity lending program, \$462,000 was available under an overdraft protection lending program and \$4,435,000 was available under commercial lines of credit. Amounts outstanding under these programs were assessed interest ranging from 0.50% below the prime rate to 4.00% over the prime rate. At June 30, 2007, amounts drawn on standby letters of credit were assessed rates of 2.00% over the rate being earned on the passbook collateralizing the credit.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Savings Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Savings Bank upon extension of credit, is based on management's credit evaluation. Collateral held varies but primarily includes residential and income-producing commercial real estate properties.

Standby letters of credit are conditional commitments issued by the Savings Bank to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending other loan commitments. The Savings Bank requires collateral supporting these letters of credit when deemed necessary. Management believes that the proceeds obtained through a liquidation of such collateral would be sufficient to cover the maximum potential amount of future payments required under the corresponding guarantees. The amount of the liability as of June 30, 2008 and 2007 for guarantees under standby letters of credit issued is not material.

At June 30, 2008, the Company had commitments for building improvements in the amount of approximately \$2.4 million.

**Note 15 - Fair Value of Financial Instruments**

The fair value of a financial instrument is defined as the amount at which the instrument could be exchanged in a current transaction between willing parties, other than a forced liquidation sale. Significant estimations were used for the purposes of this disclosure. Estimated fair values have been determined using the best available data and estimation methodology suitable for each category of financial instruments. However, there are inherent weaknesses in any estimation technique. Therefore, for substantially all financial instruments, the fair value estimates herein are not necessarily indicative of the amounts the Savings Bank could have realized in a sales transaction on the dates indicated. The estimated fair value amounts have been measured as of their respective year ends, and have not been reevaluated or updated for purposes of these financial statements subsequent to those respective dates. As such, the estimated fair values of these financial instruments subsequent to the respective reporting dates may be different than the amounts reported at each year end.

The following information should not be interpreted as an estimate of the fair value of the entire Savings Bank since a fair value calculation is only provided for a limited portion of the Savings Bank's assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Savings Bank's disclosures and those of other companies may not be meaningful. The fair value estimates, methods and assumptions for financial instruments are set forth below.

**Cash and Cash Equivalents**

For cash and cash equivalents, the carrying amount is a reasonable estimate of fair value.

**Securities Held to Maturity and Trading Securities**

The fair values for securities held to maturity and trading securities are based on quoted market prices, where available. If quoted market prices are not available, fair value is estimated using quoted market prices for similar securities.

**Loans Receivable**

The fair value of loans receivable is estimated by discounting future cash flows, using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities, of such loans.

**Federal Home Loan Bank Stock**

The carrying amount of Federal Home Loan Bank stock approximates fair value.

**Accrued Interest Receivable and Payable**

The carrying amounts of accrued interest receivable and payable approximate fair value.

**Deposits**

Fair values for demand deposits, savings accounts and club accounts are, by definition, equal to the amount payable on demand at the reporting date. Fair values of fixed-maturity certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on similar instruments with similar maturities.

**Short-Term Borrowings and Long-term Debt**

Fair values of borrowings are estimated using discounted cash flow analyses, based on rates currently available to the Savings Bank for advances from the Federal Home Loan Bank with similar terms and remaining maturities.

**Note 15 - Fair Value of Financial Instruments (Continued)****Off-Balance Sheet Financial Instruments**

Fair values of commitments to extend credit are estimated using the fees currently charged to enter into similar agreements, taking into account market interest rates, the remaining terms, and the present credit worthiness of the counterparties.

As of June 30, 2008 and 2007, the fair value of the commitments to extend credit was not considered to be material.

The carrying amounts and estimated fair values of financial instruments at June 30, 2008 and 2007 are as follows:

	<b>2008</b>	<b>Estimated</b>	<b>2007</b>	<b>Estimated</b>
	<b>Carrying</b>	<b>Fair</b>	<b>Carrying</b>	<b>Fair</b>
	<b>Amount</b>	<b>Value</b>	<b>Amount</b>	<b>Value</b>
	<b>(In Thousands)</b>			
Financial assets:				
Cash and cash equivalents	\$ 4,695	\$ 4,695	\$ 4,269	\$ 4,269
Trading securities	82	82	114	114
Securities held to maturity	28,743	28,195	29,336	28,684
Loans receivable	254,290	254,325	233,498	233,526
Federal Home Loan Bank stock	2,112	2,112	1,669	1,669
Accrued interest receivable	1,680	1,680	1,513	1,513
Financial liabilities:				
Deposits	225,371	226,468	211,118	211,611
Advances from Federal Home Loan Bank of New York	37,068	38,874	27,889	27,861
Accrued interest payable	176	176	116	116

**Note 16 - Parent Only Financial Statements****Statements of Financial Condition**

	<b>June 30, 2008</b>	<b>2007</b>
	<b>(In Thousands)</b>	
<b>Assets</b>		
Cash and due from banks	\$9,762	\$ 10,470
Loans receivable	1,865	1,973
Investment in subsidiaries	31,802	30,889
Other assets	43	38
<b>Total Assets</b>	<b>\$43,472</b>	<b>\$43,370</b>
<b>Liabilities</b>		
Other liabilities	\$76	\$24
<b>Total liabilities</b>	<b>76</b>	<b>24</b>
<b>Stockholders' Equity</b>		
Stockholders' equity:		
Common stock	562	562
Paid-in capital	24,188	24,153
Unearned ESOP	(1,770 )	(1,939 )
Retained earnings	21,026	20,623
Treasury Stock	(609 )	—
Accumulated other comprehensive loss	(1 )	(53 )
<b>Total Stockholders' Equity</b>	<b>43,396</b>	<b>43,346</b>
<b>Total Liabilities and Stockholders' Equity</b>	<b>\$43,472</b>	<b>\$43,370</b>

**Statements of Income**

	<b>Years Ended June 30,</b>	
	<b>2008</b>	<b>2007</b>
	<b>(In Thousands)</b>	
Equity in undistributed earnings of subsidiaries	\$659	\$ 1,325
Interest income	159	83
Non-interest expense	(238 )	(58 )
<b>Income Before Income Taxes</b>	<b>580</b>	<b>1,350</b>
Income tax (benefit) expense	(32 )	18
<b>Net Income</b>	<b>\$612</b>	<b>\$ 1,332</b>





## Note 16 - Parent Only Financial Statements (Continued)

## Statements of Cash Flows

	<b>Years Ended June 30,</b>	
	<b>2008</b>	<b>2007</b>
	<b>(In Thousands)</b>	
<b>Cash Flows from Operating Activities</b>		
Net income	\$ 612	\$ 1,332
Adjustments to reconcile net income to net cash used in operating activities:		
Equity in undistributed earnings of subsidiaries	(659 )	(1,325 )
Net change in other assets and liabilities	(20 )	(14 )
<b>Net Cash (Used in) Operating Activities</b>	<b>(67 )</b>	<b>(7 )</b>
<b>Cash Flows from Investing Activities</b>		
Purchase of common stock of savings bank	—	(10,228 )
ESOP loan	—	(2,023 )
Repayment of ESOP loan receivable	108	50
<b>Net Cash Provided by (Used in) Investing Activities</b>	<b>108</b>	<b>(12,201 )</b>
<b>Cash Flows from Financing Activities</b>		
Proceeds from initial public stock offering	—	24,502
Common stock acquired by the ESOP	—	(2,023 )
Dividends paid to minority stockholders	(140 )	—
Purchase of treasury stock	(609 )	—
<b>Net Cash Provided by (Used in) Financing Activities</b>	<b>(749 )</b>	<b>22,479</b>
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	<b>(708 )</b>	<b>10,271</b>
<b>Cash and Cash Equivalents - Beginning</b>	<b>10,470</b>	<b>199</b>
<b>Cash and Cash Equivalents - Ending</b>	<b>\$ 9,762</b>	<b>\$ 10,470</b>

**Note 17 - Quarterly Results of Operations (Unaudited)**

The following is a condensed summary of quarterly results of operations for the years ended June 30, 2008 and 2007:

	<b>Year Ended June 30, 2008</b>			
	<b>First</b>	<b>Second</b>	<b>Third</b>	<b>Fourth</b>
	<b>Quarter</b>	<b>Quarter</b>	<b>Quarter</b>	<b>Quarter</b>
	<b>(In Thousands, Except Per Share Data)</b>			
Interest income	\$ 4,103	\$ 4,199	\$ 4,176	\$ 4,148
Interest expense	2,280	2,328	2,258	2,176
<b>Net Interest Income</b>	1,823	1,871	1,918	1,972
Provision for loan losses	15	40	40	40
<b>Net Interest Income after Provision for Loan Losses</b>	1,808	1,831	1,878	1,932
Non-interest income	159	165	119	125
Non-interest expenses	1,783	1,635	1,736	1,936
<b>Income before Income Taxes</b>	184	361	261	121
Income taxes	58	127	91	39
<b>Net Income</b>	\$ 126	\$ 234	\$ 170	\$ 82
Earnings per share:				
Basic and diluted	\$ 0.02	\$ 0.04	\$ 0.03	\$ 0.02

**Note 17 - Quarterly Results of Operations (Unaudited) (Continued)**

	Year Ended June 30, 2007			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	(In Thousands, Except Per Share Data)			
Interest income	\$3,874	\$4,041	\$4,102	\$4,114
Interest expense	2,195	2,310	2,081	2,227
<b>Net Interest Income</b>	1,679	1,731	2,021	1,887
Provision for loan losses	—	—	—	5
<b>Net Interest Income after Provision for Loan Losses</b>	1,679	1,731	2,021	1,882
Non-interest income	153	163	1,120	143
Non-interest expenses	1,611	1,625	1,720	1,784
<b>Income before Income Taxes</b>	221	269	1,421	241
Income taxes	78	97	562	83
<b>Net Income</b>	\$143	\$172	\$859	\$158
Earnings per share:				
Basic and diluted	\$0.05	\$0.06	\$0.16	\$0.03

**Note 18 – Recent Accounting Pronouncements**

In September 2006, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standards (“SFAS”) No. 157, “Fair Value Measurements”, which defines fair value, establishes a framework for measuring fair value under GAAP, and expands disclosures about fair value measurements. SFAS No. 157 applies to other accounting pronouncements that require or permit fair value measurements. The new guidance is effective for financial statements issued for fiscal years beginning after November 15, 2007, and for interim periods within those fiscal years. The Company does not expect the adoption of SFAS No. 157 to have a material impact on its financial condition, results of operations or cash flows.

In February 2007, the FASB issued SFAS No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities-Including an amendment of FASB Statement No. 115.” SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. Unrealized gains and losses on items for which the fair value option has been elected will be recognized in earnings at each subsequent reporting date. SFAS No. 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and for interim periods within those fiscal years. The Company does not expect the adoption of SFAS No. 159 to have a material impact on its financial condition, results of operations or cash flows.

In September 2006, the FASB’s Emerging Issues Task Force (“EITF”) issued EITF Issue No. 06-4, “Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split Dollar Life Insurance Arrangements” (“EITF 06-4”). EITF 06-4 requires the recognition of a liability related to the postretirement

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**Note 18 – Recent Accounting Pronouncements (Continued)**

benefits covered by an endorsement split-dollar life insurance arrangement. The consensus highlights that the employer (who is also the policyholder) has a liability for the benefit it is providing to its employee. As such, if the policyholder has agreed to maintain the insurance policy in force for the employee's benefit during his or her retirement, then the liability recognized during the employee's active service period should be based on the future cost of insurance to be incurred during the employee's retirement. Alternatively, if the policy holder has agreed to provide the employee with a death benefit, then the liability for the future death benefit should be recognized by following the guidance in SFAS No. 106 or Accounting Principals Board (APB) Opinion No. 12, as appropriate. For transition, an entity can choose to apply the guidance using either of the following approaches: (a) a change in accounting principle through retrospective application to all periods presented or (b) a change in accounting principle through a cumulative-effect adjustment to the balance in retained earnings at the beginning of the year of adoption. The adoption is required in fiscal years beginning after December 15, 2007, with early adoption permitted. Upon the implementation of EITF 06-04 on July 1, 2008, the Company recorded a cumulative effect adjustment of \$96,000 as a reduction of retained earnings. The future annual expense is not expected to be material.

In June 2007, the EITF reached a consensus on Issue No. 06-11, "Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards" ("EITF 06-11"). EITF 06-11 states that an entity should recognize a realized tax benefit associated with dividends on non-vested equity shares, non-vested equity share units and outstanding equity share options charged to retained earnings as an increase in additional paid in capital. The amount recognized in additional paid in capital should be included in the pool of excess tax benefits available to absorb potential future tax deficiencies on share-based payment awards. EITF 06-11 should be applied prospectively to income tax benefits of dividends on equity-classified share-based payment awards that are declared in fiscal years beginning after December 15, 2007. The Company expects that EITF 06-11 will not have an impact on its consolidated financial statements.

Staff Accounting Bulletin ("SAB") No. 110 (SAB 110) amends and replaces Question 6 of Section D.2 of Topic 14 "Share-Based Payment," of the Staff Accounting Bulletin series. Question 6 of Section D.2 of Topic 14 expresses the views of the staff regarding the use of the "simplified" method in developing an estimate of expected term of "plain vanilla" share options and allows usage of the "simplified" method for share option grants prior to December 31, 2007. SAB 110 allows public companies which do not have historically sufficient experience to provide a reasonable estimate to continue use of the "simplified" method for estimating the expected term of "plain vanilla" share option grants after December 31, 2007. SAB 110 is effective January 1, 2008. The Company expects that SAB 110 will not have a material impact on its consolidated financial statements.

In February 2008, the FASB issued FASB Staff Position (FSP) 157-2, "Effective Date of FASB Statement No. 157," that permits a one-year deferral in applying the measurement provisions of Statement No. 157 to non-financial assets and non-financial liabilities (non-financial items) that are not recognized or disclosed at fair value in an entity's financial statements on a recurring basis (at least annually). Therefore, if the change in fair value of a non-financial item is not required to be recognized or disclosed in the financial statements on an annual basis or more frequently, the effective date of application of Statement 157 to that item is deferred until fiscal years beginning after November 15, 2008 and interim periods within those fiscal years. This deferral does not apply, however, to an entity that applied Statement 157 in interim or annual financial statements prior to the issuance of FSP 157-2. The Company is currently evaluating the potential impact, if any, of the adoption of FSP 157-2 on its consolidated financial condition, results of operations and cash flows.

In May 2008, the FASB issued SFAS No. 162, "The Hierarchy of Generally Accepted Accounting Principles." This Statement identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements. This Statement is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, "The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles." The Company is currently evaluating the potential impact the new pronouncement will have on its consolidated financial statements.



**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) 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 as of September 29, 2008.

**MSB FINANCIAL CORP.**

/s/ Gary T. Jolliffe  
By: Gary T. Jolliffe  
President and Chief Executive Officer  
(Duly Authorized Representative)

Pursuant to the requirement of the Securities Exchange Act of 1934, this report has been signed below on September 29, 2008 by the following persons on behalf of the registrant and in the capacities indicated.

/s/ Gary T. Jolliffe  
Gary T. Jolliffe  
President, Chief Executive Officer and Director

Albert N. Olsen  
Chairman of the Board

/s/ E. Haas Gallaway  
E. Haas Gallaway, Jr.  
Director

/s/ W. Scott Gallaway  
W. Scott Gallaway  
Director

/s/ Dr. Thomas G. McCain  
Dr. Thomas G. McCain  
Director

/s/ Ferdinand J. Rossi  
Ferdinand J. Rossi  
Director

/s/ Michael A. Shriner  
Michael A. Shriner  
Executive Vice President, Chief Operating  
Officer and Director

/s/ Jeffrey E. Smith  
Jeffrey E. Smith  
Vice President and Chief Financial Officer  
(Principal Financial and Accounting Officer)

