

Magyar Bancorp, Inc.  
Form 10-Q  
May 13, 2011

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT UNDER SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934  
For the quarterly period ended March 31, 2011

Commission File Number 000-51726

Magyar Bancorp, Inc.  
(Exact Name of Registrant as Specified in Its Charter)

Delaware  
(State or Other Jurisdiction of Incorporation or  
Organization)

20-4154978  
(I.R.S. Employer Identification Number)

400 Somerset Street, New Brunswick, New Jersey  
(Address of Principal Executive Office)

08901  
(Zip Code)

(732) 342-7600

(Issuer's Telephone Number including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

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

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

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

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

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

| Class                          | Outstanding at May 1, 2011 |
|--------------------------------|----------------------------|
| Common Stock, \$0.01 Par Value | 5,798,831                  |

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MAGYAR BANCORP, INC.

Form 10-Q Quarterly Report

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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

MAGYAR BANCORP, INC. AND SUBSIDIARY  
Consolidated Balance Sheets  
(In Thousands, Except Share and Per Share Data)

|   | March 31,<br>2011 | September 30,<br>2010<br>(Unaudited) |
|---|-------------------|--------------------------------------|
| <b>Assets</b>   |                   |                                      |
| Cash  | \$ 1,309          | \$ 1,126                             |
| Interest earning deposits with banks  | 13,942            | 19,960                               |
| Total cash and cash equivalents   | 15,251            | 21,086                               |
| Investment securities - available for sale, at fair value   | 28,009            | 14,187                               |
| Investment securities - held to maturity, at amortized cost (fair value of \$42,527 and \$45,398 at March 31, 2011 and September 30, 2010, respectively)                          | 42,397            | 44,479                               |
| Federal Home Loan Bank of New York stock, at cost   | 2,690             | 2,775                                |
| Loans receivable, net of allowance for loan losses of \$3,769 and \$4,766 at March 31, 2011 and September 30, 2010, respectively  | 394,439           | 403,886                              |
| Bank owned life insurance   | 9,484             | 9,306                                |
| Accrued interest receivable   | 1,975             | 1,950                                |
| Premises and equipment, net   | 19,964            | 20,142                               |
| Other real estate owned ("OREO")  | 16,371            | 12,655                               |
| Other assets  | 7,223             | 7,483                                |
| <b>Total assets</b>   | <b>\$537,803</b>  | <b>\$ 537,949</b>                    |
| <b>Liabilities and Stockholders' Equity</b>   |                   |                                      |
| <b>Liabilities</b>  |                   |                                      |
| Deposits  | \$430,530         | \$ 427,932                           |
| Escrowed funds  | 1,257             | 1,555                                |
| Federal Home Loan Bank of New York advances   | 43,891            | 45,769                               |
| Securities sold under agreements to repurchase  | 15,000            | 15,000                               |
| Accrued interest payable  | 370               | 418                                  |
| Accounts payable and other liabilities  | 2,876             | 3,098                                |
| <b>Total liabilities</b>  | <b>493,924</b>    | <b>493,772</b>                       |
| <b>Stockholders' equity</b>   |                   |                                      |
| Preferred stock: \$.01 Par Value, 1,000,000 shares authorized; none issued  | -                 | -                                    |
| Common stock: \$.01 Par Value, 8,000,000 shares authorized; 5,923,742 issued; 5,798,831 and 5,783,131 outstanding at March 31, 2011 and September 30, 2010, respectively, at cost | 59                | 59                                   |
| Additional paid-in capital  | 26,337            | 26,396                               |
| Treasury stock: 124,911 and 140,611 shares at March 31, 2011 and September 30, 2010, respectively, at cost  | (1,514 )          | (1,704 )                             |
| Unearned Employee Stock Ownership Plan shares   | (1,284 )          | (1,342 )                             |

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|  |           |            |
|--|-----------|------------|
| Retained earnings                          | 21,109    | 21,300     |
| Accumulated other comprehensive loss       | (828 )    | (532 )     |
| Total stockholders' equity                 | 43,879    | 44,177     |
| Total liabilities and stockholders' equity | \$537,803 | \$ 537,949 |

The accompanying notes are an integral part of these statements.

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MAGYAR BANCORP, INC. AND SUBSIDIARY  
 Consolidated Statements of Operations  
 (In Thousands, Except Per Share Data)

|   | For the Three Months<br>Ended March 31, |              | For the Six Months<br>Ended March 31, |               |
|---|---|--------------|---------------------------------------|---------------|
|   | 2011                                    | 2010         | 2011                                  | 2010          |
|   | (Unaudited)                             |              |                                       |               |
| Interest and dividend income  |   |              |                                       |               |
| Loans, including fees   | \$5,005                                 | \$5,788      | \$10,152                              | \$11,588      |
| Investment securities   |   |              |                                       |               |
| Taxable   | 533                                     | 632          | 1,035                                 | 1,327         |
| Tax-exempt  | 1                                       | 1            | 3                                     | 3             |
| Federal Home Loan Bank of New York stock                                | 40                                      | 46           | 87                                    | 91            |
| <b>Total interest and dividend income</b>                               | <b>5,579</b>                            | <b>6,467</b> | <b>11,277</b>                         | <b>13,009</b> |
| Interest expense  |   |              |                                       |               |
| Deposits  | 1,278                                   | 1,667        | 2,694                                 | 3,484         |
| Borrowings  | 597                                     | 698          | 1,207                                 | 1,415         |
| <b>Total interest expense</b>   | <b>1,875</b>                            | <b>2,365</b> | <b>3,901</b>                          | <b>4,899</b>  |
| <b>Net interest and dividend income</b>                                 | <b>3,704</b>                            | <b>4,102</b> | <b>7,376</b>                          | <b>8,110</b>  |
| <b>Provision for loan losses</b>  | <b>478</b>                              | <b>750</b>   | <b>836</b>                            | <b>1,150</b>  |
| <b>Net interest and dividend income after provision for loan losses</b> | <b>3,226</b>                            | <b>3,352</b> | <b>6,540</b>                          | <b>6,960</b>  |
| Other income  |   |              |                                       |               |
| Service charges   | 235                                     | 259          | 576                                   | 501           |
| Other operating income  | 104                                     | 130          | 216                                   | 248           |
| Gains on sales of loans   | 10                                      | 39           | 459                                   | 115           |
| Gains on sales of investment securities                                 | 35                                      | 270          | 35                                    | 349           |
| Gains (losses) on the sales of OREO                                     | (157 )                                  | 97           | (292 )                                | 97            |
| <b>Total other income</b>   | <b>227</b>                              | <b>795</b>   | <b>994</b>                            | <b>1,310</b>  |
| Other expenses  |   |              |                                       |               |
| Compensation and employee benefits                                      | 1,987                                   | 1,897        | 3,857                                 | 4,617         |
| Occupancy expenses  | 709                                     | 631          | 1,376                                 | 1,253         |
| Advertising   | 49                                      | 47           | 102                                   | 89            |
| Professional fees   | 303                                     | 341          | 550                                   | 568           |
| Service fees  | 145                                     | 144          | 289                                   | 289           |
| REO expenses  | 113                                     | 81           | 236                                   | 125           |
| FDIC deposit insurance premiums   | 357                                     | 284          | 706                                   | 551           |
| Other expenses  | 391                                     | 441          | 856                                   | 799           |

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|   |           |        |           |        |
|---|-----------|--------|-----------|--------|
| Total other expenses                              | 4,054     | 3,866  | 7,972     | 8,291  |
| Income (loss) before income tax expense (benefit) | (601 )    | 281    | (438 )    | (21 )  |
| Income tax expense (benefit)                      | (244 )    | 2      | (208 )    | (321 ) |
| Net income (loss)                                 | \$(357 )  | \$279  | \$(230 )  | \$300  |
| Net income (loss) per share-basic and diluted     | \$(0.06 ) | \$0.05 | \$(0.04 ) | \$0.05 |

The accompanying notes are an integral part of these statements.

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MAGYAR BANCORP, INC. AND SUBSIDIARY  
Consolidated Statement of Changes in Stockholders' Equity  
For the Six Months Ended March 31, 2011  
(In Thousands, Except for Share Amounts)  
(Unaudited)

|  | Common Stock<br>Shares<br>Outstanding | Par<br>Value | Additional<br>Paid-In<br>Capital | Treasury<br>Stock | Unearned<br>ESOP<br>Shares | Retained<br>Earnings | Other<br>Comprehensive<br>Loss | Total    |
|--|---------------------------------------|--------------|----------------------------------|-------------------|----------------------------|----------------------|--------------------------------|----------|
| Balance, September 30, 2010  | 5,783,131                             | \$59         | \$ 26,396                        | \$(1,704 )        | \$(1,342 )                 | \$21,300             | \$ (532 )                      | \$44,177 |
| Comprehensive loss:  |                                       |              |                                  |                   |                            |                      |                                |          |
| Net loss   | -                                     | -            | -                                | -                 | -                          | (230 )               | -                              | (230 )   |
| Unrealized loss on securities available-for-sale, net of tax benefit of \$108          | -                                     | -            | -                                | -                 | -                          | -                    | (214 )                         | (214 )   |
| Reclassification adjustment for gains included in net loss, net of tax benefit of \$14 | -                                     | -            | -                                | -                 | -                          | -                    | (21 )                          | (21 )    |
| Unrealized loss on derivatives, net of tax benefit of \$40                             | -                                     | -            | -                                | -                 | -                          | -                    | (61 )                          | (61 )    |
| Total comprehensive loss   |                                       |              |                                  |                   |                            |                      |                                | (526 )   |
| Treasury stock used for restricted stock plan  | 15,700                                | -            | (229 )                           | 190               | -                          | 39                   | -                              | -        |
| ESOP shares allocated  | -                                     | -            | (31 )                            | -                 | 58                         | -                    | -                              | 27       |
| Stock-based compensation expense   | -                                     | -            | 201                              | -                 | -                          | -                    | -                              | 201      |
| Balance, March 31, 2011  | 5,798,831                             | \$59         | \$ 26,337                        | \$(1,514 )        | \$(1,284 )                 | \$21,109             | \$ (828 )                      | \$43,879 |

The accompanying notes are an integral part of this statement.

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MAGYAR BANCORP, INC. AND SUBSIDIARY  
Consolidated Statements of Cash Flows  
(In Thousands)

|   | For the Six Months<br>Ended March 31,<br>2011          2010<br>(Unaudited) |          |
|---|--|----------|
| Operating activities  |  |          |
| Net income (loss)   | \$(230   | ) \$300  |
| Adjustment to reconcile net income (loss) to net cash provided<br>by operating activities |  |          |
| Depreciation expense  | 485  | 560      |
| Premium amortization on investment securities, net  | 155  | 75       |
| Provision for loan losses   | 836  | 1,150    |
| Provision for loss on other real estate owned   | 449  | -        |
| Proceeds from the sales of loans  | 7,613  | 1,875    |
| Gains on sale of loans  | (459   | ) (115   |
| Gains on sales of investment securities   | (35  | ) (349   |
| Gains on the sales of other real estate owned   | (157   | ) (97    |
| ESOP compensation expense   | 27   | 24       |
| Stock-based compensation expense  | 201  | 151      |
| (Increase) decrease in accrued interest receivable  | (25  | ) 156    |
| Increase in surrender value bank owned life insurance                                     | (178   | ) (224   |
| Decrease (increase) in other assets   | 320  | (3,262   |
| Decrease in accrued interest payable  | (48  | ) (148   |
| Decrease in accounts payable and other liabilities  | (222   | ) (74    |
| Net cash provided by operating activities   | 8,732  | 22       |
| Investing activities  |  |          |
| Net (increase) decrease in loans receivable   | (2,124   | ) 4,182  |
| Purchases of investment securities held to maturity                                       | (7,747   | ) (7,153 |
| Purchases of investment securities available for sale                                     | (18,091  | ) (1,775 |
| Sales of investment securities held to maturity   | -  | 4,000    |
| Sales of investment securities available for sale   | 2,016  | 3,555    |
| Proceeds from calls of investment securities held to maturity                             | -  | 3,028    |
| Principal repayments on investment securities held to maturity                            | 9,752  | 4,445    |
| Principal repayments on investment securities available for sale                          | 1,854  | 1,688    |
| Purchases of premises and equipment   | (307   | ) (101   |
| Investment in other real estate owned   | (968   | ) (81    |
| Proceeds from the sale of other real estate owned   | 541  | 887      |
| Redemption of Federal Home Loan Bank stock  | 85   | 47       |
| Net cash (used) provided by investing activities  | (14,989  | ) 12,722 |
| Financing activities  |  |          |
| Net increase (decrease) in deposits   | 2,598  | (13,319  |
| Net decrease in escrowed funds  | (298   | ) (15    |
| Repayments of long-term advances  | (1,878   | ) (1,037 |
| Net cash provided (used) by financing activities  | 422  | (14,371  |

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|   |          |          |
|---|----------|----------|
| Net decrease in cash and cash equivalents                         | (5,835 ) | (1,627 ) |
| Cash and cash equivalents, beginning of period                    | 21,086   | 7,921    |
| Cash and cash equivalents, end of period                          | \$15,251 | \$6,294  |
| <b>Supplemental disclosures of cash flow information</b>          |          |          |
| Cash paid for   |          |          |
| Interest  | \$3,949  | \$5,047  |
| Income taxes  | \$6      | \$4      |
| <b>Non-cash investing activities</b>                              |          |          |
| Real estate acquired in full satisfaction of loans in foreclosure | \$3,581  | \$5,238  |

The accompanying notes are an integral part of these statements.

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MAGYAR BANCORP, INC. AND SUBSIDIARY  
Notes to Consolidated Financial Statements  
(Unaudited)

NOTE A – BASIS OF PRESENTATION

The consolidated financial statements include the accounts of Magyar Bancorp, Inc. (the “Company”), its wholly owned subsidiary Magyar Bank, and the Bank’s wholly owned subsidiaries Magyar Service Corporation, Hungaria Urban Renewal, LLC, and MagBank Investment Company. All material intercompany transactions and balances have been eliminated. The Company prepares its financial statements on the accrual basis and in conformity with accounting principles generally accepted in the United States of America (“US GAAP”). The unaudited information furnished herein reflects all adjustments (consisting of normal recurring accruals) that are, in the opinion of management, necessary to a fair statement of the results for the interim periods presented.

Operating results for the three and six months ended March 31, 2011 are not necessarily indicative of the results that may be expected for the year ending September 30, 2011. The September 30, 2010 information has been derived from the audited consolidated financial statements at that date but does not include all of the information and footnotes required by US GAAP for complete financial statements.

The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the valuation of other real estate owned, and the assessment of realizability of deferred income tax assets.

The Company has evaluated events and transactions occurring subsequent to the balance sheet date of March 31, 2011 for items that should potentially be recognized or disclosed in these financial statements. The evaluation was conducted through the date these financial statements were issued.

NOTE B- RECENT ACCOUNTING PRONOUNCEMENTS

In connection with the preparation of quarterly and annual reports in accordance with the Securities and Exchange Commission’s (SEC) Securities Exchange Act of 1934, SEC Staff Accounting Bulletin Topic 11.M requires the disclosure of the impact that recently issued accounting standards will have on financial statements when they are adopted in the future.

In October 2009, the FASB issued Accounting Standards Update (“ASU”) 2009-16, Transfers and Servicing (Topic 860) - Accounting for Transfers of Financial Assets. This Update amends the Codification for the issuance of FASB Statement No. 166, Accounting for Transfers of Financial Assets-an amendment of FASB Statement No. 140. The amendments in this Update improve financial reporting by eliminating the exceptions for qualifying special-purpose entities from the consolidation guidance and the exception that permitted sale accounting for certain mortgage securitizations when a transferor has not surrendered control over the transferred financial assets. In addition, the amendments require enhanced disclosures about the risks that a transferor continues to be exposed to because of its continuing involvement in transferred financial assets. Comparability and consistency in accounting for transferred financial assets will also be improved through clarifications of the requirements for isolation and limitations on portions of financial assets that are eligible for sale accounting. This Update is effective at the start of a reporting entity’s first fiscal year beginning after November 15, 2009. The ASU did not have a material impact on the Company’s consolidated financial statements.

In October 2009, the FASB issued ASU 2009-17, Consolidations (Topic 810) - Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities. This Update amends the Codification for the issuance of FASB Statement No. 167, Amendments to FASB Interpretation No. 46(R). The amendments in this Update replace the quantitative-based risks and rewards calculation for determining which reporting entity, if any, has a controlling financial interest in a variable interest entity with an approach focused on identifying which reporting entity has the power to direct the activities of a variable interest entity that most significantly impact the entity's economic

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performance and (1) the obligation to absorb losses of the entity or (2) the right to receive benefits from the entity. An approach that is expected to be primarily qualitative will be more effective for identifying which reporting entity has a controlling financial interest in a variable interest entity. The amendments in this Update also require additional disclosures about a reporting entity's involvement in variable interest entities, which will enhance the information provided to users of financial statements. This Update is effective at the start of a reporting entity's first fiscal year beginning after November 15, 2009. The ASU did not have a material impact on the Company's consolidated financial statements.

The FASB has issued ASU 2010-06, Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements. This ASU requires some new disclosures and clarifies some existing disclosure requirements about fair value measurement as set forth in Codification Subtopic 820-10. The FASB's objective is to improve these disclosures and, thus, increase the transparency in financial reporting. Specifically, ASU 2010-06 amends Codification Subtopic 820-10 to now require: (1) a reporting entity to disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers; and (2) in the reconciliation for fair value measurements using significant unobservable inputs, a reporting entity should present separately information about purchases, sales, issuances, and settlements. In addition, ASU 2010-06 clarifies the requirements of the following existing disclosures: (1) for purposes of reporting fair value measurement for each class of assets and liabilities, a reporting entity needs to use judgment in determining the appropriate classes of assets and liabilities; and (2) a reporting entity should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements. ASU 2010-06 is effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. Early adoption is permitted. The ASU did not have a material impact on the Company's consolidated financial statements.

The FASB issued ASU 2010-20, Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses, in an effort to help investors assess the credit risk of a company's receivables portfolio and the adequacy of its allowance for credit losses held against the portfolios by expanding credit risk disclosures. This ASU requires more information about the credit quality of financing receivables in the disclosures to financial statements, such as aging information and credit quality indicators. The amendments in this Update apply to all public and nonpublic entities with financing receivables. Financing receivables include loans and trade accounts receivable. However, short-term trade accounts receivable, receivables measured at fair value or lower of cost or fair value, and debt securities are exempt from these disclosure amendments. The amendments require disclosures as of the end of a reporting period effective for periods ending on or after December 15, 2010. The amendments that require disclosures about activity that occurs during a reporting period are effective for periods beginning on or after December 15, 2010. The portions of the ASU that were not delayed by ASU 2011-01 (see below) did not have a material impact on the Company's consolidated financial statements.

The FASB issued ASU 2011-01, Receivables (Topic 310): Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings in Update No. 2010-20 in January 2011 to temporarily delay the effective date of the disclosures about troubled debt restructurings in Update 2010-20 for public entities. Under the existing effective date in Update 2010-20, public-entity creditors would have provided disclosures about troubled debt restructurings for periods beginning on or after December 15, 2010. The delay was intended to allow the Board time to complete its deliberations on what constitutes a troubled debt restructuring.

The FASB issued ASU 2011-02, Receivables (Topic 310): A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring in April 2011 to help creditors in determining whether a creditor has granted a concession and whether a debtor is experiencing financial difficulties for purposes of determining whether a

restructuring constitutes a troubled debt restructuring. In evaluating whether a restructuring constitutes a troubled debt restructuring, a creditor must separately conclude that both 1) the restructuring constitutes a concession and 2) the debtor is experiencing financial difficulties. In addition, the amendments to Topic 310 clarify the guidance on a creditor's evaluation of whether it has granted a concession and whether a debtor is experiencing financial difficulties. The amendments in this Update are effective for the first interim or annual period beginning on or after June 15, 2011, and should be applied retrospectively to the beginning of the annual period of adoption. The Company is evaluating the updates to Topic 310 and does not expect their implementation to have a material impact on its consolidated financial statements.

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## NOTE C - CONTINGENCIES

The Company, from time to time, is a party to routine litigation that arises in the normal course of business. In the opinion of management, the resolution of this litigation, if any, would not have a material adverse effect on the Company's consolidated financial position or results of operations.

## NOTE D - EARNINGS PER SHARE

Basic and diluted earnings per share for the three and six months ended March 31, 2011 and 2010 were calculated by dividing net income by the weighted-average number of shares outstanding for the period. All stock options and restricted stock awards were anti-dilutive for the three and six months ended March 31, 2011 and the three and six months ended March 31, 2010. The following table shows the Company's earnings per share for the periods presented:

|   | For the Three Months<br>Ended March 31,  |         | For the Six Months<br>Ended March 31, |         |
|---|--|---------|---------------------------------------|---------|
|   | 2011                                     | 2010    | 2011                                  | 2010    |
|   | (In thousands except for per share data) |         |                                       |         |
| Income (loss) applicable to common shares                                       | \$ (357 )                                | \$ 279  | \$ (230 )                             | \$ 300  |
| Weighted average number of common shares outstanding - basic                    | 5,800                                    | 5,782   | 5,798                                 | 5,780   |
| Stock options and restricted stock  | -  | -       | -                                     | -       |
| Weighted average number of common shares and common share equivalents - diluted | 5,800                                    | 5,782   | 5,798                                 | 5,780   |
| Basic earnings (loss) per share   | \$ (0.06 )                               | \$ 0.05 | \$ (0.04 )                            | \$ 0.05 |
| Diluted earnings (loss) per share   | N/A                                      | \$ 0.05 | N/A                                   | \$ 0.05 |

Options to purchase 188,276 shares of common stock at a weighted average price of \$14.61 and 25,588 shares of restricted shares at a weighted average price of \$10.15 were outstanding and not included in the computation of diluted earnings per share for the three and six months ended March 31, 2011 because the grant (or option strike) price was greater than the average market price of the common shares during the periods. Options to purchase 188,276 shares of common stock at an average price of \$14.61 and 30,084 restricted shares at a weighted average price of \$14.55 were outstanding and not included in the computation of diluted earnings per share for the three and six months ended March 31, 2010 because the grant (or option strike) price was greater than the average market price of the common shares during the periods.

## NOTE E – STOCK-BASED COMPENSATION AND STOCK REPURCHASE PROGRAM

The Company follows FASB Accounting Standards Codification ("ASC") Section 718, Compensation-Stock Compensation, which covers a wide range of share-based compensation arrangements including share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. ASC 718 requires that compensation cost relating to share-based payment transactions be recognized in financial statements. The cost is measured based on the fair value of the equity or liability instruments issued.

ASC 718 also requires the Company to realize as a financing cash flow rather than an operating cash flow, as previously required, the benefits of realized tax deductions in excess of previously recognized tax benefits on compensation expense. In accordance with SEC Staff Accounting Bulletin (“SAB”) No. 107, the Company classified share-based compensation for employees and outside directors within “compensation and employee benefits” in the consolidated statement of operations to correspond with the same line item as the cash compensation paid.

Stock options generally vest over a five-year service period and expire ten years from issuance. Management recognizes compensation expense for all option grants over the awards’ respective requisite service periods. The fair values of all option grants were estimated using the Black-Scholes option-pricing model. Since there was limited

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historical information on the volatility of the Company's stock, management also considered the average volatilities of similar entities for an appropriate period in determining the assumed volatility rate used in the estimation of fair value. Management estimated the expected life of the options using the simplified method allowed under SAB No. 107. The 7-year Treasury yield in effect at the time of the grant provided the risk-free rate for periods within the contractual life of the option. Management recognizes compensation expense for the fair values of these awards, which have graded vesting, on a straight-line basis over the requisite service period of the awards. Once vested, these awards are irrevocable. Shares will be obtained from either the open market or treasury stock upon share option exercise.

Restricted shares generally vest over a five-year service period on the anniversary of the grant date. Once vested, these awards are irrevocable. The product of the number of shares granted and the grant date market price of the Company's common stock determine the fair value of restricted shares under the Company's restricted stock plans. Management recognizes compensation expense for the fair value of restricted shares on a straight-line basis over the requisite service period.

The following is a summary of the status of the Company's stock option activity and related information for its option plan for the three months ended March 31, 2011:

|                                  | Number of<br>Stock<br>Options | Weighted<br>Average<br>Exercise<br>Price | Weighted<br>Average<br>Remaining<br>Contractual<br>Life | Aggregate<br>Intrinsic<br>Value |
|----------------------------------|-------------------------------|--|---|---------------------------------|
| Balance at September 30,<br>2010 | 188,276                       | \$ 14.61                                 |   |                                 |
| Granted                          | -                             | -  |   |                                 |
| Exercised                        | -                             | -  |   |                                 |
| Forfeited                        | -                             | -  |   |                                 |
| Balance at March 31, 2011        | 188,276                       | \$ 14.61                                 | 5.9 years   | \$ -                            |
| Exercisable at March 31,<br>2011 | 154,561                       | \$ 14.61                                 | 5.9 years   | \$ -                            |

The following is a summary of the Company's non-vested stock awards as of March 31, 2011 and changes during the six months ended March 31, 2011:

|                               | Number of<br>Stock<br>Awards | Weighted<br>Average<br>Grant Date<br>Fair Value |
|-------------------------------|------------------------------|---|
| Balance at September 30, 2010 | 45,390                       | \$ 11.45  |
| Granted                       | -                            | -   |
| Vested                        | (15,697)                     | 14.55   |
| Forfeited                     | -                            | -   |
| Balance at March 31, 2011     | 29,693                       | \$ 9.81   |

Stock option and stock award expenses included with compensation expense were \$81,000 and \$120,000, respectively, for the six months ended March 31, 2011.

The Company announced in November 2007 its second stock repurchase program of up to 5% of its publicly-held outstanding shares of common stock, or 129,924 shares. Through March 31, 2011, the Company had repurchased a total of 66,970 shares of its common stock at an average cost of \$9.39 per share under this program. No shares have been repurchased during the six months ended March 31, 2011. Under the stock repurchase program, 62,954 shares of the 129,924 shares authorized remained available for repurchase as of March 31, 2011. The Company's intended use of the repurchased shares is for general corporate purposes, including the funding of awards granted under the 2006 Equity Incentive Plan.

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The Company has an Employee Stock Ownership Plan ("ESOP") for the benefit of employees of the Company and the Bank who meet the eligibility requirements as defined in the plan. The ESOP trust purchased 217,863 shares of common stock in the open market using proceeds of a loan from the Company. The total cost of shares purchased by the ESOP trust was \$2.3 million, reflecting an average cost per share of \$10.58. The Bank will make cash contributions to the ESOP on an annual basis sufficient to enable the ESOP to make the required loan payments to the Company. The loan bears a variable interest rate that adjusts annually every January 1st to the then published Prime Rate (3.25% at January 1, 2011) with principal and interest payable annually in equal installments over thirty years. The loan is secured by shares of the Company's stock.

As the debt is repaid, shares are released as collateral and allocated to qualified employees. Accordingly, the shares pledged as collateral are reported as unearned ESOP shares in the Consolidated Balance Sheet. As shares are released from collateral, the Company reports compensation expense equal to the then current market price of the shares, and the shares become outstanding for earnings per share computations.

At March 31, 2011, shares allocated to participants totaled 84,631. Unallocated ESOP shares held in suspense totaled 133,232 at March 31, 2011 and had a fair market value of \$572,898. The Company's contribution expense for the ESOP was \$27,000 and \$24,000 for the six months ended March 31, 2011 and 2010, respectively.

## NOTE F - COMPREHENSIVE INCOME (LOSS)

The components of comprehensive income (loss) and the related income tax effects are as follows:

|   | Three Months Ended March 31, |                                     |                         |                         |                                     |                         |
|---|------------------------------|-------------------------------------|-------------------------|-------------------------|-------------------------------------|-------------------------|
|   | Before<br>Tax<br>Amount      | 2011<br>Tax<br>Benefit<br>(Expense) | Net of<br>Tax<br>Amount | Before<br>Tax<br>Amount | 2010<br>Tax<br>Benefit<br>(Expense) | Net of<br>Tax<br>Amount |
| Unrealized holding gains arising during period on:                |                              |                                     |                         |                         |                                     |                         |
| Available-for-sale investments                                    | \$ 100                       | \$ (46 )                            | \$ 54                   | \$ 395                  | \$ (153 )                           | \$ 242                  |
| Less reclassification adjustment for gains realized in net income | (35 )                        | 14                                  | (21 )                   | (270 )                  | 107                                 | (163 )                  |
| Interest rate derivatives   | (28 )                        | 11                                  | (17 )                   | (72 )                   | 29                                  | (43 )                   |
| Other comprehensive income, net                                   | \$ 37                        | \$ (21 )                            | \$ 16                   | \$ 53                   | \$ (17 )                            | \$ 36                   |

## Six Months Ended March 31,

2011

2010

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|   | Before<br>Tax<br>Amount | Tax<br>Benefit<br>(Expense) | Net of<br>Tax<br>Amount<br>(Dollars in thousands) | Before<br>Tax<br>Amount | Tax<br>Benefit<br>(Expense) | Net of<br>Tax<br>Amount |
|---|-------------------------|-----------------------------|---|-------------------------|-----------------------------|-------------------------|
| Unrealized holding losses arising during period on:               |                         |                             |   |                         |                             |                         |
| Available-for-sale investments                                    | \$ (321 )               | \$ 107                      | \$ (214 )   | \$ 105                  | \$ (45 )                    | \$ 60                   |
| Less reclassification adjustment for gains realized in net income | (35 )                   | 14                          | (21 )   | (349 )                  | 139                         | (210 )                  |
| Interest rate derivatives   | (101 )                  | 40                          | (61 )   | (150 )                  | 60                          | (90 )                   |
| Other comprehensive loss, net                                     | \$ (457 )               | \$ 161                      | \$ (296 )   | \$ (394 )               | \$ 154                      | \$ (240 )               |

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NOTE G – FAIR VALUE DISCLOSURES

We use fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Our securities available-for-sale are recorded at fair value on a recurring basis. Additionally, from time to time, we may be required to record at fair value other assets or liabilities on a non-recurring basis, such as held-to-maturity securities, mortgage servicing rights, loans receivable and other real estate owned, or OREO. These non-recurring fair value adjustments involve the application of lower-of-cost-or-market accounting or write-downs of individual assets.

In accordance with ASC 820, we group our assets and liabilities at fair value in three levels, based on the markets in which the assets are traded and the reliability of the assumptions used to determine fair value. These levels are:

Level 1 Valuation is based upon quoted prices for identical instruments traded in active markets.

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Level 2 Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-based valuation techniques for which all significant assumptions are observable in the market.

Level 3 Valuation is generated from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect our own estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include the use of option pricing models, discounted cash flow models and similar techniques. The results cannot be determined with precision and may not be realized in an actual sale or immediate settlement of the asset or liability.

We base our fair values on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC 820 requires us to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

The following is a description of valuation methodologies used for assets measured at fair value on a recurring basis.

Securities available-for-sale

Our available-for-sale portfolio is carried at estimated fair value on a recurring basis, with any unrealized gains and losses, net of taxes, reported as accumulated other comprehensive income/loss in stockholders' equity. Our securities available-for-sale portfolio consists of U.S government and government-sponsored enterprise obligations, municipal bonds, and mortgage-backed securities. The fair values of these securities are obtained from an independent nationally recognized pricing service. Our independent pricing service provides us with prices which are categorized as Level 2, as quoted prices in active markets for identical assets are generally not available for the securities in our portfolio. Various modeling techniques are used to determine pricing for our mortgage-backed securities, including option pricing and discounted cash flow models. The inputs to these models include benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers and reference data.

Derivative financial instruments

The Company uses interest rate floors to manage its interest rate risk. The interest rate floors have been designated as cash flow hedging instruments. The valuation of these instruments is determined using widely accepted valuation techniques including discounted cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs, including interest rate curves and implied volatilities.

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The following table provides the level of valuation assumptions used to determine the carrying value of our assets measured at fair value on a recurring basis.

|   | Total     | Fair Value at March 31, 2011 |           |         |
|---|-----------|------------------------------|-----------|---------|
|   |           | Level 1                      | Level 2   | Level 3 |
| (Dollars in thousands)                                |           |                              |           |         |
| Securities available for sale:                        |           |                              |           |         |
| Obligations of U.S. government agencies:              |           |                              |           |         |
| Mortgage backed securities - residential              | \$ 3,528  | \$ -                         | \$ 3,528  | \$ -    |
| Obligations of U.S. government-sponsored enterprises: |           |                              |           |         |
| Mortgage-backed securities-residential                | 13,761    | -                            | 13,761    | -       |
| Mortgage backed securities-commercial                 | 4,173     | -                            | 4,173     | -       |
| Debt securities                                       | 4,842     | -                            | 4,842     | -       |
| Private label mortgage-backed securities-residential  | 1,705     | -                            | 1,705     | -       |
| Total securities available for sale                   | \$ 28,009 | \$ -                         | \$ 28,009 | \$ -    |

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|   | Total     | Fair Value at September 30, 2010 |           |         |
|---|-----------|----------------------------------|-----------|---------|
|   |           | Level 1                          | Level 2   | Level 3 |
|   |           | (Dollars in thousands)           |           |         |
| Securities available for sale:                        |           |                                  |           |         |
| Obligations of U.S. government agencies:              |           |                                  |           |         |
| Mortgage backed securities - residential              | \$ 3,878  | \$ -                             | \$ 3,878  | \$ -    |
| Obligations of U.S. government-sponsored enterprises: |           |                                  |           |         |
| Mortgage-backed securities-residential                | 2,940     | -                                | 2,940     | -       |
| Mortgage backed securities-commercial                 | 4,270     | -                                | 4,270     | -       |
| Debt securities                                       | 1,002     | -                                | 1,002     | -       |
| Private label mortgage-backed securities-residential  | 2,097     | -                                | 2,097     | -       |
| Total securities available for sale                   | \$ 14,187 | \$ -                             | \$ 14,187 | \$ -    |
| Derivatives   | 51        | -                                | 51        | -       |
|   | \$ 14,238 | \$ -                             | \$ 14,238 | \$ -    |

The following is a description of valuation methodologies used for assets measured at fair value on a non-recurring basis.

#### Mortgage Servicing Rights, net

Mortgage Servicing Rights (MSRs) are carried at the lower of cost or estimated fair value. The estimated fair value of MSR is determined through a calculation of future cash flows, incorporating estimates of assumptions market participants would use in determining fair value including market discount rates, prepayment speeds, servicing income, servicing costs, default rates and other market driven data, including the market's perception of future interest rate movements and, as such, are classified as Level 3.

#### Impaired Loans

Loans which meet certain criteria are evaluated individually for impairment. A loan is impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. All amounts due according to the contractual terms means that both the contractual interest and principal payments of a loan will be collected as scheduled in the loan agreement. Three impairment measurement methods are used, depending upon the collateral securing the asset: 1) the present value of expected future cash flows discounted at the loan's effective interest rate (the rate of return implicit in the loan); 2) the asset's observable market price; or 3) the fair value of the collateral if the asset is collateral dependent. The regulatory agencies require this method for loans from which repayment is expected to be provided solely by the underlying collateral. Our impaired loans are generally collateral dependent and, as such, are carried at the estimated fair value of the collateral less estimated selling costs. Fair value is estimated through current appraisals, and adjusted as necessary, by management, to reflect current market conditions and, as such, are generally classified as Level 3.

Appraisals of collateral securing impaired loans are conducted by approved, qualified, and independent third-party appraisers. Such appraisals are ordered via the Bank's credit administration department, independent from the lender who originated the loan, once the loan is deemed impaired, as described in the previous paragraph. Impaired loans are generally re-evaluated with an updated appraisal within one year of the last appraisal. However, the Company also

obtains updated appraisals on performing construction loans that are approaching their maturity date to determine whether or not the fair value of the collateral securing the loan remains sufficient to cover the loan amount prior to considering an extension. The Company discounts the appraised “as is” value of the collateral for estimated selling and disposition costs and compares the resulting fair value of collateral to the outstanding loan amount. If the outstanding loan amount is greater than the discounted fair value, the Company requires a reduction in the outstanding loan balance or additional collateral before considering an extension to the loan. If the borrower is unwilling or unable to reduce the loan balance or increase the collateral securing the loan, it is deemed impaired and the difference between the loan amount and the fair value of collateral, net of estimated selling and disposition costs, is charged off through a reduction of the allowance for loan loss.

#### Other Real Estate Owned

The fair value of other real estate owned is determined through current appraisals, and adjusted as necessary, by management, to reflect current market conditions. As such, other real estate owned is generally classified as Level 3.

The following table provides the level of valuation assumptions used to determine the carrying value of our assets measured at fair value on a non-recurring basis at March 31, 2011.

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|                         | Total     | Fair Value at March 31, 2011 |         |           |
|-------------------------|-----------|------------------------------|---------|-----------|
|                         |           | Level 1                      | Level 2 | Level 3   |
|                         |           | (Dollars in thousands)       |         |           |
| Impaired loans          | \$ 6,869  | \$ -                         | \$ -    | \$ 6,869  |
| Other real estate owned | 3,446     | -                            | -       | 3,446     |
|                         | \$ 10,315 | \$ -                         | \$ -    | \$ 10,315 |

|                | Total     | Fair Value at September 30, 2010 |         |           |
|----------------|-----------|----------------------------------|---------|-----------|
|                |           | Level 1                          | Level 2 | Level 3   |
|                |           | (Dollars in thousands)           |         |           |
| Impaired loans | \$ 16,193 | \$ -                             | \$ -    | \$ 16,193 |

The following methods and assumptions were used to estimate the fair value of each class of financial instruments not already disclosed above for which it is practicable to estimate fair value:

Cash and interest earning deposits with banks: The carrying amounts are a reasonable estimate of fair value.

Held to maturity securities: The fair values of our held to maturity securities are obtained from an independent nationally recognized pricing service. Our independent pricing service provides us with prices which are categorized as Level 2, as quoted prices in active markets for identical assets are generally not available for the securities in our portfolio.

Loans: Fair value for the loan portfolio, excluding impaired loans with specific loss allowances, is estimated based on discounted cash flow analysis using interest rates currently offered for loans with similar terms to borrowers of similar credit quality.

Federal Home Loan Bank of New York ("FHLB") stock: The carrying amount of FHLB stock approximates fair value and considers the limited marketability of the investment.

Bank-owned life insurance: The carrying amounts are based on the cash surrender values of the individual policies, which is a reasonable estimate of fair value.

The fair value of commitments to extend credit is estimated based on the amount of unamortized deferred loan commitment fees. The fair value of letters of credit is based on the amount of unearned fees plus the estimated costs to terminate the letters of credit. Fair values of unrecognized financial instruments including commitments to extend credit and the fair value of letter of credit are considered immaterial.

Deposits: The fair value of deposits with no stated maturity, such as money market deposit accounts, interest-bearing checking accounts and savings accounts, is equal to the amount payable on demand. The fair value of certificates of deposit is based on the discounted value of contractual cash flows. The discount rate is equivalent to current market rates for deposits of similar size, type and maturity.

Accrued interest receivable and payable: For these short-term instruments, the carrying amount is a reasonable estimate of fair value.

Federal Home Loan Bank of New York advances and securities sold under reverse repurchase agreements: The fair value of borrowings is based on the discounted value of contractual cash flows. The discount rate is equivalent to the

rate currently offered by the Federal Home Loan Bank of New York for borrowings of similar maturity and terms.

The carrying amounts and estimated fair values of the Company's financial instruments at March 31, 2011 and September 30, 2010 were as follows:

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|   | March 31, 2011    |                   | September 30, 2010 |                   |
|---|-------------------|-------------------|--------------------|-------------------|
|   | Carrying Value    | Fair Value        | Carrying Value     | Fair Value        |
| (Dollars in thousands)                      |                   |                   |                    |                   |
| <b>Financial assets</b>                     |                   |                   |                    |                   |
| Investment securities                       | \$ 70,406         | \$ 70,536         | \$ 58,666          | \$ 59,585         |
| Loans, net of allowance for loan losses     | 394,439           | 398,629           | 403,886            | 408,790           |
| Bank owned insurance policies               | 9,484             | 9,484             | 9,306              | 9,306             |
| <b>Financial liabilities</b>                |                   |                   |                    |                   |
| <b>Deposits</b>                             |                   |                   |                    |                   |
| <b>Demand, NOW and money market savings</b> |                   |                   |                    |                   |
| Certificates of deposit                     | \$ 247,422        | \$ 247,422        | \$ 239,917         | \$ 239,917        |
|   | 183,108           | 186,667           | 188,015            | 191,636           |
| <b>Total deposits</b>                       | <b>\$ 430,530</b> | <b>\$ 434,089</b> | <b>\$ 427,932</b>  | <b>\$ 431,553</b> |
| <b>Borrowings</b>                           |                   |                   |                    |                   |
| Interest rate derivatives                   | \$ 58,891         | \$ 61,542         | \$ 60,769          | \$ 64,068         |
|   | \$ -              | \$ -              | \$ 51              | \$ 51             |

The fair value of commitments to extend credit is estimated based on the amount of unamortized deferred loan commitment fees. The fair value of letters of credit is based on the amount of unearned fees plus the estimated cost to terminate the letters of credit. Fair values of unrecognized financial instruments including commitments to extend credit and the fair value of letters of credit are considered immaterial.

Cash and cash equivalents, accrued interest receivable and accrued interest payable are not presented in the above table as the carrying amounts shown in the consolidated balance sheet equal fair value.

**NOTE H - INVESTMENT SECURITIES**

The following table is an analysis of the amortized cost and fair values of securities available for sale at March 31, 2011 and September 30, 2010:

|   | At March 31, 2011 |                  |                         |            | At September 30, 2010. |                  |                         |            |
|---|-------------------|------------------|-------------------------|------------|------------------------|------------------|-------------------------|------------|
|   | Amortized Cost    | Unrealized Gains | Gross Unrealized Losses | Fair Value | Amortized Cost         | Unrealized Gains | Gross Unrealized Losses | Fair Value |
| (Dollars in thousands)                          |                   |                  |                         |            |                        |                  |                         |            |
| <b>Securities available for sale:</b>           |                   |                  |                         |            |                        |                  |                         |            |
| <b>Obligations of U.S. government agencies:</b> |                   |                  |                         |            |                        |                  |                         |            |
| Mortgage backed securities - residential        | \$ 3,542          | \$ 21            | \$ (35 )                | \$ 3,528   | \$ 3,904               | \$ -             | \$ (26 )                | \$ 3,878   |
| <b>Obligations of U.S. government-sponsored</b> |                   |                  |                         |            |                        |                  |                         |            |

enterprises:

|  |           |       |           |           |           |        |           |           |
|--|-----------|-------|-----------|-----------|-----------|--------|-----------|-----------|
| Mortgage-backed securities-residential               | 14,081    | 70    | (390 )    | 13,761    | 2,833     | 107    | -         | 2,940     |
| Mortgage backed securities-commercial                | 4,195     | -     | (22 )     | 4,173     | 4,274     | -      | (4 )      | 4,270     |
| Debt securities                                      | 5,000     | -     | (158 )    | 4,842     | 1,001     | 1      | -         | 1,002     |
| Private label mortgage-backed securities-residential | 1,734     | -     | (29 )     | 1,705     | 2,362     | -      | (265 )    | 2,097     |
| Total securities available for sale                  | \$ 28,552 | \$ 91 | \$ (634 ) | \$ 28,009 | \$ 14,374 | \$ 108 | \$ (295 ) | \$ 14,187 |

The maturities of the debt securities and mortgage-backed securities available-for-sale at March 31, 2011 are summarized in the following table:

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|                                 | At March 31, 2011      |               |
|---------------------------------|------------------------|---------------|
|                                 | Amortized<br>Cost      | Fair<br>Value |
|                                 | (Dollars in thousands) |               |
| Due within 1 year               | \$ -                   | \$ -          |
| Due after 1 but within 5 years  | 1,000                  | 1,000         |
| Due after 5 but within 10 years | 4,000                  | 3,842         |
| Due after 10 years              | -                      | -             |
| Total debt securities           | 5,000                  | 4,842         |
| Mortgage-backed securities:     |                        |               |
| Residential                     | 19,357                 | 18,994        |
| Commercial                      | 4,195                  | 4,173         |
| Total                           | \$ 28,552              | \$ 28,009     |

The following table is an analysis of the amortized cost and fair values of securities held to maturity at March 31, 2011 and September 30, 2010:

|   | At March 31, 2011          |                              |                               |               | At September 30, 2010      |                              |                               |               |
|---|----------------------------|------------------------------|-------------------------------|---------------|----------------------------|------------------------------|-------------------------------|---------------|
|   | Gross<br>Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value | Gross<br>Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
|   | (Dollars in thousands)     |                              |                               |               |                            |                              |                               |               |
| Securities held to<br>maturity:                             |                            |                              |                               |               |                            |                              |                               |               |
| Obligations of U.S.<br>government agencies:                 |                            |                              |                               |               |                            |                              |                               |               |
| Mortgage-backed<br>securities-residential                   | \$ 16,285                  | \$ 178                       | \$ (135 )                     | \$ 16,328     | \$ 18,407                  | \$ 401                       | \$ -                          | \$ 18,808     |
| Mortgage-backed<br>securities-commercial                    | 1,685                      | 19                           | -                             | 1,704         | 1,725                      | 22                           | -                             | 1,747         |
| Obligations of U.S.<br>government-sponsored<br>enterprises: |                            |                              |                               |               |                            |                              |                               |               |
| Mortgage backed<br>securities-residential                   | 16,124                     | 250                          | (65 )                         | 16,309        | 17,880                     | 425                          | -                             | 18,305        |
| Debt securities   | 6,496                      | 4                            | (117 )                        | 6,383         | 4,499                      | 35                           | -                             | 4,534         |
| Private label<br>mortgage-backed<br>securities-residential  | 1,735                      | 74                           | (82 )                         | 1,727         | 1,871                      | 101                          | (70 )                         | 1,902         |
| Obligations of state and<br>political subdivisions          | 72                         | 4                            | -                             | 76            | 97                         | 5                            | -                             | 102           |
| Total securities held to<br>maturity                        | \$ 42,397                  | \$ 529                       | \$ (399 )                     | \$ 42,527     | \$ 44,479                  | \$ 989                       | \$ (70 )                      | \$ 45,398     |

The maturities of the debt securities and the mortgage backed securities held to maturity at March 31, 2011 are summarized in the following table:

At March 31, 2011

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|                                    | Amortized<br>Cost<br>(Dollars in thousands) | Fair<br>Value |
|------------------------------------|---|---------------|
| Due within 1 year                  | \$ -  | \$ -          |
| Due after 1 but within 5 years     | 2,072                                       | 2,037         |
| Due after 5 but within 10 years    | 1,500                                       | 1,440         |
| Due after 10 years                 | 2,996                                       | 2,982         |
| Total debt securities              | 6,568                                       | 6,459         |
| <b>Mortgage-backed securities:</b> |   |               |
| Residential                        | 34,144                                      | 34,364        |
| Commercial                         | 1,685                                       | 1,704         |
| Total                              | \$ 42,397                                   | \$ 42,527     |

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## NOTE I – IMPAIRMENT OF INVESTMENT SECURITIES

The Company recognizes credit-related other-than-temporary impairment on debt securities in earnings while noncredit-related other-than-temporary impairment on debt securities not expected to be sold are recognized in other comprehensive income (“OCI”).

We review our investment portfolio on a quarterly basis for indications of impairment. This review includes analyzing the length of time and the extent to which the fair value has been lower than the cost, the financial condition and near-term prospects of the issuer, including any specific events which may influence the operations of the issuer and the intent and ability to hold the investment for a period of time sufficient to allow for any anticipated recovery in the market. We evaluate our intent and ability to hold debt securities based upon our investment strategy for the particular type of security and our cash flow needs, liquidity position, capital adequacy and interest rate risk position. In addition, the risk of future other-than-temporary impairment may be influenced by prolonged recession in the U.S. economy, changes in real estate values and interest deferrals.

Investment securities with fair values less than their amortized cost contain unrealized losses. The Company evaluated these securities and determined that the decline in value was primarily related to fluctuations in the interest rate environment and were not related to any company or industry specific event. The Company does not intend to sell these securities and has determined that it is not more likely than not that the Company would be required to sell these securities prior to maturity or market price recovery. Management has considered factors regarding other than temporarily impaired securities and determined that there are no securities with impairment that is other than temporary as of March 31, 2011.

The following tables present the gross unrealized losses and fair value at March 31, 2011 and September 30, 2010 for both available for sale and held to maturity securities by investment category and time frame for which the loss has been outstanding:

|   | Number<br>of<br>Securities | Less Than 12 Months |                      | March 31, 2011<br>12 Months Or Greater |                      | Total         |                      |
|---|----------------------------|---------------------|----------------------|--|----------------------|---------------|----------------------|
|   |                            | Fair<br>Value       | Unrealized<br>Losses | Fair<br>Value                          | Unrealized<br>Losses | Fair<br>Value | Unrealized<br>Losses |
| (Dollars in thousands)                                      |                            |                     |                      |  |                      |               |                      |
| Obligations of U.S.<br>government agencies:                 |                            |                     |                      |  |                      |               |                      |
| Mortgage-backed<br>securities-residential                   | 3                          | \$ 6,427            | \$ (170 )            | \$ -                                   | \$ -                 | \$ 6,427      | \$ (170 )            |
| Mortgage-backed<br>securities-commercial                    | 1                          | -                   | -                    | 22                                     | -                    | 22            | -                    |
| Obligations of U.S.<br>government-sponsored<br>enterprises: |                            |                     |                      |  |                      |               |                      |
| Mortgage-backed securities<br>- residential                 | 12                         | 18,372              | (455 )               | -                                      | -                    | 18,372        | (455 )               |
| Mortgage backed securities<br>- commercial                  | 1                          | 4,173               | (22 )                | -                                      | -                    | 4,173         | (22 )                |
| Debt securities   | 7                          | 10,221              | (275 )               | -                                      | -                    | 10,221        | (275 )               |

Private label

mortgage-backed securities:

|             |    |           |           |          |           |           |             |
|-------------|----|-----------|-----------|----------|-----------|-----------|-------------|
| Residential | 3  | -         | -         | 2,539    | (111 )    | 2,539     | (111 )      |
| Total       | 27 | \$ 39,193 | \$ (922 ) | \$ 2,561 | \$ (111 ) | \$ 41,754 | \$ (1,033 ) |

The investment securities listed above currently have fair values less than amortized cost and therefore contain unrealized losses. The Company evaluated these securities and determined that the decline in value was primarily related to fluctuations in the interest rate environment and were not related to any company or industry specific event. At March 31, 2011, there were twenty-seven investment securities with unrealized losses. The Company anticipates full recovery of amortized costs with respect to these securities. The Company does not intend to sell these securities and has determined that it is not more likely than not that the Company would be required to sell these securities prior to maturity or market price recovery. Management has considered factors regarding other than temporarily impaired securities and determined that there are no securities with impairment that is other than temporary as of March 31, 2011.

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|  | Number<br>of<br>Securities | Less Than 12 Months |                      | September 30, 2010<br>12 Months Or Greater |                      | Total            |                      |
|--|----------------------------|---------------------|----------------------|--|----------------------|------------------|----------------------|
|  |                            | Fair<br>Value       | Unrealized<br>Losses | Fair<br>Value                              | Unrealized<br>Losses | Fair<br>Value    | Unrealized<br>Losses |
| (Dollars in thousands)                                       |                            |                     |                      |  |                      |                  |                      |
| Obligations of U.S.<br>government agencies:                  |                            |                     |                      |  |                      |                  |                      |
| Mortgage-backed<br>securities-residential                    | 2                          | \$ 3,878            | \$ (26 )             | \$ -                                       | \$ -                 | \$ 3,878         | \$ (26 )             |
| Obligations of U.S.<br>government-<br>sponsored enterprises: |                            |                     |                      |  |                      |                  |                      |
| Mortgage backed<br>securities - commercial                   | 1                          | 4,270               | (4 )                 | -  | -                    | 4,270            | (4 )                 |
| Private label<br>mortgage-backed<br>securities:              |                            |                     |                      |  |                      |                  |                      |
| Residential  | 3                          | -                   | -                    | 2,964                                      | (335 )               | 2,964            | (335 )               |
| <b>Total</b>   | <b>6</b>                   | <b>\$ 8,148</b>     | <b>\$ (30 )</b>      | <b>\$ 2,964</b>                            | <b>\$ (335 )</b>     | <b>\$ 11,112</b> | <b>\$ (365 )</b>     |

## NOTE J – LOANS RECEIVABLE, NET AND RELATED ALLOWANCE FOR LOAN LOSSES

Loans receivable, net were comprised of the following:

|                                    | March 31,<br>2011 | September<br>30,<br>2010 |
|------------------------------------|-------------------|--------------------------|
| (Dollars in thousands)             |                   |                          |
| One-to four-family residential     | \$ 161,811        | \$ 165,462               |
| Commercial real estate             | 125,631           | 116,222                  |
| Construction                       | 39,684            | 57,086                   |
| Home equity lines of credit        | 22,134            | 22,823                   |
| Commercial business                | 35,805            | 33,676                   |
| Other                              | 13,002            | 13,277                   |
| <b>Total loans receivable</b>      | <b>398,067</b>    | <b>408,546</b>           |
| Net deferred loan costs            | 141               | 106                      |
| Allowance for loan losses          | (3,769 )          | (4,766 )                 |
| <b>Total loans receivable, net</b> | <b>\$ 394,439</b> | <b>\$ 403,886</b>        |

The segments of the Bank's loan portfolio are disaggregated to a level that allows management to monitor risk and performance. The residential mortgage loan segment is further disaggregated into two classes: amortizing term loans, which are primarily first liens, and home equity lines of credit, which are generally second liens. The commercial loan segment is further disaggregated into three classes. Commercial real estate loans include loans secured by multifamily structures, owner-occupied commercial structures, and non-owner occupied nonresidential

properties. The construction loan segment consists primarily of developers or investors for the purpose of acquiring, developing and constructing residential or commercial structures and to a lesser extent one-to-four family residential construction loans made to individuals for the acquisition of and/or construction on a lot or lots on which a residential dwelling is to be built. Construction loans to developers and investors have a higher risk profile because the ultimate buyer, once development is completed, is generally not known at the time of the loan. The commercial business loan segment consists of loans made for the purpose of financing the activities of commercial customers and consists primarily of revolving lines of credit. The consumer loan segment consists primarily of stock-secured installment loans, but also includes unsecured personal loans and overdraft lines of credit connected with customer deposit accounts.

Management evaluates individual loans in all segments for possible impairment if the loan either is in nonaccrual status, or is risk rated Substandard and is greater than 90 days past due. Loans are considered to be impaired when, based on current information and events, it is probable that the Company 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 evaluating impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding

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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.

Once the determination has been made that a loan is impaired, the recorded investment in the loan is compared to the fair value of the loan using one of three methods: (a) the present value of expected future cash flows discounted at the loan's effective interest rate; (b) the loan's observable market price; or (c) the fair value of the collateral securing the loan, less anticipated selling and disposition costs. The method is selected on a loan-by loan basis, with management primarily utilizing the fair value of collateral method. If there is a shortfall between the fair value of the loan and the recorded investment in the loan, the Company charges the difference to the allowance for loan loss as a charge-off and carries the impaired loan on its books at fair value. It is the Company's policy to evaluate impaired loans on an annual basis to ensure the recorded investment in a loan does not exceed its fair value.

The following table presents impaired loans by class, segregated by those for which a specific allowance was required and charged-off and those for which a specific allowance was not necessary for the period presented:

|                                | Impaired Loans with Specific Allowance |                   | Impaired Loans with No Specific Allowance | Total Impaired Loans |                          |
|--------------------------------|--|-------------------|---|----------------------|--------------------------|
|                                | Recorded Investment                    | Related Allowance | Recorded Investment                       | Recorded Investment  | Unpaid Principal Balance |
| (Dollars in thousands)         |  |                   |   |                      |                          |
| March 31, 2011                 |  |                   |   |                      |                          |
| One-to four-family residential | \$ -                                   | \$ -              | \$ 2,282                                  | \$ 2,282             | \$ 2,336                 |
| Commercial real estate         | -                                      | -                 | 7,638                                     | 7,638                | 8,771                    |
| Construction                   | -                                      | -                 | 13,153                                    | 13,153               | 18,826                   |
| Home equity lines of credit    | -                                      | -                 | 1,303                                     | 1,303                | 1,397                    |
| Commercial business            | -                                      | -                 | 715                                       | 715                  | 876                      |
| Other                          | -                                      | -                 | 18  | 18                   | 18                       |
| Total impaired loans           | \$ -                                   | \$ -              | \$ 25,109                                 | \$ 25,109            | \$ 32,224                |

At September 30, 2010, impaired loans, none of which had specific allowances, totaled \$27,412,000.

The following table presents the average recorded investment in impaired loans for the periods indicated. There was no interest income recognized on impaired loans during the periods presented.

|                                | For the Three Months Ended March 31, 2011 | For the Six Months Ended March 31, 2011 |
|--------------------------------|---|---|
| (Dollars in thousands)         |   |   |
| One-to four-family residential | \$ 2,301                                  | \$ 2,351                                |
| Commercial real estate         | 7,933                                     | 8,031                                   |

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|                                      |           |           |
|--------------------------------------|-----------|-----------|
| Construction                         | 13,051    | 13,357    |
| Home equity lines of credit          | 1,303     | 1,303     |
| Commercial business                  | 783       | 1,010     |
| Other                                | 9         | 6         |
| Average investment in impaired loans | \$ 25,380 | \$ 26,058 |

Management uses a ten point internal risk rating system to monitor the credit quality of the overall loan portfolio. The first six categories are considered not criticized, and are aggregated as “Pass” rated. The criticized rating categories utilized by management generally follow bank regulatory definitions. The Special Mention category includes assets that are currently protected but are potentially weak, resulting in an undue and unwarranted credit risk, but not to the point of justifying a Substandard classification. Loans in the Substandard category have well-defined weaknesses that jeopardize the liquidation of the debt, and have a distinct possibility that some loss will be sustained if the weaknesses

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are not corrected. All loans greater than three months past due are considered Substandard. Any portion of a loan that has been charged off is placed in the Loss category.

To help ensure that risk ratings are accurate and reflect the present and future capacity of borrowers to repay a loan as agreed, the Bank has a structured loan rating process with several layers of internal and external oversight. Generally, consumer and residential mortgage loans are included in the Pass categories unless a specific action, such as severe delinquency, bankruptcy, repossession, or death occurs to raise awareness of a possible credit event. The Bank's Commercial Loan Officers are responsible for the timely and accurate risk rating of the loans in their portfolios at origination and on an ongoing basis. The Asset Review Committee performs monthly reviews of all commercial relationships internally rated 6 ("Watch") or worse. Confirmation of the appropriate risk grade is performed by an external Loan Review Company that semi-annually reviews and assesses loans within the portfolio. Generally, the external consultant reviews commercial relationships greater than \$500,000 and/or criticized relationships greater than \$250,000. Detailed reviews, including plans for resolution, are performed on loans classified as Substandard on a monthly basis.

The following table presents the classes of the loan portfolio summarized by the aggregate Pass and the criticized categories of Special Mention, Substandard and Doubtful within the Bank's internal risk rating system for the period presented:

|                                      | Pass              | Special<br>Mention | Substandard      | Doubtful     | Total             |
|--------------------------------------|-------------------|--------------------|------------------|--------------|-------------------|
| (Dollars in thousands)               |                   |                    |                  |              |                   |
| March 31, 2011                       |                   |                    |                  |              |                   |
| One-to<br>four-family<br>residential | \$ 153,691        | \$ 4,854           | \$ 3,266         | \$ -         | \$ 161,811        |
| Commercial real<br>estate            | 110,111           | 5,119              | 10,401           | -            | 125,631           |
| Construction                         | 16,218            | 7,232              | 16,234           | -            | 39,684            |
| Home equity<br>lines of credit       | 18,999            | 1,192              | 1,943            | -            | 22,134            |
| Commercial<br>business               | 28,754            | 5,102              | 1,882            | 67           | 35,805            |
| Other                                | 12,984            | -                  | 18               | -            | 13,002            |
| <b>Total</b>                         | <b>\$ 340,757</b> | <b>\$ 23,499</b>   | <b>\$ 33,744</b> | <b>\$ 67</b> | <b>\$ 398,067</b> |

Management further monitors the performance and credit quality of the loan portfolio by analyzing the age of the portfolio as determined by the length of time a recorded payment is past due. The following table presents the classes of the loan portfolio summarized by the aging categories of performing loans and nonaccrual loans for the period presented:

|                        | 30-59<br>Days<br>Past Due | 60-89<br>Days<br>Past Due | 90 Days +<br>Past Due | Total<br>Past Due | Non-<br>Accrual | Total<br>Loans |
|------------------------|---------------------------|---------------------------|-----------------------|-------------------|-----------------|----------------|
| (Dollars in thousands) |                           |                           |                       |                   |                 |                |
| March 31,<br>2011      | \$ 158,724                | \$ 648                    | \$ 157                | \$ 2,282          | \$ 3,087        | \$ 2,282       |
|                        |                           |                           |                       |                   |                 | \$ 161,811     |

|                                      |            |          |          |           |           |           |            |
|--------------------------------------|------------|----------|----------|-----------|-----------|-----------|------------|
| One-to<br>four-family<br>residential |            |          |          |           |           |           |            |
| Commercial<br>real estate            | 115,401    | 2,021    | 129      | 8,080     | 10,230    | 7,879     | 125,631    |
| Construction                         | 21,691     | 1,669    | 3,171    | 13,153    | 17,993    | 13,153    | 39,684     |
| Home equity<br>lines of credit       | 20,632     | -        | 199      | 1,303     | 1,502     | 1,303     | 22,134     |
| Commercial<br>business               | 34,836     | 15       | -        | 954       | 969       | 715       | 35,805     |
| Other                                | 12,934     | -        | 50       | 18        | 68        | 18        | 13,002     |
| Total                                | \$ 364,218 | \$ 4,353 | \$ 3,706 | \$ 25,790 | \$ 33,849 | \$ 25,350 | \$ 398,067 |

At September 30, 2010, nonaccrual loans totaled \$27,417,000 and loans ninety days or more delinquent and accruing interest totaled \$583,000.

An allowance for loan losses (“ALL”) is maintained to absorb losses from the loan portfolio. The ALL is based on management’s continuing evaluation of the risk characteristics and credit quality of the loan portfolio, assessment of current economic conditions, diversification and size of the portfolio, adequacy of collateral, past and anticipated loss experience, and the amount of non-performing loans.

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The Bank's methodology for determining the ALL is based on the requirements of ASC Section 310-10-35 for loans individually evaluated for impairment (discussed above) and ASC Subtopic 450-20 for loans collectively evaluated for impairment, as well as the Interagency Policy Statements on the Allowance for Loan and Lease Losses and other bank regulatory guidance.

Loans that are collectively evaluated for impairment are analyzed with general allowances being made as appropriate. For general allowances, historical loss trends are used in the estimation of losses in the current portfolio. These historical loss amounts are modified by other qualitative and economic factors.

The loans are segmented into classes based on their inherent varying degrees of risk, as described above. Management tracks the historical net charge-off activity by segment and utilizes this figure, as a percentage of the segment, as the general reserve percentage for pooled, homogenous loans that have not been deemed impaired. Typically, an average of losses incurred over a defined number of consecutive historical years is used. A 5 year history is currently utilized for all loan segments except for construction loans, where the highest single year loss percentage of the most recent five years is used in place of a 5 year average.

Non-impaired credits are segregated for the application of qualitative factors. Management has identified a number of additional qualitative factors which it uses to supplement the historical charge-off factor because these factors are likely to cause estimated credit losses associated with the existing loan pools to differ from historical loss experience. The additional factors that are evaluated quarterly and updated using information obtained from internal, regulatory, and governmental sources are: national and local economic trends and conditions; levels of and trends in delinquency rates and non-accrual loans; trends in volumes and terms of loans; effects of changes in lending policies; experience, ability, and depth of lending staff; value of underlying collateral; and concentrations of credit from a loan type, industry and/or geographic standpoint.

Management reviews the loan portfolio on a quarterly basis using a defined, consistently applied process in order to make appropriate and timely adjustments to the ALL. When information confirms all or part of specific loans to be uncollectible, these amounts are promptly charged off against the ALL. Since loans individually evaluated for impairment are promptly written down to their fair value, typically there is no portion of the ALL for loans individually evaluated for impairment.

The following table summarizes the primary segments of the ALL, segregated into the amount required for loans individually evaluated for impairment and the amount required for loans collectively evaluated for impairment as of March 31, 2011:

|  | One-to<br>Four-<br>Family<br>Residential | Commercial<br>Real Estate | Commercial<br>Construction | Home<br>Equity<br>Lines of<br>Credit | Commercial<br>Business | Other | Unallocated | Total   |
|--|--|---------------------------|----------------------------|--------------------------------------|------------------------|-------|-------------|---------|
| (Dollars in thousands)                 |  |                           |                            |                                      |                        |       |             |         |
| ALL balance at<br>December 31,<br>2010 | \$474                                    | \$ 927                    | \$ 1,695                   | \$65                                 | \$ 605                 | \$12  | \$ 509      | \$4,287 |
| Charge-offs                            | (32 )                                    | (585 )                    | (224 )                     | -                                    | (155 )                 | -     |             | (996 )  |
| Recoveries                             | -  | -                         | -                          | -                                    | -                      | -     |             | -       |
| Provision                              | 22                                       | 808                       | (133 )                     | (4 )                                 | 192                    | 2     | (409 )      | 478     |
| ALL balance at<br>March 31, 2011       | \$464                                    | \$ 1,150                  | \$ 1,338                   | \$61                                 | \$ 642                 | \$14  | \$ 100      | \$3,769 |
| Loans receivable:                      |  |                           |                            |                                      |                        |       |             |         |

|   |           |            |           |          |           |          |           |
|---|-----------|------------|-----------|----------|-----------|----------|-----------|
| Individually<br>evaluated<br>for impairment | \$2,282   | \$ 7,638   | \$ 13,153 | \$1,303  | \$ 715    | \$18     | \$25,109  |
| Collectively<br>evaluated<br>for impairment | 159,529   | 117,993    | 26,531    | 20,831   | 35,090    | 12,984   | 372,958   |
| Total                                       | \$161,811 | \$ 125,631 | \$ 39,684 | \$22,134 | \$ 35,805 | \$13,002 | \$398,067 |

The allowance for loan losses is based on estimates, and actual losses will vary from current estimates. Management believes that the segmentation of the loan portfolio into homogeneous pools and the related historical loss ratios and

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other qualitative factors, as well as the consistency in the application of assumptions, result in an ALL that is representative of the risk found in the components of the portfolio at any given date.

## NOTE K - DEPOSITS

A summary of deposits by type of account are summarized as follows:

|                         | March 31,<br>2011      | September<br>30,<br>2010 |
|-------------------------|------------------------|--------------------------|
|                         | (Dollars in thousands) |                          |
| Demand accounts         | \$ 46,225              | \$ 37,298                |
| Savings accounts        | 61,762                 | 61,867                   |
| NOW accounts            | 40,455                 | 51,473                   |
| Money market accounts   | 98,980                 | 89,279                   |
| Certificates of deposit | 152,105                | 156,528                  |
| Retirement certificates | 31,003                 | 31,487                   |
|                         | \$ 430,530             | \$ 427,932               |

## NOTE L – INCOME TAXES

The Company records income taxes using the asset and liability method. Accordingly, deferred tax assets and liabilities: (i) are recognized for the expected future tax consequences of events that have been recognized in the financial statements or tax returns; (ii) are attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases; and (iii) are measured using enacted tax rates expected to apply in the years when those temporary differences are expected to be recovered or settled.

Where applicable, deferred tax assets are reduced by a valuation allowance for any portions determined not likely to be realized. The valuation allowance is assessed by management on a quarterly basis and adjusted, by a charge or credit to income tax expense, as changes in facts and circumstances warrant. In assessing whether it is more likely than not that some portion or all of the deferred tax assets will not be realized, management considers projections of future taxable income, the projected periods in which current temporary differences will be deductible, the availability of carry forwards, and existing tax laws and regulations. Due to the uncertainty of the Company's ability to realize the benefit of certain deferred tax assets within statutory time limits, the net deferred tax assets are partially offset by a valuation allowance at March 31, 2011, the amount of which has not materially changed from that in place at September 30, 2010.

A reconciliation of income tax (benefit) between the amounts calculated based upon pre-tax income (loss) at the Company's federal statutory rate and the amounts reflected in the consolidated statements of operations are as follows:

| For the three Months<br>Ended March 31, |      | For the Six Months<br>Ended March 31, |      |
|---|------|---------------------------------------|------|
| 2011                                    | 2010 | 2011                                  | 2010 |
| (in thousands)                          |      | (in thousands)                        |      |

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|   |           |        |           |           |
|---|-----------|--------|-----------|-----------|
| Income tax benefit at 34%<br>statutory federal tax rate                   | \$ (204 ) | \$ 96  | \$ (149 ) | \$ (7 )   |
| Change in valuation allowance<br>related<br>to deferred income tax assets | -         | (325 ) | -         | (325 )    |
| State tax (benefit) expense   | (18 )     | 1      | (13 )     | 3         |
| Other   | (22 )     | 230    | (46 )     | 8         |
| Income tax (benefit)  | \$ (244 ) | \$ 2   | \$ (208 ) | \$ (321 ) |

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## NOTE M - FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK

The Company uses derivative financial instruments, such as interest rate floors and collars, as part of its interest rate risk management. Interest rate caps and floors are agreements whereby one party agrees to pay or receive a floating rate of interest on a notional principal amount for a predetermined period of time if certain market interest rate thresholds are met. The Company considers the credit risk inherent in these contracts to be negligible.

As of March 31, 2011, the Company did not hold any interest rate floors or collars. As of September 30, 2010, the Company held one Prime-based interest rate floor with a maturity date of December 27, 2010. The counterparty in the transaction was Wells Fargo (formerly Wachovia Bank, N.A). In accordance with cash flow hedge accounting, the amortization of the costs of the derivatives flowed through the Company's income statement as a reduction to loan interest income. In addition, all changes in fair value of the derivative contracts are recorded through other comprehensive income.

The table below shows the notional amount, strike and maturity date of our interest rate derivative contract as of March 31, 2011 and September 30, 2010.

|                        | Notional<br>Amount | Strike | Maturity<br>Date | Fair Value        |                       |
|------------------------|--------------------|--------|------------------|-------------------|-----------------------|
|                        |                    |        |                  | March 31,<br>2011 | September 30,<br>2010 |
| (Dollars in thousands) |                    |        |                  |                   |                       |
| Interest rate<br>floor | \$ 5,000           | 7.25 % | 12/27/10         | \$ -              | \$ 51                 |

The 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 are commitments to extend credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the balance sheets.

|   | March 31,<br>2011 | September 30,<br>2010 |
|---|-------------------|-----------------------|
| (Dollars in thousands)  |                   |                       |
| Financial instruments whose contract amounts<br>represent credit risk |                   |                       |
| Letters of credit   | \$ 1,548          | \$ 2,048              |
| Unused lines of credit  | 37,240            | 42,890                |
| Fixed rate loan commitments   | 8,268             | 3,746                 |
| Variable rate loan commitments  | 96                | 100                   |
|   | \$ 47,152         | \$ 48,784             |

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

Forward-Looking Statements

When used in this filing and in future filings by the Company with the Securities and Exchange Commission, in the Company's press releases or other public or shareholder communications, or in oral statements made with the approval of an authorized executive officer, the words or phrases, "anticipate," "would be," "will allow," "intends to," "will likely result," "are expected to," "will continue," "is anticipated," "estimated," "projected," "believes", or similar expressions are intended to identify "forward looking statements." Forward-looking statements are subject to numerous risks and uncertainties, including, but not limited to, those risks previously disclosed in the Company's filings with the SEC, general economic conditions, changes in interest rates, regulatory considerations, competition, technological developments, retention and recruitment of qualified personnel, and market acceptance of the Company's pricing, products and services, and with respect to the loans extended by the Bank and real estate owned, the following: risks related to the economic environment in the market areas in which the Bank operates, particularly with respect to the real estate market in New Jersey; the risk that the value of the real estate securing these loans may decline in value; and the risk that significant expense may be incurred by the Company in connection with the resolution of these loans.

The Company wishes to caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made, and advises readers that various factors, including regional and national economic conditions, substantial changes in levels of market interest rates, credit and other risks of lending and investing activities, and competitive and regulatory factors, could affect the Company's financial performance and could cause the Company's actual results for future periods to differ materially from those anticipated or projected.

The Company does not undertake, and specifically disclaims any obligation, to update any forward-looking statements to reflect occurrences or unanticipated events or circumstances after the date of such statements.

Critical Accounting Policies

Critical accounting policies are defined as those that are reflective of significant judgments and uncertainties, and could potentially result in materially different results under different assumptions and conditions. Critical accounting policies may involve complex subjective decisions or assessments. We consider the following to be our critical accounting policies.

**Allowance for Loan Losses.** The allowance for loan losses is the amount estimated by management as necessary to cover credit losses in the loan portfolio both probable and reasonably estimable at the balance sheet date. The allowance is established through the provision for loan losses which is charged against income. In determining the allowance for loan losses, management makes significant estimates and has identified this policy as one of our most critical. Due to the high degree of judgment involved, the subjectivity of the assumptions utilized and the potential for changes in the economic environment that could result in changes to the amount of the recorded allowance for loan losses, the methodology for determining the allowance for loan losses is considered a critical accounting policy by management.

As a substantial amount of our loan portfolio is collateralized by real estate, appraisals of the underlying value of property securing loans and discounted cash flow valuations of properties are critical in determining the amount of the allowance required for specific loans. Assumptions for appraisals and discounted cash flow valuations are instrumental in determining the value of properties. Overly optimistic assumptions or negative changes to assumptions could significantly affect the valuation of a property securing a loan and the related allowance determined. The assumptions supporting such appraisals and discounted cash flow valuations are carefully reviewed by management to determine that the resulting values reasonably reflect amounts realizable on the related loans.

Management performs a quarterly evaluation of the adequacy of the allowance for loan losses. We consider a variety of factors in establishing this estimate including, but not limited to, current economic conditions, delinquency statistics, geographic and industry concentrations, the adequacy of the underlying collateral, the financial strength of the borrower, results of internal loan reviews and other relevant factors. This evaluation is inherently subjective as it requires material estimates by management that may be susceptible to significant change based on changes in economic and real estate market conditions.

The evaluation has a specific and general component. The specific component relates to loans that are delinquent or otherwise identified as impaired through the application of our loan review process and our loan grading system. All

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such loans are evaluated individually, with principal consideration given to the value of the collateral securing the loan and discounted cash flows. Specific impairment allowances are established as required by this analysis. The general component is determined by segregating the remaining loans by type of loan, risk weighting (if applicable) and payment history. We also analyze historical loss experience, delinquency trends, general economic conditions and geographic and industry concentrations. This analysis establishes factors that are applied to the loan groups to determine the amount of the general component of the allowance for loan losses.

Actual loan losses may be significantly greater than the allowances we have established, which could have a material negative effect on our financial results.

**Other Real Estate Owned.** Real estate acquired through foreclosure, or a deed-in-lieu of foreclosure, is recorded at fair value less estimated selling costs at the date of acquisition or transfer, and subsequently at the lower of its new cost or fair value less estimated selling costs. Adjustments to the carrying value at the date of acquisition or transfer are charged to the allowance for loan losses. The carrying value of the individual properties is subsequently adjusted to the extent it exceeds estimated fair value less estimated selling costs, at which time a provision for losses on such real estate is charged to operations.

Appraisals are critical in determining the fair value of the other real estate owned amount. Assumptions for appraisals are instrumental in determining the value of properties. Overly optimistic assumptions or negative changes to assumptions could significantly affect the valuation of a property. The assumptions supporting such appraisals are carefully reviewed by management to determine that the resulting values reasonably reflect amounts realizable.

**Deferred Income Taxes.** The Company records income taxes using the asset and liability method. Accordingly, deferred tax assets and liabilities: (i) are recognized for the expected future tax consequences of events that have been recognized in the financial statements or tax returns; (ii) are attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases; and (iii) are measured using enacted tax rates expected to apply in the years when those temporary differences are expected to be recovered or settled.

Where applicable, deferred tax assets are reduced by a valuation allowance for any portions determined not likely to be realized. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income tax expense in the period of enactment. The valuation allowance is adjusted, by a charge or credit to income tax expense, as changes in facts and circumstances warrant.

Comparison of Financial Condition at March 31, 2011 and September 30, 2010

Total assets decreased \$146,000, or 0.03%, to \$537.8 million at March 31, 2011 from \$537.9 million at September 30, 2010. The decrease resulted from a \$9.4 million decrease in loans receivable, net of allowance for loan loss, and a \$5.8 million decrease in cash and cash equivalents, offset by an \$11.7 million increase in investment securities and a \$3.7 million increase in other real estate owned.

Total loans receivable decreased \$10.5 million during the six months ended March 31, 2011 to \$398.1 million and were comprised of \$161.8 million (40.6%) in one-to-four family residential mortgage loans, \$125.6 million (31.6%) in commercial real estate loans, \$39.7 million (10.0%) in construction loans, \$35.8 million (9.0%) in commercial business loans, and \$35.2 million (8.8%) in home equity lines of credit and other loans. Contraction of the portfolio during the six- months ended March 31, 2011 occurred primarily in construction loans, which decreased \$17.4 million, followed by one-to-four family residential mortgage loans, which decreased \$3.7 million. Commercial real estate and business loans increased \$9.4 million and \$2.1 million, respectively. The Company ceased originating new non-owner occupied construction loans in October 2008 and intends to continue decreasing construction loans as a percentage of total loans.

Total non-performing loans decreased by \$2.2 million to \$25.8 million at March 31, 2011 from \$28.0 million at September 30, 2010. The ratio of non-performing loans to total loans was 6.5% at March 31, 2011 compared to 6.9% at September 30, 2010.

Included in the non-performing loan totals were fourteen construction loans totaling \$13.2 million, fourteen commercial loans totaling \$9.0 million, four residential mortgage loans totaling \$2.3 million, three home equity lines of credit totaling \$1.3 million, and two consumer loans totaling \$18,000.

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Adverse economic conditions have led to high levels of non-performing loans, particularly in the Company's construction loan portfolio. The repayment of construction loans is typically dependent upon the sale of the collateral securing the loan, which has been negatively impacted by rapid deterioration in the housing market and decreased buyer demand. As a result, construction projects have slowed and reached their maturity dates. In order for the Company to extend the loans beyond the original maturity date, the value of the collateral securing the loan must be assessed, which is typically done by obtaining an updated third-party appraisal. Given the deterioration in the economy and, specifically, the housing market, updated valuations of the collateral reflect depreciation from earlier assessments. To the extent that an updated valuation of the collateral is insufficient to cover a collateral-dependent loan, the Company reduces the balance of the loan via a charge to the allowance for loan loss.

Non-performing construction loans decreased \$1.4 million, or 9.6%, to \$13.2 million at March 31, 2011 from \$14.6 million at September 30, 2010. The decrease was attributable to the transfer of three loans totaling \$3.0 million to other real estate owned, the restructuring of three loans totaling \$840,000, and charge-offs totaling \$1.0 million, partially offset by one new non-performing construction loan totaling \$3.4 million. At March 31, 2011, non-performing construction loans consisted of four loans totaling \$6.8 million secured by incomplete single family homes, two loans totaling \$1.5 million secured by incomplete condominium units, and eight loans totaling \$4.9 million secured by land and other real estate. These loans were used for land acquisition and construction in various locations in the States of New Jersey and Pennsylvania. Magyar Bank is determining the proper course of action to collect the principal outstanding on these loans. Year-to-date, the Bank has charged off \$1.0 million in construction loan balances through a reduction of its allowance for loan loss.

Construction loans may contain interest reserves on which the interest is capitalized to the loan. At March 31, 2011, there was one performing construction loan with an interest reserve representing an outstanding balance of \$1.1 million, original interest reserves of \$94,000, advanced interest reserves of \$8,000, and a remaining interest reserve balance of \$86,000. At September 30, 2010, there were four performing construction loans with interest reserves representing outstanding balances of \$13.7 million, original interest reserves of \$1.1 million, advanced interest reserves of \$644,000, and remaining interest reserve balances of \$411,000.

Underwriting for construction loans with and without interest reserves has followed a uniform process. Construction loan progress is monitored on a monthly basis by management of the Bank as well as by the Board of Directors. Each time an advance is requested, an inspection is made of the project by an outside engineer or appraiser, depending on the size and complexity of the project, to determine the amount of work completed and if the costs to date are supported adequately. The Bank's construction loan operations personnel compare the advance request with the original budget and remaining loan funds available to ensure the project is in balance and that at all times the amount remaining on the loan is sufficient to complete the project.

A number of the Bank's construction loans have been extended due to slower sales as a result of economic conditions. In cases where updated appraisals reflect collateral values insufficient to cover the loan, additional collateral and/or a principal reduction is required to extend the loan. Some of the Bank's loans that originally had interest reserves are non-performing. The Bank does not have any currently non-performing loans with active interest reserves. Once a loan is deemed impaired, any interest reserve is frozen and the loan is placed on non-accrual so that no future interest income is recorded on these loans. The Bank ceased originating new non-owner occupied construction loans in October 2008.

Non-performing loans secured by one-to four-family residential properties decreased \$169,000, or 4.7%, to \$3.6 million at March 31, 2011 from \$3.8 million at September 30, 2010. The loans consisted of three commercial-purpose loans totaling \$3.0 million and four consumer loans totaling \$614,000. The Company has not and does not intend to originate or purchase sub-prime loans or option-ARM loans. Fiscal year-to-date, the Bank has charged off \$55,000 in non-accrual residential mortgage loans through a reduction of its allowance for loan loss.

Non-performing commercial real estate loans decreased \$148,000, or 1.8%, to \$8.1 million at March 31, 2011 from \$8.2 million at September 30, 2010. The loans were in various stages of foreclosure and collection at March 31, 2011. Fiscal year-to-date, the Bank has charged off \$585,000 in non-accrual commercial real estate loans through a reduction of its allowance for loan loss.

Non-performing commercial business loans decreased \$511,000, or 34.9%, to \$954,000 at March 31, 2011 from \$1.5 million at September 30, 2010. Of the seven non-performing commercial business loans, one totaling \$529,000 was secured by real estate. The Bank is in the process of collecting the principal outstanding on the non-accrual loans which

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will include foreclosure proceedings for those loans secured by real estate. Fiscal year-to-date, the Bank has charged off \$188,000 in non-performing commercial business loans through a reduction of its allowance for loan loss.

The allowance for loan losses decreased by \$997,000 during the six months ended March 31, 2011 to \$3.8 million. The decrease during the six month period was primarily attributable to net charge-offs totaling \$1.8 million, partially offset by provisions for loan loss of \$836,000. The decrease in the allowance for loan losses was primarily attributable to contraction in the loan portfolio, specifically in construction loans, which decreased \$17.4 million, or 30.5%, during the six month period. Since non-performing construction loans have accounted for the majority of the Bank's loan charge-offs, a large portion of the allowance for loan loss is maintained for performing construction loans. The recent significant decline in construction loan balances has reduced the required reserves for performing construction loans and therefore the total allowance for loan loss.

The allowance for loan loss does not include a specific reserve for non-performing loans as all such loans are reported at the lower of amortized cost or fair value, based upon updated independent appraisals of collateral or the discounted value of expected loan repayments. Valuations of such loans are performed at least annually with charge-offs recorded when appraised values, net of estimated selling and disposition costs, are less than the loan balances. The allowance for loan losses as a percentage of non-performing loans was 14.6% at March 31, 2011 compared with 17.0% at September 30, 2010. At March 31, 2011 our allowance for loan losses as a percentage of total loans was 0.95% compared with 1.17% at September 30, 2010. Future increases in the allowance for loan losses may be necessary based on possible future increases in non-performing loans and charge-offs, possible additional deterioration of collateral values, and the possible continuation or deterioration of the current adverse economic environment.

Investment securities increased \$11.7 million to \$70.4 million at March 31, 2011 from \$58.7 million at September 30, 2010. The increase was the result of purchases totaling \$25.8 million of U.S. Government-sponsored enterprise obligations, offset by principal repayments totaling \$11.6 million, the sale of one security totaling \$2.0 million, a market value adjustment in the available-for-sale portfolio of \$356,000, and security amortization of \$155,000 during the six months ended March 31, 2011.

Other real estate owned increased \$3.7 million to \$16.4 million at March 31, 2011 from \$12.7 million at September 30, 2010. The increase was primarily the result of the foreclosure of collateral securing three construction loans which consisted of two completed residential homes and one incomplete 10-unit condominium building.

Other real estate owned at March 31, 2011 consisted of six residential properties, one commercial real estate property, three substantially completed condominium projects, four partially completed residential properties, and seventeen real estate lots approved for residential homes. The Bank is determining the proper course of action for its other real estate owned, which may include holding the properties until the real estate market improves, selling the properties to a developer and completing partially completed homes for either rental or sale. At March 31, 2011, the Company had contracts of sale or was negotiating contracts of sale on nine properties with carrying values totaling \$8.1 million. The Company does not anticipate any additional losses on these properties.

Total deposits increased \$2.6 million, or 0.6%, to \$430.5 million during the six months ended March 31, 2011. The increase in deposits occurred in money market account balances, which increased \$9.7 million, or 10.9%, to \$99.0 million and in non-interest checking accounts, which increased \$8.9 million, or 23.9%, to \$46.2 million. Offsetting the increase were decreases in interest-bearing checking accounts, which decreased \$11.0 million, or 21.4%, to \$40.5 million and certificates of deposit (including individual retirement accounts), which decreased \$4.9 million to \$183.1 million. The Company's ability to maintain its net interest margin in the first half of its fiscal year was largely a result of the replacement of higher-rate certificates of deposit with non-interest checking and money market balances.

Included in total deposits at March 31, 2011 were \$1.8 million in Certificate of Deposit Account Registry Service (CDARS) Reciprocal certificates of deposit and \$10.7 million in brokered certificates of deposit. At September 30, 2010, the Company held \$2.9 million in CDARS Reciprocal certificates of deposit and \$14.7 million in brokered certificates of deposit.

Federal Home Loan Bank of New York advances decreased \$1.9 million during the six months ended March 31, 2011 to \$43.9 million, or 8.2% of assets. The decrease resulted from maturities of longer-term advances that were repaid using inflows from deposits. Securities sold under agreements to repurchase were unchanged during the six months ended March 31, 2011.

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Stockholders' equity decreased \$298,000, or 0.7%, to \$43.9 million at March 31, 2011 from \$44.2 million at September 30, 2010. The decrease was due to the Company's results from operations and changes in the Company's accumulated other comprehensive loss during the six month period. The Company's book value per share decreased to \$7.57 at March 31, 2011 from \$7.64 at September 30, 2010.

During the six months ended March 31, 2011, the Company did not repurchase any shares. Through March 31, 2011, the Company had repurchased 66,970 shares at an average price of \$9.39 pursuant to the second stock repurchase plan, which has reduced outstanding shares to 5,798,831.

Average Balance Sheets for the Three and Six Months Ended March 31, 2011 and 2010

The table on the following page presents certain information regarding the Company's financial condition and net interest income for the three and six months ended March 31, 2011 and 2010. The table presents the annualized average yield on interest-earning assets and the annualized average cost of interest-bearing liabilities. We derived the yields and costs by dividing annualized income or expense by the average balance of interest-earning assets and interest-bearing liabilities, respectively, for the periods shown. We derived average balances from daily balances over the periods indicated. Interest income includes fees that we consider adjustments to yields.

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**MAGYAR BANCORP, INC. AND SUBSIDIARY**  
**Comparative Average Balance Sheets**  
(Dollars In Thousands)

|   | For the Three Months Ended March 31, |                                |                            |                    |                                |                            |
|---|--------------------------------------|--------------------------------|----------------------------|--------------------|--------------------------------|----------------------------|
|   | 2011                                 |                                |                            | 2010               |                                |                            |
|   | Average<br>Balance                   | Interest<br>Income/<br>Expense | Yield/Cost<br>(Annualized) | Average<br>Balance | Interest<br>Income/<br>Expense | Yield/Cost<br>(Annualized) |
| <b>Interest-earning assets:</b>   |                                      |                                |                            |                    |                                |                            |
| Interest-earning deposits   | \$9,344                              | \$4                            | 0.18 %                     | \$4,362            | \$1                            | 0.07 %                     |
| Loans receivable, net   | 393,798                              | 5,005                          | 5.15 %                     | 431,721            | 5,788                          | 5.44 %                     |
| <b>Securities</b>   |                                      |                                |                            |                    |                                |                            |
| Taxable   | 72,344                               | 529                            | 2.97 %                     | 64,860             | 631                            | 3.94 %                     |
| Tax-exempt (1)  | 77                                   | 2                              | 8.44 %                     | 102                | 1                              | 5.80 %                     |
| FHLB of NY stock  | 2,760                                | 40                             | 5.91 %                     | 3,178              | 46                             | 5.90 %                     |
| Total interest-earning assets   | 478,323                              | 5,580                          | 4.73 %                     | 504,223            | 6,467                          | 5.20 %                     |
| Noninterest-earning assets  | 53,639                               |                                |                            | 51,591             |                                |                            |
| Total assets  | \$531,962                            |                                |                            | \$555,814          |                                |                            |
| <b>Interest-bearing liabilities:</b>                                    |                                      |                                |                            |                    |                                |                            |
| Savings accounts (2)  | \$61,667                             | 89                             | 0.58 %                     | \$63,025           | 174                            | 1.12 %                     |
| NOW accounts (3)  | 134,935                              | 256                            | 0.77 %                     | 137,339            | 356                            | 1.05 %                     |
| Time deposits (4)   | 182,936                              | 933                            | 2.07 %                     | 204,031            | 1,137                          | 2.26 %                     |
| Total interest-bearing deposits   | 379,538                              | 1,278                          | 1.37 %                     | 404,395            | 1,667                          | 1.67 %                     |
| Borrowings  | 60,727                               | 597                            | 3.99 %                     | 70,131             | 698                            | 4.04 %                     |
| Total interest-bearing liabilities                                      | 440,265                              | 1,875                          | 1.73 %                     | 474,526            | 2,365                          | 2.02 %                     |
| Noninterest-bearing liabilities   | 48,026                               |                                |                            | 41,102             |                                |                            |
| Total liabilities   | 488,291                              |                                |                            | 515,628            |                                |                            |
| Retained earnings   | 43,671                               |                                |                            | 40,186             |                                |                            |
| Total liabilities and retained earnings                                 | \$531,962                            |                                |                            | \$555,814          |                                |                            |
| <b>Tax-equivalent basis adjustment</b>                                  |                                      |                                |                            |                    |                                |                            |
|   |                                      | (1 )                           |                            |                    | -                              |                            |
| Net interest income   |                                      | \$3,704                        |                            |                    | \$4,102                        |                            |
| Interest rate spread  |                                      |                                | 3.00 %                     |                    |                                | 3.18 %                     |
| Net interest-earning assets   | \$38,058                             |                                |                            | \$29,697           |                                |                            |
| Net interest margin (5)   |                                      |                                | 3.14 %                     |                    |                                | 3.30 %                     |
| Average interest-earning assets to average interest-bearing liabilities | 108.64 %                             |                                |                            | 106.26 %           |                                |                            |

(1)

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Calculated using 34% tax rate for the three months ended March 31, 2011 and 0% for the three months ended March 31, 2010.

- (2) Includes passbook savings, money market passbook and club accounts.
- (3) Includes interest-bearing checking and money market accounts.
- (4) Includes certificates of deposits and individual retirement accounts.
- (5) Calculated as annualized net interest income divided by average total interest-earning assets.

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MAGYAR BANCORP, INC. AND SUBSIDIARY  
Comparative Average Balance Sheets  
(Dollars In Thousands)

|   | For the Six Months Ended March 31, |              |            |          |              |        |      |        |   |
|---|------------------------------------|--------------|------------|----------|--------------|--------|------|--------|---|
|   | 2011                               | Interest     | Yield/Cost |          |              |        | 2010 |        |   |
| Average   | Income/                            | (Annualized) | Average    | Interest | Yield/Cost   |        |      |        |   |
| Balance   | Expense                            |              | Balance    | Expense  | (Annualized) |        |      |        |   |
| Interest-earning assets:  |                                    |              |            |          |              |        |      |        |   |
| Interest-earning deposits   | \$14,367                           | \$15         | 0.21       | %        | \$2,463      | \$1    | 0.08 | %      |   |
| Loans receivable, net   | 395,944                            | 10,152       | 5.14       | %        | 435,365      | 11,588 | 5.34 | %      |   |
| Securities  |                                    |              |            |          |              |        |      |        |   |
| Taxable   | 68,061                             | 1,020        | 3.00       | %        | 67,596       | 1,326  | 3.93 | %      |   |
| Tax-exempt (1)  | 87                                 | 4            | 4.40       | %        | 112          | 3      | 5.86 | %      |   |
| FHLB of NY stock  | 2,756                              | 87           | 6.34       | %        | 3,227        | 91     | 5.66 | %      |   |
| Total interest-earning assets   | 481,215                            | 11,278       | 4.70       | %        | 508,763      | 13,009 | 5.13 | %      |   |
| Noninterest-earning assets  | 53,526                             |              |            |          |              |        |      |        |   |
| Total assets  | \$534,741                          |              |            |          |              |        |      |        |   |
| Interest-bearing liabilities:   |                                    |              |            |          |              |        |      |        |   |
| Savings accounts (2)  | \$62,280                           | \$198        | 0.64       | %        | \$60,663     | \$333  | 1.10 | %      |   |
| NOW accounts (3)  | 137,761                            | 596          | 0.87       | %        | 134,940      | 711    | 1.06 | %      |   |
| Time deposits (4)   | 184,049                            | 1,900        | 2.07       | %        | 207,748      | 2,440  | 2.36 | %      |   |
| Total interest-bearing deposits   | 384,090                            | 2,694        | 1.41       | %        | 403,351      | 3,484  | 1.73 | %      |   |
| Borrowings  | 60,498                             | 1,207        | 4.00       | %        | 71,172       | 1,415  | 3.99 | %      |   |
| Total interest-bearing liabilities                                      | 444,588                            | 3,901        | 1.76       | %        | 474,523      | 4,899  | 2.07 | %      |   |
| Noninterest-bearing liabilities   | 46,257                             |              |            |          |              |        |      |        |   |
| Total liabilities   | 490,845                            |              |            |          |              |        |      |        |   |
| Retained earnings   | 43,896                             |              |            |          |              |        |      |        |   |
| Total liabilities and retained earnings                                 | \$534,741                          |              |            |          |              |        |      |        |   |
| Tax-equivalent basis adjustment   |                                    |              |            |          |              |        |      |        |   |
|   | (1 )                               |              | -          |          |              |        |      |        |   |
| Net interest income   | \$7,376                            |              | \$8,110    |          |              |        |      |        |   |
| Interest rate spread  |                                    |              | 2.94       | %        |              |        |      | 3.06   | % |
| Net interest-earning assets   | \$36,627                           |              |            |          |              |        |      |        |   |
| Net interest margin (5)   |                                    |              | 3.07       | %        |              |        |      | 3.20   | % |
| Average interest-earning assets to average interest-bearing liabilities | 108.24                             | %            |            |          |              |        |      | 107.22 | % |

(1) Calculated using 34% tax rate for the six months ended March 31, 2011 and 0% for the six months ended March 31, 2010.

(2) Includes passbook savings, money market passbook and club accounts.

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- (3) Includes interest-bearing checking and money market accounts.
- (4) Includes certificates of deposits and individual retirement accounts.
- (5) Calculated as annualized net interest income divided by average total interest-earning assets.

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Comparison of Operating Results for the Three Months Ended March 31, 2011 and 2010

**Net Income.** Net income decreased \$636,000, to a net loss of \$357,000 for the three months ended March 31, 2011 from net income of \$279,000 for the three months ended March 31, 2010.

**Net Interest and Dividend Income.** Net interest and dividend income decreased \$398,000, or 9.7%, to \$3.7 million for the three months ended March 31, 2011 from \$4.1 million for the three months ended March 31, 2010. Total interest and dividend income decreased \$888,000 to \$5.6 million for the three month period ended March 31, 2011 while total interest expense decreased \$490,000 to \$1.9 million from the same three month period one year earlier. For the comparison period our interest rate spread decreased 18 basis points to 3.00% from 3.18%.

**Interest and Dividend Income.** The decrease in interest and dividend income of \$888,000, or 13.7%, to \$5.6 million for the three months ended March 31, 2011 was primarily due to a decrease in overall yield of interest-earning assets to 4.73% from 5.20%, and a decrease in the average balance of interest-earning assets of \$25.9 million to \$478.3 million for the three months ended March 31, 2011 from \$504.2 million for the three months ended March 31, 2010.

Interest earned on loans decreased \$783,000, or 13.5%, to \$5.0 million for the three months ended March 31, 2011 compared with the prior year period due to a \$37.9 million decrease in the average balance of loans between the periods and a 29 basis point decrease in the average yield on such loans to 5.15% from 5.44%. The decrease in yield between the two periods was due primarily to the lower market interest rate environment.

Interest earned on our investment securities, excluding Federal Home Loan Bank of New York stock, decreased \$99,000, or 15.6%, due to a 96 basis point decrease in the average yield on such securities to 2.97% for the three months ended March 31, 2011 from 3.94% for the three months ended March 31, 2010. The decrease in yield on investment securities was due to lower market interest rates than the prior year period. The average balance of such securities increased \$7.4 million, or 11.5%, to \$72.4 million for the three months ended March 31, 2011 from \$65.0 million for the three months ended March 31, 2010.

**Interest Expense.** Interest expense decreased \$490,000, or 20.7%, to \$1.9 million for the three months ended March 31, 2011 from \$2.4 million for the three months ended March 31, 2010. The decrease in interest expense was primarily due to a 29 basis point decrease in the average cost of such liabilities to 1.73% from 2.02%, and a decrease in the average balance of interest-bearing liabilities of \$34.2 million, or 7.2%, to \$440.3 million from \$474.5 million.

The average balance of interest bearing deposits decreased \$24.9 million to \$379.5 million from \$404.4 million while the average cost of such deposits decreased to 1.37% from 1.67% in the lower market interest rate environment. As a result, interest paid on deposits decreased to \$1.3 million for the three months ended March 31, 2011 from \$1.7 million for the three months ended March 31, 2010.

Interest paid on advances and securities sold under agreements to repurchase decreased to \$597,000 for the three months ended March 31, 2011 from \$698,000 for the prior year period due to a decrease in the average balance of such borrowings to \$60.7 million from \$70.1 million. In addition, the average cost of advances and securities sold under agreements to repurchase decreased 5 basis points to 3.99% for the three months ended March 31, 2011 from 4.04% for the prior year period, reflecting the repayment of higher interest-bearing advances between periods.

**Provision for Loan Losses.** We establish provisions for loan losses, which are charged to earnings, at a level necessary to absorb known and inherent losses that are both probable and reasonably estimable at the date of the financial statements. In evaluating the level of the allowance for loan losses, management considers historical loss experience, the types of loans and the amount of loans in the loan portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, peer group information and prevailing economic

conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available or as future events occur. After an evaluation of these factors, management recorded a provision of \$478,000 for the three months ended March 31, 2011 compared to a provision of \$750,000 for the prior year period.

Net charge-offs were \$996,000 for the three months ended March 31, 2011 compared with \$758,000 for the three months ended March 31, 2010. The level of loan charge-offs increased from the prior year as a result of the continued depreciation of real estate collateral securing non-performing residential and construction loans due to the ongoing economic environment. During the three months ended March 31, 2011, the Bank reduced the carrying balance on seven loans totaling \$6.8 million to the appraised fair value of collateral, net of estimated disposition costs, securing the loans.

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Determining the amount of the allowance for loan losses necessarily involves a high degree of judgment. Management reviews the level of the allowance on a quarterly basis, and establishes the provision for loan losses based on the factors set forth in the preceding paragraph. As management evaluates the allowance for loan losses, the increased risk associated with larger non-homogenous construction, commercial real estate and commercial business loans may result in larger additions to the allowance for loan losses in future periods.

Other Income. Non-interest income decreased \$568,000, or 71.4%, to \$227,000 during the three months ended March 31, 2011 compared to \$795,000 for the three months ended March 31, 2010. The decrease was attributable to lower gains on the sales of assets.

The Company recorded a \$157,000 loss on other real estate owned for the three months ended March 31, 2011, which was a decrease of \$254,000 from a gain of \$97,000 for the three months ended March 31, 2010. The losses were the result of valuation allowances placed against two properties with an aggregate carrying value of \$978,000 that are under contract of sale and are expected to close during the next quarter. In addition, gains on the sale of available-for-sale investment securities decreased \$235,000 to \$35,000 for the three months ended March 31, 2011 from \$270,000 for the three months ended March 31, 2010.

Other Expenses. Non-interest expenses increased \$188,000, or 4.9%, to \$4.1 million from \$3.9 million for the three months ended March 31, 2010.

Compensation and benefit expenses increased \$90,000, or 4.7%, due to additional staffing for the Bank's Bridgewater branch office in June 2010 and annual merit increases for employees and directors during the year. Occupancy expenses increased \$78,000, or 12.4%, due to the opening and operation of the new Bridgewater branch. In addition, the Federal Deposit Insurance Corporation deposit insurance premiums increased \$73,000, or 25.7%. Partially offsetting these increases were decreases in professional fees and other miscellaneous expenses.

Income Tax (Benefit) Expense. The Company recorded a tax benefit of \$244,000 for the three months ended March 31, 2011, compared to a tax expense of \$2,000 for the three months ended March 31, 2010. The effective tax rate for the Company was 40.6% for the three months ended March 31, 2011.

Comparison of Operating Results for the Six Months Ended March 31, 2011 and 2010

Net Income (Loss). Net income decreased \$530,000, to a net loss of \$230,000 for the six months ended March 31, 2011 compared with net income of \$300,000 for the six months ended March 31, 2010.

Net Interest and Dividend Income. Net interest and dividend income decreased \$734,000, or 9.1%, to \$7.4 million for the six months ended March 31, 2011 from \$8.1 million for the six months ended March 31, 2010. Total interest and dividend income decreased \$1.7 million to \$11.3 million for the six month period ended March 31, 2011 while total interest expense decreased \$998,000 to \$3.9 million from the same six month period in 2010. For the comparison period our interest rate spread decreased 12 basis points to 2.94% from 3.06%.

Interest and Dividend Income. Total interest and dividend income decreased \$1.7 million, or 13.3%, to \$11.3 million for the six months ended March 31, 2011 from \$13.0 million for the same period last year. The decrease in interest income was primarily due to a 43 basis point decrease in the overall yield of interest-bearing assets to 4.70% from 5.13% and a decrease in the average balance of interest-earning assets of \$27.6 million to \$481.2 million from \$508.8 million.

Interest earned on loans decreased \$1.4 million, or 12.4%, to \$10.2 million for the six months ended March 31, 2011 from \$11.6 million for the prior year period. While the average yield on such loans decreased 20 basis points, to 5.14% from 5.34%, the average balance of loans decreased \$39.5 million, or 9.1%, to \$395.9 million for the six

months ended March 31, 2011 from \$435.4 million for the six months ended March 31, 2010.

Interest earned on investment securities, excluding Federal Home Loan Bank of New York stock, decreased \$292,000, or 22.0%, to \$1.0 million for the six month period ended March 31, 2011 from \$1.3 million a year earlier. The average balance of such securities increased \$440,000, or 0.6%, to \$68.1 million from \$67.7 million and the average yield on investment securities fell 93 basis point to 3.00% from 3.93%. The decreased yield on investment securities resulted

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from the lower interest rate environment during the six months ended March 31, 2011 compared with the prior year period.

**Interest Expense.** Interest expense decreased \$998,000, or 20.4%, to \$3.9 million for the six months ended March 31, 2011 from \$4.9 million for the six months ended March 31, 2010. The decrease in interest expense was primarily due to a 31 basis point decrease in the average cost of such liabilities to 1.76% from 2.07% and a decrease in the average balance of interest-bearing liabilities of \$29.9 million, or 6.3%, to \$444.6 million.

The average balance of interest bearing deposits decreased \$19.3 million to \$384.1 million for the six months ended March 31, 2011 from \$403.4 million for the same period last year while the average cost of such deposits decreased 32 basis points to 1.41% from 1.73%. This resulted in a \$790,000 decrease in interest paid on deposits to \$2.7 million for the six months ended March 31, 2011 from \$3.5 million for the six months ended March 31, 2010.

Interest on advances and securities sold under agreements to repurchase decreased \$208,000 to \$1.2 million for the six months ended March 31, 2011 compared to the prior year period. The decrease in interest expense was due to a decrease in average balance to \$60.5 million from \$71.2 million partially offset by a 1 basis point increase in the average cost of advances and securities sold under agreements to repurchase to 4.00% for the six months ended March 31, 2011 from 3.99% for the prior year period. The increase in cost of advances was due to the repayment of the Company's overnight line of credit, which bore a lower rate than the term advances remaining.

**Provision for Loan Losses.** The provision for loan losses was \$836,000 for the six months ended March 31, 2011 compared to \$1.2 million for the six months ended March 31, 2010. The decrease in the provision for loan loss was due primarily to the stabilization of non-performing loan levels and lower levels of outstanding construction loans.

Non-performing loans decreased \$2.2 million to \$25.8 million at March 31, 2011 from \$28.0 million at March 31, 2010. Net charge-offs were \$1.8 million for the six months ended March 31, 2011 compared to \$1.1 million for the six months ended March 31, 2010.

The loan charge-offs during the six months ended March 31, 2011 resulted primarily from additional write-downs of loans previously deemed impaired. Four non-performing construction loans totaling \$7.4 million were further written down by \$1.0 million during the six months based on updated appraisals of the real estate securing the loans, reflecting continued depreciation from one year earlier. Of these four loans, two totaling \$3.0 million at September 30, 2010 were transferred to other real estate owned. In addition, the Company wrote down three commercial business loan totaling \$3.9 million by \$773,000 and two loans secured by residential mortgages totaling \$294,000 by \$55,000 during the six months ended March 31, 2011.

**Other Income.** Non-interest income decreased \$316,000, or 24.1%, to \$994,000 for the six months ended March 31, 2011 compared to \$1.3 million for the six months ended March 31, 2010. The decrease was attributable to lower gains on the sales of assets.

The Company recorded a \$292,000 loss for other real estate owned for the six months ended March 31, 2011, which decreased \$389,000 from a gain of \$97,000 for the six months ended March 31, 2010. The losses were the result of valuation allowances totaling \$449,000 that were placed against three properties previously carried for \$3.9 million that are under contract of sale. In addition, gains on the sale of available-for-sale investment securities decreased \$314,000 to \$35,000 for the six months ended March 31, 2011 from \$349,000 for the six months ended March 31, 2010. Partially offsetting the lower gains were gains from the sales of loans, which increased \$344,000 to \$459,000 for the six months ended March 31, 2011 compared with \$115,000 for the three months ended March 31, 2010.

Other Expenses. Non-interest expenses decreased \$319,000, or 3.8%, to \$8.0 million for the six months ended March 31, 2011 from \$8.3 million for the six months ended March 31, 2010.

Compensation and benefit expenses decreased \$760,000 during the six months ended March 31, 2011 primarily due to a one-time charge of \$852,000 during the prior year period due to the resignation of the Company's President and CEO in the prior year period. Absent the charge from the prior year period, compensation and benefit expenses increased \$92,000 due to additional staffing for the Bank's Bridgewater branch office opened in June 2010 and annual merit increases for employees and directors during the year.

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Partially offsetting the decrease in compensation and benefit expenses between the six months periods was an increase in occupancy expense of \$123,000, or 9.8%, due to the opening and operation of the Bridgewater branch, an increase in FDIC deposit insurance premiums of \$155,000, or 28.1%, and an increase in other real estate owned expenses of \$111,000, or 88.8%.

**Income Tax Expense (Benefit).** The Company recorded a tax benefit of \$208,000 for the six months ended March 31, 2011, compared to a benefit of \$321,000 for the six months ended March 31, 2010. The current period benefit resulted from the Company's results from operations and reflected an effective tax rate of 47.5%. The prior period benefit resulted primarily from a partial reduction in the valuation allowance previously recorded against its deferred tax asset. The reduction in the valuation allowance was based on the anticipated utilization of the Company's net operating losses within the allowable Federal and State carryover periods.

Where applicable, deferred tax assets are reduced by a valuation allowance for any portions determined not likely to be realized. The valuation allowance is assessed by management on a quarterly basis and adjusted, by a charge or credit to income tax expense, as changes in facts and circumstances warrant. In assessing whether it is more likely than not that some portion or all of the deferred tax assets will not be realized, management considers projections of future taxable income, the projected periods in which current temporary differences will be deductible, the availability of carry forwards, and existing tax laws and regulations. The valuation allowance in place on deferred tax assets at March 31, 2011, did not materially change from that in place on September 30, 2010.

## LIQUIDITY AND CAPITAL RESOURCES

### Liquidity

The Company's liquidity is a measure of its ability to fund loans, pay withdrawals of deposits, and other cash outflows in an efficient, cost-effective manner. The Company's short-term sources of liquidity include maturity, repayment and sales of assets, excess cash and cash equivalents, new deposits, other borrowings, and new advances from the Federal Home Loan Bank. There has been no material adverse change during the six month ended March 31, 2011 in the ability of the Company and its subsidiaries to fund their operations.

At March 31, 2011, the Company had commitments outstanding under letters of credit of \$1.5 million, commitments to originate loans of \$8.4 million, and commitments to fund undisbursed balances of closed loans and unused lines of credit of \$37.2 million. There has been no material change during the six months ended March 31, 2011 in any of the Company's other contractual obligations or commitments to make future payments.

### Capital Requirements

On April 22, 2010, Magyar Bank entered into agreements with the Federal Deposit Insurance Corporation ("FDIC"), its principal federal banking regulator, and the New Jersey Department of Banking and Insurance (the "Department"), which require the Bank to take certain measures to improve its safety and soundness. In connection with these agreements, the Bank stipulated to the issuance by the FDIC and the Department of consent orders against the Bank (the "Consent Orders") relating to certain findings from a recent examination of the Bank. The Consent Orders were filed with the Securities and Exchange Commission on Form 8-K as Exhibits 10.1 and 10.2 on April 23, 2010.

Among the corrective actions required were for the Bank to develop, within 30 days of the April 22, 2010 effective date of the Consent Orders, a written capital plan that details the manner in which the Bank will achieve a Tier 1 capital as a percentage of the Bank's total assets of at least 8%, and total qualifying capital as a percentage of risk-weighted assets of at least 12%. The Bank developed and filed a capital plan on a timely basis with the FDIC and the Department and the plan remains under review by those regulatory authorities.

At March 31, 2011, the Bank's Tier 1 capital as a percentage of the Bank's total assets was 7.90%, and total qualifying capital as a percentage of risk-weighted assets was 12.71%.

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Item Quantitative and Qualitative Disclosures about Market Risk

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Not applicable to smaller reporting companies.

Item 4 – Controls and Procedures

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective to ensure that information required to be disclosed in the reports that Magyar Bancorp, Inc. files or submits under the Securities Exchange Act of 1934, is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms.

There has been no change in Magyar Bancorp, Inc.'s internal control over financial reporting during Magyar Bancorp, Inc.'s six months ended March 31, 2011 that has materially affected, or is reasonably likely to materially affect, Magyar Bancorp, Inc.'s internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal proceedings

There is no material pending legal proceedings to which the Company or its subsidiaries is a party other than ordinary routine litigation incidental to their respective businesses.

Item 1A. Risk Factors

Not applicable to smaller reporting companies.

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

a.) Not applicable.

b.) Not applicable.

c.) The Company did not repurchase any shares during the six months ended March 31, 2011.

Item 3. Defaults Upon Senior Securities

None

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

None

Item 5. Other Information

a.) Not applicable.

b.) There were no material changes to the procedures by which security holders may recommend nominees to the Company's Board of Directors during the period covered by the Form 10-Q.

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Item 6. Exhibits

Exhibits

31.1 Certification of Chief Executive Officer Pursuant to Rule 13a-14(a)

31.2 Certification of Chief Financial Officer Pursuant to Rule 13a-14(a)

32.1 Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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Signatures

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

MAGYAR BANCORP, INC.  
(Registrant)

Date: May 13, 2011

/s/ John S. Fitzgerald  
John S. Fitzgerald  
President and Chief Executive Officer

Date: May 13, 2011

/s/ Jon R. Ansari  
Jon R. Ansari  
Senior Vice President and Chief Financial Officer