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PRUDENTIAL BANCORP INC OF PENNSYLVANIA  
Form 10-Q  
February 14, 2007

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(MARK ONE)

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

FOR THE QUARTERLY PERIOD ENDED DECEMBER 31, 2006  
OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES  
EXCHANGE ACT OF 1934  
FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_  
COMMISSION FILE NUMBER: 000-51214

PRUDENTIAL BANCORP, INC. OF PENNSYLVANIA  
(Exact Name of Registrant as Specified in Its Charter)

PENNSYLVANIA  
(State or Other Jurisdiction of  
Incorporation or Organization)

68-0593604  
(I.R.S. Employer Identification No.)

1834 OREGON AVENUE  
PHILADELPHIA, PENNSYLVANIA  
Address of Principal Executive Offices)

19145  
(Zip Code)

(215) 755-1500  
(Registrant'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 preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

Indicate the number of shares outstanding of each of the issuer's classes of

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common stock as of the latest practical date: as of February 9, 2007, 12,017,750 shares were issued and outstanding

PRUDENTIAL BANCORP, INC. OF PENNSYLVANIA

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PRUDENTIAL BANCORP, INC. OF PENNSYLVANIA AND SUBSIDIARIES

UNAUDITED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

|   | DECEMBER<br>2006 |
|---|------------------|
| <hr/>   |                  |
| ASSETS  |                  |
| Cash and amounts due from depository institutions   | \$ 5,005         |
| Interest-bearing deposits   | 8,406            |
| <hr/>   |                  |
| Total cash and cash equivalents   | 13,412           |
| Investment securities held to maturity (estimated fair value--December 31, 2006, \$126,154,442; September 30, 2006, \$129,593,126)    | 128,930          |
| Investment securities available for sale (amortized cost--December 31, 2006, \$38,007,273; September 30, 2006, \$38,007,246)          | 38,711           |
| Mortgage-backed securities held to maturity (estimated fair value--December 31, 2006, \$47,654,088; September 30, 2006, \$49,526,374) | 48,689           |
| Mortgage-backed securities available for sale (amortized cost--December 31, 2006, \$4,372,274; September 30, 2006, \$4,534,743)       | 4,456            |
| Loans receivable--net of allowance for loan losses (December 31, 2006, \$677,956; September 30, 2006, \$617,956)                      | 218,771          |
| Accrued interest receivable:  |                  |
| Loans receivable  | 1,296            |
| Mortgage-backed securities  | 227              |
| Investment securities   | 1,950            |
| Federal Home Loan Bank stock--at cost   | 2,148            |
| Office properties and equipment--net  | 1,674            |
| Prepaid expenses and other assets   | 6,685            |
| <hr/>   |                  |
| TOTAL ASSETS  | \$ 466,954       |
| <hr/>   |                  |
| LIABILITIES AND RETAINED EARNINGS   |                  |
| LIABILITIES:  |                  |
| Deposits:   |                  |
| Noninterest-bearing   | \$ 4,583         |
| Interest-bearing  | 346,017          |
| <hr/>   |                  |
| Total deposits  | 350,601          |
| Advances from Federal Home Loan Bank  | 24,773           |
| Accrued interest payable  | 639              |
| Advances from borrowers for taxes and insurance   | 1,751            |
| Accounts payable and accrued expenses   | 942              |
| Accrued dividend payable  | 462              |
| Deferred income taxes, net  | 301              |
| <hr/>   |                  |
| Total liabilities   | 379,472          |
| <hr/>   |                  |

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## COMMITMENTS AND CONTINGENCIES (Note 8)

### STOCKHOLDERS' EQUITY:

|  |         |
|--|---------|
| Preferred stock, \$.01 par value, 10,000,000 shares authorized, none issued  | 125     |
| Common stock, \$.01 par value, 40,000,000 shares authorized, issued 12,563,750;<br>outstanding - 12,017,750 at December 31, 2006; 12,064,320 at September 30, 2006 | 54,818  |
| Additional paid-in capital   | (4,070) |
| Unearned ESOP shares   | (7,048) |
| Treasury stock, at cost: 546,000 shares at December 31, 2006;<br>499,430 shares at September 30, 2006  | 43,143  |
| Retained earnings  | 513     |
| Accumulated other comprehensive income   | -----   |

|                            |        |
|----------------------------|--------|
| Total stockholders' equity | 87,482 |
|----------------------------|--------|

|  |            |
|--|------------|
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | \$ 466,954 |
|--|------------|

See notes to unaudited consolidated financial statements.

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## PRUDENTIAL BANCORP, INC. OF PENNSYLVANIA AND SUBSIDIARIES

### UNAUDITED CONSOLIDATED STATEMENTS OF INCOME

|  | THREE MONTHS ENDED<br>DECEMBER 31, |              |
|--|------------------------------------|--------------|
|  | 2006                               | 2005         |
| <b>INTEREST INCOME:</b>                |                                    |              |
| Interest on loans                      | \$ 3,824,889                       | \$ 2,880,667 |
| Interest on mortgage-backed securities | 710,852                            | 845,318      |
| Interest and dividends on investments  | 2,147,405                          | 2,060,257    |
|  | -----                              | -----        |
| Total interest income                  | 6,683,146                          | 5,786,242    |
|  | -----                              | -----        |
| <b>INTEREST EXPENSE:</b>               |                                    |              |
| Interest on deposits                   | 3,203,519                          | 2,425,343    |
| Interest on borrowings                 | 390,368                            | 195,090      |
|  | -----                              | -----        |
| Total interest expense                 | 3,593,887                          | 2,620,433    |
|  | -----                              | -----        |
| NET INTEREST INCOME                    | 3,089,259                          | 3,165,809    |
| PROVISION FOR LOAN LOSSES              | 60,000                             | -            |
|  | -----                              | -----        |
| NET INTEREST INCOME AFTER PROVISION    |                                    |              |

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|                                |            |              |
|--------------------------------|------------|--------------|
| FOR LOAN LOSSES                | 3,029,259  | 3,165,809    |
|                                | -----      | -----        |
| NON-INTEREST INCOME:           |            |              |
| Fees and other service charges | 145,285    | 145,245      |
| Other                          | 164,846    | 25,496       |
|                                | -----      | -----        |
| Total non-interest income      | 310,131    | 170,741      |
|                                | -----      | -----        |
| NON-INTEREST EXPENSE:          |            |              |
| Salaries and employee benefits | 1,115,310  | 1,091,934    |
| Data processing                | 119,427    | 126,794      |
| Professional services          | 227,835    | 76,132       |
| Office occupancy               | 88,135     | 70,467       |
| Depreciation                   | 62,150     | 61,677       |
| Payroll taxes                  | 66,565     | 62,734       |
| Director compensation          | 71,087     | 69,150       |
| Other                          | 271,349    | 269,038      |
|                                | -----      | -----        |
| Total non-interest expense     | 2,021,858  | 1,827,926    |
|                                | -----      | -----        |
| INCOME BEFORE INCOME TAXES     | 1,317,532  | 1,508,624    |
|                                | -----      | -----        |
| INCOME TAXES:                  |            |              |
| Current                        | 301,962    | 515,258      |
| Deferred (benefit) expense     | 119,809    | (93,075)     |
|                                | -----      | -----        |
| Total income tax               | 421,771    | 422,183      |
|                                | -----      | -----        |
| NET INCOME                     | \$ 895,761 | \$ 1,086,441 |
|                                | =====      | =====        |
| BASIC EARNINGS PER SHARE       | \$ 0.08    | \$ 0.09      |
| DILUTED EARNINGS PER SHARE     | \$ 0.08    | \$ 0.09      |

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See notes to unaudited consolidated financial statements.

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PRUDENTIAL BANCORP, INC. OF PENNSYLVANIA AND SUBSIDIARIES

UNAUDITED CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY AND  
COMPREHENSIVE INCOME

-----

| COMMON<br>STOCK | ADDITIONAL<br>PAID-IN<br>CAPITAL | UNEARNED<br>ESOP<br>SHARES | TREASURY<br>STOCK |
|-----------------|----------------------------------|----------------------------|-------------------|
|-----------------|----------------------------------|----------------------------|-------------------|

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|   |            |               |                |              |
|---|------------|---------------|----------------|--------------|
| BALANCE, OCTOBER 1, 2006  | \$ 125,638 | \$ 54,798,121 | \$ (4,126,501) | \$ (6,422,47 |
| Comprehensive income:   |            |               |                |              |
| Net income  |            |               |                |              |
| Net unrealized holding loss on available for sale securities arising during the period, net of income tax benefit of \$11,159 |            |               |                |              |
| Comprehensive income  |            |               |                |              |
| Treasury stock purchased  |            |               |                | (626,36      |
| Cash dividend declared (\$0.04 per share)   |            |               |                |              |
| Cumulative adjustment related to the adoption of SAB 108  |            |               |                |              |
| ESOP shares committed to be released  | -          | 20,753        | 55,777         |              |
| BALANCE, December 31, 2006  | \$ 125,638 | \$ 54,818,874 | \$ (4,070,724) | \$ (7,048,84 |

|   | TOTAL STOCKHOLDERS' EQUITY | COMPREHENSIVE INCOME |
|---|----------------------------|----------------------|
| BALANCE, OCTOBER 1, 2006  | \$ 87,447,640              |                      |
| Comprehensive income:   |                            |                      |
| Net income  | 895,761                    | 895,761              |
| Net unrealized holding loss on available for sale securities arising during the period, net of income tax benefit of \$11,159 | (20,615)                   | (20,615)             |
| Comprehensive income  |                            | \$ 875,146           |
| Treasury stock purchased  | (626,366)                  |                      |
| Cash dividend declared (\$0.04 per share)   | (462,618)                  |                      |
| Cumulative adjustment related to the adoption of SAB 108  | 171,978                    |                      |
| ESOP shares committed to  |                            |                      |

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|  |                                  |                                  |                            |                   |
|--|----------------------------------|----------------------------------|----------------------------|-------------------|
| be released  | 76,530                           | -----                            |                            |                   |
| BALANCE, December 31, 2006   | \$ 87,482,310                    | =====                            |                            |                   |
|  | COMMON<br>STOCK                  | ADDITIONAL<br>PAID-IN<br>CAPITAL | UNEARNED<br>ESOP<br>SHARES | TREASURY<br>STOCK |
|  | -----                            | -----                            | -----                      | -----             |
| BALANCE, OCTOBER 1, 2005   | \$ 125,638                       | \$ 54,733,760                    | \$ (4,349,611)             | \$ (654,411)      |
| Comprehensive income:  |                                  |                                  |                            |                   |
| Net income   |                                  |                                  |                            |                   |
| Net unrealized holding gain on<br>available for sale securities<br>arising during the period, net<br>of income tax expense of \$46,446 |                                  |                                  |                            |                   |
| Comprehensive income   |                                  |                                  |                            |                   |
| Cash dividend declared<br>(\$ .04 per share)   |                                  |                                  |                            |                   |
| ESOP shares committed to<br>be released  | -                                | 10,499                           | 55,778                     |                   |
|  | -----                            | -----                            | -----                      | -----             |
| BALANCE, December 31, 2005   | \$ 125,638                       | \$ 54,744,259                    | \$ (4,293,833)             | \$ (654,411)      |
|  | =====                            | =====                            | =====                      | =====             |
|  | TOTAL<br>STOCKHOLDERS'<br>EQUITY | COMPREHENSIVE<br>INCOME          |                            |                   |
|  | -----                            | -----                            |                            |                   |
| BALANCE, OCTOBER 1, 2005   | \$ 90,825,298                    |                                  |                            |                   |
| Comprehensive income:  |                                  |                                  |                            |                   |
| Net income   | 1,086,441                        | 1,086,441                        |                            |                   |
| Net unrealized holding gain on<br>available for sale securities<br>arising during the period, net<br>of income tax expense of \$46,446 | 86,257                           | 86,257                           |                            |                   |
|  |                                  | -----                            |                            |                   |
| Comprehensive income   |                                  | \$ 1,172,698                     |                            |                   |

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|  |               |
|--|---------------|
| Cash dividend declared<br>(\$ .04 per share) | (481,806)     |
| ESOP shares committed to<br>be released      | 66,277        |
|  | -----         |
| BALANCE, December 31, 2005                   | \$ 91,582,467 |
|  | =====         |

See notes to audited financial statements.

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PRUDENTIAL BANCORP, INC. OF PENNSYLVANIA AND SUBSIDIARIES

UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

|  | THREE<br>ENDED DE |
|--|-------------------|
|  | 2006              |
|  | -----             |
| OPERATING ACTIVITIES:  |                   |
| Net income   | \$ 895,761        |
| Adjustments to reconcile net income to net cash used in<br>operating activities: |                   |
| Provision for loan losses  | 60,000            |
| Depreciation   | 62,150            |
| Net accretion of premiums/discounts  | (24,662)          |
| Net accretion of deferred loan fees and costs                                    | (97,033)          |
| Amortization of ESOP   | 76,530            |
| Income from bank owned life insurance  | (55,814)          |
| Deferred income tax expense (benefit)  | 119,810           |
| Changes in assets and liabilities which used cash:                               |                   |
| Accounts payable and accrued expenses  | (284,001)         |
| Accrued interest payable   | (2,252,997)       |
| Prepaid expenses and other assets  | (33,062)          |
| Accrued interest receivable  | (278,716)         |
|  | -----             |
| Net cash used in operating activities  | (1,812,034)       |
|  | -----             |
| INVESTING ACTIVITIES:  |                   |
| Purchase of investment securities held to maturity                               | (6,997,500)       |
| Loans originated or acquired   | (12,995,556)      |
| Principal collected on loans   | 13,678,619        |
| Principal payments received on mortgage-backed securities:                       |                   |
| held-to-maturity   | 2,007,567         |
| available-for-sale   | 165,398           |
| Proceeds from calls and maturities of investment securities held to maturity     | 10,155,556        |
| Purchase of Federal Home Loan Bank stock   | (92,800)          |
| Proceeds from redemption of Federal Home Loan Bank stock                         | 161,500           |
| Purchases of equipment   | (15,353)          |
|  | -----             |



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|  |                            |
|--|----------------------------|
| Net cash provided by (used in) investing activities                    | 6,067,431<br>-----         |
| <b>FINANCING ACTIVITIES:</b>   |                            |
| Net decrease in demand deposits, NOW accounts,<br>and savings accounts | (2,815,055)                |
| Net increase in certificates of deposit                                | 6,123,691                  |
| Repayment of advances from Federal Home Loan Bank                      | (7,010,066)                |
| Increase in advances from borrowers for taxes and insurance            | 521,557                    |
| Cash dividend paid   | (464,481)                  |
| Purchase of treasury stock   | (626,366)<br>-----         |
| Net cash (used in) provided by financing activities                    | (4,270,720)<br>-----       |
| <br>NET DECREASE IN CASH AND CASH EQUIVALENTS                          | <br>(15,323)               |
| <br>CASH AND CASH EQUIVALENTS--Beginning of period                     | <br>13,427,536<br>-----    |
| <br>CASH AND CASH EQUIVALENTS--End of period                           | <br>\$ 13,412,213<br>===== |
| <b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW<br/>INFORMATION:</b>          |                            |
| Interest paid on deposits and advances from Federal<br>Home Loan Bank  | \$ 5,846,765<br>=====      |
| <br>Income taxes paid  | <br>\$ 503,000<br>=====    |

See notes to consolidated unaudited financial statements.

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PRUDENTIAL BANCORP, INC. OF PENNSYLVANIA AND SUBSIDIARIES

NOTES TO CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS

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1. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

Prudential Bancorp, Inc. of Pennsylvania (the "Company") is a Pennsylvania corporation, which was organized to be the mid-tier holding company for Prudential Savings Bank (the "Bank"), which is a Pennsylvania-chartered, FDIC-insured savings bank with six full service branches in the Philadelphia area. The Company was organized in conjunction with the Bank's reorganization from a mutual savings bank to the mutual holding company structure in March 2005. The Bank is principally in the business of attracting deposits from its community through its branch offices and investing those deposits, together with funds from borrowings and operations, primarily in single-family residential loans and construction loans.

Prudential Mutual Holding Company, a Pennsylvania corporation, is the mutual holding company parent of the Company. Prudential Mutual Holding

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Company owns 57.5% (6,910,062 shares) of the Company's outstanding common stock as of December 31, 2006 and must always own at least a majority of the voting stock of the Company. In addition to the shares of the Company, Prudential Mutual Holding Company was capitalized with \$100,000 in cash from the Bank in connection with the completion of the reorganization. The consolidated financial statements of the Company include the accounts of the Company and the Bank. In addition, Prudential Mutual Holding Company receives dividends on the common stock of the Company that it holds. All significant intercompany balances and transactions have been eliminated.

Prior to the reorganization described above, the Board of Directors approved a plan of charter conversion in May 2004 pursuant to which the Bank would convert its charter from a Pennsylvania-chartered mutual savings and loan association to a Pennsylvania-chartered mutual savings bank. The conversion to a Pennsylvania-chartered mutual savings bank was completed on August 20, 2004. As a result of the charter conversion, the Bank's primary federal banking regulator changed from the Office of Thrift Supervision to the Federal Deposit Insurance Corporation. The Pennsylvania Department of Banking remains as the Bank's state banking regulator.

In November 2005, the Bank formed PSB Delaware, Inc., a Delaware Corporation, as a subsidiary of the Bank. In March 2006, all mortgage-backed securities owned by the Company were transferred to PSB Delaware, Inc. The activity of PSB Delaware, Inc. is included as part of the consolidated financial statements.

The accompanying unaudited consolidated financial statements were prepared in accordance with the instructions to Form 10-Q, and therefore do not include all the information or footnotes necessary for complete financial statements in conformity with accounting principles generally accepted in the United States of America. However, all normal recurring adjustments that, in the opinion of management, are necessary for a fair presentation of the financial statements have been included. The results for the three months ended December 31, 2006 are not necessarily indicative of the results that may be expected for the fiscal year ending September 30, 2007, or any other period. These financial statements should be read in conjunction with the audited consolidated financial statements of the Company and the accompanying notes thereto for the year ended September 30, 2006 included in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2006.

USE OF ESTIMATES IN THE PREPARATION OF FINANCIAL STATEMENTS--The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the 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. The most significant estimates and assumptions in the Company's consolidated financial statements are recorded in the allowance for loan losses and deferred income taxes. Actual results could differ from those estimates.

DIVIDEND PAYABLE - On December 20, 2006, the Company's Board of Directors declared a quarterly cash dividend of \$.04 on the common stock of the Company payable on January 31, 2007 to the shareholders of record at the close of business on January 12, 2007 which resulted in a payable

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of \$462,618 at December 31, 2006. A portion of the cash dividend was payable to Prudential Mutual Holding Company on its shares of the Company's common stock and totaled \$276,402.

EMPLOYEE STOCK OWNERSHIP PLAN - In fiscal 2005, the Company established an employee stock ownership plan ("ESOP") for substantially all of its full-time employees. The ESOP purchased 452,295 shares of the Company's common stock for an aggregate cost of approximately \$4.5 million. Shares of the Company's common stock purchased by the ESOP are held in a suspense account until released for allocation to participants. Shares are allocated to each eligible participant based on the ratio of each such participant's compensation, as defined in the ESOP, to the total compensation of all eligible plan participants. As the unearned shares are released from the suspense account, the Company recognizes compensation expense equal to the fair value of the ESOP shares during the periods in which they become committed to be released. To the extent that the fair value of the ESOP shares released differs from the cost of such shares, the difference is charged or credited to equity as additional paid-in capital. As of December 31, 2006, the Company had allocated a total of 39,585 shares from the suspense account to participants. For the quarter ended December 31, 2006 recognized \$76,530 in compensation expense.

TREASURY STOCK - Stock held in treasury by the Company is accounted for using the cost method, which treats stock held in treasury as a reduction to total stockholders' equity.

COMPREHENSIVE INCOME--The Company presents in the unaudited consolidated statement of changes in stockholders' equity and comprehensive income those amounts from transactions and other events which currently are excluded from the statement of income and are recorded directly to stockholders' equity. For the quarters ended December 31, 2006 and 2005 the only components of comprehensive income were net income and unrealized holding gains and losses, net of income tax expense and benefit, on available for sale securities. Comprehensive income totaled \$875,146 and \$1,172,698 for the three months ended December 31, 2006 and 2005, respectively.

RECENT ACCOUNTING PRONOUNCEMENTS - In March 2006, the FASB issued SFAS No. 156, ACCOUNTING FOR SERVICING OF FINANCIAL ASSETS- AN AMENDMENT OF FASB STATEMENT NO. 140 ("SFAS No. 140" and "SFAS No. 156"). SFAS No. 140 establishes, among other things, the accounting for all separately recognized servicing assets and servicing liabilities. SFAS No. 156 amends SFAS No. 140 to require that all separately recognized servicing assets and servicing liabilities be initially measured at fair value, if practicable. SFAS No. 156 permits, but does not require, the subsequent measurement of separately recognized servicing assets and servicing liabilities at fair value. Under SFAS No. 156, an entity can elect subsequent fair value measurement to account for its separately recognized servicing assets and servicing liabilities. Adoption of SFAS No. 156 is required as of the beginning of the first fiscal year that begins after September 15, 2006. The Company has adopted SFAS No. 156 for the fiscal year beginning October 1, 2006 and there was not a material impact to its financial condition or results of operations as a result of the adoption of SFAS No. 156.

On July 13, 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"), which is effective for fiscal years beginning after December 15, 2006. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in the financial statements in accordance with FASB Statement No. 109, "Accounting for Income Taxes." This Interpretation prescribes a comprehensive model for how a

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company should recognize, measure, present and disclose in its financial statements uncertain tax positions that the company has taken or expects to take on a tax return. The Company is currently assessing the impact of FIN 48 on its financial statements.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurement." SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. This Statement does not require any new fair value

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measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The Company is currently assessing the impact of SFAS No. 157 on its financial statements.

In September 2006, the Financial Accounting Standards Board ("FASB") issued SFAS No. 158, "Employer's Accounting for Defined Benefit Pension and Other Postretirement Plans--an amendment of FASB Statements No. 87, 88, 106, and 132(R)." SFAS No. 158 requires an employer to recognize in its statement of financial position an asset for a plan's overfunded status or a liability for a plan's underfunded status, measure a plan's assets and its obligations that determine its funded status as of the end of the employer's fiscal year, and recognize changes in the funded status of a defined benefit postretirement plan in the year in which the changes occur. Those changes will be reported in comprehensive income and as a separate component of stockholders' equity. SFAS No. 158 is effective for publicly held companies for fiscal years ending after December 15, 2006. The Bank participates in a multiple-employer defined benefit plan. We do not anticipate that the implementation of SFAS No. 158 will have any impact on our financial position, results of operations and cash flows because it is not applicable to multi-employer defined benefit plans.

In September 2006, the Securities and Exchange Commission ("SEC") issued SAB No. 108 expressing the SEC staff's views regarding the process of quantifying financial statement misstatements and the build up of improper amounts on the balance sheet. SAB No. 108 requires that registrants quantify errors using both a balance sheet and income statement approach and evaluate whether either approach results in a misstated amount that, when all relevant quantitative and qualitative factors are considered, is material. The built up misstatements, while not considered material in the individual years in which the misstatements were built up, may be considered material in a subsequent year if a company were to correct those misstatements through current period earnings. Initial application of SAB No. 108 allows registrants to elect not to restate prior periods but to reflect the initial application in their annual financial statements covering the first fiscal year ending after November 15, 2006. The cumulative effect of the initial application should be reported in the carrying amounts of assets and liabilities as of the beginning of that fiscal year and the offsetting adjustment, net of tax, should be made to the opening balance of retained earnings for that year.

The Company implemented SAB No. 108 on October 1, 2006 which resulted in an increase in mortgage-backed securities held to maturity of approximately \$321,000, an increase in income tax liabilities of approximately \$149,000 and a cumulative adjustment to increase retained

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earnings as of that date by approximately \$172,000. The adjustment relates to two separate accounting entries. The first entry pertains to the method of accounting that was utilized in past years for the recognition of investment income on mortgage-backed securities. Prior to fiscal 2006, the Company used the straight line method over the contractual life of the securities rather than using the effective yield method prescribed by SFAS No. 91, "Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases". The impact of this entry was the correction of an understatement of mortgage-backed securities by approximately \$321,000 and a corresponding understatement of income tax payable of \$109,000. The second entry relates to a write off of a deferred tax asset of approximately \$40,000 that was incorrectly accounted for in prior periods.

In prior periods, management performed a quantitative and qualitative analysis of the differences between these two methods of accounting and concluded that there was not a material impact on any past individual quarter or annual reporting periods.

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2. EARNINGS PER SHARE

Basic earnings per common share is computed based on the weighted average number of shares outstanding. Diluted earnings per share is computed based on the weighted average number of shares outstanding and common share equivalents ("CSEs") that would arise from the exercise of dilutive securities. As of December 31, 2006 the Company did not issue and does not have outstanding any CSEs.

The calculated basic and diluted earnings per share are as follows:

|   | FOR THE QUARTER ENDED<br>DECEMBER 31, 2006 |            | FOR THE QU<br>DECEMBER |
|---|--|------------|------------------------|
|   | BASIC                                      | DILUTED    | BASIC                  |
| Net income  | \$ 895,761                                 | \$ 895,761 | \$ 1,086,441           |
| Weighted average shares outstanding used in<br>basic earnings per share computation | 11,627,147                                 | 11,627,147 | 12,058,411             |
| Effect of CSEs  | -  | -          | -                      |
| Adjusted weighted average shares used in<br>diluted earnings per share computation  | 11,627,147                                 | 11,627,147 | 12,058,411             |
| Earnings per share - basic and diluted  | \$ 0.08                                    | \$ 0.08    | \$ 0.09                |

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3. INVESTMENT SECURITIES

The amortized cost and fair value of securities, with gross unrealized gains and losses, are as follows:

|  | DECEMBER 31, 2006 |                              |                           |
|--|-------------------|------------------------------|---------------------------|
|  | AMORTIZED<br>COST | GROSS<br>UNREALIZED<br>GAINS | GROSS<br>UNREALI<br>LOSSE |
| Securities held to maturity:   |                   |                              |                           |
| Debt securities - U.S. Treasury securities<br>and securities of U.S. Government agencies | \$126,046,111     | \$ 10,975                    | \$ (2,746,                |
| Debt securities - Municipal bonds  | 2,884,520         | 3,542                        | (44,                      |
|  | -----             | -----                        | -----                     |
| Total securities held to maturity  | \$128,930,631     | \$ 14,517                    | \$ (2,790,                |
|  | =====             | =====                        | =====                     |
| Securities available for sale:   |                   |                              |                           |
| Debt securities - U.S. Treasury securities<br>and securities of U.S. Government agencies | \$ 2,998,827      | \$ -                         | \$ (71,                   |
| FNMA stock   | 84                | 7,043                        | (71,                      |
| Mutual fund  | 34,982,453        | -                            | (1,000,                   |
| FHLMC preferred stock  | 25,909            | 1,769,231                    | (1,000,                   |
|  | -----             | -----                        | -----                     |
| Total securities available for sale  | \$ 38,007,273     | \$ 1,776,274                 | \$ (1,072,                |
|  | =====             | =====                        | =====                     |

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|  | SEPTEMBER 30, 2006 |                              |                           |
|--|--------------------|------------------------------|---------------------------|
|  | AMORTIZED<br>COST  | GROSS<br>UNREALIZED<br>GAINS | GROSS<br>UNREALI<br>LOSSE |
| Securities held to maturity:   |                    |                              |                           |
| Debt securities - U.S. Treasury securities<br>and securities of U.S. Government agencies | \$129,199,382      | \$ -                         | \$ (2,458,                |
| Debt securities - Municipal bonds  | 2,884,501          | 6,574                        | (38,                      |
|  | -----              | -----                        | -----                     |
| Total securities held to maturity  | \$132,083,883      | \$ 6,574                     | \$ (2,497,                |
|  | =====              | =====                        | =====                     |
| Securities available for sale:   |                    |                              |                           |
| Debt securities - U.S. Treasury securities<br>and securities of U.S. Government agencies | \$ 2,998,800       | \$ -                         | \$ (64,                   |
| FNMA stock   | 84                 | 6,625                        | (64,                      |

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|                                     |               |              |          |
|-------------------------------------|---------------|--------------|----------|
| Mutual fund                         | 34,982,453    | -            | (930,    |
| FHLMC preferred stock               | 25,909        | 1,727,724    |          |
|                                     | -----         | -----        | -----    |
| Total securities available for sale | \$ 38,007,246 | \$ 1,734,349 | \$ (994, |
|                                     | =====         | =====        | =====    |

The following table shows the gross unrealized losses and related estimated fair values of the Company's investment and mortgage-backed securities, aggregated by investment category and length of time that individual securities have been in a continuous loss position at December 31, 2006:

|                                       | LESS THAN 12 MONTHS     |                      | M             |
|---------------------------------------|-------------------------|----------------------|---------------|
|                                       | GROSS UNREALIZED LOSSES | ESTIMATED FAIR VALUE | GRO UNREA LOS |
|                                       | -----                   | -----                | -----         |
| Securities held to maturity:          |                         |                      |               |
| U.S. Treasury and Government agencies | \$ 115,605              | \$ 8,725,410         | \$ 2,6        |
| Municipal bonds                       | -                       | -                    |               |
|                                       | -----                   | -----                | -----         |
| Total securities held to maturity     | 115,605                 | 8,725,410            | 2,6           |
|                                       | -----                   | -----                | -----         |
| Securities available for sale:        |                         |                      |               |
| U.S. Treasury and Government agencies | -                       | -                    |               |
| Mutual fund                           | -                       | -                    | 1,0           |
|                                       | -----                   | -----                | -----         |
| Total securities available for sale   | -                       | -                    | 1,0           |
|                                       | -----                   | -----                | -----         |
| Total                                 | \$ 115,605              | \$ 8,725,410         | \$ 3,7        |
|                                       | =====                   | =====                | =====         |

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The following table shows the gross unrealized losses and related estimated fair values of the Company's investment and mortgage-backed securities, aggregated by investment category and length of time that individual securities have been in a continuous loss position at September 30, 2006:

|  | LESS THAN 12 MONTHS |                | GRO UNREA |
|--|---------------------|----------------|-----------|
|  | GROSS UNREALIZED    | ESTIMATED FAIR | UNREA     |
|  | -----               | -----          | -----     |

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|                                       | LOSSES    | VALUE        | LOSSES |
|---------------------------------------|-----------|--------------|--------|
|                                       | -----     | -----        | -----  |
| Securities held to maturity:          |           |              |        |
| U.S. Treasury and Government agencies | 76,277    | 8,919,209    | 2,3    |
| Municipal bonds                       | -         | -            |        |
|                                       | -----     | -----        | -----  |
| Total securities held to maturity     | 76,277    | 8,919,209    | 2,4    |
|                                       | -----     | -----        | -----  |
| Securities available for sale:        |           |              |        |
| U.S. Treasury and Government agencies | -         | -            |        |
| Mutual fund                           | -         | -            | 9      |
|                                       | -----     | -----        | -----  |
| Total securities available for sale   | -         | -            | 9      |
|                                       | -----     | -----        | -----  |
| Total                                 | \$ 76,277 | \$ 8,919,209 | \$ 3,4 |
|                                       | =====     | =====        | =====  |

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. For all securities that are in an unrealized loss position for an extended period of time and for all securities whose fair value is significantly below amortized cost, the Company performs an evaluation of the specific events attributable to the market decline of the security. The Company considers the length of time and extent to which the security's market value has been below cost as well as the general market conditions, industry characteristics, and the fundamental operating results of the issuer to determine if the decline is other-than-temporary. The Company also considers as part of the evaluation its intent and ability to hold the security until its market value has recovered to a level at least equal to the amortized cost. When the Company determines that a security's unrealized loss is other-than-temporary, a realized loss is recognized in the period in which the decline in value is determined to be other-than-temporary. The write-downs are measured based on public market prices of the security at the time the Company determines the decline in value was other-than temporary.

At December 31, 2006, securities in a gross unrealized loss position for twelve months or longer consist of 121 securities having an aggregate depreciation of 2.4% from the Company's amortized cost basis. Securities in a gross unrealized loss position for less than twelve months consist of 10 securities having an aggregate depreciation of 1.3% from the Company's amortized cost basis. The unrealized losses disclosed above are primarily related to movement in market interest rates. Although the fair value will fluctuate as the market interest rates move, the majority of the Company's investment portfolio consists of low risk securities from U.S. government agencies or government sponsored enterprises. If held to maturity, the contractual principal and interest payments of such securities are expected to be received in full. As such, no loss in value is expected over the lives of the securities. Although not all of the securities are classified as held to maturity, the Company has the ability to hold these securities until they mature and does not intend to sell the securities at a loss. The Company also has a significant investment in a mutual fund that invests in adjustable-rate mortgage-backed securities. Management believes that the estimated fair value of the mutual fund is also primarily dependent upon



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the movement in market interest rates. Although the investment in the mutual fund is classified as available for sale, the Company has the intent and ability to hold the mutual fund until the fair value increases and does not intend to sell it at a loss. Based on the above, management believes that the unrealized losses are temporary.

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

|                                  | DECEMBER 31, 2006 |                      |                    |                      |
|----------------------------------|-------------------|----------------------|--------------------|----------------------|
|                                  | HELD TO MATURITY  |                      | AVAILABLE FOR SALE |                      |
|                                  | AMORTIZED COST    | ESTIMATED FAIR VALUE | AMORTIZED COST     | ESTIMATED FAIR VALUE |
| Due within one year              | \$ 7,084,776      | \$ 7,063,923         | \$ -               | \$ -                 |
| Due after one through five years | 32,086,823        | 31,654,197           | -                  | -                    |
| Due after five through ten years | 38,432,259        | 37,748,930           | 1,000,000          | 1,000,000            |
| Due after ten years              | 51,326,773        | 49,687,392           | 1,998,827          | 1,998,827            |
| Total                            | \$128,930,631     | \$126,154,442        | \$ 2,998,827       | \$ 2,998,827         |

|                                  | SEPTEMBER 30, 2006 |                      |                    |                      |
|----------------------------------|--------------------|----------------------|--------------------|----------------------|
|                                  | HELD TO MATURITY   |                      | AVAILABLE FOR SALE |                      |
|                                  | AMORTIZED COST     | ESTIMATED FAIR VALUE | AMORTIZED COST     | ESTIMATED FAIR VALUE |
| Due within one year              | \$ 13,084,653      | \$ 13,033,970        | \$ -               | \$ -                 |
| Due after one through five years | 33,084,146         | 32,601,588           | -                  | -                    |
| Due after five through ten years | 39,986,258         | 39,355,977           | 1,000,000          | 1,000,000            |
| Due after ten years              | 45,928,826         | 44,601,591           | 1,998,800          | 1,998,800            |
| Total                            | \$132,083,883      | \$129,593,126        | \$ 2,998,800       | \$ 2,998,800         |

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4. MORTGAGE-BACKED SECURITIES

Mortgage-backed securities are summarized as follows:

|                                     | DECEMBER 31, 2006 |                              |                               |
|-------------------------------------|-------------------|------------------------------|-------------------------------|
|                                     | AMORTIZED<br>COST | GROSS<br>UNREALIZED<br>GAINS | GROSS<br>UNREALIZED<br>LOSSES |
| Securities held to maturity         |                   |                              |                               |
| GNMA pass-through certificates      | \$45,408,527      | \$ 53,981                    | \$ (1,012,909)                |
| FNMA pass-through certificates      | 1,439,962         | -                            | (45,838)                      |
| FHLMC pass-through certificates     | 1,841,212         | 16                           | (30,863)                      |
|                                     | -----             | -----                        | -----                         |
| Total securities held to maturity   | \$48,689,701      | \$ 53,997                    | \$ (1,089,610)                |
|                                     | =====             | =====                        | =====                         |
| Securities available for sale       |                   |                              |                               |
| FNMA pass-through certificates      | \$ 4,372,274      | \$ 84,362                    | \$ -                          |
|                                     | -----             | -----                        | -----                         |
| Total securities available for sale | \$ 4,372,274      | \$ 84,362                    | \$ -                          |
|                                     | =====             | =====                        | =====                         |

|                                     | SEPTEMBER 30, 2006 |                              |                               |
|-------------------------------------|--------------------|------------------------------|-------------------------------|
|                                     | AMORTIZED<br>COST  | GROSS<br>UNREALIZED<br>GAINS | GROSS<br>UNREALIZED<br>LOSSES |
| Securities held to maturity         |                    |                              |                               |
| GNMA pass-through certificates      | \$46,991,401       | \$ 157,936                   | \$ (896,360)                  |
| FNMA pass-through certificates      | 1,448,326          | -                            | (52,683)                      |
| FHLMC pass-through certificates     | 1,920,007          | 22                           | (42,275)                      |
|                                     | -----              | -----                        | -----                         |
| Total securities held to maturity   | \$50,359,734       | \$ 157,958                   | \$ (991,318)                  |
|                                     | =====              | =====                        | =====                         |
| Securities available for sale       |                    |                              |                               |
| FNMA pass-through certificates      | \$ 4,534,743       | \$ 80,564                    | \$ -                          |
|                                     | -----              | -----                        | -----                         |
| Total securities available for sale | \$ 4,534,743       | \$ 80,564                    | \$ -                          |
|                                     | =====              | =====                        | =====                         |

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The following table shows the gross unrealized losses and related estimated fair values of the Company's mortgage-backed securities and length of time that individual securities have been in a continuous loss position at December 31, 2006:

|                                 | LESS THAN 12 MONTHS     |                      | MORE THAN 12 MONTHS     |                      |
|---------------------------------|-------------------------|----------------------|-------------------------|----------------------|
|                                 | GROSS UNREALIZED LOSSES | ESTIMATED FAIR VALUE | GROSS UNREALIZED LOSSES | ESTIMATED FAIR VALUE |
| Securities held to maturity:    |                         |                      |                         |                      |
| GNMA pass-through certificates  | \$ 562,093              | \$25,141,790         | \$ 450,816              | \$14,455             |
| FNMA pass-through certificates  | -                       | -                    | 45,838                  | 1,393                |
| FHLMC pass-through certificates | 30,863                  | 1,809,497            | -                       | -                    |
| Total                           | \$ 592,956              | \$26,951,287         | \$ 496,654              | \$15,848             |

At December 31, 2006, all mortgage-backed-securities available-for-sale were in an unrealized gain position.

The following table shows the gross unrealized losses and related estimated fair values of the Company's mortgage-backed securities, and length of time that individual securities have been in a continuous loss position at September 30, 2006:

|                                 | LESS THAN 12 MONTHS     |                      | MORE THAN 12 MONTHS     |                      |
|---------------------------------|-------------------------|----------------------|-------------------------|----------------------|
|                                 | GROSS UNREALIZED LOSSES | ESTIMATED FAIR VALUE | GROSS UNREALIZED LOSSES | ESTIMATED FAIR VALUE |
| Securities held to maturity:    |                         |                      |                         |                      |
| GNMA pass-through certificates  | \$ 526,169              | \$25,601,666         | \$ 370,191              | \$11,199             |
| FNMA pass-through certificates  | 52,209                  | 1,395,273            | 474                     | -                    |
| FHLMC pass-through certificates | 42,275                  | 1,876,570            | -                       | -                    |
| Total                           | \$ 620,653              | \$28,873,509         | \$ 370,665              | \$11,200             |

At September 30, 2006, all mortgage-backed securities available-for-sale were in an unrealized gain position

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. For all securities that are in an unrealized loss position for an extended period of time and for all securities whose fair value is significantly below amortized cost, the Company performs an evaluation of the specific events attributable to the market decline of the security. The Company considers the length of

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time and extent to which the security's market value has been below cost as well as the general market conditions, industry characteristics, and the fundamental operating results of the issuer to determine if the decline is other-than-temporary. The Company also considers as part of the evaluation its intent and ability to hold the security until its market value has recovered to a level at least equal to the amortized cost. When the Company determines that a security's unrealized loss is other-than-temporary, a realized loss is recognized in the period in which the decline in value is determined to be other-than-temporary. The write-downs are measured based on public market prices of the security at the time the Company determines the decline in value was other-than-temporary.

At December 31, 2006, mortgage-backed securities in a gross unrealized loss position for twelve months or longer consist of 10 securities having an aggregate depreciation of 3.0% from the Company's amortized cost basis. Mortgage-backed securities in a gross unrealized loss position for less than twelve months consist of 26

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securities having an aggregate depreciation of 2.2% from the Company's amortized cost basis. The unrealized losses disclosed above are primarily related to movement in market interest rates. Although the fair value will fluctuate as the market interest rates move, all of the Company's mortgage-backed securities portfolio consists of low-risk securities issued by U.S. government sponsored enterprises. If held to maturity, the contractual principal and interest payments of such securities are expected to be received in full. As such, no loss in value is expected over the lives of the securities. The Company has the ability to hold these securities until they mature and does not intend to sell the securities at a loss. Based on the above, management believes that the unrealized losses are temporary. The determination of whether a decline in market value is temporary is necessarily a matter of subjective judgment. The timing and amount of any realized losses reported in the Company's financial statements could vary if conclusions other than those made by management were to determine whether an other-than-temporary impairment exists.

### 5. LOANS RECEIVABLE

Loans receivable consist of the following:

|   | DECEMBER 31,<br>2006 | SEPTEMBER 30,<br>2006 |
|---|----------------------|-----------------------|
|   | -----                | -----                 |
| One-to-four family residential          | \$ 155,890,617       | \$ 155,453,827        |
| Multi-family residential                | 4,736,365            | 5,073,903             |
| Commercial real estate                  | 11,938,650           | 11,338,845            |
| Construction and land development       | 77,395,043           | 82,800,690            |
| Commercial business                     | 162,427              | 233,979               |
| Consumer                                | 1,249,794            | 1,239,063             |
|   | -----                | -----                 |
| Total loans                             | 251,372,896          | 256,140,307           |
| Undisbursed portion of loans-in-process | (32,182,589)         | (36,257,661)          |

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|                           |                |                |
|---------------------------|----------------|----------------|
| Deferred loan fees        | 259,150        | 152,841        |
| Allowance for loan losses | (677,956)      | (617,956)      |
|                           | -----          | -----          |
| Net                       | \$ 218,771,501 | \$ 219,417,531 |
|                           | =====          | =====          |

The following schedule summarizes the changes in the allowance for loan losses:

|                              | THREE MONTHS ENDED DECEMBER 31, |            |
|------------------------------|---------------------------------|------------|
|                              | 2006                            | 2005       |
|                              | -----                           | -----      |
| Balance, beginning of period | \$ 617,956                      | \$ 557,956 |
| Provision for loan losses    | 60,000                          | -          |
| Charge-offs                  | -                               | -          |
| Recoveries                   | -                               | -          |
|                              | -----                           | -----      |
| Balance, end of period       | \$ 677,956                      | \$ 557,956 |
|                              | =====                           | =====      |

Nonperforming loans (which consist of nonaccrual loans and loans in excess of 90 days delinquent and still accruing interest) at December 31, 2006 and September 30, 2006 amounted to approximately \$378,000 and \$151,000, respectively.

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6. DEPOSITS

Deposits consist of the following major classifications:

|   | DECEMBER 31,  |         | SEPTEMBER 30, |         |
|---|---------------|---------|---------------|---------|
|   | 2006          |         | 2006          |         |
|   | AMOUNT        | PERCENT | AMOUNT        | PERCENT |
|   | -----         | -----   | -----         | -----   |
| Money market deposit accounts                 | \$ 64,861,446 | 18.5%   | \$ 64,498,290 | 18.5%   |
| NOW accounts                                  | 32,221,899    | 9.2     | 34,202,808    | 9.2     |
| Passbook, club and statement savings          | 75,792,005    | 21.6    | 76,989,307    | 21.6    |
| Certificates maturing in six months or less   | 89,300,431    | 25.5    | 77,904,032    | 25.5    |
| Certificates maturing in more than six months | 88,425,346    | 25.2    | 93,698,054    | 25.2    |
|   | -----         | -----   | -----         | -----   |
| Total   | \$350,601,127 | 100.0%  | \$347,292,491 | 100.0%  |
|   | =====         | =====   | =====         | =====   |

At December 31, 2006 and September 30, 2006, the weighted average cost of funds was 3.6% and 3.5%, respectively.

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7. INCOME TAXES

Items that gave rise to significant portions of deferred income taxes are as follows:

|  | DECEMBER 31,<br>2006 | SEPTEMBER 30,<br>2006 |
|--|----------------------|-----------------------|
|  | -----                | -----                 |
| Deferred tax assets:                             |                      |                       |
| Deposit premium                                  | \$ 301,818           | \$ 314,054            |
| Allowance for loan losses                        | 179,987              | 246,632               |
| Other  | -                    | 39,639                |
|  | -----                | -----                 |
| Total  | 481,805              | 600,325               |
|  | -----                | -----                 |
| Deferred tax liabilities:                        |                      |                       |
| Unrealized gain on available for sale securities | 275,178              | 286,336               |
| Property   | 411,900              | 406,834               |
| Mortgage servicing rights                        | 9,381                | 9,754                 |
| Deferred loan fees                               | 87,022               | 50,788                |
|  | -----                | -----                 |
| Total  | 783,481              | 753,712               |
|  | -----                | -----                 |
| Net deferred tax liability                       | \$ (301,676)         | \$ (153,387)          |
|  | =====                | =====                 |

8. COMMITMENTS AND CONTINGENT LIABILITIES

At December 31, 2006, the Company had \$7,560,500 in outstanding commitments to originate fixed and variable rate loans with market interest rates ranging from 6.00% to 9.25%. At September 30, 2006, the Company had \$4,932,800 in outstanding commitments to originate fixed and variable-rate loans with market interest rates ranging from 6.00% to 9.25%.

The Company also had commitments under unused lines of credit of \$5,695,204 and \$6,706,481 at December 31, 2006 and September 30, 2006, respectively, and letters of credit outstanding of \$110,000 at both December 31, 2006 and September 30, 2006.

Among the Company's contingent liabilities are exposures to limited recourse arrangements with respect to the Company's sales of whole loans and participation interests. At December 31, 2006, the exposure, which represents a portion of credit risk associated with the interests sold, amounted to \$64,451. This exposure is for the life of the related loans and payables, on our proportionate share, as actual losses are incurred.

The Company is involved in various legal proceedings occurring in the ordinary course of business. Management of the Company, based on discussions with litigation counsel, believes that such proceedings will not have a material adverse effect on the financial condition or operations of the Company. There can be no assurance that any of the outstanding legal proceedings to which the Company is a party will not be decided adversely to the Company's interests and have a material adverse effect on the financial condition and operations of the Company.

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

OVERVIEW. Prudential Bancorp, Inc. of Pennsylvania (the "Company") was formed by Prudential Savings Bank (the "Bank") in connection with the Bank's reorganization into the mutual holding company form. The Company's results of operations are primarily dependent on the results of the Bank, which is a wholly owned subsidiary of the Company. The Company's results of operations depend to a large extent on net interest income, which is the difference between the income earned on its loan and securities portfolios and the cost of funds, which is the interest paid on deposits and borrowings. Results of operations are also affected by our provisions for loan losses, non-interest income and non-interest expense. Non-interest expense principally consists of salaries and employee benefits, office occupancy, depreciation, data processing expense, payroll taxes and other expense. Our results of operations are also significantly affected by general economic and competitive conditions, particularly changes in interest rates, government policies and actions of regulatory authorities. Future changes in applicable laws, regulations or government policies may materially impact our financial condition and results of operations. The Bank is subject to regulation by the Federal Deposit Insurance Corporation ("FDIC") and the Pennsylvania Department of Banking. The Bank's main office is in Philadelphia, Pennsylvania, with five additional banking offices located in Philadelphia and Delaware Counties in Pennsylvania. The Bank's primary business consists of attracting deposits from the general public and using those funds together with borrowings to originate loans and to invest primarily in U.S. Government and agency securities and mortgage-backed securities. In November 2005, the Bank formed PSB Delaware, Inc., a Delaware Corporation, as a subsidiary of the Bank. In March 2006, all mortgage-backed securities owned by the Company were transferred to PSB Delaware, Inc. The activity of PSB Delaware, Inc. is included as part of the consolidated financial statements.

CRITICAL ACCOUNTING POLICIES. In reviewing and understanding financial information for the Company, you are encouraged to read and understand the significant accounting policies used in preparing our financial statements. These policies are described in Note 2 of the Notes to Consolidated Financial Statements included in the Annual Report filed on Form 10-K for the year ended September 30, 2006. The accounting and financial reporting policies of the Company conform to accounting principles generally accepted in the United States of America and to general practices within the banking industry. The preparation of the Company's consolidated financial statements 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. Management evaluates these estimates and assumptions on an ongoing basis. The following accounting policies comprise those that management believes are the most critical to aid in fully understanding and evaluating our reported financial results. These policies require numerous estimates or economic assumptions that may prove inaccurate or may be subject to variations which may significantly affect our reported results and financial condition for the period or in future periods.

ALLOWANCE FOR LOAN LOSSES. The allowance for loan losses is established through a provision for loan losses charged to expense. Loans are charged against the allowance for loan losses when management believes that the collectibility of the principal is unlikely. Subsequent recoveries are added to the allowance. The allowance is an amount that management believes will cover known and inherent losses in the loan portfolio, based on evaluations of the collectibility of

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loans. The evaluations take into consideration such factors as changes in the types and amount of loans in the loan portfolio, historical loss experience, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral, estimated losses relating to specifically identified loans, and current economic conditions. This evaluation is inherently subjective as it requires material estimates including, among others, exposure at default, the amount and timing of expected future cash flows on impacted loans, value of collateral, estimated losses on our commercial, construction and residential loan portfolios and general amounts for historical loss experience. All of these estimates may be susceptible to significant change.

While management uses the best information available to make loan loss allowance evaluations, adjustments to the allowance may be necessary based on changes in economic and other conditions or changes in accounting guidance. Historically, our estimates of the allowance for loan loss have not required significant adjustments from management's initial estimates. In addition, the Pennsylvania Department of Banking and the FDIC, as an integral

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part of their examination processes, periodically review our allowance for loan losses. The Pennsylvania Department of Banking and the FDIC may require the recognition of adjustments to the allowance for loan losses based on their judgment of information available to them at the time of their examinations. To the extent that actual outcomes differ from management's estimates, additional provisions to the allowance for loan losses may be required that would adversely impact earnings in future periods.

INCOME TAXES. We make estimates and judgments to calculate some of our tax liabilities and determine the recoverability of some of our deferred tax assets, which arise from temporary differences between the tax and financial statement recognition of revenues and expenses. We also estimate a reserve for deferred tax assets if, based on the available evidence, it is more likely than not that some portion or all of the recorded deferred tax assets will not be realized in future periods. These estimates and judgments are inherently subjective. In the past, our estimates and judgments to calculate our deferred tax accounts have not required significant revision to our initial estimates.

In evaluating our ability to recover deferred tax assets, we consider all available positive and negative evidence, including our past operating results and our forecast of future taxable income. In determining future taxable income, we make assumptions for the amount of taxable income, the reversal of temporary differences and the implementation of feasible and prudent tax planning strategies. These assumptions require us to make judgments about our future taxable income and are consistent with the plans and estimates we use to manage our business. Any reduction in estimated future taxable income may require us to record an additional valuation allowance against our deferred tax assets. An increase in the valuation allowance would result in additional income tax expense in the period and could have a significant impact on our future earnings.

FORWARD-LOOKING STATEMENTS. In addition to historical information, this Quarterly Report on Form 10-Q includes certain "forward-looking statements" based on management's current expectations. The Company's actual results could differ materially, as such term is defined in the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended, from management's expectations. Such forward-looking statements include statements regarding management's current intentions, beliefs or expectations as well as the assumptions on which such statements are based. These forward-looking statements are subject to significant business, economic and competitive uncertainties and



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contingencies, many of which are not subject to the Company's control. You are cautioned that any such forward-looking statements are not guarantees of future performance and involve risks and uncertainties, and that actual results may differ materially from those contemplated by such forward-looking statements. Factors that could cause future results to vary from current management expectations include, but are not limited to, general economic conditions, legislative and regulatory changes, monetary and fiscal policies of the federal government, changes in tax policies, rates and regulations of federal, state and local tax authorities, changes in interest rates, deposit flows, the cost of funds, demand for loan products, demand for financial services, competition, changes in the quality or composition of the Company's loan and investment portfolios, changes in accounting principles, policies or guidelines and other economic, competitive, governmental and technological factors affecting the Company's operations, markets, products, services and fees.

The Company undertakes no obligation to update or revise any forward-looking statements to reflect changed assumptions, the occurrence of unanticipated events or changes to future operating results that occur subsequent to the date such forward-looking statements are made.

### COMPARISON OF FINANCIAL CONDITION AT DECEMBER 31, 2006 AND SEPTEMBER 30, 2006

At December 31, 2006, the Company's total assets were \$467.0 million, a decrease of \$5.4 million from \$472.4 million at September 30, 2006. The decrease was primarily attributable to net repayments in the investment and mortgage-backed security portfolios of \$5.0 million. Management chose to use the proceeds from these repayments to repay higher cost short-term advances from the Federal Home Loan Bank ("FHLB").

Total liabilities decreased \$5.5 million to \$379.5 million at December 31, 2006 from \$384.9 million at September 30, 2006. The decrease was primarily attributable to the repayment of FHLB advances which decreased by \$7.0 million, from \$31.8 million at September 30, 2006 to \$24.8 million at December 31, 2006. Also contributing to the decrease was a \$2.3 million decrease in accrued interest payable as interest on certificates are generally paid annually at

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December 31. These decreases were partially offset by a \$3.3 million increase in deposits, primarily in certificates of deposit.

Stockholders' equity increased slightly, by \$35,000 to \$87.5 million at December 31, 2006 as compared to \$87.4 million at September 30, 2006. Effective October 1, 2006, the cumulative adjustment related to the adoption of SAB 108 was recognized for an increase in retained earnings of \$172,000 primarily related to the amortization of premiums and discounts on our mortgage-backed securities portfolio. Also contributing to the increase was the recognition of \$896,000 in net income for quarter ended December 31, 2006 offset in part by the cost of stock repurchased during the quarter of \$626,000 and the declaration of cash dividends of \$463,000. Smaller changes were also noted in the amortization of unearned employee stock ownership shares and other comprehensive income.

### COMPARISON OF RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED DECEMBER 31, 2006 AND 2005

NET INCOME. Net income was \$896,000 for the quarter ended December 31, 2006 as compared to \$1.1 million for the same period in 2005, a decrease of 17.6%. The decrease was primarily due to a \$194,000 increase in non-interest expense for the quarter ended December 31, 2006.

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NET INTEREST INCOME.

Net interest income decreased \$77,000 or 2.4% to \$3.1 million for the three months ended December 31, 2006 as compared to \$3.2 million for the same period in 2005. The decrease was due to a \$974,000 or 37.1% increase in interest expense partially offset by an \$897,000 or 15.5% increase in interest income. The increase in interest expense resulted primarily from an 85 basis point increase to 3.86% in the weighted average rate paid on interest-bearing liabilities, reflecting the increase in market rates of interest during the past year. Also contributing to the increase in interest expense was a \$24.7 million or 7.1% increase in the average balance of interest-bearing liabilities for the three months ended December 31, 2006, as compared to the same period in 2005. The increase in interest income resulted primarily from a 56 basis point increase in the weighted average yield earned on such assets to 5.89% for the quarter ended December 31, 2006 from the comparable period in 2005 combined with a \$20.1 million or 4.6% increase in the average balance of interest-earning assets for the three months ended December 31, 2006, as compared to the same period in 2005.

For the quarter ended December 31, 2006, the net interest margin was 2.72%, as compared to 2.92% for the comparable period in 2005. The compression in the net interest margin reflected the more rapid increase in the rate paid on the interest-bearing liabilities due to their greater interest rate sensitivity, partially offset by an increase in rates earned on interest-earning assets combined with an increase in the volume of interest-earning assets.

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AVERAGE BALANCES, NET INTEREST INCOME, AND YIELDS EARNED AND RATES PAID. The following table shows for the periods indicated the total dollar amount of interest from average interest-earning assets and the resulting yields, as well as the interest expense on average interest-bearing liabilities, expressed both in dollars and rates, and the net interest margin. Tax-exempt income and yields have not been adjusted to a tax-equivalent basis. All average balances are based on monthly balances. Management does not believe that the monthly averages differ significantly from what the daily averages would be.

|  | Three Months<br>Ended December 31, |          |                       |                  |
|--|------------------------------------|----------|-----------------------|------------------|
|  | -----<br>2006<br>-----             |          |                       |                  |
|  | Average<br>Balance                 | Interest | Average<br>Yield/Rate | Averag<br>Balanc |
|  | (Dollars in Thousands)             |          |                       |                  |
| Interest-earning assets:               |                                    |          |                       |                  |
| Investment securities                  | \$173,251                          | \$ 2,105 | 4.86%                 | \$171,465        |
| Mortgage-backed securities             | 54,337                             | 711      | 5.23                  | 65,444           |
| Loans receivable(1)                    | 221,224                            | 3,825    | 6.92                  | 179,901          |
| Other interest-earning assets          | 5,192                              | 42       | 3.24                  | 17,116           |
|  | -----                              | -----    |                       | -----            |
| Total interest-earning assets          | 454,004                            | 6,683    | 5.89                  | 433,926          |
|  |                                    | -----    |                       |                  |
| Cash and non-interest-bearing balances | 4,389                              |          |                       | 4,501            |
| Other non-interest-earning assets      | 11,437                             |          |                       | 7,400            |
|  | -----                              |          |                       | -----            |

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|   |           |          |       |           |
|---|-----------|----------|-------|-----------|
| Total assets  | \$469,830 |          |       | \$445,827 |
|   | =====     |          |       | =====     |
| Interest-bearing liabilities:   |           |          |       |           |
| Savings accounts  | \$ 75,111 | 587      | 3.13  | \$ 84,803 |
| Money market deposit and NOW accounts                                   | 94,210    | 836      | 3.55  | 102,696   |
| Certificates of deposit   | 173,643   | 1,779    | 4.10  | 144,941   |
|   | -----     |          |       | -----     |
| Total deposits  | 342,964   | 3,202    | 3.73  | 332,440   |
| Advances from Federal Home Loan Bank                                    | 27,973    | 390      | 5.58  | 13,817    |
| Advances from borrowers for taxes and insurance                         | 1,450     | 2        | 0.55  | 1,397     |
|   | -----     |          |       | -----     |
| Total interest-bearing liabilities                                      | 372,387   | 3,594    | 3.86  | 347,654   |
|   | -----     |          |       | -----     |
| Non-interest-bearing demand accounts                                    | 5,552     |          |       | 2,284     |
| Other liabilities   | 4,093     |          |       | 4,150     |
|   | -----     |          |       | -----     |
| Total liabilities   | 382,032   |          |       | 354,088   |
| Stockholders' equity  | 87,798    |          |       | 91,739    |
|   | -----     |          |       | -----     |
| Total liabilities and Stockholders' equity                              | \$469,830 |          |       | \$445,827 |
|   | =====     |          |       | =====     |
| Net interest-earning assets   | \$ 81,617 |          |       | \$ 86,272 |
|   | =====     |          |       | =====     |
| Net interest income; interest rate spread                               |           | \$ 3,089 | 2.03% |           |
|   |           | =====    |       |           |
| Net interest margin(2)  |           |          | 2.72% |           |
|   |           |          | ===== |           |
| Average interest-earning assets to average interest-bearing liabilities |           | 121.92%  |       |           |
|   |           | -----    |       |           |

(1) Includes non-accrual loans. Calculated net of unamortized deferred fees, undisbursed portion of loans-in-process and allowance for loan losses.

(2) Equals net interest income divided by average interest-earning assets.

PROVISIONS FOR LOAN LOSSES. Provisions for loan losses are charged to earnings to maintain the total allowance for loan losses at a level believed by management to cover all known and inherent losses in the loan portfolio which are both probable and reasonably estimable. Management's analysis includes consideration of the Company's historical experience, the volume and type of lending conducted by the Company, the amount of the Company's classified assets, the status of past due principal and interest payments, general economic conditions, particularly as they relate to the Company's primary market area, and other factors related to the collectibility of the Company's loan portfolio. The Company established a provision for loan losses of \$60,000 for the quarter ended December 31, 2006. No provisions were made during the comparable period in 2005. The provision in the 2006 period was established due to the continued growth in the loan portfolio experienced over the year.

At December 31, 2006, the Company's non-performing assets totaled \$378,000 or 0.1% of total assets and consisted of four single-family residential real estate loans. At such dates, the allowance for loan losses totaled \$678,000, or 0.3% of total loans and 179.2% of non-performing loans.

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Management continues to review its loan portfolio to determine the extent, if any, to which further additional loss provisions may be deemed necessary. There can be no assurance that the allowance for losses will be adequate to cover losses which may in fact be realized in the future and that additional provisions for losses will not be required.

NON-INTEREST INCOME. Non-interest income increased \$139,000 for the quarter ended December 31, 2006, as compared to the same period in 2005. The increase was primarily due a successful recovery of \$88,000, which represented a portion of our losses and legal fees related to a previously disclosed lawsuit which was settled in 2004. Also contributing to the increase was an increase in income from bank owned life insurance ("BOLI") of \$47,000 for the quarter ended December 31, 2006 compared to the comparable period in 2005. Income from BOLI was minimal during the 2005 period as the BOLI was purchased during December 2005.

NON-INTEREST EXPENSES. Non-interest expense increased \$194,000 for the quarter ended December 31, 2006 compared to the same quarter in 2005. This was primarily due to an increase in professional fees of \$152,000. The preponderance of the increase in professional fees was related to expenses associated with the defense of a previously disclosed lawsuit commenced in October 2006 by a shareholder, Stilwell Value Partners I, L.P., and increased costs incurred in connection with being a public company.

INCOME TAX EXPENSE. Income tax expense for the quarters ended December 31, 2006 and 2005 was \$422,000 in both periods. The effective income tax rate was 32.0% for the quarter ended December 31, 2006 compared to 28.0% for the quarter ended December 31, 2005. The lower effective tax rate in the 2005 period was primarily attributable to certain tax benefits the Company realized as a result of the adjustment of a valuation allowance during the first quarter of fiscal 2006 that had previously been established for accrued liabilities related to prior period tax accruals.

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### LIQUIDITY AND CAPITAL RESOURCES

The Company's liquidity, represented by cash and cash equivalents, is a product of its operating, investing and financing activities. Our primary sources of funds are from deposits, scheduled principal and interest payments on loans, loan prepayments and the maturity of loans, mortgage-backed securities and other investments, and other funds provided from operations. While scheduled payments from the amortization of loans and mortgage-backed securities and maturing investment securities are relatively predictable sources of funds, deposit flows and loan and securities prepayments can be greatly influenced by market rates of interest, economic conditions and competition. We also maintain excess funds in short-term, interest-bearing assets that provide additional liquidity. At December 31, 2006, our cash and cash equivalents amounted to \$13.4 million. In addition, our available for sale investment and mortgage-backed securities amounted to an aggregate of \$43.2 million at such date.

We use our liquidity to fund existing and future loan commitments, to fund maturing certificates of deposit and demand deposit withdrawals, to invest in other interest-earning assets, and to meet operating expenses. At December 31, 2006, the Company had \$7.6 million in outstanding commitments to originate fixed and variable rate loans, not including loans in process. The Company also had commitments under unused lines of credit of \$5.7 million and letters of credit outstanding of \$110,000 at December 31, 2006. Certificates of deposit at December 31, 2006 maturing in one year or less totaled \$136.5 million. Based upon historical experience, we anticipate that a significant portion of the

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maturing certificates of deposit will be redeposited with us.

In addition to cash flow from loan and securities payments and prepayments as well as from sales of available for sale securities, we have significant borrowing capacity available to fund liquidity needs should the need arise. Our borrowings consist solely of advances from the Federal Home Loan Bank of Pittsburgh, of which we are a member. Under terms of the collateral agreement with the Federal Home Loan Bank, we pledge residential mortgage loans and mortgage-backed securities as well as our stock in the Federal Home Loan Bank as collateral for such advances. However, use of FHLB advances has been relatively limited and the amount outstanding has remained relatively constant during the past several years. At December 31, 2006, we had \$24.8 million in outstanding FHLB advances and we had \$259.3 million in additional FHLB advances available to us.

We anticipate that we will continue to have sufficient funds and alternative funding sources to meet our current commitments.

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The following table summarizes the Company and Bank's regulatory capital ratios as of December 31, 2006 and September 30, 2005 and compares them to current regulatory guidelines.

|  | ACTUAL RATIO | REQUIRED FOR<br>CAPITAL ADEQUACY<br>PURPOSES | TO BE<br>WELL CAPITALIZED<br>UNDER PROMPT<br>CORRECTIVE ACTION<br>PROVISIONS |
|--|--------------|--|--|
| December 31, 2006:                       |              |  |  |
| Tier 1 capital (to average assets)       |              |  |  |
| The Company                              | 18.51%       | 4.0%   | N/A  |
| The Bank                                 | 14.93%       | 4.0%   | 5.0%   |
| Tier 1 capital (to risk weighted assets) |              |  |  |
| The Company                              | 39.49%       | 4.0%   | N/A  |
| The Bank                                 | 31.85%       | 4.0%   | 6.0%   |
| Total capital (to risk weighted assets)  |              |  |  |
| The Company                              | 39.95%       | 8.0%   | N/A  |
| The Bank                                 | 32.32%       | 8.0%   | 10.0%  |
| September 30, 2006:                      |              |  |  |
| Tier 1 capital (to average assets)       |              |  |  |
| The Company                              | 18.64%       | 4.0%   | N/A  |
| The Bank                                 | 14.74%       | 4.0%   | 5.0%   |
| Tier 1 capital (to risk weighted assets) |              |  |  |
| The Company                              | 39.23%       | 4.0%   | N/A  |
| The Bank                                 | 31.12%       | 4.0%   | 6.0%   |
| Total capital (to risk weighted assets)  |              |  |  |
| The Company                              | 39.68%       | 8.0%   | N/A  |
| The Bank                                 | 31.56%       | 8.0%   | 10.0%  |

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### IMPACT OF INFLATION AND CHANGING PRICES

The financial statements, accompanying notes, and related financial data of the Company presented herein have been prepared in accordance with generally accepted accounting principles which requires the measurement of financial position and operating results in terms of historical dollars, without considering changes in the relative purchasing power of money over time due to inflation.

Unlike most industrial companies, substantially all of the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates have a more significant impact on a financial institution's performance than the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or in the same magnitude as the price of goods and services, since such prices are affected by inflation to a larger extent than interest rates. In the current interest rate environment, liquidity and the maturity structure of the Company's assets and liabilities are critical to the maintenance of acceptable performance levels.

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

**HOW WE MANAGE MARKET RISK.** Market risk is the risk of loss from adverse changes in market prices and rates. Our market risk arises primarily from the interest rate risk which is inherent in our lending, investment and deposit gathering activities. To that end, management actively monitors and manages interest rate risk exposure. In addition to market risk, our primary risk is credit risk on our loan portfolio. We attempt to manage credit risk through our loan underwriting and oversight policies.

The principal objective of our interest rate risk management function is to evaluate the interest rate risk embedded in certain balance sheet accounts, determine the level of risk appropriate given our business strategy, operating environment, capital and liquidity requirements and performance objectives, and manage the risk consistent with approved guidelines. We seek to manage our exposure to risks from changes in interest rates while at the same time trying to improve our net interest spread. We monitor interest rate risk as such risk relates to our operating strategies. We have established an Asset/Liability Committee which is comprised of our President and Chief Executive Officer, Chief Financial Officer, Chief Lending Officer, Treasurer and Controller. The Asset/Liability Committee meets on a regular basis and is responsible for reviewing our asset/liability policies and interest rate risk position. Both the extent and direction of shifts in interest rates are uncertainties that could have a negative impact on future earnings.

In recent years, we primarily have utilized the following strategies in our efforts to manage interest rate risk:

- o we have increased our originations of shorter term loans and/or loans with adjustable rates of interest, particularly construction and land development loans;
- o we have invested in securities with "step-up" rate features providing for increased interest rates prior to maturity according to a pre-determined schedule and formula; and
- o we have maintained moderate levels of short-term liquid assets.

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However, notwithstanding the foregoing steps, we remain subject to a significant level of interest rate risk in a rising rate environment due to the high proportion of our loan portfolio that consists of fixed-rate loans as well as our decision to invest a significant amount of our assets in long-term, fixed-rate investment and mortgage-backed securities designated as held to maturity. In addition, our interest rate spread and margin have been adversely affected due to the tightening of the yield curve. Likewise, our unwillingness to originate long-term, fixed-rate residential mortgage loans at low rates has resulted in borrowers in many cases refinancing loans elsewhere, requiring us to reinvest the resulting proceeds from the loan payoffs at low current market rates of interest. Thus, both of these strategies have increased our interest rate risk.

**GAP ANALYSIS.** The matching of assets and liabilities may be analyzed by examining the extent to which such assets and liabilities are "interest rate sensitive" and by monitoring a Company's interest rate sensitivity "gap." An asset or liability is said to be interest rate sensitive within a specific time period if it will mature or reprice within that time period. The interest rate sensitivity gap is defined as the difference between the amount of interest-earning assets maturing or repricing within a specific time period and the amount of interest-bearing liabilities maturing or repricing within that same time period. A gap is considered positive when the amount of interest rate sensitive assets exceeds the amount of interest rate sensitive liabilities. A gap is considered negative when the amount of interest rate sensitive liabilities exceeds the amount of interest rate sensitive assets. During a period of rising interest rates, a negative gap would tend to affect adversely net interest income while a positive gap would tend to result in an increase in net interest income. Conversely, during a period of falling interest rates, a negative gap would tend to result in an increase in net interest income while a positive gap would tend to affect adversely net interest income.

The following table sets forth the amounts of our interest-earning assets and interest-bearing liabilities outstanding at December 31, 2006, which we expect, based upon certain assumptions, to reprice or mature in each of the future time periods shown (the "GAP Table"). Except as stated below, the amounts of assets and liabilities shown which reprice or mature during a particular period were determined in accordance with the earlier of term to repricing or the contractual maturity of the asset or liability. The table sets forth an approximation of the projected repricing of assets

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and liabilities at December 31, 2006, on the basis of contractual maturities, anticipated prepayments, and scheduled rate adjustments within a three-month period and subsequent selected time intervals. The loan amounts in the table reflect principal balances expected to be redeployed and/or repriced as a result of contractual amortization and anticipated prepayments of adjustable-rate loans and fixed-rate loans, and as a result of contractual rate adjustments on adjustable-rate loans. Annual prepayment rates for adjustable-rate and fixed-rate single-family and multi-family residential and commercial mortgage loans are assumed to range from 8.4% to 25.9%. The annual prepayment rate for mortgage-backed securities is assumed to range from 7.74% to 22.92%. Money market deposit accounts, savings accounts and interest-bearing checking accounts are assumed to have annual rates of withdrawal, or "decay rates," based on information from the FDIC. For savings accounts and checking accounts, the decay rates are 60% in one to three years, 20% in three to five years and 20% in five to 10 years. For money market accounts, the decay rates are 50% in three to 12 months and 50% in 13 to 36 months.

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|   | 3 Months<br>or Less    | More than<br>3 Months<br>to 1 Year | More than<br>1 Year<br>to 3 Years | More than<br>3 Years<br>to 5 Years |
|---|------------------------|------------------------------------|-----------------------------------|------------------------------------|
|   | (Dollars in Thousands) |                                    |                                   |                                    |
| Interest-earning assets(1):   |                        |                                    |                                   |                                    |
| Investment securities(2)  | \$16,234               | \$21,964                           | \$19,382                          | \$18,093                           |
| Mortgage-backed securities  | 1,536                  | 4,598                              | 11,217                            | 9,164                              |
| Loans receivable(3)   | 60,529                 | 27,333                             | 44,735                            | 29,534                             |
| Other interest earning assets   | 10,555                 | -                                  | -                                 | -                                  |
| <b>Total interest-earning assets</b>  | <b>\$88,854</b>        | <b>\$53,895</b>                    | <b>\$75,334</b>                   | <b>\$56,791</b>                    |
| Interest-bearing liabilities:   |                        |                                    |                                   |                                    |
| Savings accounts  | \$ 169                 | \$ 195                             | \$44,690                          | \$14,897                           |
| Money market deposit and NOW accounts   | -                      | 32,431                             | 49,581                            | 5,717                              |
| Certificates of deposits  | 52,152                 | 84,331                             | 24,788                            | 16,455                             |
| Advances from Federal Home Loan Bank  | 11,018                 | 54                                 | 149                               | 13,156                             |
| Advances from borrowers for taxes and insurance   | -                      | -                                  | -                                 | -                                  |
| <b>Total interest-bearing liabilities</b>   | <b>\$ 63,339</b>       | <b>\$117,011</b>                   | <b>\$119,208</b>                  | <b>\$ 50,225</b>                   |
| Interest-earning assets<br>less interest-bearing liabilities  | \$ 25,515              | \$(63,116)                         | \$(43,874)                        | \$ 6,566                           |
| Cumulative interest-rate sensitivity gap (4 )   | \$ 25,515              | \$(37,601)                         | \$(81,475)                        | \$(74,900)                         |
| Cumulative interest-rate gap as a<br>percentage of total assets at December 31, 2006                                      | 5.46%                  | -8.05%                             | -17.45%                           | -16.04%                            |
| Cumulative interest-earning assets<br>as a percentage of cumulative interest-<br>bearing liabilities at December 31, 2006 | 140.28%                | 79.15%                             | 72.80%                            | 78.58%                             |

(1) Interest-earning assets are included in the period in which the balances are expected to be redeployed and/or repriced as a result of anticipated prepayments, scheduled rate adjustments and contractual maturities.

(2) For purposes of the gap analysis, investment securities are stated at amortized cost.

(3) For purposes of the gap analysis, loans receivable includes non-performing loans and is gross of the allowance for loan losses, but net of undisbursed portion of loans-in-process and unamortized deferred loan fees.

(4) Interest-rate sensitivity gap represents the difference between net interest-earning assets and interest-bearing liabilities.



Certain shortcomings are inherent in the method of analysis presented in the foregoing table. For example, although certain assets and liabilities may have similar maturities or periods to repricing, they may react in different degrees to changes in market interest rates. Also, the interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types may lag behind changes in market rates. Additionally, certain assets, such as adjustable-rate loans, have features which restrict changes in interest rates both on a short-term basis and over the life of the asset. Further, in the event of a change in interest rates, prepayment and early withdrawal levels would likely deviate significantly from those assumed in calculating the table. Finally, the ability of many borrowers to service their adjustable-rate loans may be adversely affected in the event of an interest rate increase.

NET PORTFOLIO VALUE ANALYSIS. Our interest rate sensitivity also is monitored by management through the use of a model which generates estimates of the changes in our net portfolio value ("NPV") over a range of interest rate scenarios. NPV is the present value of expected cash flows from assets, liabilities and off-balance sheet contracts. The NPV ratio, under any interest rate scenario, is defined as the NPV in that scenario divided by the market value of assets in the same scenario. The following table sets forth our NPV as of December 31, 2006 and reflects the changes to NPV as a result of immediate and sustained changes in interest rates as indicated.

| Change in<br>Interest Rates<br>In Basis Points<br>(Rate Shock) | Net Portfolio Value |             |          | NPV as % of Portfolio<br>Value of Assets |    |
|--|---------------------|-------------|----------|--|----|
|  | Amount              | \$ Change   | % Change | NPV Ratio                                | Ch |
| (Dollars in Thousands)   |                     |             |          |  |    |
| 300  | \$ 60,944           | \$ (33,773) | (35.66)% | 14.74%                                   | (5 |
| 200  | 71,485              | (23,232)    | (24.53)% | 16.68%                                   | (3 |
| 100  | 82,933              | (11,784)    | (12.44)% | 18.65%                                   | (1 |
| Static   | 94,717              | -           | -        | 20.53%                                   |    |
| (100)  | 99,894              | 5,177       | 5.47%    | 21.19%                                   | 0  |
| (200)  | 97,181              | 2,464       | 2.60%    | 20.51%                                   | (0 |
| (300)  | 94,913              | 196         | 0.21%    | 19.91%                                   | (0 |

As is the case with the GAP Table, certain shortcomings are inherent in the methodology used in the above interest rate risk measurements. Modeling changes in NPV require the making of certain assumptions which may or may not reflect the manner in which actual yields and costs respond to changes in market interest rates. In this regard, the models presented assume that the composition of our interest sensitive assets and liabilities existing at the beginning of a period remains constant over the period being measured and also assumes that a particular change in interest rates is reflected uniformly across the yield curve regardless of the duration to maturity or repricing of specific assets and liabilities. Accordingly, although the NPV model provides an indication of interest rate risk exposure at a particular point in time, such model is not intended to and does not provide a precise forecast of the effect of changes in market interest rates on net interest income and will differ from actual

results.

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ITEM 4. CONTROLS AND PROCEDURES

Our management evaluated, with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) or 15d-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and regulations and are operating in an effective manner.

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

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PART II

ITEM 1. LEGAL PROCEEDINGS

On October 4, 2006, Stilwell Value Partners I, L.P. ("Stilwell") filed suit in the United States District Court for the Eastern District of Pennsylvania against Prudential Mutual Holding Company (the "MHC"), Prudential Bancorp, Inc. of Pennsylvania (the "Company") and each of the directors of the MHC and the Company individually seeking equitable relief including (i) enjoining the Company and the directors from allowing the MHC to participate in any shareholder vote to consider the adoption of proposed stock option and stock recognition and retention plans (collectively, the "Stock Plans") and (ii) enjoining MHC from participating in any shareholder vote to approve the Stock Plans. In the event that the MHC and the Company are not enjoined, Stilwell is seeking damages, the amount to be determined at trial.

Stilwell alleges that the Company's prospectus used to solicit offers to purchase shares of the Company's common stock in connection with the mutual holding reorganization of Prudential Savings Bank "promised" that the Stock Plans would be submitted only for consideration by the Company's public shareholders and not the MHC which controls a majority of the Company's issued and outstanding shares of common stock and that Stilwell relied on such promise in determining to invest in the common stock of the Company. Stilwell also alleges the individual directors have violated their fiduciary duties to Stilwell by delaying the consideration of the Stock Plans until such time that MHC can vote its shares on the Stock Plans assuring their approval by shareholders. The Company believes Stilwell's allegations are without merit and intends to vigorously defend the case. On November 20, 2006, the Company, the MHC and the director defendants filed a motion to dismiss the complaint, asserting, among other things, that the prospectus contained no "promise," implied or otherwise, that the MHC would never vote on the adoption of the Stock Plans and that the breach of fiduciary duty claim, with respect to the timing of any such vote, is legally insufficient. Stilwell filed an opposition brief to

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the Company's motion on December 20, 2006 and the Company filed its reply brief on January 8, 2007.

Since the case is in its early stages, no prediction can be made as to the outcome thereof.

Other than the above referenced litigation, the Company is involved in various legal proceedings occurring in the ordinary course of business. Management of the Company, based on discussions with litigation counsel, believes that such proceedings will not have a material adverse effect on the financial condition or operations of the Company. There can be no assurance that any of the outstanding legal proceedings to which the Company is a party will not be decided adversely to the Company's interests and have a material adverse effect on the financial condition and operations of the Company.

ITEM 1A. RISK FACTORS

There were no material changes from the risk factors described in the Company's annual report on Form 10-K for the year ended September 30, 2006.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

- (a) Not applicable
- (b) Not applicable
- (c) Purchases of Equity Securities

The Company's repurchases of its common stock made during the quarter are set forth in the following table:

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| PERIOD                         | TOTAL NUMBER<br>OF SHARES<br>PURCHASED | AVERAGE PRICE<br>PAID PER SHARE | TOTAL NUMBER<br>OF SHARES<br>PURCHASED AS<br>PART OF<br>PUBLICLY<br>ANNOUNCED<br>PLANS OR<br>PROGRAMS |
|--------------------------------|--|---------------------------------|---|
| October 1 - October 31, 2006   | -                                      | \$ -                            | -   |
| November 1 - November 30, 2006 | 46,570                                 | 13.40                           | 46,570  |
| December 1 - December 31, 2006 | -                                      | -                               | -   |
| Total                          | 46,570                                 | \$ 13.40                        | 46,570  |

Notes to the table

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- (1) On April 6, 2006, the Company announced its second stock repurchase program to repurchase 269,000 shares or approximately 5% of the Company's outstanding common stock held by shareholders other than Prudential Mutual Holding Company, such program to commence upon completion of the first program (which was completed in May 2006). The second repurchase program was completed in November 2006.
- (2) On January 17, 2007, the Company announced its third stock repurchase program to repurchase up to 255,384 shares or approximately 5% of the Company's outstanding common stock held by shareholders other than Prudential Mutual Holding Company.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Not applicable

ITEM 5. OTHER INFORMATION

Not applicable

ITEM 6. EXHIBITS

| Exhibit No. | Description   |
|-------------|---|
| -----       | -----   |
| 10.1        | Directors' Compensation - fiscal 2007                             |
| 31.1        | Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer |
| 31.2        | Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer |
| 32.0        | Section 1350 Certifications                                       |

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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.

PRUDENTIAL BANCORP, INC. OF PENNSYLVANIA

DATE: February 14, 2007

BY: /s/ Thomas A. Vento

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THOMAS A. VENTO  
PRESIDENT AND CHIEF EXECUTIVE OFFICER

DATE: February 14, 2007

BY: /s/ Joseph R. Corrato

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JOSEPH R. CORRATO  
EXECUTIVE VICE PRESIDENT AND CHIEF

FINANCIAL OFFICER

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