EFC BANCORP INC
Form 10-Q
November 14, 2002

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2002

or

o **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 1-13605

EFC BANCORP, INC.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**36-4193304** (I.R.S. Employer Identification No.)
1695 Larkin Avenue, Elgin, Illinois (Address of principal executive offices)	**60123** (Zip Code)

(847) 741-3900
(Registrant's telephone number, including area code)

Not Applicable
(Former name, former address and former fiscal year, if changes since last report)

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

Yes ý No o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12(b)-2 of the Exchange Act).

Yes o No ý

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 4,622,328 shares of common stock, par value $0.01 per share, were outstanding as of November 12, 2002.

EFC Bancorp, Inc.

Form 10-Q

For the Quarter Ended September 30, 2002

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PART I. FINANCIAL INFORMATION
EFC BANCORP, INC.

Item 1. Financial Statements.

EFC BANCORP, INC.
AND SUBSIDIARIES

Consolidated Balance Sheets (unaudited)

September 30, 2002 and December 31, 2001

		September 30, 2002	December 31, 2001
Assets			
Cash and cash equivalents:			
On hand and in banks	$	2,948,128	3,186,966
Interest bearing deposits with financial institutions		35,007,194	14,988,324
Loans receivable, net		567,429,893	537,070,664
Mortgage-backed securities available-for-sale, at fair value		14,717,883	13,855,715
Investment securities available-for-sale, at fair value		83,393,645	68,615,462
Foreclosed real estate		1,985,742	
Stock in Federal Home Loan Bank of Chicago, at cost		9,245,700	8,891,900
Accrued interest receivable		3,860,421	3,682,120
Office properties and equipment, net		12,983,942	10,990,206
Other assets		17,252,838	12,162,083
Total assets	$	748,825,386	673,443,440
Liabilities and Stockholders' Equity			
Liabilities:			
Deposits	$	492,481,847	420,084,289
Borrowed money		171,831,662	175,200,000
Advance payments by borrowers for taxes and insurance		531,922	1,226,614
Income taxes payable		269,297	419,125
Accrued expenses and other liabilities		9,467,149	7,884,849
Total liabilities		674,581,877	604,814,877
Minority interest		(54,330)	
Stockholders' Equity:			
Preferred stock, par value $.01 per share, authorized 2,000,000 shares; no shares issued			
Common stock, par value $.01 per share, authorized 25,000,000 shares; issued 7,491,434 shares		74,914	74,914
Additional paid-in capital		71,684,612	71,663,695
Treasury stock, at cost, 2,824,906 and 2,884,873 shares at September 30, 2002 and December 31, 2001, respectively		(33,073,211)	(33,584,554)
Unearned employee stock ownership plan (ESOP), 409,533 and 439,498 shares at September 30, 2002 and December 31, 2001, respectively		(6,123,548)	(6,571,619)
Unearned stock award plan, 65,553 and 107,943 shares at September 30, 2002 and December 31, 2001, respectively		(729,278)	(1,200,866)
Retained earnings, substantially restricted		40,961,399	38,015,742
Accumulated other comprehensive income		1,502,951	231,251
Total stockholders' equity		74,297,839	68,628,563

	September 30, 2002	December 31, 2001
Commitments and contingencies		
Total liabilities and stockholders' equity	$ 748,825,386	673,443,440

See accompanying notes to consolidated financial statements.

EFC BANCORP, INC.
AND SUBSIDIARIES

Consolidated Statements of Income (unaudited)

For the three and nine months ended September 30, 2002 and 2001

	Three months ended September 30,		Nine months ended September 30,	
	2002	2001	2002	2001
Interest income:				
Loans secured by real estate	$ 8,387,811	8,626,654	25,599,335	24,907,222
Other loans	1,377,223	1,126,235	3,790,146	3,095,326
Mortgage-backed securities available-for-sale	124,541	184,003	477,568	645,220
Investment securities available-for-sale and interest bearing deposits with financial institutions	1,129,267	1,201,799	3,419,047	3,921,678
Total interest income	11,018,842	11,138,691	33,286,096	32,569,446
Interest expense:				
Deposits	3,449,025	4,193,496	10,233,315	12,699,663
Borrowed money	2,313,926	2,243,800	6,937,225	6,615,046
Total interest expense	5,762,951	6,437,296	17,170,540	19,314,709
Net interest income before provision for loan losses	5,255,891	4,701,395	16,115,556	13,254,737
Provision for loan losses	225,000	135,000	675,000	330,000
Net interest income after provision for loan losses	5,030,891	4,566,395	15,440,556	12,924,737
Noninterest income:				
Service fees	608,330	308,739	1,377,122	829,784
Insurance and brokerage commissions	59,919	73,966	370,259	255,510
Information Technology sales and service income, net	243,355		984,234	
Gain on sale of securities		32,812		32,812
Gain on sale of foreclosed real estate				8,014
Gain on sale of loans	200,409		200,409	
Other	231,427	17,511	639,426	47,911

	Three months ended September 30,		Nine months ended September 30,	
Total noninterest income	1,343,440	433,028	3,571,450	1,174,031
Noninterest expense:				
Compensation and benefits	2,586,407	1,940,722	7,706,939	5,663,616
Office building, net	607,876	461,660	1,658,569	1,337,670
Federal insurance premiums	19,206	17,354	56,164	57,311
Advertising	181,981	113,276	450,553	428,943
Data processing	229,200	204,756	680,533	614,639
NOW/checking account expenses	155,282	82,098	402,697	222,190
Other	452,324	373,302	1,307,996	1,103,907
Total noninterest expense	4,232,276	3,193,168	12,263,451	9,428,276
Income before income taxes and minority interest	2,142,055	1,806,255	6,748,555	4,670,492
Income tax expense	727,242	637,492	2,173,162	1,639,122
Income before minority interest	1,414,813	1,168,763	4,575,393	3,031,370
Minority interest	34,377		36,885	
Net income	$ 1,449,190	1,168,763	4,612,278	3,031,370
Earnings per share:				
Basic	$ 0.34	0.27	1.10	0.71
Diluted	0.32	0.27	1.04	0.71

See accompanying notes to consolidated financial statements.

EFC BANCORP, INC.
AND SUBSIDIARIES

Consolidated Statements of Cash Flows (unaudited)

For the nine months ended September 30, 2002 and 2001

	2002	2001
Cash flows from operating activities:		
Net income	$ 4,612,278	3,031,370
Adjustment to reconcile net income to net cash provided by operating activities:		
Amortization of premiums and discounts, net	(8,633)	114,569
Provision for loan losses	675,000	330,000
Stock award plan shares allocated	471,588	476,037
ESOP shares committed to be released	448,071	448,071
Change in fair value of ESOP shares	20,917	(111,432)
Gain on sale of securities		(32,812)

	2002	2001
Gain on sale of foreclosed real estate		(8,014)
Gain on sale of loans	(200,409)	
Minority interest in subsidiary	(54,330)	
Depreciation of office properties and equipment	591,328	553,559
(Increase)/decrease in accrued interest receivable and other assets, net	(5,659,933)	6,753
Increase in income taxes payable, accrued expenses and other liabilities, net	695,135	3,222,568
Net cash provided by operating activities	1,591,012	8,030,669
Cash flows from investing activities:		
Net (increase)/decrease in loans receivable	5,106,839	(25,427,983)
Purchases of loans receivable	(51,143,896)	(45,229,516)
Proceeds from the sale of loans	13,217,497	
Purchases of mortgage-backed securities available-for-sale	(5,130,634)	(6,241,440)
Principal payments on mortgage-backed securities available-for-sale	4,147,334	4,419,684
Maturities of investment securities available-for-sale	19,547,992	24,135,018
Proceeds from the sale of investment securities available for sale		4,032,812
Purchases of investment securities available-for-sale	(32,111,658)	(20,091,594)
Purchases of office properties and equipment	(2,585,064)	(1,327,081)
Purchases of stock in the Federal Home Loan Bank of Chicago	(353,800)	(1,000,000)
Cash investment in majority-owned subsidiary	(420,000)	
Proceeds from the sale of foreclosed real estate		4,104,916
Net cash used in investing activities	(49,725,390)	(62,625,184)
Cash flows from financing activities:		
Net increase in deposits	72,397,558	38,065,721
Proceeds from borrowed money	609,750	60,000,000
Repayments on borrowed money	(3,978,088)	(25,000,000)
Cash dividends paid	(1,626,153)	(1,571,164)
Purchase of treasury stock	(51,325)	(2,192,733)
Stock options exercised	562,668	
Net cash provided by financing activities	67,914,410	69,301,824
Net increase in cash and cash equivalents	19,780,032	14,707,309
Cash and cash equivalents at beginning of period	18,175,290	27,022,671
Cash and cash equivalents at end of period	$ 37,955,322	41,729,980

See accompanying notes to consolidated financial statements.

EFC BANCORP, INC.

Notes to Consolidated Financial Statements

Note 1: BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements include the accounts of EFC Bancorp, Inc. (the Company), its majority-owned subsidiary, Computer Dynamics Group Inc. (CDGI), its wholly-owned subsidiary, Elgin Financial Savings Bank (the Bank) and its wholly-owned subsidiary, Fox Valley Service Corporation of Elgin. A controlling interest in CDGI was purchased for $420,000 in January 2002. The accompanying financial statements include the operating results of CDGI for the three and nine months ended September 30, 2002 since the date of acquisition. Certain amounts for the prior year have been reclassified to conform to the current year presentation.

In the opinion of the management of the Company, the accompanying consolidated financial statements include all normal recurring adjustments necessary for a fair presentation of the financial position and results of operations for the periods presented. All significant intercompany transactions have been eliminated in consolidation. These interim financial statements have been prepared according to the rules and regulations of the Securities and Exchange Commission and therefore certain information and footnote disclosures normally included in financial statements presented in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. The results of operations for the interim periods are not necessarily indicative of the results to be expected for the full year. It is suggested that the accompanying unaudited consolidated financial statements be read in conjunction with the Company's 2001 Annual Report on Form 10-K. Currently, other than investing in various securities, the Company does not directly transact any material business other than through the Bank. Accordingly, the discussion herein addresses the operations of the Company as they are conducted through the Bank.

Note 2: COMPREHENSIVE INCOME

The Company's comprehensive income for the three and nine month periods ended September 30, 2002 and 2001 are as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2002	**2001**	**2002**	**2001**
Net income	$ 1,449,190	1,168,763	$ 4,612,278	3,031,370
Other comprehensive income, net of tax:				
Unrealized holding gains on securities arising during the period, net of tax effect	716,014	453,582	1,271,700	966,223
Reclassification adjustment for net gain on sales of securities realized in net income		(20,672)		(20,672)
Comprehensive income	$ 2,165,204	1,601,673	$ 5,883,978	3,976,921

There were no sales of investment securities as of and for the three and nine months ended September 30, 2002. For both the three and nine month periods ended September 30, 2001 the sale of securities resulted in a gain of $32,812 ($20,672 net of tax effect).

Note 3: COMPUTATION OF PER SHARE EARNINGS

Basic earnings per share is calculated by dividing net income by the weighted average number of common shares outstanding. Diluted earnings per share is calculated by dividing net income by the weighted average number of common shares outstanding adjusted for the dilutive effect of outstanding stock options. ESOP shares are only considered outstanding for earnings per share calculations when they are released or committed to be released.

Presented below are the calculations for the basic and diluted earnings per share:

	Three months ended September 30,		Nine months ended September 30,	
	2002	**2001**	**2002**	**2001**

	Three months ended September 30,		Nine months ended September 30,	
Basic:				
Net income	$ 1,449,190	1,168,763	4,612,278	3,031,370
Weighted average shares outstanding	4,240,404	4,241,304	4,209,620	4,276,511
Basic earnings per share	$ 0.34	0.27	1.10	0.71
Diluted:				
Net income	$ 1,449,190	1,168,763	4,612,278	3,031,370
Weighted average shares outstanding	4,240,404	4,241,304	4,209,620	4,276,511
Effect of dilutive stock options outstanding	236,356	66,248	206,074	14,394
Diluted weighted average shares outstanding	4,476,760	4,307,552	4,415,694	4,290,905
Diluted earnings per share	$ 0.32	0.27	1.04	0.71

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

The following analysis discusses changes in the financial condition at September 30, 2002 and results of operations for the three and nine months ended September 30, 2002, and should be read in conjunction with the Company's Unaudited Consolidated Financial Statements and the notes thereto, appearing in Part I, Item 1 of this document.

Forward-Looking Statements

This report contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. The Company intends such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995, and is including this statement for purposes of these safe harbor provisions. Forward-looking statements, which are based on certain assumptions and describe future plans, strategies and expectations of the Company, are generally identified by use of the words "believe," "expect," "intend," "anticipate," "estimate," "project," or similar expressions. The Company's ability to predict results or the actual effect of future plans or strategies is inherently uncertain. Factors which could have a material adverse effect on the operations of the Company and the subsidiaries include, but are not limited to, changes in: interest rates, general economic conditions, legislative/regulatory changes, monetary and fiscal policies of the U.S. Government, including policies of the U.S. Treasury and the Federal Reserve Board, the quality or composition of the loan or investment portfolios, demand for loan products, deposit flows, competition, demand for financial services in the Company's market area and accounting principles and guidelines. These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. Further information concerning the Company and its business, including additional factors that could materially affect the Company's financial results, is included in the Company's filings with the SEC, including its 2001 Annual Report on Form 10-K.

The Company does not undertake and specifically disclaims any obligation to publicly release the result of any revisions which may be made to any forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

Comparison of Financial Condition at September 30, 2002 and December 31, 2001

Total assets at September 30, 2002 were $748.8 million, which represented an increase of $75.4 million, or 11.2%, compared to $673.4 million at December 31, 2001. The increase in total assets was primarily as a result of an increase in loans receivable of $30.3 million, or 5.7%, to $567.4 million at September 30, 2002 from $537.1 million at December 31, 2001. The increase in loans receivable was primarily attributable to strong loan demand and loan purchases during the period. In addition, cash and cash equivalents increased $19.8 million, or 108.8%, to $38.0 million at September 30, 2002 from $18.2 million at December 31, 2001 and investment securities increased $14.8 million, or 21.5%, to $83.4 million at September 30, 2002 from $68.6 million at December 31, 2001. The growth in total assets was funded by increases in deposits. Deposits increased $72.4 million to $492.5 million at September 30, 2002 from $420.1 million at December 31, 2001. Stockholders' equity increased by $5.7 million to $74.3 million at September 30, 2002 from $68.6 million at December 31, 2001. The increase in stockholders' equity was primarily the result of the Company's increase in net income during the period, proceeds from the exercise of stock options, and a $1.3 million increase in the Company's accumulated other comprehensive income relating to its available-for-sale investment portfolio, the effect of which was partially offset by dividends paid.

Comparison of Operating Results For the Three Months Ended September 30, 2002 and 2001

General. The Company's net income increased $280,000, or 24.0%, to $1.4 million for the three months ended September 30, 2002, from $1.2 million for the three months ended September 30, 2001.

Interest Income. Interest income decreased $120,000, or 1.1%, to $11.0 million for the three months ended September 30, 2002, compared with $11.1 million for the same period in 2001. This decrease resulted from an increase in the average balance of interest-earning assets, offset by a decrease in the average rate earned on those interest-earning assets. The average balance of interest-earning assets increased by $76.2 million, or 12.2%, to $703.6 million for the three months ended September 30, 2002 from $627.4 million for the comparable period in 2001. The average yield on interest-earning assets decreased by 80 basis points to 6.33% for the three months ended September 30, 2002 from 7.13% for the three months ended September 30, 2001.

Mortgage loan interest income decreased by $239,000 for the three months ended September 30, 2002 compared with the same period in 2001. The average balance of mortgage loans increased $26.7 million, while the loan yield decreased by 62 basis points from 7.55% to 6.93%. Interest income from other loans increased $251,000 for the three months ended September 30, 2002. This increase resulted from a combination of an increase in average balance of $25.3 million, offset by a 113 basis point decrease in yield from 7.64% for the three months ended September 30, 2001 to 6.51% for the three months ended September 30, 2002. Interest income from investment securities, mortgage-backed securities and short-term deposits decreased by $32,000 for the three months ended September 30, 2002, compared with the same period in 2001. This decrease resulted from a combination of an increase in average balance of $23.6 million, offset by a 104 basis point decrease in yield from 5.02% for the three months ended September 30, 2001 to 3.98% for the three months ended September 30, 2002. The decrease in yield is largely attributed to the effect of the lower interest rate environment reducing yields on short-term deposits.

Interest Expense. Interest expense decreased by $674,000, or 10.5%, to $5.8 million for the three months ended September 30, 2002 from $6.4 million for the three months ended September 30, 2001. This decrease resulted from an increase in the average balance of interest-bearing liabilities, offset by a decrease in the average rate paid on those interest-bearing liabilities. The average balance of interest-bearing liabilities increased by $82.5 million, or 15.2%, to $625.7 million for the three months ended September 30, 2002 from $543.2 million for the three months ended September 30, 2001. This change reflects a $79.4 million increase in the deposit accounts, which is primarily attributable to a $41.6 million increase in money market accounts, a $24.4 million increase in passbook savings accounts and a $9.9 million increase in certificates of deposit, partially offset by a decrease of $3.5 million in NOW accounts. The remaining $3.2 million increase is attributable to advances from the FHLB-Chicago. The average rate paid on combined deposits and borrowed money decreased by 106 basis points to 3.68% for the three months ended September 30, 2002 from 4.74% for the three months ended September 30, 2001.

Net Interest Income Before Provision for Loan Losses. Net interest income before provision for loan losses increased $554,000, or 11.8%, to $5.3 million for the three months ended September 30, 2002 from $4.7 million for the comparable period in 2001. The net interest margin as a percent of interest-earning assets increased by 3 basis points to 3.05% for the three months ended September 30, 2002 from 3.02% for the comparable period in 2001.

Provision for Loan Losses. The provision for loan losses increased by $90,000, to $225,000 for the three months ended September 30, 2002 from $135,000 in 2001. This increase is primarily due to the growth and change in the composition of the loan portfolio. At September 30, 2002, December 31, 2001 and September 30, 2001, non-performing loans totaled $2.1 million, $2.6 million and $1.2 million, respectively. At September 30, 2002, the ratio of the allowance for loan losses to non-performing loans was 136.5% compared to 87.4% at December 31, 2001 and 175.4% at September 30, 2001. The ratio of the allowance to total loans was 0.52%, 0.42% and 0.40%, at September 30, 2002, December 31, 2001 and September 30, 2001, respectively. There were no charge-offs for the three months ended September 30, 2002. Charge-offs totaled $16,000 for the three months ended September 30, 2001. Management periodically calculates an allowance sufficiency analysis based upon the portfolio composition, asset classifications, loan-to-value ratios, probable impairments in the loan portfolio, and other factors.

Noninterest Income. Noninterest income totaled $1.3 million and $433,000 for the three months ended September 30, 2002 and 2001, respectively. The increase in noninterest income is primarily attributable to increases in service fees of $300,000, information/technology sales and service income of $243,000 related to the Company's majority-owned subsidiary CDGI, an increase of $178,000 in the cash surrender value of the Company's bank owned life insurance primarily purchased in December 2001, and $200,000 in gains on sale of loans. There were no loan sales for the comparable period in 2001.

Noninterest Expense. Noninterest expense increased $1.0 million, to $4.2 million for the three months ended September 30, 2002 from $3.2 million for the comparable period in 2001. Compensation and benefits increased by $646,000. This increase was primarily due to a combination of annual salary increases, the addition of staff and the related compensation and benefits expenses of CDGI. The additional staff expenses are primarily attributed to the opening of the Bank's new Carpentersville, Illinois branch. All other operating expenses, including advertising, audit, data processing, marketing, postage, communications, and other expense increased by a combined $393,000, or 31.4%, to $1.6 million for the three months ended September 30, 2002 from $1.2 million for the three months ended September 30, 2001. Of the increase in other operating expenses, $158,000 or 40.3% is related to CDGI.

Management continues to emphasize the importance of expense management and control while continuing to provide expanded banking services to a growing market base.

Income Tax Expense. Income tax expense totaled $727,000 and $637,000 for the three months ended September 30, 2002 and 2001, respectively. The increase was primarily due to a $336,000 increase in earnings before income taxes to $2.1 million for the three months ended September 30, 2002 from $1.8 million for the prior year period. The effective tax rate was 34.0% and 35.3% for the three months ended September 30, 2002 and 2001, respectively. The decrease in the effective tax rate for the three months ended September 30, 2002 is primarily due to the increase in tax exempt income including municipal interest income and an increase in income from bank owned life insurance.

Comparison of Operating Results For the Nine Months Ended September 30, 2002 and 2001

General. The Company's net income increased $1.6 million, or 52.2%, to $4.6 million for the nine months ended September 30, 2002, from $3.0 million for the nine months ended September 30, 2001.

Interest Income. Interest income increased $717,000, or 2.2%, to $33.3 million for the nine months ended September 30, 2002, compared with $32.6 million for the same period in 2001. The increase in interest income was primarily due to an increase in average interest-earning assets, which increased by $82.3 million, or 13.7%, to $682.1 million for the nine months ended September 30, 2002 from $599.8 million for the comparable period in 2001, offset by a decrease in the average yield on interest-earning assets by 69 basis points to 6.57% for the nine months ended September 30, 2002 from 7.26% for the nine months ended September 30, 2001.

Mortgage loan interest income increased by $692,000 for the nine months ended September 30, 2002 compared with the same period in 2001. The average balance of mortgage loans increased $43.1 million, while the loan yield decreased by 48 basis points from 7.56% to 7.08%. Interest income from other loans increased $695,000 for the nine months ended September 30, 2002. This increase resulted from a combination of an increase in average balance of $26.4 million, offset by a 156 basis point decrease in yield from 8.08% for the nine months ended September 30, 2001 to 6.52% for the nine months ended September 30, 2002. Interest income from investment securities, mortgage-backed securities and short-term deposits decreased by $334,000 for the nine months ended September 30, 2002, compared with the same period in 2001. This decrease resulted from a combination of an increase in average balance of $12.1 million, offset by a 100 basis point decrease in yield from 5.58% for the nine months ended September 30, 2001 to 4.58% for the nine months ended September 30, 2002. The decrease in yield is largely attributed to the effect of the lower interest rate environment reducing yields on short-term deposits.

Interest Expense. Interest expense decreased by $2.1 million, or 11.1%, to $17.2 million for the nine months ended September 30, 2002 from $19.3 million for the nine months ended September 30, 2001. This decrease resulted from an increase in the average balance of interest-bearing liabilities, offset by a decrease in the average rate paid on those interest-bearing liabilities. The average balance of interest-bearing liabilities increased by $87.4 million, or 16.8%, to $606.4 million for the nine months ended September 30, 2002 from $519.0 million for the nine months ended September 30, 2001. This change reflects a $75.3 million increase in the deposit accounts, which is primarily attributable to a $50.4 million increase in money market accounts and a $28.1 million increase in passbook savings accounts, partially offset by a decrease of $6.1 million in certificates of deposits. The remaining $12.1 million increase is attributable to advances from the FHLB-Chicago. The average rate paid on combined deposits and borrowed money decreased by 118 basis points to 3.78% for the nine months ended September 30, 2002 from 4.96% for the nine months ended September 30, 2001.

Net Interest Income Before Provision for Loan Losses. Net interest income before provision for loan losses increased $2.8 million, or 21.6%, to $16.1 million for the nine months ended September 30, 2002 from $13.3 million for the comparable period in 2001. The net interest margin as a percent of interest-earning assets increased by 26 basis points to 3.22% for the nine months ended September 30, 2002 from 2.96% for the comparable period in 2001.

Provision for Loan Losses. The provision for loan losses increased by $345,000, to $675,000 for the nine months ended September 30, 2002 from $330,000 in 2001. This increase is primarily due to the growth and change in the composition of the loan portfolio. At September 30, 2002, December 31, 2001 and September 30, 2001, non-performing loans totaled $2.1 million, $2.6 million and $1.2 million, respectively. Charge-offs totaled $3,000 and $101,000 for the nine months ended September 30, 2002 and 2001, respectively. Management periodically

calculates an allowance sufficiency analysis based upon the portfolio composition, asset classifications, loan-to-value ratios, potential impairments in the loan portfolio, and other factors.

Noninterest Income. Noninterest income totaled $3.6 million and $1.2 million for the nine months ended September 30, 2002 and 2001, respectively. The increase in noninterest income is primarily attributable to increases in service fees of $547,000, insurance and brokerage commissions of $114,000, gains on sale of loans of $200,000, information/technology sales and service income of $984,000 related to the Company's majority-owned subsidiary CDGI and an increase of $515,000 in the cash surrender value of the Company's bank owned life insurance. The increase in insurance and brokerage commissions is the result of a greater emphasis placed on this area.

Noninterest Expense. Noninterest expense increased $2.9 million, to $12.3 million for the nine months ended September 30, 2002 from $9.4 million for the comparable period in 2001. Compensation and benefits increased by $2.0 million. This increase was primarily due to a combination of annual salary increases, the addition of staff and the related compensation and benefits expenses of CDGI. The additional staff expenses are primarily attributed to the opening of the Bank's new Carpentersville, Illinois branch. All other operating expenses, including advertising, audit, data processing, marketing, postage, communications, and other expense increased by a combined $792,000, or 21.0%, to $4.6 million for the nine months ended September 30, 2002 from $3.8 million for the nine months ended September 30, 2001. Of the increase in other operating expenses, $450,000 or 56.8% is related to CDGI. Management continues to emphasize the importance of expense management and control while continuing to provide expanded banking services to a growing market base.

Income Tax Expense. Income tax expense totaled $2.2 million and $1.6 million for the nine months ended September 30, 2002 and 2001, respectively. The increase was primarily due to a $2.0 million increase in earnings before income taxes to $6.7 million for the nine months ended September 30, 2002 from $4.7 million for the prior year period. The effective tax rate was 32.2% and 35.1% for the nine months ended September 30, 2002 and 2001, respectively. The decrease in the effective tax rate for the nine months ended September 30, 2002 is primarily due to the increase in tax exempt income including municipal interest income and increase in income from bank owned life insurance.

Liquidity and Capital Resources

