SECURITIES AND EXCHANGE COMMISSION

# FORM 10-K

Annual report pursuant to section 13 and 15(d)

Filing Date: **1996-12-30** | Period of Report: **1996-09-30**
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## FILER

**COMMUNITY FEDERAL BANCORP INC**
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SIC: **6035** Savings institution, federally chartered

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OR THE SECURITIES EXCHANGE ACT OF 1934 (FEE REQUIRED)
FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 1996

Commission File Number: 1-13964

COMMUNITY FEDERAL BANCORP, INC.
(Exact name of small business issuer
as specified in its charter)

| Delaware | 63-086536 |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

| 333 Court Street, Tupelo, Mississippi | 38802 |
|---|---|
| (Address of principal executive offices) | (Zip Code) |

The registrants's telephone number,
including area code: (601)842-3981

Securities registered pursuant to Section 12(g) of the Act:
Common Stock, par value $0.01 per share

The registrant (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 12 months and (2) has been subject to such filing requirements for the past 90 days.

Disclosure of delinquent filers pursuant to Item 405 of Regulation S-B is not contained in this form, and disclosure will not be contained, to the best of the registrant's knowledge, in the definitive proxy statement incorporated by reference in
Part III of this Form 10-K.

The registrant's revenues for its most recent fiscal year were $2,148,258.

The aggregate market value of the registrant's outstanding common stock held by non-affiliates of the registrant at September 30, 1996 was approximately $66,728,914 (based on 3,954,306 shares at the most recent trading price of which

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management was aware $16.875 on December 17, 1996) (for this purpose, the registrant's directors and executive officers and stock benefit plans and trusts have not been deemed to be non-affiliates).

The total number of outstanding shares of the registrant's common stock at September 30, 1996 was 4,628,750.

Transitional small business disclosure format: No.

DOCUMENTS INCORPORATED BY REFERENCE

(1) Portions of the Proxy Statement for the Registrant's 1996 Annual Meeting of Stockholders (the "Proxy Statement") are incorporated by reference in Part III of this form.
(2) Portions of the Registrants's Annual Report of Stockholders for fiscal year 1996 are incorporated by reference in Part III of this form.

ITEM 1.--DESCRIPTION OF BUSINESS

General

The Community Federal Bancorp, Inc. (the "Company") was incorporated under the laws of the State of Delaware in November 1995 at the direction of management of Community Federal Savings Bank (the "Savings Bank") for the purpose of serving as a savings institution holding company of the Savings Bank upon the acquisition of all of the capital stock issued by the Savings Bank upon the consummation of its reorganization from a mutual holding company organization to a stock holding company organization (the "Conversion"). Before the Conversion, the Company did not engage in any material operations. After the Conversion, the Company's principal assets have been the outstanding capital stock of the Savings Bank, a portion of the net proceeds of the Conversion and a note receivable from the Company's Employee Stock Ownership Plan ("ESOP"), and the Company's principal business has been the business of the Savings Bank.

The holding company structure permits the Company to expand the financial services offered through the Savings Bank. As a holding company, the Company has greater flexibility than the Savings Bank to diversify its business activities through existing or newly formed subsidiaries or through acquisition or merger with other financial institutions. The Company is classified as a unitary savings institution holding company and is subject to regulation by the Office of Thrift Supervision ("OTS"). As long as the Company remains a unitary savings institution holding company, under current law the

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Company could diversify its activities in such a manner as to include any activities allowed by law or regulation to a unitary savings institution holding company.

The Company's executive offices are located at 333 Court Street, Tupelo, Mississippi 38802, and it telephone number is (601) 842-3981.

The Savings Bank is a federally chartered savings bank that was organized on August 25, 1994 as a subsidiary of the Mutual Holding Company. The Savings Bank and its predecessors have conducted business in Tupelo, Mississippi and surrounding communities through an office in downtown Tupelo since 1933. At September 30, 1996, the Savings Bank had $204.0 million of total assets, $136.9 million of total liabilities, including $131.7 million of deposits, and $67.1 million of equity.

The Savings Bank is primarily engaged in attracting deposits from the general public and using that and other available sources of funds to originate loans secured by one-to-four family residences (one-to-four family units) primarily located in Lee County, Mississippi and portions of surrounding counties (the "Primary Market Area"). Such loans amounted to $102.0 million or 86.7% of the Savings Bank's total net loan portfolio, at September 30, 1996. To a lesser extent, the Savings Bank originates other mortgage loans secured by multi-family and non-residential real estate, which amounted to $7.2 million or 6.1% of the total net loan portfolio, at September 30, 1996 and construction loans for one-to-four family and multi-family residences which amounted to $3.4 million or 2.8% of the Savings Bank's total net loan portfolio as of that same date. In addition, the Savings Bank also offers loans to local businesses and automobile loans to individuals. As of September 30, 1996, the commercial loans amounted to $3.3 million or 2.8% of the Savings Bank's total net loan portfolio. The automobile loans together with loans secured by savings accounts and other consumer loans had a total balance of $4.2 million or 3.6% of the Savings Bank's total net loan portfolio as of September 30, 1996. The Savings Bank also has an investment portfolio consisting of mortgage-backed securities which are insured by federal agencies, and collateralized mortgage obligations, U.S. government and agency obligations, obligations of the State of Mississippi and its political subdivisions, mutual funds and Federal Home Loan Bank (" FHLB"), Federal National Mortgage Association (" FNMA"), and Federal Home Loan Mortgage Corporation (" FHLMC") stock. As of September 30, 1996, the carrying value of investments that management has the intent and ability to hold until maturity was $4.8 million and the carrying value of investments that were available for sale was $75.1 million. In addition, as of that same date, the Savings

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Bank's aggregate cash and interest-bearing deposits in other banks totaled $4.2 million.

Market Area

The Savings Bank generally conducts business through its main office located in Tupelo, Mississippi, the county seat of Lee County, Mississippi.  Tupelo is located in northeastern Mississippi, approximately 90 miles southeast of Memphis, Tennessee.  Tupelo's population was 30,685 in 1990, an increase from 23,905 in 1980.  Between 1980 and 1990, Lee County grew from 57,061 to 65,581 people.  This section of the state has grown 13% faster in population than the remainder of Mississippi due to its diverse economic base.  A diversified manufacturing base of over 200 companies is represented in Lee County alone, which is considered part of the Mid-South region that includes southern Tennessee and northeastern Alabama. Manufacturing, product marketing and convention business, health care, agriculture, entertainment, and recreation are significant sectors of economic activity.

Lee County is one of three counties in Mississippi that have shown consistent growth in the manufacturing sector from 1960 to 1991.  During that period Lee County experienced a 220% increase in manufacturing jobs, totaling 15,720 in 1991.  In Lee and the surrounding counties of Chickasaw, Itawamba, Monroe, Pontotoc, Prentiss, and Union, manufacturing jobs provided 54.7% of total employment in 1950 and 50.1% in 1991. Non-manufacturing jobs increased 808% during the period of 1950 to 1991.  Major employers in Lee County include Tecumseh, a Fortune 500 company, which operates two plants in the county producing air conditioning and refrigerator compressors, Action Industries, a furniture manufacturer, and Cooper Tire & Rubber Company and North Mississippi Medical Center, the largest rural hospital in the United States.  The medical center is the largest employer in the county.  Retail sales also provide a strong component in the economy, totaling $882 million in 1992.  A large shopping mall, the Mall at Barnes Crossing, had 6.1 million visitors in 1992.

Lee County is the leading upholstered furniture manufacturing region in the nation and Tupelo acts as host to the annual Furniture Market, the second largest furniture exposition in the United States.  A 1.2 million square foot Market Exhibition Space, a 9,200 seat Coliseum, and the Livestock Arena help accommodate those attending furniture, entertainment and agricultural activities.  Moreover, Tupelo has a modern airport capable of receiving air carrier service from Atlanta and Memphis.

The North Mississippi Medical Center, with more than 190

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doctors representing 41 medical and surgical specialties, is located in Tupelo. The medical center is the State's largest hospital and is one of only two hospitals in the South affiliated with the National Cancer Institute.

In agriculture, Lee County economic activity is diversified among forestry products (chipmills, saw mills, and plywood products), cattle, cotton, soybean, poultry and egg production, and milk production. Forestry represents the largest segment of agricultural activity and represented $60.3 million in production in 1991.

In education, the Tupelo School District was the tenth largest in the State in 1992. By comparison, in 1985, the district was the 18th largest in the State. More than half of the certified school system staff hold masters degrees or better. A branch of the University of Mississippi is located in Tupelo providing accredited business and educational degree programs on the graduate and undergraduate level. Neighboring Itawamba Community College provides vocational programs. It is one of ten charter members of the National Coalition of Advanced Technology Centers in the nation. The Tupelo-Lee County Vocational Technical Center features modern vocational training in electronics, business computer applications and computer-assisted drafting. Tupelo is the home to the Technology Center.

Lending Activities

General. As a federally chartered savings association, the Savings Bank has general authority to originate and purchase loans secured by real estate located throughout the United States. Notwithstanding this nationwide lending authority, substantially all of the mortgage loans in the Savings Bank's portfolio are secured by properties located in its Primary Market Area.

A savings association generally may not make loans to one borrower and related entities in an amount which exceeds 15% of its unimpaired capital and surplus, although loans in an amount equal to an additional 10% of unimpaired capital and surplus may be made to a borrower if the loans are fully secured by readily marketable securities. At September 30, 1996, the Savings Bank's loans-to-one borrower limit was $6.8 million and its five largest loans or groups of loans-to-one borrower, including related entities, were $1,960,000, $1,759,000, $1,540,000, $953,000, and $839,000. Each of these loans is secured by real estate, a substantial portion of which is rental property. All of these loans or groups of loans were performing in accordance with their terms at September 30, 1996.

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Loan Portfolio Composition. The following table sets forth the composition of the Savings Bank's loan portfolio by type of loan at the dates indicated:

<TABLE>
<CAPTION>

| | September 30, | | | | | |
|---|---|---|---|---|---|---|
| | 1996 | | 1995 | | 1994 | |
| | Amount | % | Amount | % | Amount | % |
| <S> | <C> | <C> | <C> | <C> | <C> | <C> |
| Mortgage Loans: | | | | | | |
| One-to-four family residential | 102,021 | 86.73 | 86,716 | 88.50 | 75,811 | 89.97 |
| Multi-family and non-residential | 7,165 | 6.09 | 5,946 | 6.07 | 6,728 | 7.98 |
| Construction loans | 3,337 | 2.84 | 3,310 | 3.38 | 1,120 | 1.33 |
| Total mortgage loans | 112,523 | 95.66 | 95,972 | 97.94 | 83,659 | 99.28 |
| Commercial Loans: | 3,253 | 2.77 | 1,537 | 1.57 | 0 | 0.00 |
| Consumer Loans: | | | | | | |
| Automobile | 1,318 | 1.12 | 1,072 | 1.09 | 720 | .85 |
| Savings accounts | 1,369 | 1.15 | 1,052 | 1.07 | 1,108 | 1.32 |
| Other | 1,524 | 1.30 | 529 | .54 | 0 | 0.00 |
| Total consumer loans | 4,211 | 3.57 | 2,653 | 2.71 | 1,828 | 2.17 |
| Total loans | 119,987 | 102.00 | 100,162 | 102.22 | 85,487 | 101.45 |
| Less: | | | | | | |
| Loans in process | 1,356 | 1.15 | 1,279 | 1.31 | 429 | .51 |
| Unearned discounts and net deferred loan origination fees | 428 | 0.36 | 343 | .35 | 267 | .32 |
| Allowance for loan losses | 572 | 0.49 | 552 | .56 | 522 | .62 |
| Loans receivable, net | 117,631 | 100.00 | 97,988 | 100.00 | 84,269 | 100.00 |

<CAPTION>

| | September 30, | | | |
|---|---|---|---|---|
| | 1993 | | 1992 | |
| | Amount | % | Amount | % |
| <S> | <C> | <C> | <C> | <C> |
| Mortgage Loans: | | | | |
| One-to-four family residential | 75,246 | 89.13 | 76,248 | 90.07 |
| Multi-family and non-residential | 6,675 | 7.91 | 6,154 | 7.27 |
| Construction loans | 686 | .81 | 528 | .62 |
| Total mortgage loans | 82,607 | 97.85 | 82,930 | 97.96 |

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| | | | | |
|---|---|---|---|---|
| Commercial Loans | 0 | 0 | 0 | 0 |
| Consumer Loans: | | | | |
| Automobile | 1,533 | 1.82 | 1,000 | 1.18 |
| Savings accounts | 1,328 | 1.57 | 1,343 | 1.59 |
| Other | 0 | 0 | 0 | 0 |
| Total consumer loans | 2,861 | 3.39 | 2,343 | 2.77 |
| Total loans | 85,468 | 101.24 | 85,273 | 100.73 |
| Less: | | | | |
| Loans in process | 302 | .36 | 50 | .06 |
| Unearned discounts and net deferred loan origination fees | 237 | .28 | 166 | .20 |
| Allowance for loan losses | 500 | .60 | 400 | .47 |
| Loans receivabe, net | 84,429 | 100.00 | 84,657 | 100.00 |

</TABLE>

Contractual Principal Repayments and Interest Rates.  The following table sets forth certain information at September 30, 1996 regarding the dollar amount of loans maturing in the Savings Bank's portfolio, based on the contractual terms to maturity, before giving effect to net items.  Demand loans, loans having no stated schedule of repayments and no stated maturity and overdrafts are reported as due in one year.

<TABLE>
<CAPTION>

| | 3 Months Or Less | Over 3 Months Through 6 Months | Over 6 Months Through 1 Year | Over 1 Year Through 3 Years | Over 3 Years Through 5 Years |
|---|---|---|---|---|---|
| | | | (In thousands) | | |
| <S> | <C> | <C> | <C> | <C> | <C> |
| Mortgage Loans: | | | | | |
| Adjustable | 1 | 0 | 7 | 72 | 161 |
| Fixed | 2,427 | 2,176 | 803 | 1,096 | 1,304 |
| Consumer: | 986 | 1,298 | 308 | 555 | 898 |
| Commercial: | 20 | 0 | 0 | 203 | 693 |
| Total | 3,434 | 3,474 | 1,118 | 1,926 | 3,147 |

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Over

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| <S> | Five years <C> | Total <C> |
|---|---|---|
| | (In Thousands) | |
| Mortgage Loans: | | |
| Adjustable | 56,325 | 56,566 |
| Fixed | 48,151 | 55,957 |
| Consumer: | 75 | 4,211 |
| Commercial: | 2,337 | 3,253 |
| Total | 106,888 | 119,987 |

</TABLE>

The following table sets forth the dollar amount of all loans, before net items, due after one year from September 30, 1996 which have fixed interest rates or which have adjustable interest rates.

| | Fixed Rates | Adjustable Rates | Total |
|---|---|---|---|
| | | (In thousands) | |
| One-to-four family residential | 45,838 | 54,455 | 100,293 |
| Multi-family and non-residential | 4,713 | 2,103 | 6,816 |
| Consumer | 1,619 | 0 | 1,619 |
| Commercial | 3,233 | 0 | 3,233 |
| Total | 55,403 | 56,558 | 111,961 |

Scheduled contractual amortization of loans does not reflect the actual term of the Savings Bank's loan portfolio. The average life of loans is substantially less than their contractual terms because of prepayments and due-on-sale clauses, which give the Savings Bank the right to declare a conventional loan immediately due and payable in the event, among other things, that the borrower sells the real property subject to the mortgage.

Originations, Purchases, Servicing, and Sales of Loans. The lending activities of the Savings Bank are subject to written, non-discriminatory underwriting standards and loan origination procedures established by the Savings Bank's Board of Directors and management. Loan originations are obtained by a variety of sources, including referrals from real estate brokers, developers, builders, existing customers, newspaper, radio, periodical advertising, and walk-in customers. Loan applications are taken by lending personnel, and the loan processing department supervises the acquisition of credit reports, appraisals, and other documentation involved with a loan. Property valuations are generally prepared for the

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Savings Bank by a qualified independent appraiser selected from a list approved by the Savings Bank's Board of Directors. The Savings Bank generally relies on an attorney's opinion of title that each loan collateralized by real property has been properly secured. Hazard insurance is also required on all secured property and flood insurance is required if the property is within a designated flood plain. In addition, the Savings Bank requires credit life insurance if a borrower has no or inadequate life insurance, except in cases where such insurance is generally unavailable because of a borrower's age.

The Savings Bank's loan approval process is intended to assess the borrower's ability to repay the loan, the viability of the loan and the adequacy of the value of the property that will secure the loan. A loan application file is first reviewed by a loan officer of the Savings Bank and then, in most cases, is submitted for approval to the Loan Committee. In addition, the Savings Bank's President and Chief Executive Officer has been delegated authority to approve any loan authorized under the Savings Bank's real estate lending policy.

The Savings Bank originates substantially all of the mortgage loans in its portfolio and holds them until maturity. In fiscal 1994 and 1993, the Savings Bank purchased $900,000 and $1 million of automobile loans, respectively, to diversify its loan portfolio and to shorten the term of its average contractual maturity. It had no purchases of consumer or other loans in fiscal 1996 or 1995, but has instead established a consumer lending department which originated $5.3 million and $3.4 million of consumer loans in fiscal 1996 and 1995, respectively. It also began offering commercial loans during fiscal 1995 and originated $2.1 million and $1.6 million of commercial loans during fiscal 1996 and 1995, respectively. During the three-year period ended September 30,1996, the Savings Bank had loan sales of $352,000 consisting of first mortgage loans with terms of 30 years and secured by one-to-four family residences.

During the 1980s, the Savings Bank sold a small percentage of the mortgage loans it originated to FNMA but retained the servicing on such loans. The Savings Bank no longer actively sells loans with servicing rights retained. As a result, the servicing portfolio has decreased from $5.7 million at September 30, 1993 to $2.2 million at September 30, 1996 due to principal repayments. See Note 5 of the Notes to Financial Statements.

The following table shows total loans originated, loan reductions, and the net increase in Community's loan portfolio during the periods indicated:

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<TABLE>
<CAPTION>

| <S> | 1996 | 1995 | 1994 | 1993 | 1992 |
|---|---|---|---|---|---|
| | Year ended September 30, (In thousands) | | | | |
| Loan Originations: | | | | | |
| One-to-four family residential | 34,978 | 19,673 | 20,821 | 22,643 | 28,020 |
| Multi-family and non-residential | 635 | 0 | 2,062 | 544 | 2,766 |
| Construction | 8,199 | 5,478 | 1,346 | 1,137 | 1,397 |
| Commercial | 2,149 | 1,608 | 0 | 0 | 0 |
| Consumer | 5,345 | 3,425 | 905 | 1,502 | 2,333 |
| Total loans originated | 51,306 | 30,184 | 25,134 | 25,862 | 34,516 |
| Purchases: | 0 | 0 | 900 | 1,000 | 1,000 |
| Total loans originated and purchased | 51,306 | 30,184 | 26,034 | 26,826 | 35,516 |
| Sales and Loan Principal Repayments: | | | | | |
| Loans sold proceeds | 0 | 220 | 130 | 0 | 0 |
| Loan repayments | 31,629 | 17,201 | 26,243 | 26,826 | 32,136 |
| Total loans sold proceeds and loan principal repayments | 31,629 | 17,421 | 26,373 | 26,649 | 32,136 |
| Loan originations (repayments), net | 19,677 | 12,763 | (339) | 177 | 3,380 |
| Increase (decrease) due to other items, net | (34) | 956 | 179 | (405) | (273) |
| Net increase (decrease) in net loan portfolio | 19,643 | 13,719 | (160) | (228) | 3,107 |

</TABLE>

One-to-Four Family Residential Loans.  The primary lending activity of the Savings Bank is the origination of loans secured by first mortgage liens on one-to-four family residences.  At September 30, 1996, $102.0 million or 86.7% of the Savings Bank's total net loan portfolio consisted of one-to-four family first mortgage residential loans.  As of such date the average balance of the Savings Bank's one-to-four family mortgage loans was $47,519.

The loan-to-value ratio, maturity, and other provisions of the loans made by the Savings Bank generally have reflected the policy of making less than the maximum loan permissible under applicable regulations, in accordance with sound lending practices, market conditions, and underwriting standards established by the Savings Bank.  While it has been the

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Savings Bank's practice in most cases to require a loan-to-value ratio of 80%, the Savings Bank's lending policy on one-to-four family residential mortgage loans generally limits the maximum loan-to-value ratio to 85% of the lesser of the appraised value or purchase price of the property. In cases where loan-to-value ratios exceed 85%, the Savings Bank requires private mortgage insurance.

The Savings Bank offers fixed-rate one-to-four family residential loans with terms up to 15 years. Such loans are amortized on a monthly basis with principal and interest due each month and customarily include "due-on-sale" clauses. While the Savings Bank reserves the right to enforce such a clause in any case, it has been its practice to waive the clause in most cases. As of September 30, 1996, approximately 99% of all of the Savings Bank's mortgage loan portfolio consisted of conventional loans; the remainder are loans insured by the Federal Housing Administration or partially guaranteed by the Department of Veterans Affairs.

The Savings Bank is aware that there are inherent risks in originating fixed-rate one-to-four family residential loans for its portfolio, especially during periods of historically low interest rates, but recognized the need to respond to market demand for fixed-rate loans. To respond to these market demands, the Savings Bank has emphasized 15-year fixed-rate loans with an origination fee but no points and only minimal closing costs. The Savings Bank also generally confines its one-to-four family residential lending to its Primary Market Area where it is more familiar with the details of the real estate market and its knowledge of the local economy allows it to better assess a borrower's ability to repay a loan.

Since 1982, the Savings Bank has been offering adjustable-rate loans in order to decrease the vulnerability of its operations to changes in interest rates. All of the adjustable-rate mortgage loans in its portfolio have interest rates that adjust on an annual basis. The demand for adjustable-rate loans in the Savings Bank's primary market area has been a function of several factors, including the level of interest rates, the expectations of changes in the level of interest rates and the difference between the interest rates offered for fixed-rate loans and adjustable-rate loans. The relative amount of fixed rate and adjustable-rate residential loans that can be originated at any time is largely determined by the demand for each in a competitive environment. As interest rates fluctuated since 1982, the demand for fixed- and adjustable-rate loans has changed as the Savings Bank's customers have preferred adjustable rates in a high interest-rate environment and fixed-rate loans as interest

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rates decreased. In order to continue to increase and then to maintain a high percentage of adjustable-rate one-to-four family residential loans, the Savings Bank has offered various forms of adjustable-rate loans and in some cases has purchased mortgage-backed securities and CMOs collateralized by adjustable-rate mortgage loans. As a result, at September 30, 1996, $56.4 million, or 55.2%, of the one-to-four family residential loans in the Savings Bank's loan portfolio (before net items) consisted of adjustable-rate loans.

The Savings Bank's one-to-four family residential adjustable-rate loans are fully amortizing loans with contractual maturities of up to 30 years. These loans have a fixed-rate of interest for up to three years and for the remainder of the loan's term adjust annually in accordance with a designated index. The Savings Bank currently offers an adjustable-rate mortgage with a 2% limit on the rate adjustment per period and a 6% limit on the rate adjustment over the life of the loan. The Savings Bank's underwriting standards for adjustable-rate mortgage loans require that it assess a potential borrower's ability to make principal and interest payments assuming a 2% increase in the interest rate from the rate at the time of origination. The Savings Bank's adjustable-rate loans are not convertible by their terms into fixed rate loans, are assumable with the Savings Bank's approval, do not contain prepayment penalties and do not produce negative amortization.

Due to the generally lower rates of interest prevailing in recent periods, the Savings Bank's ability to originate adjustable-rate loans has decreased as consumer preference for fixed-rate loans has increased. However, the Savings Bank has continued to originate adjustable-rate one-to-four family residential loans during this period by offering an adjustable-rate loan with an origination fee but no points and only minimal closing costs. As a result, even as consumer preference for such loans decreased, adjustable-rate mortgage loans represented $14.2 million or 40.7% of the Savings Bank's total originations of one-to-four family residential loans during the year ended September 30, 1996 as compared to 65% and 43% of such originations for the years ended September 30, 1995 and 1994, respectively.

Adjustable-rate loans decrease the risks associated with changes in interest rates but involve other risks, primarily because as interest rates rise, the payment by the borrower rises to the extent permitted by the terms of the loan, thereby increasing the potential for default. At the same time, the marketable of the underlying property may be adversely affected by higher interest rates. The Savings Bank believes that these risks, which have not had a material adverse effect on the Savings Bank to date, generally are less

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than the risks associated with holding fixed-rate loans in an increasing interest rate environment.

Non-Residential Real Estate and Multi-Family Residential Loans.

At September 30, 1996, $7.2 million or 6.1% of the Savings Bank's total net loan portfolio, consisted of loans secured by existing non-residential and multi-family residential real estate. The Savings Bank's non-residential and multi-family real estate loans include primarily loans secured by small office buildings, family-type business establishments and apartment buildings. All of the Savings Bank's non-residential and multi-family real estate loans are secured by properties located in the Savings Bank's Primary Market Area. The average amount of the Savings Bank's non-residential and multi-family real estate loans are secured by properties located in the Savings Bank's Primary Market Area. The average amount of the Savings Bank's non-residential and multi-family real estate loans was $298,000 at September 30, 1996 and the largest was $1.8 million. Originations of non-residential real estate and multi-family residential real estate amounted to .52%, 0%, and 8.2% of the Savings Bank's total loan originations in fiscal 1996, 1995, and 1994, respectively.

The Savings Bank's non-residential and multi-family loans have terms which range up to 25 years and loan-to-value ratios of up to 80%. The Savings Bank originates both fixed-rate and adjustable-rate non-residential and multi-family real estate loans. As of September 30, 1996, $2.1 million, or 29% of the Savings Bank's non-residential and multi-family residential real estate loans had adjustable rates of interest. A potential borrower must demonstrate that he or she has the ability to make principal and interest payments assuming a 2% increase in the interest rate from the rate at the time of origination.

The Savings Bank requires appraisals of all properties securing non-residential and multi-family residential real estate loans. Appraisals are performed by an independent appraiser designated by the Savings Bank and are reviewed by management. In originating multi-family residential and non-residential real estate loans, the Savings Bank considers the quality and location of the real estate, the credit of the borrower, cash flow of the project and the quality of management involved with the property. Corporate loans require the personal guaranty of the entity's controlling shareholders. Hazard insurance is required as well as flood insurance if the property is located in a designated flood zone.

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Multi-family residential and non-residential real estate lending is generally considered to involve a higher degree of risk than one-to-four family residential lending. Such lending typically involves large loan balances concentrated in a single borrower or groups of related borrowers. In addition, the payment experience on loans secured by income-producing properties is typically dependent on the successful operation of the related real estate project and thus may be subject to a greater extent to adverse conditions in the real estate market or in the economy generally. The Savings Bank generally attempts to mitigate the risks associated with multi-family residential and non-residential real estate lending by, among other things, lending only in its Primary Market Area and lending only to individuals who have an established relationship with the Savings Bank and/or who have substantial ties to the community.

Construction Loans.

The Savings Bank makes construction loans to individuals for the construction of their residences and to developers for the construction of one-to-four family and multi-family residences. Construction lending is generally limited to the Savings Bank's Primary Market Area. At September 30, 1996, construction loans amounted to $3.3 million or 2.8% of the Savings Bank's total net loan portfolio. Construction financing is generally considered to involve a higher degree of risk of loss than long-term financing on improved, owner-occupied real estate because of the uncertainties of construction, including possible delays in completing the structure, the possibility of costs exceeding the initial estimates and the need to obtain a tenant or purchaser if the property will not be owner occupied. In the event of a delay in the completion of the construction, the Savings Bank may grant an extension, but such extensions are generally conditioned upon the payment of interest in full for the initial term.

Construction loans to individuals are separate from the permanent financing on the structure. However, a borrower only qualifies for a construction loan if he or she has obtained a commitment for a permanent loan from the Savings Bank at the end of the construction phase. The term of a construction loan to an individual generally does not exceed the greater of 180 days or the term of the permanent loan commitment. Loan payouts occur only after an inspection by the Savings Bank's appraiser of the site has been made and documented by the Savings Bank. Payouts are based on the percentage of the construction completed as of the inspection date. Interest rates on construction loans to individuals are

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based on current local economic conditions. The loan-to-value ratio on such loans must be 80% or less of the appraised value of the completed structure.

The majority of construction loans to developers are to selected local developers with whom the Bank is familiar and are for the construction of single-family dwellings on a pre-sold or on a speculative basis. The Bank generally limits to two the number of unsold houses which a developer may have under construction in a project. Construction loans to developers are generally made for a one- to two-year term depending on the size and scope of the project. Payment of accrual interest generally is required on at least a semiannual basis and the amount of a loan is generally based on the owner's equity in the property but may not exceed 80% of appraised value or contract price. Loan proceeds are disbursed in stages after inspection of the project indicates that such disbursements are for expenses which have already been incurred and which have added to the value of the project.

Consumer Loans. Subject to the restrictions contained in federal laws and regulations, the Savings Bank also is authorized to make loans for a wide variety of personal or consumer purposes. In order to broaden the mix of the retail financial services the Savings Bank offers to its customers, in fiscal 1995 the Savings Bank established a new department that, among other things, originates consumer loans. The Savings Bank's consumer loans consist primarily of automobile loans originated by the Savings Bank during fiscal years 1996 and 1995, and purchased by the Savings Bank during fiscal years 1994 and 1993 and loans secured by savings accounts. Consumer loans at September 30, 1996 were $4.2 million, or 3.6%, of the Savings Bank's total net loan portfolio consisted of consumer loans.

As of September 30, 1996, the Savings Bank's consumer loans also consisted of loans secured by accounts at the Savings Bank which amounted to $1.4 million or 1.2% of its total net loan portfolio. Such a loan is structured to have a term that ends on the same date as the maturity date of the certificate securing it or if secured by a passbook account has a six-month term with a hold on withdrawals that would result in the balance being lower than the loan balance. Typically these loans require quarterly payments of interest only.

Consumer loans generally involve more credit risk than mortgage loans because of the type and nature of the collateral. In addition, consumer lending collections are dependent on the borrower's continuing financial stability, and thus are more likely to be adversely affected by job loss, divorce, illness, and personal bankruptcy. In many cases,

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because of the mobile nature of the collateral, it may not be readily available in the event of a default. In other cases, repossessed collateral for a defaulted consumer loan will not provide an adequate source of repayment of the outstanding loan balance because of improper repair and maintenance or depreciation of the underlying security. The remaining deficiency often does not warrant further substantial collection efforts against the borrower.

Commercial Loans. Subject to the restrictions contained in federal laws and regulations, the Savings Bank is authorized to make secured and unsecured commercial business loans for corporate and agricultural purposes, including issuing letters of credit. At September 30, 1996, $3.3 million, or 2.8%, of the Savings Bank's total net loan portfolio consisted of commercial business loans, all of which were secured. The Savings Bank began originating commercial business loans in fiscal 1995 and they accounted for 4.2% of the total loan originations during the year ended September 30, 1996.

Commercial business loans generally are deemed to entail significantly greater risk than that which is involved with more traditional real estate lending. The repayment of commercial business loans typically are dependent on the successful operations and income stream of the borrower. Such risks can be significantly affected by economic conditions. In addition, commercial lending generally requires substantially greater oversight efforts compared to residential real estate lending.

Loan Origination and Other Fees. In addition to interest earned on loans, the Savings Bank receives loan origination fees or "points" for originating loans. Loan points are a percentage of the principal amount of the mortgage loan and are charged to the borrower in connection with the origination of the loan.

In accordance with SFAS No. 91, which deals with the accounting for non-refundable fees and costs associated with originating or acquiring loans, the Savings Bank's loan origination fees and certain related direct loan origination costs are offset, and the resulting net amount is deferred and amortized as interest income over the contractual life of the related loans as an adjustment to the yield of such loans. At September 30, 1996, the Savings Bank had $428,000 of net loan fees which had been deferred and are being recognized as income over the estimated maturities of the related loans. See Notes 1 and 5 of the Notes to the Consolidated Financial Statements.

Non-Performing Assets. Beginning as of September 30, 1993,

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the Savings Bank adopted a policy under which all loans are reviewed on a regular basis and are placed on a non-accrual status when, in the opinion of management, the collection of additional interest is deemed insufficient to warrant further accrual. Generally, the Savings Bank places all loans more than 90 days past due on non-accrual status. When a loan is placed on non-accruing status, total interest accrued to date is reversed. Subsequent payments are either applied to the outstanding principal balance or recorded as interest income, depending on the assessment of the ultimate collectability of the loan. A loan is returned to accrual status when, in management's judgment, the borrower's ability to make periodic interest and principal payments is in accordance with the terms of the loan agreement.

Real estate acquired by the Savings Bank for foreclosure is classified as real estate owned until such time as it is sold. When such property is acquired it is recorded at the lower of the recorded investment in the loan or fair value, less estimated selling costs of disposition. The recorded investment is the sum of the outstanding principal loan balance plus any taxes due and acquisition costs associated with the property. Any excess of the recorded investment in the loan over the fair value of the underlying property is charged to the allowance for loan losses at the time of the loan foreclosure. Costs relating to improvement of property incurred subsequent to the acquisition are capitalized, whereas costs relating to holding the property are expensed. Valuations are periodically performed by management and a provision for estimated losses on real estate owned is charged to earnings when losses are anticipated.

As of September 30, 1996, the Savings Bank's total non-performing loans amounted to $717,000, or 0.61% of total net loans, compared to $838,000, or 0.86% of total net loans, at September 30, 1995.
The following table sets forth the amounts and categories of Community's non-performing assets at the dates indicated. Community had no troubled debt restructuring during the periods shown on the table below:

<TABLE>
<CAPTION>

| | September 30, | | | | |
|---|---|---|---|---|---|
| | 1996 | 1995 | 1994 | 1993 | 1992 |
| <S> | <C> | <C> | <C> | <C> | <C> |
| Non-Accruing Loans: | | | | | |
| One-to-four family | | | | | |

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| | | | | | |
|---|---|---|---|---|---|
| residential | 717 | 715 | 560 | 894 | 0 |
| Multi-family and non-residential real estate | 0 | 0 | 0 | 0 | 0 |
| Construction | 0 | 0 | 0 | 0 | 0 |
| Commercial | 0 | 0 | 0 | 0 | 0 |
| Consumer | 0 | 7 | 0 | 0 | 0 |
| Accruing Loans Greater Than 90 Days Delinquent: | | | | | |
| One-to-four family residential | 0 | 116 | 203 | 121 | 963 |
| Multi-family and non-residential real estate | 0 | 0 | 0 | 0 | 0 |
| Construction | 0 | 0 | 0 | 0 | 0 |
| Commercial | 0 | 0 | 0 | 0 | 0 |
| Consumer | 0 | 0 | 0 | 0 | 0 |
| Total non-performing loans | 717 | 838 | 763 | 1,015 | 963 |
| Real estate owned(1): | 0 | 139 | 141 | 164 | 0 |
| Total non-performing assets | 717 | 977 | 904 | 1,179 | 963 |
| Total non-performing loans as a percentage of total net loans | .61% | .86% | .91% | 1.20% | 1.14% |
| Total non-performing assets as a percentage of total assets | .35% | .60% | .58% | .80% | .68% |

</TABLE>

(1) Consists of real estate acquired by foreclosures.

Interest income foregone on non-accrual loans was not significant for any period shown.

Classified Assets. Federal regulations require that each insured savings association classify its assets on a regular basis. In addition, in connection with examinations of insured institutions, federal examiners have authority to identify problem assets: "substandard," "doubtful," and "loss." Substandard assets have one or more defined weaknesses and are characterized by the distinct possibility that the insured institution will sustain some loss if the deficiencies are not corrected. Doubtful assets have the weaknesses of substandard assets with the additional

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characteristic that the weaknesses make collection or liquidation in full on the basis of currently existing facts, conditions and values questionable, and there is a high possibility of loss. A loss classified asset is considered uncollectible and of such little value that continuance as an asset of the institution is not warranted. Another category designated "special mention" also must be established and maintained for assets which do not currently expose an insured institution to a sufficient degree of risk to warrant classification as substandard, doubtful or loss. Assets classified as substandard or doubtful require the institution to establish general allowances for loan losses. If an asset or portion thereof is classified loss, the insured institution must either establish specific allowances for loan losses in the amount of 100% of the portion of the asset classified loss, or charge-off such amount. General loss allowances established to cover possible losses related to assets classified substandard or doubtful may be included in determining an institution's regulatory capital, while specific valuation allowances for loan losses do not qualify as regulatory capital. Federal examiners may disagree with an insured institution's classifications and amounts reserved.

The Savings Bank's classified assets at September 30, 1996 consisted of $754,000 of loans classified as special mention, $736,000 of loans classified as substandard and no loans classified as doubtful or loss. As of September 30, 1996, total classified assets amounted to 0.73% of total assets.

The following table sets forth the Savings Bank's classified assets at the dates indicated:

| | September 30, | | |
|---|---|---|---|
| | 1996 | 1995 | 1994 |
| Classification: | | | |
| Special mention | 754 | 984 | 507 |
| Substandard | 736 | 959 | 762 |
| Doubtful | 0 | 0 | 0 |
| Loss | 0 | 0 | 0 |
| Total classified assets | 1,490 | 1,943 | 1,269 |

Allowance for Loan Losses. It is management's policy to maintain an allowance for estimated loan losses at a level which management considers adequate to absorb losses inherent in the loan portfolio at each reporting date. Management's estimation of this amount includes a review of all loans for which full collectability is not reasonably assured and considers, among other factors, prior years' loss experience, economic conditions, distribution of portfolio loans by risk

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class and the estimated value of underlying collateral. Although management believes the current allowance for loan losses to be adequate, ultimate losses may vary from their estimates; however, estimates are reviewed periodically and, as adjustments become necessary, they are reported in earnings in periods in which they become known.

At September 30, 1996, the Savings Bank's allowance for loan losses was $572,000 compared to $552,000 at September 30, 1995. As of September 30, 1996, all of the Savings Bank's allowance for loan losses was a general valuation allowance.

The following table sets forth the activity in Community's allowance for loan losses during the periods indicated.

| | 1996 | 1995 | 1994 | 1993 | 1992 |
|---|---|---|---|---|---|
| | (Dollars in thousands) | | | | |
| Allowance at beginning of period | 552 | 522 | 500 | 400 | 210 |
| Provisions | 20 | 30 | 25 | 100 | 190 |
| Charge-offs: | | | | | |
| Mortgage loans: | | | | | |
| One-to-four family residential | 0 | 0 | 12 | 0 | 0 |
| Multi-family and non-residential real estate | 0 | 0 | 0 | 0 | 0 |
| Construction | 0 | 0 | 0 | 0 | 0 |
| Total mortgage loans | 0 | 0 | 12 | 0 | 0 |
| Commercial loans | 0 | 0 | 0 | 0 | 0 |
| Consumer loans: | | | | | |
| Savings accounts | 0 | 0 | 0 | 0 | 0 |
| Automobile | 0 | 0 | 0 | 0 | 0 |
| Total consumer loans | 0 | 0 | 0 | 0 | 0 |
| Total charge-offs | 0 | 0 | 12 | 0 | 0 |
| Recoveries | 0 | 0 | 0 | 0 | 0 |
| Net charge-offs | 0 | 0 | 3 | 0 | 0 |
| Allowance at end of period | 572 | 552 | 522 | 500 | 400 |
| Allowance for loan losses to total non-performing loans at end of period | 79.78% | 65.87% | 68.41% | 49.26% | 41.54% |
| Allowance for loan losses to total net loans at end of period | .49% | .56% | .62% | .60% | .47% |

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The following table presents the allocation of the allowance for loan losses to the total amount of net loans in each category listed at the dates indicated.

<TABLE>
<CAPTION>

| | September 30, 1996 | | September 30, 1995 | |
|---|---|---|---|---|
| | Amount | % of Loans in Each Category to Total Loans | Amount | % of Loans in Each Category to Total Loans |
| <S> | <C> | <C> | <C> | <C> |
| Mortgage loans | 511 | 95.66 | 509 | 97.94 |
| Commercial | 31 | 2.77 | 15 | 1.57 |
| Consumer loans | 30 | 3.57 | 28 | 2.71 |
| Total allowance for loan losses | 572 | 102.00 | 552 | 102.22 |

<CAPTION>

| | September 30, 1994 | | September 30, 1993 | |
|---|---|---|---|---|
| | Amount | % of Loans in Each Category to Total Loans | Amount | % of Loans in Each Category to Total Loans |
| <S> | <C> | <C> | <C> | <C> |
| Mortgage loans | 497 | 99.28 | 475 | 97.85 |
| Commercial | 0 | 0 | 0 | 0 |
| Consumer loans | 25 | 2.17 | 25 | 3.39 |
| Total allowance for loan losses | 522 | 101.45 | 500 | 101.24 |

<CAPTION>

| | September 30, 1992 | |
|---|---|---|
| | Amount | % of Loans in Each Category to Total Loans |
| <S> | <C> | <C> |
| Mortgage loans | 385 | 97.96 |
| Commercial | 0 | 0 |
| Consumer loans | 15 | 2.77 |
| Total allowance | | |

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for loan losses 400 100.73

</TABLE>

Securities

The Company adopted the SFAS No. 115, Accounting for Certain Investments of Debt and Equity Securities on September 30, 1994. In accordance with SFAS No. 115, management determines the appropriate classification of debt securities at the time of purchase. Debt securities are classified as held to maturity when the Savings Bank has the positive intent and ability to hold the securities to maturity. Held to maturity securities are stated at amortized cost. Debt securities not classified as held to maturity and equity securities are classified as available for sale. Available for sale securities are stated at fair value. See Notes 1 through 4 of the Notes to Consolidated Financial Statements.

The Company's securities portfolio includes mortgage-backed securities which are insured or guaranteed by the FHLMC, GNMA, or the FNMA and Collateralized Mortgage Obligations ("CMOs"), all of which are backed by FHLMC, GNMA, or FNMA securities. Mortgage-backed securities and CMOs increase the quality of the Company's assets by virtue of the guarantees that back them, are more liquid than individual mortgage loans and may be used to collateralize borrowings or other obligations of the Company. In addition, at September 30, 1996, $1.5 million or 6.3% of the mortgage-backed securities in the Company's mortgage-backed securities and CMOs portfolio were secured by pools of adjustable-rate mortgages. Mortgage-backed securities and CMOs of this type serve to reduce the interest rate risk associated with changes in interest rates. Investments in mortgage-backed securities and CMOs as well as investments in other investment securities are managed by the Company's Investment Committee in accordance with the Company's Portfolio and Investment Policy. The Company has in its investment portfolio seven "step up" bonds issued by the FHLB of Dallas. The yield on each of these bonds increases at a prescribed rate (ranging from 0.5% to 1.0%) on each anniversary date but each is also callable by the issuer on such dates.

The following table sets forth the carrying value of the Company's investment portfolio at the dates indicated:

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| | September 30, 1996 | 1995 | 1994 |
|---|---|---|---|
| | (In thousands) | | |
| Securities available for sale: (1) | | | |
| U.S. government and federal agencies bonds and notes | 14,870 | 5,829 | 7,489 |
| State and local bonds and notes | 964 | 0 | 0 |
| Mortgage-backed securities | 23,687 | 6,339 | 6,967 |
| Collateralized mortgage obligations | 22,531 | 3,173 | 4,172 |
| Equity securities | 10,244 | 6,957 | 5,693 |
| Mutual funds | 2,816 | 2,827 | 2,785 |
| Total securities available for sale | 75,112 | 25,125 | 27,106 |
| Securities held to maturity: (2) | | | |
| U.S. government and federal agencies bonds and notes | 0 | 10,446 | 11,434 |
| State and local bonds and notes | 0 | 388 | 387 |
| Corporate bonds and notes | 0 | 1,444 | 2,358 |
| Mortgage-backed securities | 0 | 4,369 | 4,926 |
| Collateralized mortgage obligations | 4,756 | 17,190 | 17,689 |
| Total securities available for sale | 4,756 | 33,837 | 36,794 |
| Total securities | 79,868 | 58,962 | 63,900 |

The following table sets forth information regarding the scheduled maturities, amortized costs, fair value and weighted average yields for the Savings Bank's securities at September 30, 1996:

<TABLE>
<CAPTION>

| | 1 Yr or Less Carrying Value | Avg Yld | 1 to 5 Yrs Carrying Value | Avg Yld | 5 to 10 Yrs Carrying Value | Avg Yld | Other Carrying Value | Avg Yld |
|---|---|---|---|---|---|---|---|---|
| | Dollars in Thousands | | | | | | | |
| <S> | <C> | <C> | <C> | <C> | <C> | <C> | <C> | <C> |
| Securities available for sale: (1) | | | | | | | | |
| U.S. treasury and government obligations | 1,501 | 5.92 | 12,369 | 5.97 | 1,000 | 6.15 | 964 | 6.70 |
| Mortgage-backed securities | 362 | 7.66 | 6,280 | 6.25 | 4,768 | 6.35 | 12,277 | 7.61 |
| Collateralized mortgage obligations | 0 | 0.00 | 824 | 7.50 | 6,178 | 6.23 | 15,219 | 6.14 |
| Equity securities and mutual funds | 0 | 0.00 | 0 | 0.00 | 0 | 0.00 | 13,060 | 5.89 |
| Total securities available for sale | 1,863 | 6.26 | 19,473 | 6.13 | 11,946 | 6.27 | 41,830 | 6.51 |

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| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Securities held to maturity: (2) | | | | | | | | |
| Collateralized mortgage obligations | 0 | 0.00 | 972 | 6.00 | 1,003 | 7.00 | 2,725 | 6.09 |
| Total securities held to maturity | 0 | 0.00 | 972 | 6.00 | 1,003 | 7.00 | 2,725 | 6.09 |
| Total securities | 1,863 | 6.26 | 20,473 | 6.12 | 12,977 | 6.33 | 44,555 | 6.48 |

</TABLE>

1) The carrying value is the approximate fair value of the security at each reporting date.
2) The carrying value is the amortized cost of the security at each reporting date.

Cash and Interest-Bearing Deposits in Other Banks

The Savings Bank also had cash on hand and cash due from and on deposit with other banks amounting to $3.2 million, $2.9 million, and $4.4 million at September 30, 1996, 1995, and 1994, respectively.

Sources of Funds

General. Deposits are the primary source of the Company's funds for lending and other investment purposes. In addition to deposits, the Company derives funds from loan principal repayments. Loan repayments are a relatively stable source of funds, while deposit inflows and outflows are significantly influenced by general interest rates and money market conditions. Borrowings may be used on a short-term basis to compensate for reductions in the availability of funds from other sources. They may also be used on a longer term basis for general business purposes.

Deposits. The Company's deposits are attracted principally from within the Company's primary market area through the offering of a wide selection of deposit instruments, including NOW accounts, money market accounts, regular savings accounts, and term certificate accounts. Included among these deposit products are individual retirement account certificates of approximately $11.2 million at September 30, 1996. Deposit account terms vary, with the principal differences being the minimum balance required, the time periods the funds must remain on deposit and the interest rate. As of September 30, 1996, the certificates of deposit with principal amounts of $100,000 or more totaled to $33.5 million.
Interest rates paid, maturity terms, service fees and withdrawal penalties are established by the Savings Bank on a

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periodic basis. Determination of rates and terms are predicated on funds acquisition and liquidity requirements, rates paid by competitors, growth goals and federal regulations. Rates on deposits of $100,000 or more are usually negotiated with the depositor.

The following table sets forth the dollar amount of deposits in the various types of deposit programs offered at the dates indicated:

<TABLE>
<CAPTION>

| | September 30, | | | | | |
|---|---|---|---|---|---|---|
| | 1996 | | 1995 | | 1994 | |
| | Amount | % | Amount | % | Amount | % |
| | (Dollars in thousands) | | | | | |
| <S> | <C> | <C> | <C> | <C> | <C> | <C> |
| Certificates of deposit: | 112,347 | 85.28 | 116,562 | 86.63 | 108,402 | 82.13 |
| Transaction accounts: | | | | | | |
| Savings accounts | 6,873 | 5.22 | 8,184 | 6.08 | 10,472 | 7.93 |
| NOW accounts | 12,520 | 9.50 | 9,808 | 7.29 | 13,115 | 9.94 |
| Total transaction accounts | 19,393 | 14.72 | 17,992 | 13.37 | 23,587 | 17.87 |
| Total deposits | 131,740 | 100.00 | 134,554 | 100.00 | 131,989 | 100.00 |

</TABLE>

The following table sets forth the savings activities of Community during the periods indicated:

| | Year Ended September 30, | | |
|---|---|---|---|
| | 1996 | 1995 | 1994 |
| | (In thousands) | | |
| Net increase (decrease) before interest credited | (7,893) | (2,910) | (3,386) |
| Interest credited | 5,079 | 5,476 | 6,340 |
| Net increase (decrease) in deposits | (2,814) | 2,566 | 2,954 |

The following table sets forth the change in dollar and amount of deposits in the various types of accounts offered by the savings Bank between the dates indicated:

<TABLE>

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<CAPTION>

| <S> | Balance at September 30, 1996 <C> | % of Deposit <C> | Increase (Decrease) from September 30, 1995 <C> | Balance at September 30, 1995 <C> | % of Deposits <C> |
|---|---|---|---|---|---|
| Now Accounts | 12,519,798 | 9.50 | 2,711,842 | 9,807,956 | 7.29 |
| Savings Accounts | 6,873,038 | 5.22 | (1,311,366) | 8,184,404 | 6.08 |
| Certificates of deposit | 112,347,597 | 85.28 | (4,214,547) | 116,562,144 | 86.63 |
| Total | 131,740,433 | 100.00 | (2,814,071) | 134,554,504 | 100.00 |

<CAPTION>

| <S> | Increase (Decrease) from September 30, 1994 <C> | Balance at September 30, 1994 <C> | % of Deposit <C> |
|---|---|---|---|
| Now Accounts | (3,307,616) | 13,115,572 | 9.94 |
| Savings Accounts | (2,287,224) | 10,471,628 | 7.93 |
| Certificates of deposit | 8,160,288 | 108,401,856 | 82.13 |
| Total | 2,565,448 | 131,989,056 | 100.00 |

</TABLE>

The following table sets forth the maturities of Community's certificates of deposit having principal amounts of $100,000 or more at September 30, 1996:

| Certificate of Deposit Maturing In Quarter Ending: | Amount |
|---|---|
| December 31, 1996 | 9,202,790 |
| March 31, 1997 | 9,765,794 |
| June 30, 1997 | 3,706,295 |
| September 30, 1997 | 3,674,499 |
| After September 30, 1997 | 7,154,959 |
| Total certificates of deposit with Balances of $100,000 or more | 33,504,337 |

The following table sets forth the certificates of deposit in the Savings Bank classified by rates at the dates indicated:

At September 30,

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| | 1996 | 1995 |
|---|---|---|
| 3.00% to 3.99% | 0 | 369 |
| 4.00% to 4.99% | 20,952 | 23,831 |
| 5.00% to 5.99% | 67,348 | 48,748 |
| 6.00% to 6.99% | 23,945 | 43,512 |
| 7.00% to 7.99% | 102 | 102 |
| | 112,347 | 1,165,621 |

The following table sets forth the amount and maturities of Community's certificates of deposit at September 30, 1996.

<TABLE>
<CAPTION>

| <S> | One Year or Less <C> | Over One Year Through Two Years (In thousands) <C> | Over Two Years Through Three Years <C> |
|---|---|---|---|
| 4.00% to 4.99% | 20,549 | 213 | 112 |
| 5.00% to 5.99% | 50,376 | 12,494 | 2,480 |
| 6.00% to 6.99% | 2,841 | 4,198 | 5,873 |
| 7.00% to 7.99% | 0 | 0 | 102 |
| | 73,766 | 16,905 | 8,567 |

<CAPTION>

| <S> | Over Three Years Through Four Years <C> | Over Four Years <C> | Totals <C> |
|---|---|---|---|
| 4.00% to 4.99% | 78 | 0 | 20,952 |
| 5.00% to 5.99% | 1,643 | 355 | 67,348 |
| 6.00% to 6.99% | 10,956 | 77 | 23,945 |
| 7.00% to 7.99% | 0 | 0 | 102 |
| | 12,677 | 432 | 112,347 |

</TABLE>

Deposits in the Savings Bank as of September 30, 1996 were represented by the various programs described below.

<TABLE>
<CAPTION>

| Interest Rate <S> | Minimum Term <C> | Category <C> | Minimum Amount <C> | Balances <C> | Percentage of Total Savings <C> |
|---|---|---|---|---|---|
| 2.75% | None | Passbook Savings Account | 50 | 6,873,038 | 5.22 |

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| | | | | | |
|---|---|---|---|---|---|
| 2.50% | None | Golden Checking | 500 | 1,001,642 | 0.76 |
| 0.00% | None | Non-interest Checking | 100 | 317,995 | 0.24 |
| 2.50% | None | Silver Checking | 300 | 343,742 | 0.26 |
| 3.25% | None | Daily Money Market | 2,500 | 6,715,120 | 5.09 |
| 0.00% | None | Student Checking | 50 | 5,843 | 0.01 |
| 2.50% | None | Courtesy Checking | 100 | 411,216 | 0.31 |
| 0.00% | None | Community First Checking | 50 | 461,837 | 0.35 |
| 2.75% | None | Super Now Checking | 1,500 | 1,744,268 | 1.32 |
| 5.00% | None | Community First Advantage | 100,000 | 1,518,135 | 1.15 |
| | | Certificates of Deposit | | | |
| 5.20% | 12 Months | Fixed Term, Fixed Rate, Renewable | 1,000 | 23,915,890 | 18.15 |
| 5.40% | 6 Months | Fixed Term, Fixed Rate, Non-renewable | 100,000 | 3,141,395 | 2.38 |
| 5.40% | 30 Months | Fixed Term, Fixed Rate, Renewable | 1,000 | 3,842,733 | 2.92 |
| 5.30% | 24 Months | Fixed Term, Fixed Rate, Renewable | 1,000 | 9,630,073 | 7.31 |
| 4.85% | 182 Days | Fixed Term, Fixed Rate, Renewable | 1,000 | 17,593,420 | 13.35 |
| 5.00% | 9 Months | Fixed Term, Fixed Rate, Non-renewable | 1,000 | 510,297 | 0.39 |
| 5.75% | 12 Month | Fixed Term, Negotiated Jumbo Rate, Non-renewable | 100,000 | 29,050,429 | 22.05 |
| 4.00% | 91 Days | Fixed Term, Fixed Rate, Renewable | 1,000 | 1,482,945 | 1.13 |
| 5.20% | 18 Months | Fixed Term, Fixed Rate, Renewable | 1,000 | 1,893,068 | 1.44 |
| 5.50% | 36 Months | Fixed Term, Fixed Rate, Renewable | 1,000 | 8,154,632 | 6.19 |
| 5.70% | 48 Months | Fixed Term, Fixed Rate, Renewable | 1,000 | 12,991,685 | 9.86 |
| 5.35% | 25 Months | Fixed Term, Fixed Rate, Non-renewable | 1,000 | 139,030 | 0.11 |
| | | | | 131,740,433 | 100.00 |

</TABLE>

Borrowings. The Savings Bank may obtain advances from the FHLB of Dallas upon the security of its FHLB of Dallas stock and certain of the Savings Bank's residential mortgage loans, provided certain standards related to creditworthiness have been met. Such advances are made pursuant to several credit programs, each of which has its own interest rate and range of maturities. Such advances are generally available to meet seasonal and other withdrawals of deposit accounts and to permit increased lending.
The Savings Bank had no FHLB advances outstanding at

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September 30, 1996.

The following table sets forth the maximum month-end balance and average balance of Community's FHLB advances during the periods indicated. See also, Note 11 to the Consolidated Financial Statements.

| | Year Ended September 30, | | |
|---|---|---|---|
| | 1996 | 1995 | 1994 |
| | (Dollars in thousands) | | |
| Maximum balance | 1,000 | 3,000 | 0 |
| Average balance | 250 | 2,333 | 0 |
| Weighted average interest rate of FHLB advances | 5.98% | 6.34% | 0.00% |

The following table sets forth certain information as to Community's long-term (terms to maturity in excess of 90 days) and short-term (terms to maturity of 90 days or less) FHLB advances at the dates indicated:

| | 1996 | 1995 | 1994 |
|---|---|---|---|
| | (Dollars in thousands) | | |
| FHLB long-term advances | 0 | 1,000 | 0 |
| Weighted average interest rate | 0.00% | 5.98% | 0.00% |
| FHLB short-term advances | 0 | 0 | 0 |
| Weighted average interest rate | 0.00% | 0.00% | 0.00% |

Competition

The Savings Bank faces strong competition both in attracting deposits and making real estate loans. Its most direct competition for deposits has historically come from other savings associations, credit unions, and commercial banks located in northeastern Mississippi, including many large financial institutions which have greater financial and marketing resources available to them. In addition, the Savings Bank has faced additional significant competition for investors' funds from short-term money market securities and other corporate and government securities. The ability of the Savings Bank to attract and retain savings deposits depends on its ability to generally provide a rate of return, liquidity, and risk comparable to that offered by competing investment opportunities.

The Savings Bank experiences strong competition for real estate loans primarily from other savings associations, commercial banks, and mortgage banking companies. The Savings

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Bank competes for loans principally through the interest rates and loan fees it charges and the efficiently and quality of services it provides borrowers.  Competition may increase as a result of the continuing reduction of restrictions on the interstate operations of financial institutions.

REGULATION

The Company

General.  The Company, as a savings and loan holding company within the meaning of the Home Owners' Loan Act ("HOLA"), is required to register with the OTS and is subject to OTS regulations, examinations, supervision, and reporting requirements.  As a subsidiary of a savings and loan holding company, the Savings Bank is subject to certain restrictions in its dealings with the Company and affiliates thereof.

Activities Restrictions.  There are generally no restrictions on the activities of a savings and loan holding company which holds only one subsidiary savings institution.  However, if the Director of the OTS determines that there is reasonable cause to believe that the continuation by a savings and loan holding company of an activity constitutes a serious risk to the financial safety, soundness or stability of its subsidiary savings institution, the Director may impose such restrictions as deemed necessary to address such risk, including limiting (i) payment of dividends by the savings institution; (ii) transactions between the savings institution and its affiliates; and (iii) any activities of the savings institution that might create a serious risk that the liabilities of the holding company and its affiliates may be imposed on the savings institution.  Notwithstanding the above rules as to permissible business activities of unitary savings and loan holding companies, if the savings institution subsidiary of such a holding company fails to meet a Qualified Thrift Lender  "QTL" test, then such unitary holding company also shall become subject to the activities restrictions applicable to multiple savings and loan holding companies and, unless the savings institution requalifies as a QTL within one year thereafter, shall register as, and become subject to the restrictions applicable to, a bank holding company.

If the Company were to acquire control of another savings institution, other than through merger or other business combination with the Savings Bank, the Company would thereupon become a multiple savings and loan holding company.  Except where such acquisition is pursuant to the authority to approve emergency thrift acquisitions and where each subsidiary savings institution meets the QTL test, as set forth below, the activities of the Company and any of its subsidiaries

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(other than the Savings Bank or other subsidiary savings institutions) would thereafter be subject to further restrictions. Among other things, no multiple savings and loan holding company or subsidiary thereof which is not a savings institution shall commence or continue for a limited period of time after becoming a multiple savings and loan holding company or subsidiary thereof any business activity, upon prior notice to, and no objection by the OTS, other than: (i) furnishing or performing management services for a subsidiary savings institution; (ii) conducting an insurance agency or escrow business; (iii) holding, managing, or liquidating assets owned by or acquired from a subsidiary savings institution; (iv) holding or managing properties used or occupied by a subsidiary savings institution; (v) acting as trustee under deeds of trust; (vi) those activities authorized by regulation as of March 5, 1987 to be engaged in by multiple savings and loan holding companies; or (vii) unless the Director of the OTS by regulation prohibits or limits such activities for savings and loan holding companies, those activities authorized by the Federal Reserve Board as permissible for bank holding companies. Those activities described in (vii) above also must be approved by the Director of the OTS prior to being engaged in by a multiple savings and loan holding company.

Limitations on Transactions with Affiliates. Transactions between savings institutions and any affiliate are governed by Sections 23A and 23B of the Federal Reserve Act. An affiliate of a savings institution is any company or entity which controls, is controlled by or is under common control with the savings institution. In a holding company context, the parent holding company of a savings institution (such as the Company) and any companies which are controlled by such parent holding company are affiliates of the savings institution. Generally, Sections 23A and 23B (i) limit the extent to which the savings institution or its subsidiaries may engage in "covered transactions: with any one affiliate to an amount equal to 10% of such institution's capital stock and surplus, and contain an aggregate limit on all such transactions with all affiliates to an amount equal to 20% of such capital stock and surplus and (ii) require that all such transactions be on terms substantially the same, or at least as favorable, to the institution or subsidiary as those provided to a non-affiliate. The term "covered transaction" includes the making of loans, purchase of assets, issuance of a guarantee and similar other types of transactions. In addition to the restrictions imposed by Sections 23A and 23B, no savings institution may (i) loan or otherwise extend credit to an affiliate, except for any affiliate which engages only in activities which are permissible for bank holding companies, or (ii) purchase or invest in any stocks, bonds, debentures,

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notes or similar obligations of any affiliate, except for affiliates which are subsidiaries of the savings institution. In addition, Sections 22(h) and (g) of the Federal Reserve Act place restrictions on loans to execute officers, directors and principal stockholders. Under Section 22(h), loans to a director, an executive officer and to a greater than 10% stockholder of a savings institution, and certain affiliated interests of either, may not exceed, together with all other outstanding loans to such person and affiliated interests, the institution's loan to one borrower limit (generally equal to 15% of the institution's unimpaired capital and surplus). Section 22(h) permits loans to directors, executive officers and principal stockholders made pursuant to a benefit or compensation program that is widely available to employees of a subject savings association provided that no preference is given to any officer, director or principal shareholder or related interest thereto over any other employee. In addition, the aggregate amount of extensions of credit by a savings institution to all insiders cannot exceed the institution's unimpaired capital and surplus. Furthermore, Section 22(g) places additional restrictions on loans to executive officers. At September 30, 1995, the Savings Bank was in compliance with the above restrictions.
Restrictions on Acquisitions. Except under limited circumstances, savings and loan holding companies are prohibited from acquiring, without prior approval of the Director of the OTS, (i) control of any other savings institution or savings and loan holding company or substantially all the assets thereof or (ii) more than 5% of the voting shares of a savings institution or holding company thereof which is not a subsidiary. Except with the prior approval of the Director of the OTS, no director or officer of a savings and loan holding company or person owning or controlling by proxy or otherwise more than 25% of such company's stock, may acquire control of any savings institution, other than a subsidiary savings institution, or of any other savings and loan holding company.

The Director of the OTS may only approve acquisitions resulting in the formation of a multiple savings and loan holding company which controls savings institutions in more than one state if (i) the multiple savings and loan holding company involved controls a savings institution which operated a home or branch office located in the state of the institution to be acquired as of March 5, 1987; (ii) the acquirer is authorized to acquire control of the savings institution pursuant to the emergency acquisition provisions of the Federal Deposit Insurance Act ("FDIA"); or (iii) the statutes of the state in which the institution to be acquired is located specifically permit institutions to be acquired by the state-chartered institutions or savings and loan holding

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companies located in the state where the acquiring entity is located (or by a holding company that controls such state-chartered savings institutions).

The Bank Holding Company Act of 1956 specifically authorizes the Federal Reserve Board to approve an application by a bank holding company to acquire control of a savings institution. A bank holding company that controls a savings institution is also authorized to merge or consolidate the assets and liabilities to, any subsidiary bank which is a member of the BIF with the approval of the appropriate federal banking agency and the Federal Reserve Board.  As a result of these provisions, there have been a number of acquisitions of savings institutions by bank holding companies in recent years.

Federal Securities Laws.  The Company is registered with the Securities and Exchange Commission ("SEC") under the Securities Exchange Act of 1934, as amended (the "Securities Exchange Act"), and under OTS regulations.  Generally, the Common Stock may not be deregistered for at least three years after the Conversion.  The Company is subject to the information, proxy solicitation, insider trading restrictions and other requirements of the Securities Exchange Act.

The Savings Bank

General.  The OTS has extensive authority over the operations of federally chartered savings institutions.  As part of this authority savings institutions are required to file periodic reports with the OTS and are subject to periodic examinations by the OTS and the FDIC.  The investment and lending authority of savings institutions are prescribed by federal laws and regulations, and such institutions are prohibited from engaging in any activities not permitted by such laws and regulations.  Those laws and regulations generally are applicable to all federally chartered savings institutions and may also apply to state-chartered savings institutions.  Such regulation and supervision is primarily intended for the protection of depositors.

The OTS has broad enforcement authority over all savings institutions, including, among other things, the ability to assess civil money penalties, to issue cease and desist or removal orders and to initiate injunctive actions.  In general, these enforcement actions may be initiated for violations of laws and regulations and unsafe or unsound practices.  Other actions or inactions may provide the basis for enforcement action, including misleading or untimely reports filed with the OTS.

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Deposit Insurance

The deposits of the Bank are currently insured by the SAIF. Both the SAIF and the Bank Insurance Fund ("BIF"), the federal deposit insurance fund that covers the deposits of state and national banks and certain state savings Banks, are required by law to attain and thereafter maintain a reserve ration of 1.25% of insured deposits. The BIF has achieved the required reserve rate, and as a result, the FDIC reduced the average deposit insurance premium paid by BIF-insured banks to a level substantially below the average premium paid by savings institutions.

Banking legislation was enacted September 30, 1996 to eliminate the premium differential between SAIF-insured institutions and BIF-insured institutions. The legislation provides that all insured depository institutions with SAIF-assessable deposits as of March 31, 1995 pay a special one-time assessment to recapitalize the SAIF. Pursuant to this legislation, the FDIC promulgated a rule that established the special assessment necessary to recapitalize the SAIF at 65.7 basis points of SAIF-assessable deposits held by effected institutions as of March 31, 1995. Based upon its level of SAIF deposits as of March 31, 1995, the Savings Bank will pay a special assessment of approximately $870,000. The assessment was accrued in the quarter ended September 30, 1996.

Another component of the SAIF recapitalization plan provided for the merger of the SAIF and BIF on January 1, 1999, if no insured depository institution is a savings association on that date. If the Savings Bank is required to convert to a bank charter, the Company would become a bank holding company which would subject it to the more restrictive activity limits imposed on bank holding companies unless special grandfather provisions are included in applicable legislation or regulation. As of September 30, 1996, the Company has no investments or activities that would be adversely affected if it were required to become a bank holding company.

Regulatory Capital Requirements. Federal insured savings institutions are required to maintain minimum levels of regulatory capital established by the OTS. These standards generally must be as stringent as the comparable capital requirements imposed on national banks. The OTS also is authorized to impose capital requirements in excess of these standards on individual institutions on a case-by-case basis.

Current OTS capital standards require savings institutions to satisfy three different capital requirements. Under these standards, savings institutions must maintain "tangible"

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capital equal to at least 1.5% of adjusted total assets, "core" capital equal to at least 3% of adjusted total assets and "total" capital (a combination of core and "supplementary" capital) equal to at least 8.0% of "risk-weighted" assets. For purposes of the regulation, core capital generally consists of common equity (including retained earnings), noncummulative perpetual preferred stock and related surplus, minority interests in the equity accounts of fully consolidated subsidiaries, certain nonwithdrawable accounts and pledged deposits and "qualifying supervisory goodwill." Tangible capital is given the same definition as core capital but does not include qualifying supervisory goodwill and is reduced by the amount of all the savings institution's intangible assets, with only a limited exception for purchased mortgage servicing rights. The Savings Bank had no goodwill or other intangible assets at September 30, 1996. Both core and tangible capital are further reduced by an amount equal to a savings institution's debt and equity investments in subsidiaries engaged in activities not permissible to national banks (other than subsidiaries engaged in activities undertaken as agent for customers or in mortgage banking activities and subsidiary depository institutions or their holding companies). These adjustments do not affect the Savings Bank's regulatory capital. Supplementary capital generally consists of hybrid capital instruments; perpetual preferred stock which is not eligible to be included as core capital; subordinated debt and intermediate-term preferred stock; and general allowances for loan losses up to a maximum of 1.25% of risk-weighted assets.

In determining compliance with the risk-based capital requirement, a savings institution is allowed to include both core capital and supplementary capital in its total capital, provided that the amount of supplementary capital included does not exceed the savings institution's core capital. In determining the required amount of risk-based capital, total assets, including certain off-balance sheet items, are multiplied by a risk weight based on the risks inherent in the type of assets. The risk weight assigned by the OTS for principal categories of assets are (i) 0% for cash and securities issued by the U. S. Government or unconditionally backed by the full faith and credit of the U. S. Government; (ii) 20% for securities (other than equity securities) issued by U. S. Government-sponsored agencies and mortgage-backed securities issued by, or fully guaranteed as to principal and interest by, the FNMA or the FHLMC, except for those classes with residual characteristics or stripped mortgage-related securities; (iii) 50% for prudently underwritten permanent one-to-four family first lien mortgage loans not more than 90 days delinquent and having a loan-to-value ratio of not more than 80% at origination unless insured to such ratio by an

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insurer approved by the FNMA or the FHLMC, qualifying residential bridge loans made directly for the construction of one-to-four family residences and qualifying multi-family residential loans; and (iv) 100% for all other loans and investments, including consumer loans, commercial loans, and single-family residential real estate loans more than 90 days delinquent, and for repossessed assets.

At September 30, 1996, the Savings Bank exceeded all of its regulatory capital requirements. The following table sets forth the Savings Bank's compliance with applicable regulatory capital requirements at September 30, 1996:

| | Actual | | Minimum for Capital Adequacy Purposes | | To Be Well Capitalized for Prompt Corrective Action Provisions | |
|---|---|---|---|---|---|---|
| | Ratio | Amount | Ratio | Amount | Ratio | Amount |
| Stockholders' equity and ratio to total assets | 24.2% | 45,163 | | | | |
| Unrealized gain on available for sale securities | | (3,329) | | | | |
| Tangible capital, and ratio to adjusted total assets | 22.8% | 41,834 | 1.5% | 2,748 | | |
| Tier 1 (core) capital, and ratio to adjusted total assets | 22.8% | 41,834 | 3.0% | 5,496 | 5.0% | 9,160 |
| Tier 1 capital, and ratio to risk-weighted assets | 50.1% | 41,834 | 4.0% | 3,339 | 6.0% | 5,009 |
| Tier 2 capital (general allowance for loan losses) | | 572 | | | | |
| Total risk-based capital, and ratio to risk-weighted assets | 50.8% | 42,406 | 8.0% | 6,679 | 10.0% | 8,349 |
| Total assets | | 186,538 | | | | |
| Adjusted total assets | | 183,209 | | | | |
| Risk-weighted assets | | 83,487 | | | | |

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In August 1993, the OTS adopted a final rule incorporating an interest-rate risk component into the risk-based capital regulation. Under the rule, an institution with a greater than "normal" level of interest rate risk is subject to a deduction of its interest rate risk component from total capital for purposes of calculating its risk-based capital. As a result, such an institution is required to maintain additional capital in order to comply with the risk-based capital requirement. An institution with a greater than "normal" interest rate risk is defined as an institution that would suffer a loss of net portfolio value exceeding 2.0% of the estimated economic value of its assets in the event of a 200 basis point increase or decrease (with certain minor exceptions) in interest rates. The interest rate risk component is calculated, on a quarterly basis, as one-half of the difference between an institution's measured interest rate risk and 2.0% multiplied by the economic value of its assets. The rule also authorizes the Director of the OTS, or his designee, to waive or defer an institution's interest rate risk component on a case-by-case basis. The final rule was effective as of January 1, 1994, subject however to a three quarter "lag" time between the reporting date of the data used to calculate an institution's interest rate risk and the effective date of each quarter's interest rate risk component. The OTS postponed the interest rate risk capital deduction in order to provide sufficient time to implement and evaluate the OTS appeals process as well as get a better sense of the direction that the other federal banking agencies may take in their implementation of Section 305 of FDICIA.

Prompt Corrective Action. Under Section 39 of the FDIA, as added by the FDICIA, each federal banking agency was required to implement a system of promptly corrective action for institutions which it regulates. The federal banking agencies, including the OTS, adopted substantially similar regulations to implement Section 38 of the FDIA. Under the regulations, an institution is deemed to be (i) "well capitalized" if it has total risk-based capital of 10.0% or more, than a Tier 1 risk-based capital ratio of 6.0% or more, has a Tier 1 leverage capital ratio of 5.0% or more and is not subject to any order or final capital directive to meet and maintain a specific capital level for any capital measure, (ii) "adequately capitalized" if it has a total risk-based capital ratio of 8.0% or more, a Tier 1 risk-based capital ratio of 4.0% or more and a Tier 1 leverage capital ratio of 4.0% or more (3.0% under certain circumstances) and does not meet the definition of "well capitalized," (iii) "undercapitalized" if it has a total risk-based capital ratio that is less than 8.0%, a Tier 1 risk-based capital ratio that is less than 4.0% or a Tier 1 leverage capital ratio that is less than 4.0% (3.0% under certain circumstances), (iv)

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"significantly undercapitalized" if it has a total risk-based capital ratio that is less than 6.0%, a Tier 1 risk-based capital ratio that is less than 3.0% or a Tier 1 leverage capital ratio that is less than 3.0%, and (v) "critically undercapitalized" if it has a ratio of tangible equity to total assets that is equal to or less than 2.0%. Section 38 of the FDIA and the regulations promulgated thereunder also specify circumstances under which a federal banking agency may reclassify a well capitalized institution as adequately capitalized and may require an adequately capitalized institution or an undercapitalized institution to comply with supervisory actions as if it were in the next lower category (except that the FDIC may not reclassify a significantly undercapitalized institution as critically undercapitalized).

An institution generally must file a written capital restoration plan which meets specified requirements with an appropriate federal banking agency with 45 days of the date that the institution receives notice or is deemed to have notice that it is undercapitalized, significantly undercapitalized or critically undercapitalized. A federal banking agency must provide the institution with written notice of approval or disapproval with 60 days after receiving a capital restoration plan, subject to extensions by the agency.

An institution which is required to submit a capital restoration plan must concurrently submit a performance guaranty by each company that controls the institution. Such guaranty shall be limited to the lesser of (i) an amount equal to 5.0% of the institution's total assets at the time the institution was notified or deemed to have notice that it was undercapitalized or (ii) the amount necessary to restore the relevant capital measures of the institution to the levels required for the institution to be classified as adequately capitalized. Such a guarantee shall expire after the federal banking agency notifies the institution that it has remained adequately capitalized for each of four consecutive calendar quarters. An institution which fails to submit a written capital restoration plan with the requisite period, including any required performance guarantee(s), or fails in any material respect to implement a capital restoration plan, shall be subject to the restrictions in Section 38 of the FDIA which are applicable to significantly undercapitalized institutions.

Immediately upon becoming undercapitalized, an institution shall become subject to the provisions of Section 38 of the FDIA (i) restricting payment of capital distributions and management fees, (ii) requiring that the appropriate federal banking agency monitor the condition of the institution and

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its efforts to restore its capital, (iii) requiring submission of a capital restoration plan, (iv) restricting the growth of the institution's assets and (v) requiring prior approval of certain expansion proposals. The appropriate federal banking agency for an undercapitalized institution also may take any number of discretionary supervisory actions if the agency determines that any of these actions is necessary to resolve the problem of the institution at the least possible long-term cost to the deposit insurance fund, subject in certain cases to specified procedures. These discretionary supervisory actions include requiring the institution to raise additional capital; restricting transactions with affiliates; restricting interest rates paid by the institution on deposits; requiring replacement of senior executive officers and directors; restricting the activities of the institution and its affiliates; requiring divestiture of the institution or the sale of the institution to a willing purchaser; and any other supervisory action that the agency deems appropriate. These and additional mandatory and permissive supervisory actions may be taken with respect to significantly undercapitalized and critically undercapitalized institutions.

At September 30, 1996, the Savings Bank was deemed a "well capitalized" institution for purpose of the above regulations and as such was not subject to the above mentioned restrictions.

Safety and Soundness. On November 18, 1993, a joint notice of proposed rulemaking was issued by the OTS, the Office of the Comptroller of the Currency and the Federal Reserve Board (collectively, the "agencies") concerning standards for safety and soundness required to be prescribed by regulation pursuant to Section 39 of the FDIA. In general, the standards relate to (1) operational and managerial matters; (2) asset quality and earnings; and (3) compensation. The operational and managerial standards cover (a) internal controls and information systems, (b) internal audit system, (c) loan documentation, (d) credit underwriting, (e) interest rate risk exposure, (f) asset growth, and (g) compensation, fees and benefits. Under the proposed asset quality and earnings standards, the Savings Bank would be required to maintain (1) a maximum ratio of classified assets (assets classified substandard, doubtful and to the extent that related losses have not been recognized, assets classified loss) to total capital of 1.0%, and (2) minimum earnings sufficient to absorb losses without impairing capital. The last ratio concerning market value to book value was determined by the agencies not to be feasible. Finally, the proposed compensation standard states that compensation will be considered excessive if it is unreasonable or disproportionate to the services actually performed by the individual being compensated. If an insured

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depository institution or its holding company fail to meet any of the standards promulgated by regulation, then such institution or company will be required to submit a plan within 30 days to the FDIC specifying the steps it will take to correct the deficiency. In the event that an institution or company fails to submit or fails in any material respect to implement a compliance plan within the time allowed by the agency, Section 39 of the FDIA provides that the FDIC must order the institution or company to correct the deficiency and may (1) restrict asset growth; (2) require the institution or company to increase its ratio of tangible equity to assets; (3) restrict the rates of interest that the institution or company may pay; or (4) take any other action that would better carry out the purpose of prompt corrective action. The Savings Bank believes that it will be in compliance with each of the standards if they are adopted as proposed.

Liquidity Requirements. Each savings institution is required to maintain an average daily balance of liquid assets equal to a certain percentage of the sum of its average daily balance of net withdrawable deposit accounts and borrowing payable in one year or less. The liquidity requirement may vary from time to time (between 4% and 10%) depending upon economic conditions and savings flows of all savings institutions. At the present time, the required minimum liquid asset ratio is 5%. At September 30, 1996, the Savings Bank's liquidity ratio was in excess of the required minimum.

Capital Distributions. OTS regulations govern capital distributions by savings institutions, which include cash dividends, stock redemptions or repurchases, cash-out mergers, interest payments on certain convertible debt and other transactions charged to the capital account of a savings institution to make capital distributions. Generally, the regulation creates a safe harbor for specified levels of capital distributions from institutions meeting at least their minimum capital requirements, so long as such institutions notify the OTS and receive no objection to the distribution from the OTS. Savings institutions and distributions that do not qualify for the safe harbor are required to obtain prior OTS approval before making any capital distributions.

Generally, a savings institution that before and after the proposed distribution meets or exceeds its fully phased-in capital requirements (Tier 1 institutions) may make capital distributions during any calendar year equal to the higher of (i) 100% of net income for the calendar year-to-date plus 50% of its "surplus capital ratio" at the beginning of the calendar year or (ii) 75% of net income over the most recent four-quarter period. The "surplus capital ratio" is defined to mean the percentage by which the institution's ratio of

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total capital to assets exceeds the ratio of its fully phased-in capital requirement: is defined to mean an institution's capital requirements under the statutory and regulatory standards applicable on December 31, 1994, as modified to reflect any applicable individual minimum capital requirement imposed upon the institution. Failure to meet fully phased-in or minimum capital requirements will result in further restrictions on capital distributions, including possible prohibition without explicit OTS approval.

Tier 2 institutions, which are institutions that before and after the proposed distribution meet or exceed their minimum capital requirements, may make capital distributions up to 75% of their net income over the most recent four quarter period.

In order to make distributions under these safe harbors, Tier 1 and Tier 2 institutions must submit 30 days written notice to the OTS prior to making the distribution. The OTS may object to the distribution during that 30-day period based on safety and soundness concerns. In addition, a Tier 1 institution deemed to be in need of more than normal supervision by the OTS may be downgraded to a Tier 2 or Tier 3 institution as a result of such a determination.

Tier 3 institutions, which are institutions that do not meet current minimum capital requirements, or that have capital in excess of either their fully phased-in capital requirement or minimum capital requirement but which have been notified by the OTS that it will be treated as a Tier 3 institution because they are in need of more than normal supervision, cannot make any capital distribution without obtaining OTS approval prior to making such distributions.

At September 30, 1996, the Savings Bank was a Tier 1 institution for purposes of this regulation.

Loans to One Borrower. OTS regulations impose limitations on the aggregate amount of loans that a savings institution could make to any one borrower, including related entities, that follow the national bank standard. The regulations generally do not permit loans to one borrower to exceed the greater of $500,000 or 15% of unimpaired capital and surplus. Loans in an amount equal to an additional 10% of unimpaired capital and surplus also may be made to a borrower if the loans are fully secured by readily marketable securities. For information about the largest borrowers from the Savings Bank, see "Description of Business - Lending Activities - General."

Branching by Federal Savings Institutions. Effective May 11, 1992, the OTS amended its Policy Statement on Branching by Federal Savings Institutions to permit interstate branching to

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the full extent permitted by statute (which is essentially unlimited). Prior policy permitted interstate branching for federal savings institutions only to the extent allowed for state-chartered institutions in the states where the institution's home office is located and where the branch is sought. Prior policy also permitted healthy out-of-state federal institutions to branch into another state, regardless of the law in that state, provided the branch office was the result of a purchase of an institution that was in danger of default.

Generally, federal law prohibits federal savings institutions from establishing, retaining or operating a branch outside the state in which the federal institution has its home office unless the institution meets the IRS's domestic building and loan test (generally, 60% of a thrift's assets must be housing-related) ("IRS Test"). The IRS Test requirement does not apply if: (i) the branch(es) result(s) from an emergency acquisition of a troubled savings institution (however, if the troubled savings institution is acquired by a bank holding company, does not have its home office in the state of the bank holding company bank subsidiary and does not qualify under the IRS Test, its branching is limited to the branching laws for state-chartered banks in the state where the savings institution is located); (ii) the law of the state where the branch would be located would permit the branch to be established if the federal savings institution were chartered by the state in which its home office is located; or (iii) the branch was operated lawfully as a branch under state law prior to the savings institution's conversion to a federal charter.

Furthermore, the OTS will evaluate a branching applicant's record of compliance with the Community Reinvestment Act of 1977 ("CRA"). An unsatisfactory CRA record may be the basis for denial of a branching application.

Qualified Thrift Lender Test. All savings institutions are required to meet a QTL test set forth in Section 10(m) of the HOLA and regulations of the OTS thereunder to avoid certain restrictions on their operations. A saving institution that does not meet the QTL test set forth in the HOLA and implementing regulations must either convert to a bank charter or comply with the following restrictions on its operations: (i) the institution may not engage in any new activity or make any new investment, directly or indirectly, unless such activity or investment is permissible for a national bank; (ii) the branching powers of the institution shall be restricted to those of a national bank; (iii) the institution shall not be eligible to obtain any advances from its FHLB; and (iv) payment of dividends by the institution shall be subject to the rules regarding payment of dividends by a

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national bank. Upon the expiration of three years from the date the savings institution ceases to be a QTL, it must cease any activity and not retain any investment not permissible for a national bank and immediately repay any outstanding FHLB advances (subject to safety and soundness considerations).

Currently, the QTL test requires that 65% of an institution's "portfolio assets" (as defined) consist of certain housing and consumer-related assets on a monthly average basis in nine out of every 12 months. Assets that qualify without limit for inclusion as part of the 65% requirement are loans made to purchase, refinance, construct, improve or repair domestic residential housing and manufactured housing; home equity loans; mortgage-backed securities (where the mortgages are secured by domestic residential housing or manufactured housing); stock issued by the FHLB of Dallas; loans for educational purposes, loans to small businesses and loans made through debit cards or credit card accounts and direct or indirect obligations of the FDIC. In addition, the following assets, among others, may be included in meeting the test subject to an overall limit of 20% of the savings institution's portfolio assets: 50% of residential mortgage loans originated and sold within 90 days of origination; 100% of consumer and educational loans (other than loans for personal, family or personal purposes included in the unlimited category); and stock issued by the FHLMC or the FNMA. Portfolio assets consist of total assets minus the sum of (i) goodwill and other intangible assets, (ii) property used by the savings institution to conduct its business, and (iii) liquid assets up to 20% of the institution's total assets. At September 30, 1996, the qualified thrift investments of the Savings Bank were substantially in excess of 65%.

Accounting Requirements. The Financial Institutions Reform, Recovery, and Enforcement Act of 1989,("FIRREA") requires the OTS to establish accounting standards to be applicable to all savings institutions for purposes of complying with regulations, except to the extent otherwise specified in the capital standards. Such standards must incorporate generally accepted account principles ("GAAP") to the same degree as is prescribed by the federal banking agencies for banks or may be more stringent than such requirements.

Effective October 2, 1992, the OTS amended a number of its accounting regulations and reporting requirements to adopt the following standards: (i) regulatory reports will incorporate GAAP when GAAP is used by federal banking agencies; (ii) savings institution transactions, financial condition and regulatory capital must be reported and disclosed in accordance with OTS regulatory reporting requirements that

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will be at least as stringent as for national banks; and (iii) the Director of the OTS may prescribe regulatory reporting requirements more stringent than GAAP wherever the Director determines that such requirements are necessary to ensure the safe and sound reporting and operation of savings institutions.

Effective February 10, 1992, the OTS adopted a statement of policy ("Statement") set forth in Thrift Bulletin 52 concerning (i) procedures to be used in the selection of a securities dealer, (ii) the need to document and implement prudent policies and strategies for securities, whether held for investment, trading or for sale, and to establish systems and internal controls to ensure that securities activities are consistent with the financial institution's policies and strategies, (iii) securities trading and sales practices that may be unsuitable in connection with securities held in an investment portfolio, (iv) high-risk mortgage securities that are not suitable for investment portfolio holdings for financial institutions, and (v) disproportionately large holdings of long-term, zero-coupon bonds that may constitute an imprudent investment practice. The Statement applies to investment securities, high-yield, corporate debt securities, loans, mortgage-backed securities and derivative securities, and provides guidance concerning the proper classification of and accounting for securities held for investment, sale and trading. Securities held for investment, sale or trading may be differentiated based upon an institution's desire to earn an interest yield (held for investment), to realize a holding gain from assets held for indefinite periods of time (held for sale), or to earn a dealer's spread between the bid and asked prices (held for trading). Depository institution investment portfolios are maintained to provide earnings consistent with the safety factors of quality, maturity, marketability and risk diversification. Securities that are purchased to accomplish these objectives may be reported at their amortized cost only when the depository institution has both the intent and ability to hold the assets for long-term investment purposes. Securities held for investment purposes may be accounted for at amortized cost, securities held for sale are to be accounted for at the lower of cost or market, and securities held for trading are to be accounted for at market. The Savings bank believes that its investment activities have been and will continue to be conducted in accordance with the requirements of OTS policies and GAAP.

Federal Home Loan Bank System. The Savings Bank is a member of the FHLB of Dallas, which is one of 12 regional FHLBs that administers the home financing credit function of savings institutions. Each FHLB serves as a reserve or central bank for its members within its assigned region. It is funded

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primarily from proceeds derived from the sale of consolidated obligations of the FHLB System. It makes loans to members (i.e., advances) in accordance with policies and procedures established by the Board of Directors of the FHLB.

As a member, the Savings Bank is required to purchase and maintain stock in the FHLB of Dallas in an amount equal to at least 1% of its aggregate unpaid residential mortgage loans, home purchase contracts or similar obligations at the beginning of each year. At September 30, 1996, the Savings Bank had $1.2 million in FHLB stock, which was in compliance with this requirement.

As a result of FIRREA, the FHLBs are required to provide funds for the resolution of troubled savings institutions and to contribute to affordable housing programs through direct loans or interest subsidies on advances targeted for community investment and low- and moderate-income housing projects. These contributions have adversely affected the level of FHLB dividends paid and could continue to do so in the future. These contributions also could have an adverse effect on the value of FHLB stock in the future.

Federal Reserve System. The Federal Reserve Board requires all depository institutions to maintain average daily reserves equal to various percentages against their accounts. The percentages are subject to adjustment by the Federal Reserve Board. At September 30, 1996, the Savings Bank met its reserve requirement. Because required reserves must be maintained in the form of vault cash or a non-interest-bearing account at a Federal Reserve Bank, the effect of this reserve requirement is to reduce an institution's earning assets.

Taxation

General. The Company and the Savings Bank are subject to the generally applicable corporate tax provisions of the Code, and the Savings Bank is subject to certain additional provisions of the Code which apply to thrift and other types of financial institutions. The following discussion of federal taxation is intended only to summarize certain pertinent federal income tax matters and is not a comprehensive discussion of the tax rules applicable to the Savings Bank.

Fiscal Year. The Company and the Savings Bank file a consolidated federal income tax return on the basis of a fiscal year ending on September 30. Consolidated returns have the effect of eliminating intercompany distributions, including dividends, from the computation of consolidated taxable income for the taxable year in which such distributions occur.

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Thrift institutions, such as the Savings Bank, generally are subject to the provisions of the Internal Revenue Code of 1986, as amended, in the same manner as other corporations. For tax years beginning before December 31, 1995, however, by meeting certain definitional tests and other conditions prescribed by the Internal Revenue Code, thrift institutions could benefit from special deductions for annual additions to tax bad debt reserves with respect to loans. For purposes of the bad debt reserve deduction, loans were separated into "qualifying real property loans," which generally were loans secured by interests in improved real property, and "nonqualifying loans," which were all other loans. The bad debt reserve deduction with respect to nonqualifying loans was based on actual loss experience. The bad debt reserve deduction with respect to qualifying real property loans could be based upon actual loss experience (the "experience method") or a percentage of taxable income determined without regard to such deduction (the "percentage of taxable income method"). The Savings Bank historically used whichever method resulted in the highest bad debt reserve deduction in any given year.

Legislation enacted in August 1996 repealed the percentage of taxable income method of calculating the bad debt reserve. Savings institutions, like the Savings Bank, which have previously used that method are required to recapture into taxable income post-1987 reserves in excess of the reserves calculated under the experience method over a six-year period beginning with the first taxable year beginning after December 31, 1995. The start of such recapture may be delayed until the third taxable year beginning after December 31, 1995 if the dollar amount of the institution's residential loan originations in each year is not less than the average dollar amount of residential loan originated in each of the six most recent years disregarding the years with the highest and lowest originations during such period. For purposes of this test, residential loan originations would not include refinancing and home equity loans.

Beginning with the first taxable year beginning after December 31, 1995, savings institutions, such as the Savings Bank, will be treated the same as commercial banks. Institutions with $500 million or more in assets will be able to take a tax deduction only when a loan is actually charged off. Institutions with less than $500 million in assets will still be permitted to make deductible bad debt additions to reserves, but only using the experience method. The Savings Bank is expected to recapture approximately $1,025,000 of its tax bad debt reserves. The recapture will not have any effect on the Savings Bank's net income because the related tax expense has already been accrued.

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Under the experience method, the bad debt deduction to an addition to the reserve for qualifying real property loans is an amount determined under a formula based generally on the bad debts actually sustained by a savings institution over a period of years. Under the percentage of taxable income method, the bad debt reserve deduction for qualifying real property loans was computed as 8% of the thrift's taxable income. The maximum deduction could be taken as long as not less than 60% of the total dollar amount of the assets of an institution fell within certain designated categories. If the amount of qualifying assets fell below 60%, the institution would get no deduction and could be required to recapture, generally over a period of years, its existing bad debt reserves (although net operating loss carryforwards could be used to offset such recapture).

The bad debt deduction under the percentage of taxable income method was limited to the extent that the amount accumulated in the reserve for losses on qualifying real property loans exceeded 6% of such loans outstanding at the end of the taxable year. In addition, the amount claimed as a bad debt deduction when added to accumulated loss reserves was limited to the excess, if any, of 12% of total deposits or withdrawable accounts of depositors at year-end in excess of the sum of surplus, undivided profits and reserves at the beginning of the year. The percentage bad debt deduction was reduced by the deduction for losses on nonqualifying loans.

Earnings appropriated to the Savings Bank's tax bad debt reserves and claimed as tax deductions will not be available for the payment of cash dividends or other distributions to the Company (including distributions made upon dissolution or liquidation), unless the Savings Bank includes the amounts distributed in taxable income, along with the amounts deemed necessary to pay the resulting federal income tax. At September 30, 1996, the Savings Bank included the amounts distributed in taxable income, along with the amounts deemed necessary to pay the resulting federal income tax. At September 30, 1996, the Savings Bank had approximately $2.8 million of accumulated bad debt reserves for which federal income taxes have not been provided.

For taxable years beginning after September 30, 1986, the Internal Revenue Code imposes an alternative minimum tax at a rate of 20%. The alternative minimum tax generally applies to a base of regular taxable income plus certain tax preferences ("alternative minimum taxable income" or "AMTI") and is payable to the extent such AMTI exceeds an exemption amount. The Internal Revenue Code provides that an item of tax preference is the excess of the bad debt deduction allowable

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for a taxable year pursuant to the percentage of taxable income method over the amount allowable under the experience method. The other items of tax preference that constitute AMTI include (a) tax-exempt interest on newly-issued (generally qualified bonds and (b) for taxable years including 1987 through 1989, 50% of the excess of (i) the taxpayer's pre-tax adjusted net book income over (ii) AMTI (determined without regard to this latter preference and prior to reduction by net operating losses). For taxable years beginning after 1989, this latter preference has been replaced by 75% of the excess (if any) of (i) adjusted current earnings as defined in the Internal Revenue Code, over (ii) AMTI (determined without regard to this preference and prior to reduction by net operating losses). For any taxable year beginning after 1986, net operating losses can offset no more than 90% of AMTI. Certain payments of alternative minimum taxes may be used as credits against regular tax liabilities in future years. In addition, for taxable years after 1986 and before 1992, corporations, including savings institutions, are also subject to an environmental tax equal to 0.12% of the excess of AMTI for the taxable year (determined without regard to net operating losses and the deduction for the environmental tax) over $2.0 million. The Savings Bank is not currently paying any amount of alternative minimum tax but may, depending on future results of operations, be subject to this tax.

The Savings Bank's federal income tax returns have not been examined by the regulatory authorities within the past five years. For additional information, see Note 12 of Notes to Consolidated Financial Statements contained elsewhere herein.

Mississippi and Delaware Taxation

The Company and the Savings Bank are both subject to Mississippi corporate income tax and franchise tax to the extent they are engaged in business in the State of Mississippi or have income that is generated in the State of Mississippi.

A franchise tax is imposed and the tax rate of $2.50 per $1,000, or fraction thereof, of the value of capital used, invested or employed in the State of Mississippi. The franchise tax base consists of capital stock issued and outstanding, paid in capital, surplus, and retained earnings; however, in no case shall the tax base be less than the assessed value of real and tangible personal property in the State of Mississippi. If the Company is classified as a "holding company" then it may exclude from its franchise tax base the stock it owns in the Savings Bank. Mississippi law provides that the value of capital used, invested, or employed

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in Mississippi by a "holding corporation" excludes that portion of the book value of the holding corporation's investment in stock or securities of its subsidiary corporation determined by a formula. The formula states that first, the ratio of (1) the holding corporation's investment in stock or securities of its subsidiary corporation, computed using the cost method of accounting, and (2) the holding corporation's total assets, is computed. Second, the ratio is then applied to the total capital stock, surplus, paid in capital and retained earnings of the holding corporation in order to arrive at the amount of the exclusion. For purposes of Mississippi franchise taxes, a "holding corporation" is defined as a corporation, (i) owning at least eighty percent (80%) of the value and voting power of all classes of issued and outstanding stock of a corporation, excluding non-voting stock which is limited and preferred as to dividends, and (ii) deriving ninety-five (95%) of its gross receipts from dividends, interest, royalties, rents, certain services provided to members of an affiliated group and other passive sources of income.

An income tax is imposed in Mississippi at a rate of 3% on the first $5,000 of taxable income, 4% on the next $5,000 of taxable income and 5% on taxable income in excess of $10,000. For these purposes, "taxable income" generally means federal taxable income, subject to certain adjustments (including exclusion of interest income on U.S. Treasury obligations). The exclusion of income on U.S. Treasury obligations has the effect of reducing the Mississippi taxable income of savings institutions.

Two or more members of an affiliated group of corporations may elect to file a consolidated Mississippi income tax return when all the business activities of the group of affiliated corporations included in the consolidated return are conducted in, and are taxable solely in Mississippi. In addition, the Commissioner of the Mississippi Tax Commission may require any and all members of a group of affiliated corporations to file a combined or consolidated Mississippi income tax return if he believes such a return is necessary to clearly and equitably reflect the Mississippi taxable income of the affiliated group. The term "affiliated group" for Mississippi consolidated income tax returns means one or more corporations connected through stock ownership with a common parent corporation where at least 80% of the voting power of all classes of stock and at least 80% of each class of the non-voting stock of each of the member corporations, except the common parent corporation, is directly owned by one or more of the other members corporations, and the common parent directly owns stock possessing at least 80% of the voting power of all classes of stock and at least 80% of each class

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of non-voting stock of at least one of the other member corporations.

The Company was organized in the State of Delaware, and therefore it will be required to file a franchise tax return with the State of Delaware. The Company will also be required to file an income tax return in the State of Delaware if it derives income from business activities carried on in the State of Delaware. Currently, the Company does not have any business activities in the State of Delaware.

Delaware law provides two methods to calculate the Delaware Franchise Tax. One method is based on the Company's authorized number of shares and the second method is based on the Company's "assumed no-par capital" with respect to no par shares and on the Company's "assumed par value capital" with respect to par value shares. The lesser result under both methods is then used to determine the franchise tax liability in the State of Delaware.

Under the first method the franchise tax is calculated at a base rate of $90 on the first 10,000 shares, plus $50.00 per each additional 10,000 shares or part thereof.

The second method is based on "assumed no-par capital" with respect to no-par shares and an "assumed par-value capital" with respect to par value shares as follows:

1. The "assumed no-par capital" is the authorized number of shares without par value multiplied by $100. The tax on the "assumed no-par capital" is $30.00 for each $300,000 or less and is graduated as follows: (i) $50.00 for over $300,000 but not over $500,000; (ii) $90.00 for over $500,000 but not over $1,000,000; and (iii) $90 for over $1,000,000, plus $50.00 per each additional $1,000,000 or part thereof.

2. The tax on par value is $200 for each $1,000,000, or fraction thereof of an "assumed par-value capital." The "assumed par-value capital" is found as follows: (i) ascertain average asset value per share by dividing total gross assets by the total number of issued shares, including shares without par value; (ii) if average asset value is more than par value; it is multiplied by the total number of authorized par value shares; if average assets value is less than par value of any class of authorized shares, such shares must be taken at their par value. Where it is necessary to use average asset value for one class of shares and par value of any other class or classes, the "assumed par-value capital" is the sum of the

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products of the multiplications.

If a corporation has both no-par shares and par-value shares, the no-par shares are taxed as calculated above upon a share basis which is added to the tax calculated above on the par value shares.

Employees

The Savings Bank had 24 full time employees and one part-time employee at September 30, 1996. None of the employees is represented by a collective bargaining agreement.

ITEM 2.--DESCRIPTION OF PROPERTY

The following table sets forth information regarding the Association's offices at September 30, 1996:

| | Year Opened | Net Book Value at September 30, 1996 | Approximate Square Footage | Owned Or Leased |
|---|---|---|---|---|
| Main Office:<br>333 Court Street<br>Tupelo, Mississippi | 1969 | 378,502 | 10,000 | Owned |

The net book value of the Company's investment in furnishings and equipment totaled $225,000 at September 30, 1996.

ITEM 3.--LEGAL PROCEEDINGS

From time to time, the Company is a party to various legal proceedings incident to its business. At September 30, 1996, there were no legal proceedings to which the Company or its subsidiary was a party, or to which any of their property was subject, which were expected by management to result in a material loss.

ITEM 4.--SUBMISSION OF MATTERS TO A VOTE OF SECURITIES HOLDERS

No matters were submitted to a vote of securities holders during the fourth quarter of fiscal 1996.

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## ITEM 5.--MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

The information set forth (i) under "Dividend Restrictions" in Item 1 of this report and (ii) in the Notes to Consolidated Financial Statements in Item 6 of this report is incorporated herein by reference.

The information required herein by reference from page 3 of the Company's Annual Report to Stockholders for fiscal 1996 (" Annual Report"), which is included herein as Exhibit 13.

The Company's common stock began trading on the NASDAQ on March 26, 1996, under the symbol "CFTP." At September 30, 1996, there were 4,628,750 shares of the common stock outstanding and approximately 1,082 stockholders on record.

The payment of dividends on the Common Stock is subject to determination and declaration by the Board of Directors of the Company. The Board of Directors has adopted a policy of paying quarterly cash dividends on the Common Stock. In addition, from time to time, the Board of Directors may determine to pay special cash dividends in addition to, or in lieu of, regular cash dividends. The payment of future dividends will be subject to the requirements of applicable law and the determination by the Board of Directors of the Company that the net income, capital, and financial condition of the Company and the Association, thrift industry trends, and general economic conditions justify the payment of dividends, and there can be no assurance that dividends will be paid or, if paid, will continue to be paid in the future.

The following table sets forth information as to high and low sales prices of the Company's common stock and cash dividends per share of common stock for the calendar quarters indicated.

| | Price Per Share | | Dividends Per Share | |
|---|---|---|---|---|
| | High | Low | Regular | Special |
| Fiscal 1996: | | | | |
| Second quarter | 13.500 | 11.750 | .000 | .000 |
| Third quarter | 13.475 | 12.375 | .075 | .000 |
| Fourth quarter | 13.625 | 12.250 | .075 | .000 |

## ITEM 6.--SELECTED FINANCIAL DATA

The information required herein is incorporated by reference from page 4 of the Annual Report.

## ITEM 7.--MANAGEMENTS'S DISCUSSION AND ANALYSIS OF FINANCIAL

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CONDITION AND RESULTS OF OPERATIONS.

The information required herein is incorporated by reference from pages 5 through 16 of the Annual Report.

ITEM 8.--FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The financial statements required herein are incorporated by reference from pages 18 through 45 of the Annual Report.

ITEM 9.--CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not applicable.

PART III

ITEM 10.--DIRECTORS, EXECUTIVE OFFICERS, PROMOTERS, AND CONTROL PERSONS; COMPLIANCE WITH SECTION 16(A) OF THE EXCHANGE ACT

Information concerning the directors and executive officers of the Company and Transactions with Management is incorporated herein by reference to the sections captioned "Executive Officers Who Are Not Directors" in Item 1. of this report and "Proposal I--Election of Directors" in the Proxy Statement.

ITEM 11.--EXECUTIVE COMPENSATION

The information required by this item is incorporated herein by reference to the section captioned "Executive Compensation" in the Proxy Statement.

ITEM 12.--SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The information required by this item is incorporated herein by reference to the sections captioned "Voting Securities and Security Ownership" and "Proposal I--Election of Directors" in the Proxy Statement.

ITEM 13.--CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information required by this item is incorporated herein by reference to the section captioned "Transactions with Management" in the Proxy Statement.

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PART IV

ITEM 14.--EXHIBITS LIST AND REPORTS ON FORM 8-K

(a) Documents filed as part of this Report

(1) The following financial statements are incorporated by reference from item 8 hereof (see Exhibit 13 attached hereto):

Independent Auditors's Report

Consolidated Statements of Financial Condition at September 30, 1996 and 1995.

Consolidated Statements of Earnings for the Years Ended September 30, 1996, 1995 and 1994.

Consolidated Statements of Changes in Stockholders' Equity for the Years Ended September 30, 1996, 1995, and 1994.

Consolidated Statements of Cash Flows for the Years Ended September 30, 1996, 1995 and 1994.

Notes to Consolidated Financial Statements

(2) All Schedules for which provision is made in the applicable accounting regulations of the Securities and Exchange Commission are omitted because of the absence of conditions under which they are required or because the required information is included in the financial statements and related notes thereto.

(3) The following exhibits are filed as part of this Form 10-K and this list includes the Exhibit Index.

| No. | Exhibits | Page |
|---|---|---|
| 3.1 | Certificate of Incorporation | * |
| 3.2 | Bylaws | * |
| 4.1 | Specimen Common Stock Certificate | * |
| 10.1(a) | Employee Stock Ownership Plan | * |
| 13 | Annual Report to Stockholders | E-1 |
| 23 | Consent of Independent Public Accountants | E-60 |

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*Incorporated herein by reference to the Registration Statement file number 33-99962 on Form S-1.

(b) Reports on Form 8-K during the quarter ended September 30, 1996.

1. On October 30, 1996, the Company filed a current report on Form 8-K announcing the authority to repurchase up to 231,437 shares of common stock and reporting its earnings and other financial information for the quarter ended September 30, 1996.

(c) See (a)(3) above for all exhibits filed herewith and the Exhibit Index.

(d) There are no other financial statements and financial statements schedules which were excluded from Item 8 which are required to be included herein.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, as of the date indicated below:

COMMUNITY FEDERAL BANCORP, INC.

Date: December 27, 1996 By: (s)Jim Ingram
Jim Ingram
President and Chief
Executive officer
(Duly Authorized Representative)

By: (s)Sherry McCarty
Sherry McCarty
Controller
(Chief Financial and Accounting
(Officer)
(Duly Authourized Representative)

Pursuant to the requirements of the Securities Exchange Act of

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1934, this report has been signed below by the following persons on behalf of the registrant in the capacities indicated below as of the date indicated above.

Date: December 26, 1996

| | |
|---|---|
| Medford M. Leake<br>(Director) | J. Leighton Pettis<br>(Director) |
| Charles V. Imbler<br>(Director) | L. F. Sams, Jr.<br>(Director) |
| Robert R. Black, Sr.<br>(Director) | Michael R. Thomas<br>(Director) |
| Robert W. Reed, III.<br>(Director) | |

CONSENT OF INDEPENDENT PUBLIC ACCOUNTANTS

As independent public accountants, we hereby consent to the incorporation by reference in this registration statement of our report dated October 25, 1996 included in the Community Federal Bancorp Inc.'s Form 10-K for the year ended September 30, 1996 and to all references to our Firm included in this registration statement.

(S) Arthur Andersen
Arthur Andersen, LLP

Birmingham, Alabama
December 27, 1996

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To Our Stockholders:

We are pleased to provide you with the First Annual Report of Community Federal Bancorp, Inc. since becoming a Stock Company as of March 25, 1996.

Net earnings for the fiscal year ended September 30, 1996, amounted to $2.1 million, an increase of 5.4% from September 30, 1995. These earnings resulted in a 1.05% return on assets.

Legislation was passed in 1996 to recapitalize the Savings Association Insurance Fund ("SAIF") with a one time assessment. This was a cost to Community Federal of $863,000 , $535,000 net of tax benefit, thus our earnings would have been approximately $2.6 million without this assessment. This action will have a positive effect on our future earnings by reducing our SAIF premium by seventeen (17) basis points.

Stockholders' Equity as of September 30, 1996 was $67.1 million, an increase of 186.6% over September 30, 1995. This growth was primarily due to the infusion of capital from our successful stock conversion. Total assets increased during the fiscal year 25.9% to $204 million, of which 25.6% of the increase was due to the conversion.

Your Company is well capitalized and profitable. We look to the future with optimism and a determination to serve this area with personal service and dedication.

We appreciate your investment in this Company and ask for your continued support.

Jim Ingram

Community Federal Bancorp, Inc.
President and Chief Executive Officer

COMMUNITY FEDERAL BANCORP, INC.

Community Federal Bancorp, Inc. (the "Company") was incorporated at the direction of management of Community Federal Savings Bank (the "Bank") for the purpose of serving as a savings institution holding company of the Bank upon the acquisition of all of the capital stock issued by the Bank

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upon its conversion from mutual to stock form (the "Conversion") effective March 25, 1996. The Company is classified as a unitary savings institution holding company and is subject to regulation by the Office of Thrift Supervision ("OTS").

The Bank was organized in 1933 as a federally chartered mutual savings and loan association, at which time it also became a member of the Federal Home Loan Bank ("FHLB") System and obtained federal deposit insurance. The Bank currently operates through its banking office located in Tupelo, Mississippi. At September 30, 1996, the Bank had total assets of $204.0 million, deposits of $131.7 million, and stockholders' equity of $67.1 million, or 32.9% of total assets.

The Bank's business strategy has been to operate as a profitable and independent community-oriented savings institution dedicated to providing quality customer service. Generally, the Bank has sought to implement this strategy by using retail deposits as its sources of funds and maintaining most of its assets in mortgage-backed securities issued by the Federal Home Loan Mortgage Corporation ("FHLMC"), the Government National Mortgage Association ("GNMA") and the Federal National Mortgage Association ("FNMA"), loans secured by owner-occupied one-to-four-family residential real estate located in Lee County, Mississippi and portions of the surrounding counties,(" the Bank's market area"), U.S. government and agency securities, interest-earning deposits, cash and equivalents and consumer loans. The Bank's business strategy incorporates the following key elements: (1) remaining a community-oriented financial institution while maintaining a strong core customer base by providing quality service and offering customers the access to senior management and services that a community-based institution can offer; (2) attracting a relatively strong retail deposit base from the communities served by the Bank's banking offices; (3) maintaining asset quality by emphasizing investment in local residential mortgage loans, mortgage-backed securities, and other securities issued or guaranteed by the U.S. government or agencies thereof; and (4) maintaining liquidity and capital substantially in excess of regulatory requirements.

As a federally chartered savings institution, the Bank is subject to extensive regulation by the OTS. The lending activities and other investments of the Bank must comply with various federal regulatory requirements, and the OTS periodically examines the Bank for compliance with various regulatory requirements. The Federal Deposit Insurance Company ("FDIC") also has the authority to conduct special examinations. The Bank must file reports with OTS describing

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its activities and financial condition and is also subject to certain reserve requirements promulgated by the Board of Governors of the Federal Reserve System ("Federal Reserve Board").

## MARKET FOR COMMON STOCK AND RELATED STOCKHOLDER MATTERS

The Company's common stock began trading on the NASDAQ on March 26, 1996, under the symbol "CFTP." At September 30, 1996, there were 4,628,750 shares of the common stock outstanding and approximately 1082 stockholders of record.

The payment of dividends on the Common Stock is subject to determination and declaration by the Board of Directors of the Company. The Board of Directors has adopted a policy of paying quarterly cash dividends on the Common Stock. In addition, from time to time, the Board of Directors may determine to pay special cash dividends in addition to, or in lieu of, regular cash dividends. The payment of future dividends will be subject to the requirements of applicable law and the determination by the board of Directors of the Company that the net income, capital, and financial condition of the Company and the Association, thrift industry trends, and general economic conditions justify the payment of dividends, and there can be no assurance that dividends will be paid, or, if paid, will continue to be paid in the future.

The following table sets forth information as to high and low sales prices of the Company's common stock and cash dividends per share of common stock for the calendar quarters indicated.

| | Price Per Share | | Dividends Per Share | |
|---|---|---|---|---|
| | High | Low | Regular | Special |
| Fiscal 1996: | | | | |
| Second quarter | $13.500 | $11.750 | $.000 | $.000 |
| Third quarter | $13.475 | $12.375 | $.075 | $.000 |
| Fourth quarter | $13.625 | $12.250 | $.075 | $.000 |

## SELECTED CONSOLIDATED FINANCIAL AND OTHER DATA

<TABLE>
<CAPTION>

| | Year Ended September 30, | | | | |
|---|---|---|---|---|---|
| | 1996 | 1995 | 1994 | 1993 | 1992 |

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| | | | (In thousands) | | |
|---|---|---|---|---|---|
| <S> | <C> | <C> | <C> | <C> | <C> |
| INCOME STATEMENT DATA: | | | | | |
| Total interest income | $13,150 | $11,016 | $10,011 | $10,275 | $11,154 |
| Total interest expense | 6,950 | 6,267 | 6,438 | 5,312 | 6,701 |
| Net interest income | 6,200 | 4,749 | 3,573 | 4,963 | 4,453 |
| Provision for loan losses | 20 | 30 | 25 | 100 | 190 |
| Net interest income after provision for loan losses | 6,180 | 4,719 | 3,548 | 4,863 | 4,263 |
| Noninterest income | 188 | 132 | 752 | 133 | 173 |
| Noninterest expense | 3,036 | 1,672 | 1,840 | 1,508 | 1,248 |
| Income before income taxes | 3,332 | 3,179 | 2,460 | 3,488 | 3,188 |
| Provision for income taxes | 1,184 | 1,144 | 1,012 | 1,171 | 1,060 |
| Cumulative effect of change in accounting principle | 0 | 0 | 131 | 0 | 0 |
| Net income | $ 2,148 | $ 2,035 | $ 1,317 | $ 2,317 | $ 2,128 |
| Earnings per share (1) | $.27 | N/A | N/A | N/A | N/A |

</TABLE>

<TABLE>
<CAPTION>

| | | | At September 30, | | |
|---|---|---|---|---|---|
| | 1996 | 1995 | 1994 | 1993 | 1992 |
| | | | (In thousands) | | |
| <S> | <C> | <C> | <C> | <C> | <C> |
| BALANCE SHEET DATA: | | | | | |
| Total assets | $204,017 | $162,042 | $154,600 | $147,909 | $141,799 |
| Loans receivable, net | 117,631 | 97,988 | 84,269 | 84,429 | 84,657 |
| Mortgage-backed and related securities | 50,974 | 31,071 | 33,755 | 29,043 | 28,537 |
| Securities | 28,893 | 27,890 | 30,146 | 15,615 | 10,429 |
| Deposits | 131,740 | 134,555 | 131,989 | 129,035 | 125,507 |
| Stockholders' equity | 67,139 | 23,427 | 20,394 | 17,650 | 15,200 |

| | | | Year Ended June 30, | | |
|---|---|---|---|---|---|
| | 1996 | 1995 | 1994 | 1993 | 1992 |
| | | | (In thousands) | | |
| KEY OPERATING DATA: | | | | | |
| Return on average assets | 1.1% | 1.3% | 0.9% | 1.6% | 1.6% |
| Return on average equity | 4.4 | 9.4 | 7.0 | 14.0 | 15.0 |
| Average equity to average assets | 26.2 | 13.6 | 12.4 | 11.1 | 10.4 |
| Dividend payout ratio (1) | 57.9 | N/A | N/A | N/A | N/A |
| Number of offices | 1 | 1 | 1 | 1 | 1 |

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</TABLE>

(1) Earnings per share and dividend payout ratio are presented from the conversion date, March 25, 1996.

## ITEM 5.--MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### General

As is the case with most savings institutions, the profitability of the Savings Bank depends primarily on its net interest income, which is the difference between interest and dividend income on interest-earning assets, principally loans, mortgage-backed securities and investment securities, and interest expense on interest-bearing deposits. The Savings Bank's net earnings also is dependent, to a lesser extent, on the level of provision for loan losses, its non-interest income and non-interest expenses, such as compensation and benefits, occupancy and equipment, deposit insurance premiums, and miscellaneous other expenses, as well as provisions for federal and state income tax.

### Business Strategy

The Company's goal is to continue to serve its Primary Market Area as an independent, consumer-oriented financial institution dedicated to financing home ownership and providing needed financial services to its customers in an efficient manner. The principal components of its business strategy are discussed below.

Emphasis on Traditional Lending in its Primary Market Area. The Savings Bank is a traditional savings bank operating in northeastern Mississippi. The Savings Bank's primary lending emphasis has been the origination for portfolio of one-to-four family residential first mortgage loans. The Savings Bank generally limits its lending activities to its Primary Market Area. The Savings Bank believes that it has a substantial market share in Lee County and competitive market shares in the other counties in which it operates, both with respect to deposits and first mortgage loans. In order to offer a broader array of loan products to its customers, in fiscal 1995 the Savings Bank began to originate automobile and commercial loans.

Interest Rate Risk Management. The Savings Bank has actively sought to reduce vulnerability of its operations to changes in interest rates by managing the imbalance between its

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interest-earning assets and interest-bearing liabilities with shorter-term and more liquid securities and other investments. To achieve this goal, the Savings Bank has invested new funds from deposit growth and earnings and funds from repayments of loans and securities into mortgage-backed securities and collateralized mortgage obligations ("CMO") and government-related securities with a maturity or average life of five years or less. Moreover, the automobile and commercial loans that the Savings Bank began to originate in fiscal 1995 will add additional shorter-term loans that will be held in the Savings Bank's loan portfolio.

Maintain Asset Quality. Management believes that high asset quality is a key to long-term financial success. As a result, the loans which are emphasized by the Savings Bank and its related policies and practices are intended to maintain a high level of asset quality and reduced credit risk. At September 30, 1996, the Savings Bank's non-performing assets, which consist of non-accrual loans, accruing loans greater than 90 days delinquent and real estate acquired through foreclosure or by deed-in-lieu thereof, amounted to $717,000 or 0.35% of the Savings Bank's total assets.

High Levels of Regulatory Capital and Moderate Growth. The Savings Bank seeks to maintain high levels of regulatory capital to give it maximum flexibility in the changing regulatory environment and to respond to changes in the market and economic conditions. These levels of capital have been achieved through the conversion and consistent earnings enhanced by low levels of non-interest expenses at the Savings Bank's single office and have been maintained at those high levels as a result of its policies of moderate growth generally confined to its Primary Market Area. At September 30, 1996, the Savings Bank's tangible, core and risk-based capital ratios amounted to 22.8%, 22.8%, and 50.8%, respectively, which exceeded the minimum requirements of 1.5%, 3.0%, and 8.0%, respectively.

Low Non-Interest Expense. The Savings Bank's non-interest expenses were 1.6% of average total assets for the fiscal year ended September 30, 1996 and have averaged approximately 1.1% of average total assets annually for each of the five fiscal years in the period ended September 30, 1996. A principal factor in the Savings Bank's low-level of non-interest expenses is its single office operation.

Asset/Liability Management

The ability to maximize net interest income is largely dependent upon the achievement of a positive interest rate spread that can be sustained during fluctuations in prevailing

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interest rates. Interest rate sensitivity is a measure of the difference between amounts of interest-earning assets and interest-bearing liabilities which either reprice or mature within a given period of time. The difference, or the interest rate repricing "gap," provides an indication of the extent to which an institution's interest rate spread will be affected by changes in interest rates. A gap is considered positive when the amount of interest-rate sensitive assets exceeds the amount of interest-rate sensitive liabilities, and is considered negative when the amount of interest-rate sensitive liabilities exceeds the amount of interest-rate sensitive assets maturing or repricing within a given period. Generally, during a period of rising interest rates, a negative gap within shorter maturities would adversely affect net interest income, while a positive gap within shorter maturities would result in an increase in net interest income, and during a period of falling interest rates, a negative gap within shorter maturities would result in an increase in net interest income while a positive gap within shorter maturities would have the opposite effect.

The lending activities of savings associations have historically emphasized long-term, fixed-rate loans secured by one-to-four family residences, and the primary source of funds of such institutions has been deposits. The deposit accounts of savings associations generally bear interest rates that reflect market rates and largely mature or are subject to repricing within a short period of time. This factor, in combination with substantial investments in long-term, fixed-rate loans, has historically caused the income earned by savings associations on their loan portfolios to adjust more slowly to changes in interest rates than their cost of funds. In addition, during the 1980s, the Savings Bank sold a small percentage of the mortgage loans it originated to FNMA but retained the servicing on such loans. The Savings Bank no longer actively sells loans with servicing rights retained. As a result, the servicing portfolio has decreased from $5.7 million at September 30, 1993 to $2.2 million at September 30, 1996 due to principal repayments. See Note 5 of the Notes to Financial Statements.

The Savings Bank originates both fixed- and adjustable-rate residential real estate loans as market conditions dictate. In the current interest rate environment, it generally offers fixed-rate loans up to a 15-year term and adjustable-rate loans with a maximum term of 30 years. All of the adjustable-rate loans in the Savings Bank's loan portfolio are indexed to the National Average Mortgage Rate Index, published by the FHLB System monthly and are adjusted on an annual basis after an initial fixed-rate period of up to three years. While the Savings Bank does not currently sell any of its

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adjustable-rate one-to-four family residential loans, a substantial portion of such loans in the Savings Bank's portfolio would qualify for sale and securitization under FHLMC, FNMA, and Government National Mortgage Association ("GNMA") guidelines. At September 30, 1996, $45.6 million or 44.8% of the Savings Bank's loans, before net items, were fixed-rate one-to-four family residential mortgages, and $56.4 million or 55.2% were adjustable-rate one-to-four family residential first mortgage loans. All of these adjustable loans have interest rates that adjust annually after an initial fixed-rate period of up to three years with a substantial majority first adjusting two years after origination.

As market demand for adjustable-rate mortgage loans has decreased, the Savings Bank has combined origination of shorter-term fixed-rate loans and one-year adjustable loans with the purchase of low-risk CMOs and government-related securities with a maturity or average life of five years or less or with adjustable rates and investment in mutual funds. All of the Savings Bank's CMOs are backed by U.S. government securities and are first-tranche CMO investments to minimize risk. The Savings Bank's mutual fund portfolio consists of funds backed by short-term U.S. government securities and adjustable-rate loans secured by one-to-four family residences. In addition, during fiscal 1996 and 1995, respectively, $1,307,000 and $845,000 of the Savings Bank's automobile loans were originated by the Savings Bank. Previously, during fiscal 1994, 1993, and 1992 the Savings Bank purchased a total of $2.9 million of automobile loans with contractual terms ranging from one to four years. During fiscal 1995, the Savings Bank also began to originate one to four family residential short-term Balloon mortgages, one to four family residential bridge loans and commercial loans. Emphasis on shorter term and adjustable-rate loans and shorter term securities helps the Savings Bank limit its exposure to rising interest rates.

The Savings Bank anticipates continuing to follow this policy of investing in shorter-term securities and loans for as long as long-term interest rates remain at their current level or lower and will reevaluate it if there is a material and prolonged rise in interest rates. Notwithstanding the foregoing, however, because the Savings Bank's interest-bearing liabilities which mature or reprice within short periods exceed its earning assets with similar characteristics, material and prolonged increases in interest rates generally would adversely affect net interest income, while material and prolonged decreases in interest rates generally, but to a lesser extent because of their historically low levels, would have a positive effect on net interest income.

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At June 30, 1996, based on the most recent available information provided by the OTS, it was estimated, on an unaudited basis, that the Bank's net portfolio value ("NPV") (the net present value of the Bank's cash flows from assets, liabilities, and off-balance sheet items) would decrease 6%, 12%, 21%, and 29% and increase 5%, 10%, 12%, and 15% in the event of 1%, 2%, 3%, and 4% increases and decreases in market interest rates, respectively. These calculations indicate that the Bank's NPV could be adversely affected by increases in interest rates but could be favorably affected by decreases in interest rates. Computations of prospective effects of hypothetical interest rate changes are based on numerous assumptions, including relative levels of market interest rates, prepayments, and deposit run-offs and should not be relied upon as indicative of actual results. Certain shortcomings are inherent in such computations. In order to mitigate its interest rate risk, the Bank maintains substantial capital levels that management believes are sufficient to sustain unfavorable movements in market interest rates.

The OTS uses the NPV calculation to monitor institutions' interest rate risk exposure ("IRR"). The OTS has promulgated regulations regarding a required adjustment to an institution's risk-based capital based on IRR. The application of the OTS' methodology quantifies IRR as the change in the NPV which results from a theoretical 200 basis point increase or decrease in market interest rates. If the NPV from either calculation would decrease by more than 2% of the present value of the institution's assets, the institution must deduct 50% of the amount of the decrease in excess of such 2% in the calculation of risk-based capital. The IRR regulations were originally effective as of January 1, 1994, subject to a two quarter "lag" time between the reporting date of the data used to calculate an institution's interest rate risk and the effective date of each quarter's interest rate risk component. However, the Director of the OTS indicated that it would waive the capital deductions for institutions with a greater than "normal" risk until the OTS publishes an appeals process. If implemented, the Savings Bank would still have exceeded the regulatory requirement.

Changes in Financial Condition

At September 30, 1996, the Company's assets totaled $204.0 million, as compared to $162.0 million at September 30, 1995. Total assets increased by $42.0 million, or 25.9%, from September 30, 1995 to September 30, 1996. The increase in total assets during this period was principally funded through $41.4 million in net proceeds from the stock offering.

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The increase in total assets at September 30, 1996 was due primarily to a $19.6 million, or 20.0% increase in the Savings Bank's loans receivable, net and a $20.6 million, or 35.5% increase in securities. The $19.6 million increases were the result of the Company's election to invest a substantial portion of its new and excess funds into loans, especially one-to-four family residential, construction and consumer loans and securities.

During the fiscal year ended September 30, 1996, total deposits decreased by $2.8 million, or 2.1%, to $131.7 million. This decrease was the results of withdrawals from deposit accounts maintained with the Savings Bank for payment of The Company's common stock during the stock offering. Primarily, as a result ofthe stock offering and an increase in unrealized gain on securities available for sale, net of deferred taxes, of $642,000, the Company's equity increased by $43.7 million to $67.1 million at September 30, 1996 compared to $23.4 million at September 30, 1995.

Results of Operations for the Years Ended September 30, 1996, 1995, and 1994

The Company had net income of $2.1 million for the year ended September 30, 1996 compared to net income of $2.0 million for fiscal 1995. The $100,000 increase in net income represented a 4.9% increase over fiscal 1995. Net income for fiscal 1996 was materially affected by a one time special assessment to recapitalize the Savings Association Insurance Fund ("SAIF"). Net Income would have been approximately $2.6 million for the year ended September 30, 1996, a $600,000 or 29.5% increase over fiscal year ended September 30, 1995, had the Bank not paid $863,000, $535,000 net of taxes benefit, for this one time assessment. The Company's net income of $2.0 million for the fiscal year ended September 30, 1995 represented an increase of $700,000 or 54% over fiscal 1994. Net income for fiscal 1994 was materially affected by three one-time events: (1) the $1.2 million special interest payment, (2) the $382,000 stock offering expense, and (3) a $744,000 gain on the sale of FHLMC stock from the Company's available for sale portfolio sold to partially fund the special interest payment. But for these events, the Company's net income for fiscal 1994 would have been $1.8 million and net income for fiscal 1995 would have increased by approximately $200,000 or 15.4% as compared to fiscal 1994.

Net Interest Income. The Company's net interest income is determined by its interest rate spread (i.e., the difference between the yields earned on its interest-earning assets and the rates paid on its interest-bearing liabilities) and the relative amounts of interest-earning assets and interest-bearing liabilities.

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Total interest income increased by $2.1 million, or 19.4%, in the fiscal year ended September 30, 1996 compared to fiscal 1995. The increase was due primarily to a $1.5 million or 21.6% increase in interest and fees on loans receivable as the average balance increased by $13.6 million or 15.0% and the average interest rate earned on loans increased 0.44% to 8.20%. Interest income and dividends on securities held to maturity and securities available for sale (including, mortgage backed securities, CMO, Mutual Funds, and government-related securities) increased $320,000 or 8.5% resulting from an increase in the average balance of $9.0 million or 15.5%, while the average yield decreased from 6.35% to 5.96%. Interest income from other interes earning assets increased $244,000 or 110.0% as the average balance increased $5.1 million while the average yield declined form 5.33% to 5.03%.

Total interest income increased by $1.0 million, or 10.0%, for the fiscal year ended September 30, 1995 compared to the fiscal year ended September 30, 1994. This increase was due primarily to a $588,000, or 9.1%, increase in interest and fees on loans as the average balance increased by $7.6 million or 9.1% while the average interest rate earned on loans remained 7.76%. Interest income on mortgage-backed and related securities (including collateralized mortgage obligations) increased $143,000 or 7.3%, primarily resulting from an increase in the average yield from 5.63% to 6.45%. Interest income and dividends on securities (including mutual funds and mortgage-backed securities available for sale) increased by $460,000 or 38.2% for fiscal year 1995 compared to fiscal year 1994 as the average balance increased by $5.1 million or 23.7% and the average yield increased to 6.22% from 5.57%. Interest income from other interest-earning assets fell $185,000, or 45.6%, to $221,000 for 1995 as a result of a 62.5% decline in the average balance to $4.1 million.

Total interest expense increased by $682,000, or 10.9%, in fiscal year ended September 1996 compared to fiscal year ended September 30, 1995. Such increase was primarily the result of a a 50 basis point (1.0% equaling 100 basis points) increase in the average rate paid on interest bearing liabilities in response to market conditions. The increase of $2.2 million on average balance of deposits was offset by the decrease of $2 million in average balance of FHLB advances that the Savings Bank obtained from FHLB of Dallas in fiscal year 1995.

Interest expense on deposits and borrowings decreased by $171,000, or 2.7%, during the fiscal year ended September 1995 compared to fiscal 1994. Such decrease was due primarily to a decrease in interest paid on deposits, as a result of 22 basis point decrease in the average rate paid. The decrease in interest paid on deposits was partially offset by the $148,000 o finterest paid on FHLB

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advances that the Savings Bank obtained from the FHLB of Dallas during fiscal 1995. The Savings Bank borrowed from the FHLB of Dallas to meet short-term liquidity needs at interest rate that were lower than funds then available in its traditional deposit market.

The Savings Bank's net interest income increased by $1.5 million, or 30.6%, in fiscal 1996 compared to fiscal 1995. The Savings Bank's interest rate spread was 2.04% in fiscal 1996 as compared to 2.49% in fiscal 1995. The changes in the interest rate spread during the period were primarily the result of a slightly increasing interest rate environment in which the Savings Bank's interest-earning assets increased less rapidly than interest-bearing liabilities.

As a result of the foregoing, the Savings Bank's net interest income increased by $1.2 million, or 32.9%, during the fiscal year ended September 30, 1995 compared to fiscal 1994. The Savings Bank's interest rate spread was 2.49% for the fiscal year ended September 30, 1995 compared to 1.81% for the fiscal year ended September 30, 1994. However, but for the special interest payment in fiscal 1994, net interest income would have been $4.8 million and the interest rate spread for fiscal 1994 would have been 2.74%.

Provision for Loan Losses. The Savings Bank's provision for loan losses was $20,000 during the fiscal year ended September 30, 1996 compared to $30,000 and $25,000 during fiscal 1995 and 1994, respectively. Provisions for loan losses are charged to earnings to bring the total allowance to a level deemed appropriate by management based on the volume and type of lending conducted by the Savings Bank. Provisions in fiscal 1995 and 1996 were made in order to adjust the allowance for the increased volume of mortgage loans as well as the expansion of consumer and commercial lending. Commercial and consumer loans traditionally have a higher rate of default and are secured by collateral that often depreciates or is less liquid than the real estate securing mortgage loan.

The Savings Bank's methodology for evaluating the adequacy of its allowance for loan losses, which conforms with GAAP, considers collateral valuation, changes in the loan portfolio mix and certain economic indicators, causing it to be a leading indicator of inherent risk in the loan portfolio. Accordingly, it is not necessarily reflective of past trends in charge-offs and other factors. The methodology incorporates economic indicators such as growth in personal income and unemployment rates as well as other economic indicators affecting the Savings Bank's market area and considers higher risk loan groups, including growth in the

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Savings Bank's consumer and multi-family and non-residential loan portfolios.

Non-Interest Income. Non-interest income was $188,000 in fiscal 1996, an increase of $56,000, or 42.4%, compared to non-interest income of $132,000 in fiscal 1995. The primary difference in non-interest income between fiscal 1996 and fiscal 1995 was the $55,000 net gain on the sale of securities in fiscal 1996 compared to a $0 net gain on the sale of securities in fiscal 1995. Non-interest income amounted to $132,000 for the fiscal year ended September 30, 1995 compared to $752,000 for fiscal 1994. The decrease was due primarily to a $646,000 decrease in net gains on sales of securities. The gains on sales of securities in fiscal 1994 were primarily the result of the sale of FHLMC stock from the Savings Bank's available for sale portfolio that was sold in order to partially fund the special interest payment.

Non-Interest Expenses. The primary reasons for the increase in non-interest expenses in fiscal 1996 compared to fiscal 1995 were the $863,000 one-time special assessment of 65.7 basis points on SAIF insured deposits as of March 31, 1995 and the $314,000 increase in compensation and benefits which resulted from increased personnel, merit raises, and $220,000 in ESOP expense which was new in fiscal 1996. Non-interest expenses amounted to $1.7 million during the fiscal year ended September 30, 1995, a $168,000, or 9.1%, decrease over the $1.8 million of non-interest expenses during the year ended September 30, 1994. Non-interest expenses during the year ended September 30, 1994 exceeded non-interest expenses in fiscal 1993 by $332,000 or 22.0%. The primary reason for the decrease in non-interest expenses in fiscal 1995 compared to fiscal 1994 was the decrease of $339,000 or 45.4% in other expenses which were partially offset by an increase of $145,000 or 20.9% in compensation and benefits. Other expenses decreased substantially in fiscal 1995 compared to fiscal 1994 because of the $382,000 stock offering expense incurred in fiscal 1994. The primary reasons for the 1995 increase in the compensation and benefits expense were a modification in the formula used to calculate annual bonus payments from 7% to 15% of total salaries and the addition of two employees including Vice President Mark Burleson to head the consumer and commercial lending department.

Income Taxes. The provision for income taxes was $1.2 million, $1.1 million, and $1.0 million in fiscal 1996, 1995, and 1994, respectively. The changes in such respective amounts primarily reflect the fluctuations in levels of income before income taxes of the Company during those fiscal years of $3.3 million, $3.2 million, and $2.5 million, respectively. See Note 10 of the Notes to Consolidated Financial Statements.

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## Liquidity and Capital Resources

The Savings Bank is required under applicable federal regulations to maintain specified levels of "liquid" investments in qualifying types of United States Government, federal agency, and other investments having maturities of five years or less. Current OTS regulations require that a savings association maintain liquid assets of not less than 5% of its average daily balance of net withdrawable deposit accounts and borrowings payable in one year or less, of which short-term liquid assets must consist of not less than 1%. Monetary penalties may be imposed for failure to meet applicable liquidity requirements. At September 30, 1996, the Savings Bank's liquidity, as measured for regulatory purposes, was in excess of the minimum OTS requirement.

Cash was generated by the Savings Bank's operating activities during the years ended September 30, 1996, 1995, and 1994, primarily as a result of net income. The adjustments to reconcile net income to cash provided by operating activities during the periods presented consisted primarily of amortization of premiums and discounts, proceeds from the sale of loans, and increases or decreases in interest and dividends receivable, prepaid income taxes, accrued interest payable, and accrued expenses and other liabilities. The primary investing activity of the Savings Bank is lending, which is funded with cash provided by operations, as well as principal collections and maturities of interest-bearing deposits in banks. For additional information about cash flows from the Savings Bank's operating, financing, and investing activities, see the Statements of Cash Flows included in the Consolidated Financial Statements.

At September 30, 1996, the Savings Bank had outstanding $2.1 million in commitments to originate loans and $1.4 million in commitments under unadvanced construction loans. At the same date, the total amount of certificates of deposit which are scheduled to mature by September 30, 1997 was $88.4 million. The Savings Bank believes that it has adequate resources to fund commitments as they arise and that it can adjust the rate on savings certificates to retain deposits in changing interest rate environments. If the Savings Bank requires funds beyond its internal funding capabilities, advances from the FHLB of Dallas are available as an additional source of funds.

The Savings Bank is required to maintain specified amounts of capital pursuant to OTS regulations. The capital standards generally require the maintenance of regulatory capital sufficient to meet a tangible capital requirement, a core

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capital requirement, and a risk-based requirement. At September 30, 1996, the Savings Bank's tangible and core capital totaled $41.8 million, or 22.8% of adjusted total assets, which exceeded the respective minimum requirements at that date by approximately $39.1 million and $36.3 million, respectively, or 21.3% and 19.8% of total assets, respectively. The Savings Bank's risk-based capital totaled $42.4 million at September 30, 1996, or 50.8% of risk-weighted assets, which exceeded the current requirement of 8.0% by approximately $35.7 million, or 42.8% of risk-weighted assets.

Pending Accounting Pronouncements

In March 1995, the Financial Accounting Standards Board ("FASB") issued SFAS No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed of. SFAS No. 121 establishes accounting standards for the impairment and disposal of long-lived assets and certain identifiable intangibles. It requires that such assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If the review for recoverability, based on undiscounted expected future cash flows, indicates that impairment exists, the loss should be measured based on the fair value of the asset. The Company adopted SFAS No. 121, as was required, effective October 1, 1996, with no significant impact on the Company's financial position or on the results of its operations as long-lived assets are not significant.

In May 1995, the FASB issued SFAS No. 122, Accounting for Mortgage Servicing Rights, an amendment to SFAS No. 65. This statement eliminates the accounting distinction between rights to service mortgage loans for others that are acquired through loan origination activities and those acquired through purchase transactions. The Company adopted SFAS No. 122, as was required, effective October 1, 1996 with no impact on the financial statements as the Company is not currently participating in the sale or securitization of any loans in its loan portfolio.

In October 1995, the FASB issued SFAS No. 123, Accounting for Stock-Based Compensation. SFAS No. 123 established a fair value based method for accounting for stock based compensation plans but still granted entities the option of accounting for stock based compensation plans under the provisions of APB Opinion No. 25 if they provide disclosures required by SFAS No. 123. The Company adopted the provisions of this Standard, as was required, effective October 1, 1996, and elected to account for these plans under the provisions of APB No. 25 and will provide the required disclosures in future periods.

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In June 1996, the FASB issued SFAS No. 125, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.  SFAS No. 125 provides accounting and reporting standards for transfers and servicing of financial assets and extinguishments of liabilities based on consistent application of a financial-components approach that focuses on control.  Under that approach, after a transfer of financial assets, an entity recognizes the financial and servicing assets it controls and the liabilities it has incurred, derecognizes financial assets when control has been surrendered, and derecognizes liabilities when extinguished.

This statement is effective for transfers and servicing of financial assets and extinguishments of liabilities occurring after December 31, 1996, and is to be applied prospectively. Earlier or retroactive application is not permitted.
The Company will adopt the provisions of the Standard on January 1, 1997.  Based on the Company's current operating activities, management does not believe that the adoption of this statement will have a material impact on the Company's financial condition or results of operations.

Impact of Inflation and Changing Prices

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

Unlike most industrial companies, virtually all of the Savings Bank's assets and liabilities are monetary in nature.  As a result, interest rates generally have a more significant impact on a financial institution's performance than does the effect of inflation.

Average Balance, Interest, and Average Yields and Rates

The following table sets forth certain information relating to the Company's average interest-earning assets and interest-bearing liabilities and reflects the average yield on assets and the average cost of liabilities for the periods and at the date indicated.  Such yields and costs are derived by dividing income or expense by the average monthly balance of assets or liabilities, respectively, for the periods indicated.

The table also presents information for the periods indicated

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and at September 30, 1996 with respect to the difference between the weighted average yield earned on interest-earning assets and the weighted average rate paid on interest-bearing liabilities, or "interest rate spread," which savings institutions have traditionally used as an indicator of profitability. Another indicator of an institution's net interest income is its "net yield on interest-earning assets." which is its net interest income divided by the average balance of interest-earning assets. Net interest income is affected by the interest rate spread and by the relative amounts of interest-earning assets and interest-bearing liabilities. When interest-earning assets approximate or exceed interest-bearing liabilities, any positive interest rate spread will generate net interest income.

<TABLE>
<CAPTION>

| | As of September 30, 1996 | Year Ended September 30, 1996 | | |
|---|---|---|---|---|
| | Weighted Yield/Rate | Average Balance | Interest | Yield/ Rate |
| | | (Dollars in thousands) | | |
| <S> | <C> | <C> | <C> | <C> |
| Interest-earning assets: | | | | |
| Loans receivable, net | 7.83 | 104,425 | 8,563 | 8.20 |
| Mortgage-backed and related securities (1) | 6.57 | 41,171 | 2,658 | 6.46 |
| Securities (2) | 6.08 | 27,167 | 1,416 | 5.21 |
| Other interest-earning assets (3 | 4.00 | 9,242 | 465 | 5.03 |
| Total interest-earning assets | 7.25 | 182,005 | 13,102 | 7.20 |
| Non-interest-earning assets: | | 5,214 | | |
| Total assets | | 187,219 | | |
| Interest-bearing liabilities: | | | | |
| Transaction accounts | 2.99 | 26,507 | 621 | 2.79 |
| Certificates of deposit | 5.41 | 107,848 | 6,309 | 5.84 |
| Borrowings | 0.00 | 250 | 19 | 7.60 |
| Total interest-bearing liabilities | 5.08 | 134,605 | 6,949 | 5.16 |
| Non-interest-bearing | | | | |

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| | | | | |
|---|---|---|---|---|
| liabilities | | 3,531 | | |
| Total liabilities | | 138,136 | | |
| Equity | | 49,083 | | |
| Total liabilities and equity | | 187,219 | | |
| Net interest income; interest rate spread | 2.17 | | 6,153 | 2.04 |
| Net interest margin (4) | | | | 3.38 |
| Average interest-earning assets to average interest-bearing liabilities | | | | 135.21 |

<CAPTION>

| <S> | Year Ended September 30, 1995<br>Average Balance<br><C> | <br>Interest<br><C> | <br>Yield/ Rate<br><C> |
|---|---|---|---|
| Interest-earning assets: | | | |
| Loans receivable, net | $ 90,778 | $ 7,041 | 7.76% |
| Mortgage-backed and related securities (1) | 32,422 | 2,092 | 6.45 |
| Securities (2) | 26,721 | 1,662 | 6.22 |
| Other interest-earning assets (3) | 4,149 | 221 | 5.33 |
| Total interest-earning assets | $154,070 | $11,016 | 7.15 |
| Non-interest-earning assets | 5,288 | | |
| Total assets | $159,358 | | |
| Interest-bearing liabilities: | | | |
| Transaction accounts | $ 19,823 | $ 549 | 2.77 |
| Certificates of deposit | 112,278 | 5,570 | 4.96 |
| Borrowings | 2,333 | 148 | 6.34 |
| Total interest-bearing liabilities | $134,434 | $ 6,267 | 4.66 |
| Non-interest-bearing liabilities | 3,209 | | |
| Total liabilities | $137,643 | | |
| Equity | 21,715 | | |
| Total liabilities and equity | $159,358 | | |
| Net interest income; interest rate spread | | $ 4,749 | 2.49% |
| Net interest margin (4) | | | 3.08% |
| Average interest-earning assets to average interest-bearing liabilities | | | 114.61% |

<CAPTION>

| | Year Ended September 30, 1994 (5)<br>Average Balance | <br>Interest | <br>Yield/ Rate |
|---|---|---|---|

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<S> <C> <C> <C>

| | | | |
|---|---|---|---|
| Interest-earning assets: | | | |
| Loans receivable, net | $ 83,178 | $ 6,453 | 7.76% |
| Mortgage-backed and related secruties (1) | 34,585 | 1,948 | 5.63 |
| Securities (2) | 21,598 | 1,203 | 5.57 |
| Other interest-earning assets (3) | 11,050 | 406 | 3.67 |
| Total interest-earning assets | $150,411 | $10,011 | 6.66% |
| Non-interest-earning assets | 2,601 | | |
| Total assets | $153,012 | | |
| Interest-bearning liabilities: | | | |
| Transaction accounts | $ 26,179 | $ 925 | 3.53% |
| Certificates of deposit | 106,357 | 5,513 | 5.18 |
| Borrowings | 0 | 0 | 0 |
| Total interest-bearing liabilities | $132,536 | $ 6,438 | 4.85% |
| Non-interest-bearing liabilities | 1,527 | | |
| Total liabilities | $134,063 | | |
| Equity: | 18,949 | | |
| Total liabilities and equity | $153,012 | | |
| Net interest income; interest rate spread | | $ 3,573 | 1.81% |
| Net interest margin (4) | | | 2.37% |
| Average interest-earning assets to average interest-bearing liabilities | | | 113.49% |

</TABLE>

(1) Consists of mortgage-backed and related securities available for sale and held to maturity.
(2) Consists of securities available for sale and securities held to maturity.
(3) Consists primarily of interest-bearing deposits.
(4) Net interest margin is net interest income divided by average interest-earning assets.
(5) Interest expense on deposits, net interest income, interest rate spread and the net interest margin were adversely affected by the $1.2 million special interest payment.

Rate/Volume Analysis

The following table describes the extent to which changes in interest rates and changes in volume of interest-related assets and liabilities have affected Community's interest income and expense during the periods indicated. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to (i) changes in volume (change in volume multiplied by prior year rate), (ii) changes in rate (change in rate multiplied by prior year volume), and (iii) total change in rate and volume. The combined effect of changes in both rate and volume has been allocated proportionately to the change due to rate and

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the change due to volume.

<TABLE>
<CAPTION>

| <S> | 1996 Compared to 1995 Inc (Dec) Due to Rate <C> | Inc (Dec) Due to Vol <C> | Total Inc (Dec) <C> | 1995 Compared to 1994 Inc (Dec) Due to Rate (In Thousands) <C> | Inc (Dec) Due to Vol <C> | Total Inc (Dec) <C> |
|---|---|---|---|---|---|---|
| Interest-Earning Assets: | | | | | | |
| Loans | 464 | 1,106 | 1,570 | 0 | 588 | 588 |
| Mortgage-backed and related securities(1) | 1 | 565 | 566 | 252 | (108) | 144 |
| Securities (2) | (274) | 28 | (246) | (428) | 887 | 459 |
| Other interest-earning assets | (12) | 256 | 244 | 178 | (363) | (185) |
| Total interest-earning assets | 179 | 1,955 | 2,134 | 2 | 1,004 | 1,006 |
| Interest-Bearing Liabilities: | | | | | | |
| Deposits and borrowings (3) | 675 | 8 | 683 | (248) | 77 | (171) |
| Increase (decrease) in net interest income (3) | (496) | 1,947 | 1,451 | 250 | 927 | 1,177 |

</TABLE>

| | 1994 Compared to 1993 Inc (Dec) Due to Rate | Inc (Dec) Due to Vol | Total Inc (Dec) |
|---|---|---|---|
| Interest-Earning assets: | | | |
| Loans | (619) | 74 | (545) |
| Mortgage-backed and related securities (1) | 6 | 7 | 13 |
| Securities (2) | 243 | 168 | 411 |

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| | | | |
|---|---|---|---|
| Other interest-earning assets | (45) | (99) | (144) |
| Total Interest-earning assets | (415) | 150 | (265) |
| Interest-Bearing Liabilities: | | | |
| Depostis and borrowings | 1,496 | (370) | 1,126 |
| Increase (decrease) in net interest income (3) | (1,911) | 520 | (1,391) |

(1) Consists of mortgage-backed and related securities available for sale and held to maturity.
(2) Consists of securities available for sale and securities held to maturity for 1995 and 1994.
(3) A special interest payment of $1.2 million in fiscal 1994 increased the rate of deposits and borrowings and decreased the net interest during that period.

Liquidity and Capital Resources

The Company continues to maintain a high level of liquid assets in order to meet its funding requirements. At September 30, 1996 the Company had approximately $4.2 million in cash on hand and interest-bearing deposits in other banks which represented 2.06$ of total assets. At September 30, 1996, the Company's level of liquid assets, as measured for regulatory compliance purposes was 9.47%, or $5.8 million, in excess of the minimum liquidity requirement of 5%.

At September 30, 1996, the Company had $67 million of total equity or 32.9% of total assets. The Company continues to exceed its regulatory capital requirements ratios at September 30, 1996. Tangible capital and core capital were $41.8 million, which represented 22.8% of adjusted total assets and risk-based capital was $42.4 million which represented 50.8% of total risk-weighted assets at September 30, 1996. Such amounts exceeded the minimum required ratios of 1.5%, 3.0%, and 8%, respectively, by 21.3%, 19.8%, and 42.8%, respectively. At September 30, 1996, the Company continued to meet the definition of a "well-capitalized" institution the highest of the five categories under the FDICIA prompt corrective action standards.

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COMMUNITY FEDERAL BANCORP, INC.

Consolidated Financial Statements
as of September 30, 1996 and 1995
Together With
Auditor's Report

## REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To Community Federal Bancorp, Inc.:

We have audited the accompanying consolidated statements of financial condition of Community Federal Bancorp, Inc. (a Delaware corporation) AND SUBSIDIARY as of September 30, 1996 and 1995 and the related consolidated statements of income, stockholders' equity, and cash flows for the three years in the period ended September 30, 1996. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Community Federal Bancorp, Inc. and Subsidiary at September 30, 1996 and 1995 and the results of their operations and their cash flows for each of the three years ended September 30, 1996, in conformity with generally accepted accounting principles.

Birmingham, Alabama
October 25, 1996

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<TABLE>
<CAPTION>

COMMUNITY FEDERAL BANCORP, INC.

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

AS OF SEPTEMBER 30, 1996 AND 1995

ASSETS

| <S> | 1996 <C> | 1995 <C> |
|---|---|---|
| CASH AND CASH EQUIVALENTS | $ 1,764,355 | $ 1,146,100 |
| INTEREST-BEARING DEPOSITS IN BANKS | 2,441,324 | 1,749,000 |
| SECURITIES AVAILABLE FOR SALE, at fair value | 75,111,784 | 25,124,584 |
| SECURITIES HELD TO MATURITY, at amortized Cost (estimated fair value of $4,625,305 and $33,501,362, respectively | 4,755,702 | 33,836,768 |
| LOANS RECEIVABLE, net | 117,630,885 | 97,988,023 |
| ACCRUED INTEREST AND DIVIDENDS RECEIVABLE | 1,343,947 | 1,159,165 |
| REAL ESTATE OWNED | 0 | 138,972 |
| PREMISES AND EQUIPMENT, net | 607,267 | 664,748 |
| PREPAID INCOME TAXES | 0 | 44,212 |
| OTHER ASSETS | 361,678 | 190,479 |
| TOTAL ASSETS | $204,016,942 | $162,042,051 |

LIABILITIES AND STOCKHOLDER'S EQUITY

| | 1996 | 1995 |
|---|---|---|
| DEPOSITS | $131,740,433 | $134,554,504 |
| FEDERAL HOME LOAN BANK ADVANCES | 0 | 1,000,000 |
| OTHER LIABILITIES: | | |
| Accrued interest payable | 616,422 | 663,472 |
| Advances from borrowers for taxes and insurance | 444,784 | 392,844 |
| Deferred income taxes payable | 1,893,037 | 1,559,229 |
| Income taxes payable | 9,376 | 0 |
| Accrued expenses and other liabilities | 2,173,994 | 445,102 |
| Total liabilities | 136,878,046 | 138,615,151 |

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COMMITMENTS AND CONTINGENCIES

| | | |
|---|---|---|
| STOCKHOLDERS'S EQUITY: | | |
| Preferred stock, no par value; 2,000,000 shares authorized; shares issued and outstanding--none | 0 | 0 |
| Common stock, par value $.01 per share; 10,000,000 shares authorized, 4,628,750 shares issued | 46,288 | 0 |
| Additional paid-in capital | 45,006,311 | 0 |
| Retained earnings | 22,511,930 | 21,030,744 |
| Unearned compensation | (3,464,110) | 0 |
| Unrealized gain on securities available for sale, net | 3,038,477 | 2,396,156 |
| Total stockholders' equity | 67,138,896 | 23,426,900 |
| Total liabilities and stockholders' equity | $204,016,942 | $162,042,051 |

</TABLE>

The accompanying notes are an integral part of these statements.

<TABLE>
<CAPTION>

COMMUNITY FEDERAL BANCORP, INC.

CONSOLIDATED STATEMENTS OF INCOME

FOR THE YEARS ENDED SEPTEMBER 30, 1996, 1005, AND 1994

| | 1996 | 1995 | 1994 |
|---|---|---|---|
| <S> | | | |
| INTEREST INCOME: | | | |
| Interest and fees on loans: | <C> | <C> | <C> |
| Mortgage loans | $ 8,217,595 | $ 6,706,168 | $ 6,300,230 |
| Consumer loans | 262,356 | 290,673 | 152,545 |
| Commercial loans | 130,510 | 43,870 | 0 |
| Interest and dividends on securities held to maturity | 824,987 | 1,432,584 | 3,151,376 |
| Interest and dividends on securities available for sale | 3,249,772 | 2,321,642 | 0 |
| Other interest income | 464,598 | 220,885 | 406,429 |
| Total interest income | 13,149,818 | 11,015,822 | 10,010,580 |
| INTEREST EXPENSE: | | | |
| Deposits | 6,930,124 | 6,119,346 | 6,438,131 |
| Other borrowings | 19,410 | 147,970 | 0 |
| Total interest expense | 6,949,534 | 6,267,316 | 6,438,131 |
| Net interest income | 6,200,284 | 4,748,506 | 3,572,449 |

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| | | | |
|---|---|---|---|
| PROVISION FOR LOAN LOSSES | 20,000 | 30,000 | 25,000 |
| Net interest income after provision for loan losses | 6,180,284 | 4,718,506 | 3,547,449 |
| NONINTEREST INCOME: | | | |
| Gain on sale of securities available for sale, net | 54,838 | 0 | 646,168 |
| Loan servicing fees | 67,254 | 62,971 | 62,995 |
| Other income | 65,656 | 69,428 | 43,215 |
| Total noninterest income | 187,748 | 132,399 | 752,378 |
| NONINTEREST EXPENSES: | | | |
| Compensation and benefits | 1,153,133 | 839,466 | 694,431 |
| Special SAIF assessment | 863,835 | 0 | 0 |
| Deposit insurance premium | 317,896 | 305,811 | 300,881 |
| Occupancy and equipment | 134,745 | 118,774 | 100,817 |
| Gain on real estate owned, net | (15,119) | (217) | (3,318) |
| Other expenses | 580,990 | 408,031 | 746,839 |
| Total noninterest expenses | 3,035,480 | 1,671,865 | 1,839,650 |
| Income before income taxes and cumulative effect of change in accounting principle | 3,332,552 | 3,179,040 | 2,460,177 |
| PROVISION FOR INCOME TAXES | 1,184,294 | 1,144,334 | 1,012,428 |
| INCOME BEFORE CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE | 2,148,258 | 2,034,706 | 1,447,749 |
| CUMULATIVE EFFECT AT OCTOBER 1, 1994 OF CHANGE IN ACCOUNTING FOR INCOME TAXES | 0 | 0 | 130,800 |
| NET INCOME | $ 2,148,258 | $ 2,034,706 | $ 1,316,949 |
| EARNINGS PER SHARE | $.27 | N/A | N/A |

</TABLE>

The accompanying notes are an integral part of these statements.

<TABLE>

<CAPTION>

COMMUNITY FEDERAL BANCOPR, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

FOR THE YEARS ENDED SEPTEMBER 30, 1996, 1995, AND 1994

| | Common Stock | Additional Paid-In Capital | Retained Earnings |
|---|---|---|---|

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| <S> | <C> | <C> | <C> |
|---|---|---|---|
| BALANCE, September 30, 1993 | 0 | 0 | $17,679,089 |
| Net income | 0 | 0 | 1,316,949 |
| Change in net unrealized depreciation on certain marketable equity securities | 0 | 0 | 0 |
| Unrealized gain on securities available for sale | 0 | 0 | 0 |
| BALANCE, September 30, 1994 | 0 | 0 | 18,996,038 |
| Net income | 0 | 0 | 2,034,706 |
| Change in unrealized gain on securities available for sale, net | 0 | 0 | 0 |
| BALANCE, September 30, 1995 | 0 | 0 | 21,030,744 |
| Net income | 0 | 0 | 2,148,258 |
| Change in unrealized gain (loss) on securities, due to the reclassification of securities from held to maturity to available for sale, net | 0 | 0 | 0 |
| Issuance of common stock | 46,288 | 44,954,433 | 0 |
| Change in unrealized gain on securities available for sale, net | 0 | 0 | 0 |
| Amortization of unearned compensation | 0 | 51,878 | 0 |
| Dividends declared ($.15 per share) | 0 | 0 | (667,072) |
| BALANCE, September 30, 1996 | $46,288 | $45,006,311 | $22,511,930 |

<CAPTION>

| <S> | Unearned Compensation <C> | Net Unrealized Depreciation on Certain Marketable Equity Securities <C> |
|---|---|---|
| BALANCE, September 30, 1993 | 0 | $(28,989) |
| Net Income | | |
| Change in net unrealized depreciation on certain marketable equity securities | 0 | 0 |
| Unrealized gain on securities available for sale | 0 | 28,989 |
| BALANCE, September 30, 1994 | 0 | 0 |
| Net income | 0 | 0 |
| Change in unrealized gain on securities available for sale, net | 0 | 0 |
| BALANCE, September 30, 1995 | 0 | 0 |
| Net income | 0 | 0 |
| Change in unrealized gain (loss) on securities, due to the reclassification of securities from held to maturity to | | |

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| | | |
|---|---|---|
| available for sale, net | 0 | 0 |
| Issuance of Common stock | (3,632,000) | 0 |
| Change in unrealized gain on securities available for sale, net | 0 | 0 |
| Amortization of unearned compensation | 167,890 | 0 |
| Dividends declared ($.15 per share) | 0 | 0 |
| BALANCE, September 30, 1996 | $(3,464,110) | 0 |

<CAPTION>

| <S> | Unrealized Gain on Securities Available for Sale, Net <C> | Total <C> |
|---|---|---|
| BALANCE, September 30, 1993 | $ 0 | $17,650,100 |
| Net income | 0 | 1,316,949 |
| Change in net unrealized depreciation certain marketable equity securities | 0 | 28,989 |
| Unrealized gain on securities available for sale | 1,398,075 | 1,398,075 |
| BALANCE, September 30, 1994 | 1,398,075 | 20,394,113 |
| Net income | 0 | 2,034,706 |
| Change in unrealized gain on securities available for sale, net | 998,081 | 998,081 |
| BALANCE, September 30, 1995 | 2,396,156 | 23,426,900 |
| Net income | 0 | 2,148,258 |
| Change in unrealized gain (loss) on securities, due to the reclassification of securities from held to maturity to available for sale, net | (28,115) | (28,115) |
| Issurance of common stock | 0 | 41,368,721 |
| Change in unrealized gain on securities available for sale, net | 670,436 | 670,436 |
| Amortization of unearned compensation | 0 | 219,768 |
| Dividends declared ($.15) per share) | 0 | (667,072) |
| BALANCE, September 30, 1996 | $3,038,477 | $67,138,896 |

</TABLE>

The accompanying notes are an integral part of these statements.

<TABLE>
<CAPTION>

COMMUNITY FEDERAL BANCORP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

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FOR THE YEARS ENDED SEPTEMBER 30, 1996, 1995, AND 1994

| <S> | 1996 <C> | 1995 <C> | 1994 <C> |
|---|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | | |
| Net income | $ 2,148,258 | $ 2,034,706 | $1,316,949 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation | 63,832 | 55,961 | 43,084 |
| Deferred income tax provision (benefit) | (281,057) | 8,634 | 63,600 |
| Cumulative effect of change in accounting for taxes | 0 | 0 | 130,800 |
| Amortization of deferred loan fees and costs, net | 47,949 | 44,216 | 30,062 |
| Amortization of premiums and discounts, net | (84,616) | (96,389) | (137,354) |
| Amortization of unearned compensation | 219,768 | 0 | 0 |
| Provision for losses on loans | 20,000 | 30,000 | 25,000 |
| FHLB stock dividends | (72,589) | (70,900) | (44,700) |
| (Gain) loss on sale of loans | 0 | 1,444 | (200) |
| Loss on disposal of equipment | 0 | 1,299 | 0 |
| Gain on sale of securities available for sale, net | (54,838) | 0 | (646,168) |
| Loss on sale of interest bearing deposits | 0 | 558 | 0 |
| Gain on sale of real estate owned, net | (15,119) | 0 | (4,660) |
| Proceeds from sale of loans | 0 | 220,856 | 130,000 |
| Changes in assets and liabilities: | | | |
| Decrease (increase) in other assets | (171,199) | 8,727 | (42,576) |
| Decrease (increase) in interest and dividends receivable | (184,782) | (178,393) | (187,098) |
| Decrease (increase) in prepaid income taxes | 53,588 | 150,299 | 127,771 |
| Increase (decrease) in accrued interest payable | (47,050) | 303,178 | 31,699 |
| Increase (decrease) in accrued expenses and other liabilities | 1,728,892 | (64,534) | (20,189) |
| Total adjustments | 1,222,779 | 414,956 | (500,929) |
| Net cash provided by operating activities | 3,371,037 | 2,449,662 | 816,020 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | | |
| Proceeds from sale of real | | | |

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| | | | |
|---|---|---|---|
| estate owned | 190,000 | 0 | 426,000 |
| Proceeds from maturities of securities held to maturity | 1,921,600 | 3,075,834 | (5,298,025) |
| Proceeds from maturities, principal collections, and calls of securities available for sale | 13,165,134 | 3,595,826 | 0 |
| Proceeds from sales of securities held to maturity | 2,621,913 | 0 | 2,300,005 |
| (Purchase of) proceeds from maturities of interest-bearing deposits in banks, net | (692,324) | 490,393 | (655,932) |
| (Purchase of) proceeds from sale of property and equipment, net | (6,351) | (227,410) | (7,766) |
| Net change in real estate owned | (2,031) | 2,464 | (39,961) |
| Loan (originations) and principal repayments, net | (19,744,689) | (14,015,344) | 535,018 |
| Purchase of loans | 0 | 0 | (900,000) |
| Purchase of securities available for sale | (36,586,411) | 0 | 0 |
| Purchase of securities held to maturity | (559,141) | 0 | (13,407,706) |
| Net cash used by investing activities | (39,692,300) | (7,078,237) | (17,048,367) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | | |
| (Decrease) increase in customer deposits, net | (2,814,071) | 2,565,448 | 2,953,968 |
| Proceeds from (repayments of) FHLB advances, net | (1,000,000) | 1,000,000 | 0 |
| (Decrease) increase in advances from borrowers for taxes and insurance | 51,940 | 28,055 | (217) |
| Proceeds from stock offering | 41,368,721 | 0 | 0 |
| Dividends paid | (667,072) | 0 | 0 |
| Net cash provided by financing activities | 36,939,518 | 3,593,503 | 2,953,751 |
| Net increase (decrease) in cash and cash equivalents | 618,255 | (1,035,072) | (13,278,596) |
| CASH AND CASH EQUIVALENTS, beginning of year | 1,146,100 | 2,181,172 | 15,459,768 |
| CASH AND CASH EQUIVALENTS, end of year | $ 1,764,355 | $ 1,146,100 | $ 2,181,172 |

SUPPLEMENTAL CASH FLOW INFORMATION:

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| | | | |
|---|---|---|---|
| Cash paid for: | | | |
| Interest on deposits and other borrowings | $ 7,049,843 | $ 5,964,138 | $ 6,406,432 |
| Income taxes | $ 1,185,000 | $ 975,000 | $ 1,076,599 |
| SUPPLEMENTAL NONCASH INVESTING AND FINANCING ACTIVITIES: | | | |
| Transfer of mortgage loans to real estate owned | $ 33,878 | $ 0 | $ 358,884 |
| Change in net unrealized depreciation on certain marketable equity securities | $ 0 | $ 0 | $ 28,989 |
| Transfer of securities held for sale, securities, and mortgage-backed and related securities to securities available for sale at fair value | $ 0 | $ 0 | $27,105,810 |
| Change in unrealized net gain on securities available for sale, net of deferred taxes | $ 642,321 | $ 998,081 | $ 1,398,075 |
| Transfer of securities from held to maturity to available for sale at fair value | $27,758,607 | $ 0 | $ 0 |

</TABLE>

The accompanying notes are an integral part of these statements.

COMMUNITY FEDERAL BANCORP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 1996 and 1995

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
Organization, Nature of Operations, and Principles of Consolidation Community Federal Bancorp, Inc. (the "Company") was incorporated in the State of Delaware in November 1995, for the purpose of becoming a holding company to own all of

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the outstanding capital stock of Community Federal Savings Bank (the "Bank") upon the Bank's conversion from a federally chartered mutual savings association to a federally chartered stock savings association (the "Conversion"). The Bank was converted to a federally chartered stock organization in November 1995, through the sale of all of its common stock to the Company. The accounting for the conversion is in a manner similar to that utilized in a pooling of interests (see Note 18).

The accompanying consolidated financial statements include the accounts of the Company and the Bank. All significant intercompany balances and transactions have been eliminated in consolidation.

The Bank is primarily engaged in the business of obtaining funds in the form of various savings deposits products and investing those funds in mortgage loans or single family real estate and, to a lesser extent, in consumer and commercial loans. The Bank operates from its office in Tupelo, Mississippi, and originates the majority of its loans in its market area.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles 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 revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents of $1,764,355 and $1,146,100 at September 30, 1996 and 1995, respectively, consist of cash on hand of $155,000 and $135,000 at September 30, 1996 and 1995, respectively, and cash due from and on deposit with other financial institutions of $1,609,355 and $1,011,100 at September 30, 1996 and 1995, respectively. The cash due from and on deposit with other financial institutions primarily consisted of an interest-bearing account with the Federal Home Loan Bank ("FHLB").

Securities

Securities classified as securities held to maturity are carried at amortized cost, adjusted for amortization of premiums and accretion of discounts, using the level yield

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method over the estimated remaining life. The Company has the ability and positive intent to hold these securities to maturity.

All securities not considered held to maturity have been designated as available for sale and are carried at fair value. The unrealized difference between amortized cost and fair value on securities available for sale is exclude from earnings and is reported, net of deferred taxes, as a component of equity. Securities available for sale includes securities that Management intends to use as part of its asset/liability management strategy; or that may be sold in response to changes in interest rates, changes in prepayment risk, liquidity needs, or for other purposes.

Amortization of premium and accretion of discount are computed under the interest method. The adjusted cost of the specific security sold is used to compute gain or loss on the sale of securities.

On September 30, 1994, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 115, Accounting for Certain Investments in Debt and Equity Securities. In adopting SFAS No. 115, securities and mortgage-backed and related securities were classified as either available for sale or investment based on Management's current intent.

Loans Receivable

Loans receivable are stated at their unpaid principal balances, less the allowance for loan losses and net deferred loan origination fees and discounts.

The Bank ceases accrual of interest on substantially all loans when payment on a loan is in excess of 90 days past due. An allowance is established by a charge to interest income equal to all interest previously accrued but unpaid. Interest income is subsequently recognized only to the extent that cash payments are received until, in management's judgment, the borrower's ability to make periodic interest and principal payments is in accordance with the terms of the loan agreement; in which case the loan is returned to accrual status.

The allowance for loan losses is increased by charges to income and decreased by loan charge-offs, net of recoveries. The allowance for loan losses is maintained at a level which management considers adequate to absorb losses inherent in the loan portfolio at each reporting date. Management's estimation of this amount includes a review of all loans for which full collectibility is not reasonably assured and

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considers, among other factors, prior years' loss experience, economic conditions, distribution of portfolio loans by risk class, and the estimated value of the underlying collateral. Though management believes the allowance for loan losses to be adequate, ultimate losses may vary from their estimates. However, estimates are reviewed periodically and, as adjustments become necessary, they are reported in earnings in periods in which they become known.

The Bank adopted SFAS No. 114, Accounting by Creditors for Impairment of a Loan, and SFAS No. 118, Accounting by Creditors for Impairment of a Loan--Income Recognition and Disclosures, as of October 1, 1995. SFAS No. 114 requires that certain impaired loans be measured based on the present value of expected future cash flows discounted at the loans' original effective interest rate. As a practical expedient, impairment may be measured based on the loan's observable market price or the fair value of the collateral if the loan is collateral dependent. When the measure of the impaired loan is less than the recorded investment in the loan, the impairment is recorded through a provision added to the allowance for loan losses. The Bank had previously measured the allowance for loan losses using methods similar to those prescribed in SFAS No. 114. As a result of adopting these statements, no additional provision to the allowance for loan losses was required as of October 1, 1995. Because the Bank's loan portfolio consists primarily of one-to-four family residential mortgages and consumer installment loans, which are exempt from SFAS No. 114 when evaluated collectively for impairment as is done by the Bank, the Bank had no loans designated as impaired under the provisions of SFAS No. 114 at September 30, 1996.

Loan Origination Fees and Related Costs

Loan fees and certain direct costs of loan origination are deferred, and the net fee or cost is recognized as an adjustment to interest income using the level yield method over the contractual life of the loan.

Real Estate Owned

Real estate owned consists of properties sold under mortgage loans to facilitate sales of foreclosed properties. The recognition of gains and losses on the sale of real estate owned is dependent upon whether the nature and terms of the sale and future involvement of the Bank in the property meet certain requirements. If the transaction does not meet these requirements, income recognition is deferred and recognized under an alternative method in accordance with SFAS No. 66, Accounting for Sales of Real Estate.

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Real estate owned is carried at the lower of the recorded investment in the loan or the fair value of the property, less estimated costs of disposition. The recorded investment is the sum of the outstanding principal loan balance plus any accrued interest which has not been received and acquisition costs associated with the property less any write-down. Any excess of the recorded investment in the loan over the fair value of the underlying property is charged to the allowance for loan losses at the time of foreclosure. Subsequent to foreclosure, real estate owned is evaluated on an individual basis for changes in fair value. Future declines in the fair value of the asset, less costs of disposition below its carrying amount, increase the valuation allowance account. Future increases in the fair value of the asset, less costs of disposition above its carrying amount, reduce the valuation allowance account, but not below zero. Increases or decreases in the valuation allowance account are charged or credited to income. Costs relating to improvement of the property incurred subsequent to acquisition are capitalized, whereas costs relating to the holding of property are expensed. The amounts expensed in fiscal years 1996, 1995, and 1994 were $8,929, $457, and $1,140, respectively. The amounts capitalized in 1996, 1995, and 1994, were $2,031, $0, and $39,961, respectively.

Premises and Equipment

Land is carried at cost. Building, furniture, fixtures, and equipment are carried at cost, less accumulated depreciation. Building, furniture, fixtures, and equipment are depreciated using the straight-line or accelerated methods over the estimated useful lives of the assets. The estimated useful lives for furniture, fixtures, and equipment range from 3 to 20 years and for buildings and improvements range from 10 to 40 years.

Income Taxes

Effective October 1, 1993, the Company adopted SFAS No. 109, Accounting for Income Taxes. The Company had previously recorded income tax expense following SFAS No. 96, Accounting for Income Taxes. SFAS No. 109, as well as SFAS No. 96, requires the application of the asset and liability method of accounting for income taxes. The cumulative effect of adopting SFAS No. 109 was to decrease net income by $130,800 in fiscal year 1994.
Under the asset and liability method, balance sheet amounts of deferred income taxes are recognized on the temporary differences between the bases of assets and liabilities as measured by tax laws and their bases as reported in the

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financial statements. Recognition of deferred tax asset balance sheet amounts is based on management's belief that it is more likely than not that the tax benefit associated with certain temporary differences will be realized. Deferred tax expense or benefit is then recognized for the change in deferred tax liabilities or assets between periods. Under SFAS No. 109, the effect on deferred taxes of a change in tax rates is recognized in income in the period that includes the enactment date.

Pending Accounting Pronouncements

In March 1995, the Financial Accounting Standards Board ("FASB") issued SFAS No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed of. SFAS No. 121 establishes accounting standards for the impairment and disposal of long-lived assets and certain identifiable intangibles. It requires that such assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If the review for recoverability, based on undiscounted expected future cash flows, indicates that impairment exists, the loss should be measured based on the fair value of the asset. The Company adopted SFAS No. 121, as was required, effective October 1, 1996, with no significant impact on the Company's financial position or on the results of its operations as long-lived assets are not significant.

In May 1995, the FASB issued SFAS No. 122, Accounting for Mortgage Servicing Rights, an amendment to SFAS No. 65. This statement eliminates the accounting distinction between rights to service mortgage loans for others that are acquired through loan origination activities and those acquired through purchase transactions. The Company adopted SFAS No. 122, as was required, effective October 1, 1996 with no impact on the financial statements as the Company is not currently participating in the sale or securitization of any loans in its loan portfolio.

In October 1995, the FASB issued SFAS No. 123, Accounting for Stock-Based Compensation. SFAS No. 123 established a fair value based method for accounting for stock based compensation plans but still granted entities the option of accounting for stock based compensation plans under the provisions of APB Opinion No. 25 if they provide disclosures required by SFAS No. 123. The Company adopted the provisions of this Standard, as was required, effective October 1, 1996, and elected to account for these plans under the provisions of APB No. 25 and will provide the required disclosures in future periods.
In June 1996, the FASB issued SFAS No. 125, Accounting for

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Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. SFAS No. 125 provides accounting and reporting standards for transfers and servicing of financial assets and extinguishments of liabilities based on consistent application of a financial-components approach that focuses on control. Under that approach, after a transfer of financial assets, an entity recognizes the financial and servicing assets it controls and the liabilities it has incurred, derecognizes financial assets when control has been surrendered, and derecognizes liabilities when extinguished. This statement is effective for transfers and servicing of financial assets and extinguishments of liabilities occurring after December 31, 1996, and is to be applied prospectively. Earlier or retroactive application is not permitted. The Company will adopt the provisions of the Standard on January 1, 1997. Based on the Company's current operating activities, management does not believe that the adoption of this statement will have a material impact on the Company's financial condition or results of operations.

Earnings Per Share

Earnings per share for the period from March 25, 1996, the date of Conversion, to September 30, 1996, has been computed based on the earnings during that period and on the weighted average number of shares of common stock outstanding during that period. Common stock outstanding is comprised of issued shares less unallocated Employee Stock Ownership Plan ("ESOP") shares. The weighted average number of shares used for the period from March 25, 1996 through September 30, 1996, was 4,265,638. If earnings per share had been computed on a retroactive basis for the year ended September 30, 1996, recognizing earnings for the entire year, earnings per share would have been $.50 per share as compared to the $.27 per share reported in the accompanying consolidated statements of income.

Financial Statement Reclassification

The financial statements for prior years have been reclassified in order to conform with the 1996 financial statement presentation. The reclassification did not change total assets or net income in the prior year.

2. SECURITIES AVAILABLE FOR SALE

The amortized cost, gross unrealized gains and losses, and estimated fair value of securities available for sale at September 30, 1996 and 1995 are summarized as follows:

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<CAPTION>

| <S> | 1996 Amortized Cost <C> | Unrealized Gains <C> | Gross Unrealized Losses <C> | Gross Estimated Fair Value <C> |
|---|---|---|---|---|
| U.S. government and federal agencies bonds and notes | $14,989,610 | $ 1,620 | $ (121,030) | $14,870,200 |
| State and local bonds and notes | 1,121,920 | 0 | (158,380) | 963,540 |
| | 16,111,530 | 1,620 | (279,410) | 15,833,740 |
| Mortgage-backed and related securities: | | | | |
| GNMA certificates | 1,015,328 | 27,161 | 0 | 1,042,489 |
| FHLMC certificates | 14,118,927 | 99,323 | (179,651) | 14,038,599 |
| FNMA certificates | 8,759,029 | 2,789 | (156,029) | 8,605,789 |
| Collateralized mortgage obligations | 23,196,504 | 54 | (665,451) | 22,531,107 |
| Total mortgage-backed and related securities | 47,089,788 | 129,327 | (1,001,131) | 46,217,984 |
| Equity securities: | | | | |
| FNMA preferred | 1,010,000 | 0 | (10,000) | 1,000,000 |
| FHLMC preferre | 500,000 | 7,400 | 0 | 507,400 |
| FHLMC common | 457,926 | 4,038,678 | 0 | 4,496,604 |
| FNMA common | 734,975 | 2,159,257 | 0 | 2,894,232 |
| FHLB common | 1,244,500 | 0 | 0 | 1,244,500 |
| U.S. League common | 55,880 | 45,496 | 0 | 101,376 |
| Total Equity securities | 4,003,281 | 6,250,831 | (10,000) | 10,244,112 |
| Mutual funds: | 2,828,377 | 0 | (12,429) | 2,815,948 |
| Total | $70,032,976 | $6,381,778 | $(1,302,970) | $75,111,784 |

</TABLE>

<TABLE>
<CAPTION>

| <S> | Amortized Cost <C> | 1995 Gross Unrealized Gains <C> | Gross Unrealized Losses <C> | Estimated Fair Value <C> |
|---|---|---|---|---|
| U.S. government and federal agencies bonds and notes | $ 5,999,860 | $ 4,910 | $(175,695) | $ 5,829,075 |
| Mortgage-backed and related securities: | | | | |
| GNMA certificates | 1,021,720 | 32,770 | 0 | 1,054,490 |

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| | | | | |
|---|---|---|---|---|
| FHLMC certificates | 2,305,671 | 4,832 | (37,522) | 2,272,981 |
| FNMA certificates | 3,054,178 | 2,364 | (44,965) | 3,011,577 |
| Collateralized mortgage obligations | 3,181,963 | 5,822 | (14,964) | 3,172,821 |
| Total mortgage-backed and related securities | 9,563,532 | 45,788 | (97,451) | 9,511,869 |
| | | | | |
| Equity securities: | | | | |
| FHLMC preferred | 500,000 | 18,000 | 0 | 518,000 |
| FHLMC common | 457,926 | 2,581,236 | 0 | 3,039,162 |
| FNMA common | 734,975 | 1,407,275 | 0 | 2,142,250 |
| FHLB common | 1,172,100 | 0 | 0 | 1,172,100 |
| U.S. League common | 55,880 | 29,920 | 0 | 85,800 |
| Total equity securities | 2,920,881 | 4,036,431 | 0 | 6,957,312 |
| | | | | |
| Mutual Funds | 2,818,690 | 18,850 | (11,212) | 2,826,328 |
| Total | $21,302,963 | $4,105,979 | $(284,358) | $25,124,584 |

</TABLE>

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

| | September 30, 1996 | |
|---|---|---|
| | Amortized Cost | Estimated FairValue |
| Due in one year or less | $ 2,871,274 | $2,864,890 |
| Due from one to five years | 12,722,032 | 12,513,051 |
| Due from five to ten years | 18,117,415 | 17,904,412 |
| Due after ten years | 29,490,597 | 28,769,371 |
| | 63,201,318 | 62,051,724 |
| | | |
| Equity securities | 4,003,281 | 10,244,112 |
| Mutual funds | 2,828,377 | 2,815,948 |
| Total | $70,032,976 | $75,111,784 |

On December 1, 1995, the Company reassessed the appropriateness of the classification of securities held at that time and determined that certain securities previously classified as held to maturity should be reclassified as

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available for sale in accordance with the one time reassessment prescribed by the FASB Special Report "A Guide to Implementation of Statement 115 on Accounting for Certain Investments in Debt and Equity Securities." Accordingly, on December 1, 1995, the Company transferred securities having an estimated market value of $27,758,607 and unrealized gains and losses of $296,193 an $341,486, respectively, from held to maturity to available for sale.

3. SECURITIES HELD TO MATURITY

The amortized cost, gross unrealized gains and losses, and estimated fair values of securities designated as held to maturity at September 30, 1996 and 1995 are summarized as follows:

| | 1996 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Gains | Estimated Fair Value |
| Collateralized mortgage obligations | $4,755,702 | $0 | $(130,397) | $4,625,305 |
| Total | $4,755,702 | $0 | $(130,397) | $4,625,305 |

| | 1995 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
| U.S. Government and federal agencies | $10,445,513 | $ 50,667 | $ (60,560) | $10,435,620 |
| State government | 387,984 | 50,900 | 0 | 438,884 |
| Corporate | 1,443,904 | 0 | (60,279) | 1,383,625 |
| Mortgage-backed and related securities: | 176,475 | 13,127 | 0 | 189,602 |
| GNMA certificates | 3,581,227 | 142,676 | 0 | 3,723,903 |
| FHLMC certificates | 611,236 | 0 | (4,694) | 606,542 |
| FNMA certificates | 17,190,429 | 0 | (467,243) | 16,723,186 |
| Collateralized mortgage | $33,836,768 | $257,370 | $(592,776) | $33,501,362 |
| Total | | | | |

The carrying value and fair value of debt securities held to maturity by contractual maturity are shown below. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

| | September 30, 1996 | |
|---|---|---|
| | Carrying Value | Estimated Fair |

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Value

| | | |
|---|---|---|
| Due from one to five years | $1,002,977 | $ 972,450 |
| Due from five to ten years | 1,009,033 | 1,003,180 |
| Due after ten years | 2,743,692 | 2,649,675 |
| | $4,755,702 | $4,625,305 |

Collateralized mortgage obligations designated as held to maturity at September 30, 1996 bear interest at fixed and adjustable rates ranging from 5.5% to 7.0%. The collateralized mortgage obligations contractually mature at various dates ranging from April 2001 to July 2023. Gross unrealized gains in this portfolio totaled $0, and gross unrealized losses totaled $130,397, at September 30, 1996. Gross unrealized gains in the prior year's portfolio totaled $181,432, and gross unrealized losses totaled $497,566 at September 30, 1995.

4. LOANS RECEIVABLE, NET

Loans receivable at September 30, 1996 and 1995 are summarized as follows:

| | 1996 | 1995 |
|---|---|---|
| Mortgage loans: | | |
| Principal balances: | | |
| Secured by 1-4 family residences | $102,020,850 | $86,716,040 |
| Secured by multifamily and non-residential properties | 7,165,559 | 5,946,186 |
| Construction loans | 3,336,971 | 3,310,293 |
| | 112,523,380 | 95,972,519 |
| Less: | | |
| Undisbursed portion of mortgage loans | 1,355,841 | 1,278,520 |
| Unearned discounts and net deferred loan origination fees | 428,466 | 343,054 |
| Total mortgage loans | 110,739,073 | 94,350,945 |
| Commercial loans: | 3,253,228 | 1,536,412 |
| Consumer loans: | | |
| Principal balances: | | |
| Loans secured by automobiles | 1,318,211 | 1,072,415 |
| Loans secured by savings accounts | 1,369,201 | 1,051,703 |
| Other | 1,523,172 | 528,548 |
| Total loans | 118,202,885 | 98,540,023 |
| Less allowance for loan losses | 572,000 | 552,000 |
| Loans receivable, net | $117,630,885 | $97,988,023 |

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As a savings bank, the Bank has a credit concentration in 1-4 family residential real estate mortgage loans. Substantially all of the Bank's 1-4 family residential mortgage loan customers are located in its trade area of Lee, Itawamba, Prentiss, and Pontotoc Counties, Mississippi, which have a local unemployment rate at or slightly below the average for the state. Although the Bank has generally conservative underwriting standards, including a collateral policy calling for low loan to collateral values, the ability of its borrowers to meet their residential mortgage obligations is dependent upon local economic conditions.

In the normal course of business, loans are made to officers, directors, and employees of the Company and subsidiary. These loans are made on substantially the same terms, including interest rates and collateral, as those prevailing for comparable transactions with others. Such loans do not involve more than the normal risk of collectible, nor do they present other unfavorable features. As of September 30, 1996 and 1995, $1,666,839 and $1,101,281, respectively, of these loans were outstanding. During fiscal year 1996, $833,618 of new loans were made, repayments totaled $268,060.

Activity in the allowance for loan losses is summarized as follows:

| | 1996 | 1995 | 1994 |
|---|---|---|---|
| Balance at beginning of year | $552,000 | $522,000 | $500,000 |
| Provision charged to income | 20,000 | 30,000 | 25,000 |
| Charge-offs | 0 | 0 | (12,000) |
| Recoveries | 0 | 0 | 9,000 |
| Balance at end of year | $572,000 | $552,000 | $522,000 |

The Bank had loans on nonaccrual status at September 30, 1996 and 1995 in the amounts of approximately $717,000 and $722,000, respectively. Interest income forgone on nonaccrual loans was approximately $38,000 and $49,000 for fiscal years 1996 and 1995, respectively.

5. LOAN SERVICING

In 1984, the Bank sold first mortgage single-family residential loans to the Federal National Mortgage Association ("FNMA") with full recourse which are not included in the accompanying statements of financial condition. The total principal balances outstanding under these mortgages were $2,212,865, $2,932,955, and $4,049,718 at September 30, 1996, 1995, and 1994, respectively. Custodial escrow balances maintained in connection with the foregoing loan servicing

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were $45,805, $106,938, and $51,717, at September 30, 1996, 1995, and 1994, respectively. In the event of default, the Bank must pay the principal and interest under default to FNMA. The Bank would bear the burden of foreclosure losses in the event of default. Because of the Bank's credit policies, foreclosure losses in the event of default have not been significant and losses under this recourse obligation are not expected to be significant. At September 30, 1996, none of these loans were past due 90 days or more. Accordingly, no provision has been made in the financial statements for any future losses that may result from this recourse arrangement.

6. ACCRUED INTEREST AND DIVIDENDS RECEIVABLE

Accrued interest and dividends receivable at September 30, 1996 and 1995 are as follows:

| | 1996 | 1995 |
|---|---|---|
| Securities available for sale | $ 641,277 | $ 220,175 |
| Securities held to maturity | 2,276 | 348,608 |
| Loans receivable | 683,557 | 581,227 |
| Other | 16,837 | 9,155 |
| Total | $1,343,947 | $1,159,165 |

7. PREMISES AND EQUIPMENT, NET

Premises and equipment at September 30, 1996 and 1995 are summarized as follows:

| | 1996 | 1995 |
|---|---|---|
| Land | $ 137,068 | $ 137,068 |
| Building and improvements | 579,456 | 579,455 |
| Furniture, fixtures, and equipment | 377,146 | 370,796 |
| Total | 1,093,670 | 1,087,319 |
| Less accumulated depreciation | 486,403 | 422,571 |
| Premises and equipment, net | $ 607,267 | $ 664,748 |

8. DEPOSITS

Deposits at September 30, 1996 and 1995, the related ranges of interest rates payable for deposits at September 30, 1996, and the weighted average rates paid during 1996 are summarized as follows:

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| | Weighted Average Rate 1996 | 1996 Amount | 1996 Percent | 1995 Amount | 1995 Percent |
|---|---|---|---|---|---|
| <S> | <C> | <C> | <C> | <C> | <C> |
| NOW accounts, 2.5% to 5.00% | 3.14% | $ 12,519,798 | 9.50% | $9,807,956 | 7.29% |
| Savings accounts, 2.75% | 2.75% | 6,873,038 | 5.22 | 8,184,404 | 6.08 |
| | 2.99 | 19,392,836 | 14.72 | 17,992,360 | 13.37 |
| Certificates of deposit: | | | | | |
| 3% to 3.99% | | 0 | 0.00 | 368,716 | 0.27 |
| 4% to 4.99% | | 20,952,130 | 15.90 | 23,830,971 | 17.71 |
| 5% to 5.99% | | 67,348,478 | 51.12 | 48,748,368 | 36.23 |
| 6% to 6.99% | | 23,945,222 | 18.18 | 43,511,762 | 32.34 |
| 7% to 7.99% | | 101,767 | 0.08 | 102,327 | 0.08 |
| | 5.41 | 112,347,597 | 85.28 | 116,562,144 | 86.63 |
| Total | 5.04% | $131,740,433 | 100.00% | $134,554,504 | 100.00% |

The aggregate amounts of jumbo certificates of deposit with a minimum balance of $100,000 were approximately $33,504,337 and $35,379,817 at September 30, 1996 and 1995, respectively. Deposits in excess of $100,000 are not federally insured.

Scheduled maturities of certificates of deposit at September 30, 1996 are as follows:

| Year ending September 30: | |
|---|---|
| 1997 | $ 88,355,406 |
| 1998 | 13,457,046 |
| 1999 | 7,817,520 |
| 2000 | 2,713,474 |
| 2001 | 4,151 |
| Total | $112,347,597 |

Interest expense on deposits for the years ended September 30, 1996, 1995, and 1994 is summarized as follows:

| | 1996 | 1995 | 1994 |
|---|---|---|---|
| Savings accounts | $ 260,564 | $ 246,963 | $ 422,197 |
| NOW accounts | 360,598 | 302,300 | 436,873 |
| Certificates of deposit | 6,308,962 | 5,570,083 | 5,579,061 |
| Total | $6,930,124 | $6,119,346 | $6,438,131 |

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During fiscal year 1995, the Bank paid a 1% interest bonus on all active deposits as of August 5, 1994 that remained active until September 15, 1994. The fiscal year 1994 interest expense on deposits amount includes $1,242,274 representing this one-time special interest payment.

## 9. COMPENSATION AND EMPLOYEE BENEFITS

### Employee Stock Ownership Plan

In connection with the Conversion, the Bank established an ESOP for eligible employees. The ESOP purchased 363,200 shares of the Company's common stock with the proceeds of a $3,632,000 note payable from the Bank to the Company and secured by the Common Stock owned by the ESOP. Interest and principal under the note are due in quarterly installments through June 2013; interest is payable quarterly based on the average daily outstanding balance of principal at the rate of 8.25% per annum. Impact of this financing is eliminated in the consolidated financial statement presentation.

Expense related to the ESOP for fiscal 1996 was approximately $167,890. Unearned compensation related to the ESOP was approximately $3,464,000 at September 30, 1996, and is shown as a reduction of stockholders' equity in the accompanying consolidated statements of financial condition. Unearned compensation is amortized into compensation expense based on employee services rendered in relation to shares which are committed to be released.

### Defined Benefit Pension Plan

The Bank has a qualified, noncontributory defined benefit pension plan covering substantially all its employees. Benefits are based on each employee's years of service up to a maximum of 40 years and the average of that employee's compensation for the highest five consecutive calendar years out of the last ten years prior to retirement. An employee becomes fully vested upon completion of five years of qualifying service. The Bank's funding policy is to make annual contributions equal to or greater than the required minimum under ERISA. The funds are primarily invested in short-term certificates of deposit with the Bank.

The following sets forth the plan's funded status and amounts recognized in the Bank's statement of financial condition at September 30, 1996 and 1995:

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| | 1996 | 1995 |
|---|---|---|
| Actuarial present value of benefit obligations: | | |
| Accumulated benefit obligation: | | |
| Vested | $1,900,209 | $1,782,374 |
| Nonvested | 49,085 | 123,059 |
| Total | 1,949,294 | 1,905,433 |
| Additional benefit based on estimated future salary levels | 472,917 | 410,120 |
| Projected benefit obligation for service rendered to date | 2,422,211 | 2,315,553 |
| Plan assets at fair market value | 2,018,315 | 1,879,369 |
| Unfunded projected benefit obligation | (403,896) | (436,184) |
| Unrecognized net (gain) loss from past experience different from that assumed and effects of changes in assumptions | 442,654 | 536,968 |
| Unrecognized net transition obligation (asset from adoption of FASB SFAS No. 87) being amortized over 20 years | (118,279) | (127,377) |
| (Prepaid) unfunded pension cost liability (included in other assets or other liabilities) | $ 79,521 | $ 26,593 |

The components of net periodic pension expense for the years ended September 30, 1996, 1995, and 1994 are as follows:

</TABLE>
<TABLE>
<CAPTION>

| <S> | 1996 <C> | 1995 <C> | 1994 <C> |
|---|---|---|---|
| Service cost--benefits earned during the period | $ 57,591 | $ 64,357 | $ 62,588 |
| Interest cost on the projected benefit obligation | 147,926 | 139,246 | 127,974 |
| Actual return on plan assets | (120,002) | (71,001) | (73,854) |
| Net asset gain (loss) during the period deferred for later recognition | 13,507 | 14,485 | 17,489 |
| Amortization of unrecognized net obligation | (9,098) | (9,099) | (9,099) |
| Net periodic pension cost | $ 89,924 | $137,988 | $125,098 |
| Assumptions used to develop the net periodic pension cost were: | | | |
| Weighted average discount rate | 6.50% | 6.50% | 6.50% |
| Weighted average rate of compensation increase | 5.00 | 5.00 | 5.00 |
| Weighted average expected long-term | | | |

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| rate of return on plan assets | 4.00 | 4.00 | 4.00 |
|---|---|---|---|

Directors' Retirement Plan

During fiscal 1993, the Bank established the Directors' Retirement Plan ("DRP") whereby directors or their beneficiaries will be provided specific amounts of quarterly retirement benefits for a period of ten years following retirement. Directors are eligible under the plan upon the completion of ten years of service. The related compensation expense for the DRP was $52,791, $42,177, and $49,602, for fiscal years 1996, 1995, and 1994, respectively. The related accrued compensation is included in "accrued expenses and other liabilities" in the accompanying statements of financial condition.

During fiscal 1994, the Company adopted the provisions of SFAS No. 106, Accounting for Postretirement Benefits Other Than Pensions. The unfunded DRP meets the definition of such benefits as defined in SFAS No. 106. For fiscal 1996 and 1995, the projected benefit obligations were approximately $483,000 and $403,000, the accumulated benefit obligations, which were accrued for and included in "accrued expenses and other liabilities," were approximately $309,000 and $274,000, and the service costs were approximately $53,000 and $42,000, respectively. The weighted average discount rate used was 6.5% for 1996 and 1995.

10. INCOME TAXES

The provisions for income taxes for the years ended September 30, 1996, 1995, and 1994 were as follows:

| | 1996 | 1995 | 1994 |
|---|---|---|---|
| Current: | | | |
| Federal | $1,324,389 | $ 984,313 | $ 771,429 |
| State | 140,962 | 151,387 | 177,399 |
| | 1,465,351 | 1,135,700 | 948,828 |
| Deferred | (281,057) | 8,634 | 63,600 |
| Total | $1,184,294 | $1,144,334 | $1,012,428 |

The differences between the provisions for income taxes and the amounts computed by applying the statutory federal income tax rate of 34% to income before income taxes at September 30, 1996, 1995, and 1994 were as follows:

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</TABLE>
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<CAPTION>

| <S> | 1996 <C> | 1995 <C> | 1994 <C> |
|---|---|---|---|
| Expected income tax expense at federal tax rate | $1,133,068 | $1,080,874 | $836,460 |
| Increase (decrease) resulting from: | | | |
| State income tax, net | 75,840 | 99,580 | 147,000 |
| Dividend received deduction | (47,997) | (35,425) | (36,074) |
| Tax-exempt interest income | (5,798) | (8,500) | (8,500) |
| Other | 29,181 | 7,805 | 73,542 |
| | $1,184,294 | $1,144,334 | $1,012,428 |
| Effective income tax rate | 35% | 36% | 41% |

</TABLE>

Temporary differences between the financial statement carrying amounts and tax bases of assets and liabilities that give rise to significant portions of the net deferred tax liability as of September 30, 1996 and 1995 relate to the following:

| | 1996 | 1995 |
|---|---|---|
| SAIF assessment | $ 331,911 | $ 0 |
| Book allowance for loan loss | 217,360 | 209,760 |
| Retirement plan | 118,640 | 104,128 |
| Accrued bonuses | 42,066 | 32,300 |
| Deferred loan fees and costs, net | 4,848 | 104,269 |
| Other | 25,775 | 9,467 |
| Deferred tax asset | 740,600 | 459,924 |
| Unrealized gain on securities available for sale | (2,040,330) | (1,425,465) |
| Tax bad debt reserve in excess of base year | (389,734) | (363,255) |
| FHLB dividends | (101,266) | (73,682) |
| Accretion of bond discount | (20,302) | (84,556) |
| Other | (82,005) | (72,195) |
| Deferred tax liability | (2,633,637) | (2,019,153) |
| Net deferred tax liability | $ (1,893,037) | $(1,559,229) |

Thrift institutions, in determining taxable income, have historically been allowed special bad debt deductions based

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on specified experience formulae or on a percentage of taxable income before such deductions. The bad debt deduction based on the latter has been gradually reduced to 8%. On August 2, 1996, Congress passed the Small Business Job Protection Act that, will among other things, repeal the tax bad debt reserve method for thrifts effective for taxable years beginning after December 31, 1995. As a result, thrifts must recapture into taxable income the amount of their post-1987 tax bad debt reserves over a six-year period beginning after 1995. This recapture can be deferred for up to two years if the thrift satisfies a residential loan portfolio test. The Association is expected to recapture approximately $1,025,000, $390,000 tax effected, of its tax bad debt reserves into taxable income over six years as a result of this new law. The recapture will not have any effect on the Bank's net income because the related tax expense has already been accrued.

Because of such repeal, thrifts such as the Bank may only use the same tax bad debt reserve that is allowed for commercial banks. Accordingly, a thrift with assets of $500 million or less may only add to its tax bad debt reserves based upon its moving six-year average experience of actual loan losses (i.e., the experience method).

The portion of a thrift's tax bad debt reserve that is not recaptured under this new law is only subject to recapture at a later date under certain circumstances. These include stock repurchases, redemptions by the thrift or if the thrift converts to a type of institution (such as a credit union) that is not considered a commercial bank for tax purposes. However, no further recapture would be required if the thrift converted to a commercial bank charter or was acquired by a commercial bank. The Bank does not anticipate engaging in any transactions at this time that would require the recapture of its pre-1988 tax bad debt reserves of approximately $4,650,000.

11. FEDERAL HOME LOAN BANK ADVANCES

The Bank is required by its blanket floating lien agreement with the Federal Home Loan Bank ("FHLB") to pledge its portfolio of first mortgage collateral, demand deposit accounts, capital stock, and certain other assets. As of September 30, 1995, the Bank had $1,000,000 in FHLB advances outstanding at a variable rate of 5.98%, which were repaid in full during the year ended September 30, 1996.

12. REGULATORY MATTERS

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Under regulations promulgated by the Bank's primary regulator, the Office of Thrift Supervision ("OTS"), the Bank must maintain capital levels to comply with the following minimum capital requirements: (1) tangible capital equal to 1.5% of adjusted total assets; (2) leverage capital, or core capital, required to be maintained at 3% of adjusted total assets (although most institutions are required by regulators to maintain a core capital ratio of an additional 100 to 200 basis points); and (3) risk-based capital equal to 8% of its aggregate assets and off-balance sheet financial instruments as adjusted to reflect that relative credit risk.

The Bank is also subject to additional capital standards established by the Federal Deposit Insurance Corporation Improvement Act of 1991. These regulations established capital standards in five categories ranging from "critically undercapitalized" to "well capitalized", and defined "well capitalized" as at least 5% for core (leverage) capital, 6% for Tier 1 risk-based capital and at least 10% for total risk-based capital. Institutions with a core capital ratio less than 4%, a Tier 1 risk-based capital ratio less than 4%, or a total risk-based capital ratio less than 8% are considered "undercapitalized," and subject to increasingly stringent prompt corrective action measures. The Bank's capital ratios place it in the "well capitalized" category at September 30, 1996 and 1995.

A reconciliation of the Bank's stockholders' equity to the Bank's tangible, core, and risk-based capital available to meet its regulatory capital requirements is as follows:

<TABLE>
<CAPTION>

| | Actual | | Minimum for Capital Adequacy Purposes | |
|---|---|---|---|---|
| | Ratio | Amount | Ratio | Amount |
| <S> | <C> | <C> | <C> | <C> |
| Stockholders' equity and ratio to total assets | 24.2% | $ 45,163 | | |
| Unrealized gain on available for sale securities | | (3,329) | | |
| Tangible capital, and ratio to adjusted total assets | 22.8% | $ 41,834 | 1.5% | $2,748 |
| Tier I (core) capital, and ratio to adjusted total assets | 22.8% | $ 41,834 | 3.0% | $5,496 |
| Tier I capital, and ratio to risk-weighted assets | 50.1% | $ 41,834 | 4.0% | $3,339 |
| Tier 2 capital (general | | | | |

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| | | | | |
|---|---|---|---|---|
| allowance for loan losses) | | 572 | | |
| Total risk-based capital, and ratio to risk-weighted assets | 50.8% | $ 42,406 | 8.0% | $6,679 |
| Total assets | | $186,538 | | |
| Adjusted total assets | | $183,209 | | |
| Risk-weighted assets | | $ 83,487 | | |

<CAPTION>

| <S> | To be Well Capitalized for Action Provisions Ratio | Amount |
|---|---|---|
| Stockholders' euqity and ratio to total assets | | |
| Unrealized gain on available for sale securities | | |
| Tangible capital, and ratio to adjusted total assets | | |
| Tier 1 (core) capital, and ratio to adjusted total assets | 5.00% | $9,160 |
| Tier 1 capital, and ratio to risk-weighted assets | 6.00% | $5,009 |
| Tier 2 capital (general allowance for loan losses) | | |
| Total risk-based capital, and ratio to risk-weighted assets | 10.00% | $8,349 |
| Total assets | | |

Capital requirements continue to be under study by the OTS. Management continues to monitor these requirements and contemplated changes and believes that the Bank will continue to exceed its regulatory minimum requirements.

The OTS has adopted an amendment to its risk-based capital requirements that generally requires savings institutions with more than a "normal" level of interest-rate risk to maintain additional total capital. An institution will be considered to have a "normal" level of interest-rate risk exposure if the decline in its NPV after an immediate 200 basis point increase or decrease in market interest rates (whichever results in the

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greater decline) is less than 2% of the current estimated economic value of its assets. An institution with a greater than normal interest rate risk will be required to deduct from total capital, for purposes of calculating its risk-based capital requirement, an amount (the "interest-rate risk component") equal to one-half the difference between the institution's measured interest-rate risk and normal level of interest-rate risk as determined by the OTS, multiplied by the economic value of its total assets. The Association has been notified by the OTS that it will be required to incorporate the interest-rate risk component to the risk-based capital requirement. However, the interest-rate risk component of risk-based capital requirement has been waived until the OTS finalizes the process under which institutions

may appeal such
capital requirements. Based on the Bank's capital level, management does not expect that implementation of this requirement will cause the Bank to fall below its capital requirements.

13. COMMITMENTS AND CONTINGENCIES

Loan Commitments

At September 30, 1996, the Bank had outstanding commitments to originate loans in the amount of $2,082,850. Of these outstanding amounts, commitments of $760,000 were at fixed rates ranging between 7.50% and 9.25%; terms for these outstanding commitments are up to 180 days. Commitments to extend credit include exposure to some credit loss in the event of nonperformance of the customer. The Bank's credit policies and procedures for credit commitments are the same as those for extensions of credit that are recorded on the statement of financial condition.

Litigation

The Company is a defendant in certain claims and legal actions arising in the ordinary course of business. In the opinion of management, after consultation with legal counsel, the ultimate disposition of these matters is not expected to have a material adverse effect on the consolidated financial position of the Company.

14. INTEREST RATE SENSITIVITY

A portion of the Bank's interest-earning assets are long-term fixed rate mortgage loans and mortgage-backed and related securities (approximately 47%), while its principal source of funds is savings deposits with maturities of three years or less (approximately 90%). Because of the short-term nature of

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the savings deposits, their cost generally reflects returns currently available in the market. Accordingly, the savings deposits have a high degree of interest rate sensitivity, while the mortgage loan portfolio, to the extent of fixed rate loans, is relatively fixed and has much less sensitivity to changes in current market rates. Although these conditions are somewhat mitigated by the Bank's risk management strategies of selling certain long-term fixed rate loans and plans to increase amounts of short-term consumer loans originated, changes in market interest rates tend to directly affect the level of net interest income.
At June 30, 1996, based on the most recent available information provided by the Office of Thrift Supervision ("OTS"), it was estimated, on an unaudited basis, that the Bank's net portfolio value ("NPV") (the net present value of the Bank's cash flows from assets, liabilities, and off-balance sheet items) would decrease 6%, 12%, 21%, and 29% and increase 5%, 10%, 12%, and 15% in the event of 1%, 2%, 3%, and 4% increases and decreases in market interest rates, respectively. These calculations indicate that the Bank's NPV could be adversely affected by increases in interest rates but could be favorably affected by decreases in interest rates. Computations of prospective effects of hypothetical interest rate changes are based on numerous assumptions, including relative levels of market interest rates, prepayments, and deposit run-offs and should not be relied upon as indicative of actual results. Certain shortcomings are inherent in such computations. In order to mitigate its interest rate risk, the Bank maintains substantial capital levels that management believes are sufficient to sustain unfavorable movements in market interest rates.

15. FAIR VALUE OF FINANCIAL INSTRUMENTS

SFAS No. 107, Disclosures About Fair Value of Financial Instruments, requires disclosure of fair value information about financial instruments, whether or not recognized in the statement of condition, for which it is practicable to estimate that value. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in immediate settlement of the instrument. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts. Also, the fair value estimates presented herein are based on pertinent information available to Management as of September 30, 1996. Such

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amounts have not been comprehensively revalued for purposes of these financial statements since those dates and, therefore, current estimates of fair value may differ significantly from the amounts presented herein.

The following methods and assumptions were used by the Company in estimating its fair values disclosures for financial instruments:

Investment Securities

Fair values for investment securities are primarily based on quoted market prices. If a quoted market price is not available, fair value is estimated using market prices for similar securities.

Loans

For equity lines and other loans with short-term or variable rate characteristics, the carrying value reduced by an estimate for credit losses inherent in the portfolio is a reasonable estimate of fair value. The fair value of all other loans is estimated by discounting their future cash flows using interest rates currently being offered for loans with similar terms, reduced by an estimate of credit losses inherent in the portfolio. The discount rates used are commensurate with the interest rate and prepayment risks involved for the various types of loans.

Deposits

The fair value disclosed for demand deposits (e.g., interest and non-interest bearing demand, savings and money market savings), are, as required by SFAS No. 107, equal to the amounts payable on demand at the reporting date (i.e., their carrying amounts). Fair values for certificates of deposits are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated monthly maturities.

Commitments to Extend Credit

The value of these unrecognized financial instruments is estimated based on the fee income associated with the commitments which, in the absence of credit exposure, is considered to approximate their settlement value. As no significant credit exposure exists and because such fee income is not material to the Company's financial statements at September 30, 1996, the fair value of these commitments is not presented.

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Many of the Company's assets and liabilities are short-term financial instruments whose carrying amounts reported in the statement of condition approximate fair value. These items include cash and due from banks and interest-bearing bank balances. The estimated fair values of the Company's remaining on-balance sheet financial instruments as of September 30, 1996, are summarized below:

| | 1996 | |
|---|---|---|
| | Carrying Value | Estimated Fair Value |
| | (In thousands) | |
| Financial Assets: | | |
| Securities available | $ 75,112 | $ 75,112 |
| Securities held to maturity | 4,756 | 4,625 |
| Loans, net | 117,631 | 116,996 |
| Financial Liabilities: | | |
| Deposits | 131,740 | 131,648 |

SFAS No. 107 excludes certain financial instruments and all nonfinancial instruments from its disclosure requirements. The disclosures also do not include certain intangible assets, such as customer relationships, deposit base intangibles and goodwill. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company.

16. FDIC ASSESSMENT

The deposits of the Bank are currently insured by the Savings Association Insurance Fund ("SAIF"). Both the SAIF and the Bank Insurance Fund ("BIF"), the federal deposit insurance fund that covers the deposits of state and national banks and certain state savings banks, are required by law to attain and thereafter maintain a reserve ratio of 1.25% of insured deposits. The BIF has achieved the required reserve rate, and, as discussed below, during the past year the FDIC reduced the average deposit insurance premium paid by BIF-insured banks to a level substantially below the average premium paid by savings institutions.

On November 4, 1995, the FDIC approved a final rule regarding deposit insurance premiums. Beginning January 1, 1996, the rule reduced deposit insurance premiums for BIF member institutions to zero basis points (subject to a $2,000 minimum) for institutions in the lowest risk category, while holding deposit insurance premiums for SAIF members at their current levels (23 basis points for institutions in the lowest risk category).

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Banking legislation was enacted September 30, 1996 to eliminate the premium differential between SAIF-insured institutions and BIF-insured institutions. The FDIC Board of Directors met October 8, 1996 and approved a rule that, except for the possible impact of certain exemptions for de novo and "weak" institutions, established the special assessment necessary to recapitalize the SAIF at 65.7 basis points of SAIF assessable deposits held by affected institutions as of March 31, 1995. The legislation provides that all SAIF member institutions pay a special one-time assessment to recapitalize the SAIF, which in the aggregate is sufficient to bring the reserve ratio in the SAIF to 1.25% of insured deposits. It is anticipated that after recapitalization of the SAIF, premiums paid by SAIF-insured institutions will be reduced. The legislation also provides for the merger of the BIF and the SAIF, with such merger being conditioned upon the prior elimination of the thrift charter.

Based upon its level of SAIF deposits as of March 31, 1995, the Bank will pay approximately $870,000. The assessment was accrued in the quarter ended September 30, 1996.

## 17. STOCK CONVERSION

On September 15, 1995, the Conversion of the Bank from a federally-chartered mutual institution to a federally-chartered stock savings bank through amendment of its charter and issuance of common stock to the Company was completed. Related thereto, the Company sold 4,628,750 shares of common stock, par value $.01 per share, at an initial price of $10 per share in subscription and community offerings. Costs associated with the Conversion were approximately $1,285,000, including underwriting fees. These conversion costs were deducted from the gross proceeds of the sale of the common stock.

In connection with the Offering, the Association established a liquidation account in an amount equal to its regulatory capital as of the latest practicable date prior to consummation of the Offering.

The Company's ability to pay dividends will be largely dependent upon dividends to the Company from the Association. Pursuant to OTS regulations, the Association will not be permitted to pay dividends on its capital stock or repurchase shares of its stock if its stockholders' equity would be reduced below the amount required for the liquidation account or if stockholders' equity would be reduced below the amount required by the OTS.

## 18. Parent company financial statements

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Separate condensed financial statements of Community Federal Bancorp, Inc. (the "Parent Company") as of and for the year ended September 30, 1996 are presented below:

## Statement of Financial Condition

September 30, 1996

(Dollar amounts in thousands)

| | |
|---|---|
| ASSETS: | |
| Cash and cash equivalents | $ 1,633 |
| Securities available for sale | 17,091 |
| Investment in subsidiary | 45,163 |
| ESOP loan receivable | 3,498 |
| Other assets | 388 |
| Total assets | $67,773 |
| LIABILITIES: | |
| Other liabilities | $ 635 |
| STOCKHOLDERS' EQUITY: | |
| Preferred stock | 0 |
| Common stock | 46 |
| Additional paid-in capital | 45,006 |
| Retained earnings | 22,512 |
| Unearned compensation | (3,464) |
| Unrealized loss on securities available for sale, net | 3,038 |
| Total stockholders' equity | 67,138 |
| Total liabilities and stockholders' equity | $67,773 |

## Statement of Income

For the Year Ended September 30, 1996

(Dollar amounts in thousands)

| | |
|---|---|
| INTEREST INCOME: | |
| Interest and dividends on securities available for sale | $ 561 |
| Interest income from subsidiary | 207 |
| Total income | 768 |

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| | |
|---|---|
| OPERATING EXPENSE | 24 |
| INCOME BEFORE INCOME TAXES AND EQUITY IN UNDISTRIBUTED CURRENT YEAR SUBSIDIARY EARNINGS | 744 |
| INCOME TAXES | 280 |
| INCOME BEFORE EQUITY IN UNDISTRIBUTED CURRENT YEAR SUBSIDIARY EARNINGS | 464 |
| EQUITY IN UNDISTRIBUTED CURRENT YEAR SUBSIDIARY EARNINGS | 1,684 |
| Net income | $2,148 |

Statement of Cash Flows

For the Year Ended September 30, 1996

(Dollar amounts in thousands)

| | |
|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES: | |
| Net income | $ 2,148 |
| Equity in undistributed current year earnings of subsidiary | (1,684) |
| | 464 |
| Adjustments to reconcile net income to net cash provided by operating activities: | |
| Increase in other assets | (388) |
| Increase in other liabilities | 635 |
| Net cash provided by operating activities | 711 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | |
| Purchase of securities available for sale | (18,089) |
| Principal collections on mortgage-backed and related securities | 708 |
| Net cash used by investing activities | (17,381) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | |
| Proceeds from issuance of common stock | 41,368 |
| Purchase of Bank's common stock | (22,532) |
| Payments received on ESOP loan | 134 |
| Dividends paid | (667) |
| Net cash provided by financing activities | 18,303 |
| NET INCREASE IN CASH AND CASH EQUIVALENTS | 1,633 |
| CASH AND CASH EQUIVALENTS, beginning of year | 0 |
| CASH AND CASH EQUIVALENTS, end of year | $1,633 |

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Earnings are presented on a retroactive basis, recognizing earnings of the subsidiary for the year ended September 30, 1996. This presentation is based on the accounting for the Conversion at historical cost, in a manner similar to that utilized in a pooling of interests.

Directors

Medford M. Leake
Charirman of the Board
President - Steel City
Lumber Co.
Birmingham, AL

Jim Ingram
President and Chief Executive
Officer
Community Federal Bancorp, Inc./
Community Federal Savings Bank
Tupelo, MS

Charles V. Imbler, Sr.
President and Chief Executive
Officer
Truck Center, Inc.
Tupelo, MS

J. Leighton Pettis
Ophthalmologist
Tupelo, MS

L. F. Sams, Jr.
Partner, Law Firm
Mitchell, McNutt, Threadgill,
Smith & Sams
Tupelo, MS

Robert R. Black, Sr.
Retired - Periodontist
Tupelo, MS

Michael R. Thomas
President -Washington
Furniture Mfg., Inc.
Houlka, MS

Robert W. Reed III
Account Executive-
Reed Mfg. Co
Tupelo, MS

Officers

Gill Simmons, Vice President
Jack Johnson, Vice President
Mark Burleson, Vice President
Lynda Riley, Treasurer
Judy Ballard, Secretary
Sherry McCarty, Controller

Corporate Headquarters
333 Court Street
Tupelo, MS 38801
601-842-3981

Transfer Agent
Registrar and Transfer Co.
10 Commerce Drive
Cranford, NJ 07016
(800)368-5948

Independent Public Accountants
Arthur Andersen, LLP
Birmingham, AL

Special Counsel
Elias, Matz, Tiernan and
Herrick, LLP
Washington, DC

Special Counsel
Mitchell, McNutt, Threadgill, Smith
and Sams, PA

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Listing of Common Stock
Traded Over-the-Counter/
NASDAQ National Markert Stystem/
Symbol: CFTP

10-K Information
This report is availabe to
stockholders upon request to:
The Controller, P.O. Box F,
Tupelo, MS. 38801
(601)840-0302

Annual Meeting

The 1996 Annual Meeting of the Stockholders of Community Federal Bancorp, Inc. will be held at 5:00 p. m. on March 27, 1997, in the Lobby of Community Federal Savings Bank, 333 Court Street, Tupelo, Mississippi

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