SECURITIES AND EXCHANGE COMMISSION

FORM 10KSB40

Annual and transition reports of small business issuers [Section 13 or 15(d), S-B Item 405]

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SFB BANCORP INC

CIK:**1035371**| IRS No.: **621683732** | State of Incorp.:**TN** | Fiscal Year End: **1231**
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SIC: **6035** Savings institution, federally chartered

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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-KSB

(Mark One)

[X] Annual report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934 For the fiscal year ended December 31, 1998

[ ] Transition report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934 For the transition period from ________ to ________ .

Commission File No. 0-22587

SFB Bancorp, Inc.

(Name of Small Business Issuer in Its Charter)

Tennessee	62-1683732
(State or Other Jurisdiction of Incorporation Organization)	(I.R.S. Employer Identification No.)
632 East Elk Avenue, Elizabethton, Tennessee	37643
(Address of Principal Executive Offices)	(Zip Code)

(423) 543-1000

(Issuer's Telephone Number, Including Area Code)

Securities registered under to Section 12(b) of the Exchange Act: None

Securities registered under to Section 12(g) of the Exchange Act:

Common Stock, par value $0.10 per share

(Title of Class)

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

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB. [X]

State issuer's revenues for its most recent fiscal year: $4,157,000

The aggregate market value of the voting stock held by non-affiliates of the registrant, based on the average bid and asked price of the registrant's Common Stock on March 1, 1999 was $6.8 million.

As of March 16, 1999, there were issued and outstanding 692,417 shares of the registrant's Common Stock.

Transition Small Business Disclosure Format (check one): YES ___ NO X

DOCUMENTS INCORPORATED BY REFERENCE

1. Portions of the Annual Report to Stockholders for the Fiscal Year ended December 31, 1998. (Part II)

2. Portions of the Proxy Statement for the Annual Meeting of Stockholders for the Fiscal Year ended December 31, 1998. (Part III)

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PART I

Forward Looking Statements

SFB Bancorp, Inc. (the "Company") may from time to time make written or oral "Forward- Looking Statements", including statements contained in the Company's filings with the Securities and Exchange Commission (including this Annual Report on Form 10-KSB and the Exhibits thereto), in its reports to stockholders and in other communications by the Company, which are made in good faith by the Company pursuant to the "Safe Harbor" provisions of the Private Securities Litigation Reform Act of 1995.

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

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

Item 1. Description of Business

General

SFB Bancorp, Inc. is a Tennessee corporation organized in March 1997 at the direction of Security Federal Bank (the "Bank" or "Security Federal") to acquire all of the capital stock that the Bank issued in its conversion from the mutual to stock form of ownership (the "Conversion"). On May 29, 1997, the Bank completed the Conversion and became a wholly owned subsidiary of the Company. The Company is a unitary savings and loan holding company which, under existing laws, generally is not restricted in the types of business activities in which it may engage provided that the Bank retains a specified amount of its assets in housing-related investments. The Company conducts no significant business or operations of its own other than holding all of the outstanding stock of the Bank and investing the Company's portion of the net proceeds obtained in the Conversion.

The Bank, chartered in 1963 under the name Security Federal Savings and Loan Association, is a federally chartered stock savings bank headquartered in Elizabethton, Tennessee. The Bank is subject to examination and comprehensive regulation by the Office of Thrift Supervision ("OTS") and its deposits

are federally insured by the Savings Association Insurance Fund ("SAIF") of the Federal Deposit Insurance Corporation (the "FDIC"). The Bank is a member of and owns capital stock in the FHLB of Cincinnati, which is one of the 12 regional banks in the FHLB System.

The Bank operates a traditional savings bank business, attracting

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deposit accounts from the general public and using those deposits, together with other funds, primarily to originate and invest in loans secured by single-family residential real estate.

The following table sets forth certain financial ratios for the Company for the dates indicated.

	At December 31,	
	1997	1998
Return on average assets	1.18%	.94%
Return on average equity	6.99%	4.24%
Average equity to average assets	17.38%	22.24%
Dividend payout	--%	27.85%

Competition

Security Federal is one of many financial institutions serving its market area which consists of Carter County, Tennessee and the adjacent Tennessee counties of Johnson, Unicoi, Washington, and Sullivan. The competition for deposit products comes from other insured financial institutions such as commercial banks, thrift institutions, credit unions, and multi-state regional banks in the Bank's market area. Deposit competition also includes a number of insurance products sold by local agents and investment products such as mutual funds and other securities sold by local and regional brokers. Loan competition varies depending upon market conditions and comes from other insured financial institutions such as commercial banks, thrift institutions, credit unions, multi-state regional banks, and mortgage bankers.

Lending Activities

Analysis of Loan Portfolio. Set forth below is selected data relating to the composition of the Bank's loan portfolio by type of loan and type of security on the dates indicated:

	December 31,			
	1997		1998	
	Amount	Percent	Amount	Percent
Type of Loans:				
Real Estate Loans:				
One- to four-family	$31,382	75.63	$30,054	72.41
Construction	1,600	3.86	1,216	2.93
Commercial	1,433	3.45	1,566	3.77
Multi-family residential	687	1.65	1,011	2.44
Land	2,982	7.19	3,997	9.63
Commercial business loans	425	1.02	573	1.38
Consumer Loans:				
Automobile loans	2,119	5.10	2,294	5.53
Share loans	517	1.25	322	.78
Other	351	.85	470	1.13
Total loans	41,496	100.00	41,503	100.00
Less:				
Loans in process	429		619	
Deferred loan origination fees and costs	118		109	
Allowance for loan losses	301		326	
Total loans, net	$40,648		$40,449	

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Loan Maturity Tables

The following table sets forth the estimated maturity of the Bank's loan portfolio, including loans held for sale, at December 31, 1999. The table does not include prepayments or scheduled principal repayments. All mortgage loans are shown as maturing based on contractual maturities.

	Due within 1 year	Due after 1 through 5 years	Due after 5 years	Total
	(In Thousands)			
One- to four-family residential..	$ 140	$ 1,163	$ 28,751	$ 30,054
Construction....................	373	-	843	1,216
Commercial real estate...........	-	686	880	1,566
Multi-family residential.........	-	154	857	1,011
Land............................	671	2,622	704	3,997
Commercial business loans........	479	78	16	573
Consumer........................	1,129	1,957	-	3,086
Total	$ 2,792	$ 6,660	$ 32,051	$ 41,503

The following table sets forth the dollar amount of all loans due after December 31, 1999, which have pre-determined interest rates and which have floating or adjustable interest rates.

	Fixed Rates	Floating or Adjustable Rates	Total
	(In Thousands)		
One- to four-family residential....	$ 28,349	$ 1,565	$ 29,914
Construction......................	843	-	843
Commercial real estate............	1,480	86	1,566
Multi-family residential..........	902	109	1,011
Land..............................	2,812	514	3,326
Commercial business loans and consumer........................	2,025	26	2,051
Total.........................	$ 36,411	$ 2,300	$ 38,711

One- to Four-Family Residential Loans. Security Federal's primary lending activity consists of the origination of one- to four-family residential mortgage loans secured by property in the Bank's primary market area. The Bank generally originates one- to four-family residential mortgage loans in amounts up to 97% of the lesser of the appraised value or purchase price, with private mortgage insurance required on loans with a loan-to-value ratio in excess of 85%. The maximum loan-to-value ratio on mortgage loans secured by nonowner occupied properties is limited to 85% and 90% with private mortgage insurance. The Bank primarily originates and retains fixed-rate balloon loans having terms of up to 15 years, with principal and interest payments calculated using up to a 30-year amortization period.

Security Federal also offers adjustable rate mortgage loans. The interest rate on adjustable rate mortgage loans is based on an index plus a stated margin. The Bank may offer discounted initial interest rates on adjustable rate mortgage loans but the Bank requires that the borrower qualify for the adjustable rate mortgage loans at the fully indexed rate (the index rate plus the margin). Adjustable rate mortgage loans provide for periodic interest rate adjustments upward or downward of up to 2% per adjustment. The interest rate may not increase more than 5% over the life of the loan and may not decrease below the initial interest rate. Adjustable rate mortgage loans typically reprice every one, three or five years and provide for terms of up to 30 years.

Adjustable rate mortgage loans decrease the risk associated with

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changes in interest rates by periodically repricing, but involve other risks because as interest rates increase, the underlying payments by the borrower increase, thus increasing the potential for default by the borrower. At the same time, the marketability of the underlying collateral may be adversely affected by higher interest rates. Upward adjustment of the contractual interest rate is also limited by the maximum periodic and lifetime interest rate adjustment permitted by the loan documents, and, therefore is potentially limited in effectiveness during periods of rapidly rising interest rates.

Mortgage loans originated and held by the Bank generally include a due-on-sale clause, which gives the Bank the right to deem the loan immediately due and payable in the event the borrower transfers ownership of the property securing the mortgage loan without the Bank's consent.

Residential Construction Loans. Security Federal offers residential construction loans on one- to four-family residential property to the individuals who will be the owners and occupants upon completion of construction. These loans are made on a long-term basis and are classified as construction/permanent loans. Usually no principal payments are required during the first six to eight months. After that time, the payments are set at an amount that will pay off the amount of the loan over the term of the loan. The maximum loan to value ratio is 97% with private mortgage insurance.

On a limited basis, the Bank also originates speculative loans to residential builders who have established business relationships with the Bank. These speculative loans typically are made for a term of twelve months and may not require principal payments during the term of the loan. In underwriting such loans, the Bank considers the number of units that the builder has on a speculative bid basis that remain unsold. The Bank's experience has been that most speculative loans are repaid well within the twelve month period. Speculative loans are generally originated with a loan to value ratio that does not exceed 80%.

Construction lending is generally considered to involve a higher degree of credit risk than long-term financing of residential properties. The Bank's risk of loss on a construction loan is dependent largely upon the accuracy of the initial estimate of the property's value at completion of construction and the estimated cost of construction. If the estimate of construction cost and the marketability of the property upon completion of the project prove to be inaccurate, the Bank may be compelled to advance additional funds to complete the construction. Furthermore, if the final value of the completed property is less than the estimated amount, the value of the property might not be sufficient to assure the repayment of the loan. For speculative loans that the Bank originates to builders, the ability of the builder to sell completed dwelling units will depend, among other things, on demand, pricing and availability of comparable properties, and general economic conditions.

Commercial and Multi-Family Loans. Commercial real estate loans are secured by churches, office buildings, and other commercial properties. Multi-family loans are secured by apartment and condominium buildings. These loans generally have not exceeded $500,000 or had terms greater than 10 years.

Commercial and multi-family real estate lending entails significant additional risks compared to residential property lending. These loans typically involve large loan balances to single borrowers or groups of related borrowers. The repayment of these loans typically is dependent on the successful operation of the real estate project securing the loan. These risks can be significantly affected by supply and demand conditions in the market for office and retail space and may also be subject to adverse conditions in the economy. To minimize these risks, the Bank generally limits this type of lending to its market area and to borrowers who are otherwise well known to the Bank.

Commercial Business Loans. Security Federal offers commercial business loans to benefit from the higher fees and interest rates and the shorter term to maturity. Commercial business loans consist of equipment, lines of credit and other business purpose loans, which generally are secured by either the underlying properties or by the personal guarantees of the borrower.

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Unlike residential mortgage loans, which generally are made on the basis of the borrower's ability to make repayment from his or her employment and other income and which are secured by real property whose value tends to be more easily ascertainable, commercial business loans typically are made on the basis of the borrower's ability to make repayment from the cash flow of the borrower's business. As a result, the availability of funds for the repayment of commercial business loans may be substantially dependent on the success of the business itself and the general economic environment.

Consumer Loans. Consumer loans consist of home equity, automobile, farm, mobile home, and demand loans secured by savings deposit accounts. These type loans may entail greater risk than residential mortgage loans, particularly in the case of consumer loans that are unsecured or secured by assets that depreciate rapidly. Repossessed collateral for a defaulted consumer loan may not be sufficient for repayment of the outstanding loan, and the remaining deficiency may not be collectible.

Loan Approval Authority and Underwriting. The Bank's President has unlimited loan approval authority. The loan committee generally approves all residential mortgage loans of $25,000 or more, and the Bank's Board of Directors ratifies all mortgage loans and consumer loans at its regular monthly meeting. Commercial real estate loans and commercial business loans generally are approved in advance by the loan committee.

Upon receipt of a completed loan application from a prospective borrower, a credit report is ordered. Income and certain other information is verified. If necessary, additional financial information may be requested. An appraisal or other estimate of value of the real estate intended to be used as security for the proposed loan is obtained. Appraisals are processed by a member of the Bank's Board of Directors and/or outside independent fee appraisers.

Construction/permanent loans are made on individual properties. Funds advanced during the construction phase are held in a loans-in-process account and disbursed at various stages of completion, following physical inspection of the construction by a loan officer or appraiser.

Either title insurance or a title opinion is generally required on all real estate loans. Borrowers also must obtain fire and casualty insurance. Flood insurance is also required on loans secured by property which is located in a flood zone.

Loan Commitments. Verbal commitments are given to prospective borrowers on all approved real estate loans. Generally, the commitment requires acceptance within 30 days of the date of issuance. At December 31, 1998, commitments to cover originations of mortgage loans and undisbursed funds for loans-in-process were $1,440,000 and $619,000, respectively.

Non-Performing Assets. The following table sets forth information regarding non-accrual loans, real estate owned, and certain other repossessed assets and loans. As of the dates indicated, the Bank had no loans categorized as troubled debt restructuring within the meaning of SFAS 15.

<TABLE>
<CAPTION>

	At December 31,	
	1997	1998
	(Dollars in Thousands)	
<S>	<C>	<C>
Loans accounted for on a nonaccrual basis:		
Real estate loans:		

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One- to four-family residential	$ 150	$ 409
Construction	-	-
Commercial	-	-
Multi-family residential	-	-
Land	-	18
Commercial business and consumers	59	10
Total nonaccrual loans	209	437
Accruing loans which are contractually past due 90 days or more	-	-
Total nonperforming loans	209	437
Real estate owned	-	-
Total nonperforming assets	$ 209	$ 437
Nonaccrual and 90 days past due as a percentage of net loans	0.51%	1.08%
Nonaccrual and 90 days past due as a percentage of total assets	0.39%	0.84%
Total nonperforming assets as a percentage of total assets	0.39%	0.84%

</TABLE>

At December 31, 1998, interest income that would have been recorded on loans accounted for on a nonaccrual basis under the original terms of such loans was immaterial.

Classified Assets. OTS regulations provide for a classification system for problem assets of insured institutions. Under this classification system, problem assets of insured institutions are classified as "substandard," "doubtful," or "loss." An asset is considered substandard if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Substandard assets include those characterized by the "distinct possibility" that the insured institution will sustain "some loss" if the deficiencies are not corrected. Assets classified as doubtful have all of the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses present make "collection or liquidation in full," on the basis of currently existing facts, conditions, and values, "highly questionable and improbable." Assets classified as loss are those considered "uncollectible" and of such little value that their continuance as assets without the establishment of a specific loss reserve is not warranted. Assets may be designated "special mention" because of potential weakness that does not currently warrant classification in one of the aforementioned categories.

When an insured institution classifies problem assets as either substandard or doubtful, it may establish general allowances for loan losses in an amount deemed prudent by management. General allowances represent loss allowances which have been established to recognize the inherent risk associated with lending activities, but which, unlike specific allowances, have not been allocated to particular problem assets. When an insured institution classifies problem assets as loss, it is required either to establish a specific allowance for losses equal to 100% of that portion of the asset so classified or to charge off such amount. An institution's determination as to the classification of its assets and the amount of its valuation allowances is subject to review by the OTS, which may order the establishment of additional general or specific loan loss allowances. A portion of the general loan loss allowance established to cover possible losses related to assets classified as substandard or doubtful may be included in determining an institution's regulatory capital, while specific valuation allowances for loan losses generally do not qualify as regulatory capital.

In accordance with its classification of assets policy, the Bank regularly reviews the problem assets in its portfolio to determine whether any assets require classification in accordance with applicable regulations. On the basis of management's review of its assets, at December 31, 1998, the Bank had classified approximately $456,000 of assets as substandard, and $1,000 of assets as special mention. The Bank did not have any assets classified as doubtful or loss.

Foreclosed Real Estate. Real estate acquired by the Bank as a result of foreclosure is recorded as "real estate owned" until such time as it is sold.

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When real estate owned is acquired, it is recorded at the lower of the unpaid principal balance of the related loan or its fair value less disposal costs. Any write-down of real estate owned is charged to operations. At December 31, 1998, the Bank had no foreclosed real estate.

Allowances for Loan Losses. It is management's policy to provide for losses on unidentified loans in the loan portfolio. A provision for loan losses is charged to operations based on management's evaluation of the potential losses that may be incurred in the loan portfolio. The evaluation, including a review of all loans on which full collectibility of interest and principal may not be reasonably assured, considers: (i) the Bank's past loan loss experience, (ii) known and inherent risks in the portfolio, (iii) adverse situations that may affect the borrower's ability to repay, (iv) the estimated value of any underlying collateral, and (v) current economic conditions.

Management monitors the allowance for loan losses and make additions to the allowance as economic conditions dictate. There can be no assurance that the allowance for losses will be adequate to cover losses which may in fact be realized in the future and that additional provisions for losses will not be required.

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

	At December 31, 1997	At December 31, 1998
	(Dollars in Thousands)	
Total loans outstanding	$41,496	$41,503
Average loans outstanding	$39,881	$40,608
Allowance at beginning of period	$304	$301
Provision	10	31
Recoveries	-	-
Charge-offs	(13)	(6)
Allowance at end of period	$301	$326
Allowance for loan losses as a percent of total loans outstanding	0.73%	0.79%
Net loans charged off as percent of average loans outstanding	0.03%	0.01%
Ratio of allowance to nonperforming loans	144.0%	0.75%

Analysis of the Allowance for Loan Losses

The following table sets forth the allocation of the allowance by category, which management believes can be allocated only on an approximate basis. The allocation of the allowance to each category is not necessarily indicative of future loss and does not restrict the use of the allowance to absorb losses in any category.

At December 31,			
1997		1998	
Amount	Percent of Loans in Each Category to Total Loans	Amount	Percent of Loans in Each Category to Total Loans

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(Dollars in Thousands)

Real estate loans:				
One- to four-family residential......	$136	75.63%	$147	72.41%
Construction.........................	25	3.86	27	2.93
Commercial...........................	40	3.45	43	3.77
Multi-family residential............	20	1.65	22	2.44
Land.................................	30	7.19	33	9.63
Commercial business and consumer.......	50	8.22	54	8.82
Total allowance for loan losses...	$301	100.00%	$326	100.00%

Investment Activities and Mortgage-Backed Securities

General. The Bank is required under federal regulations to maintain a minimum amount of liquid assets which may be invested in specified short term securities and certain other investments. The Bank has maintained a liquidity portfolio in excess of regulatory requirements. Liquidity levels may be increased or decreased depending upon the yields on investment alternatives and upon management's judgment as to the attractiveness of the yields then available in relation to other opportunities and its expectation of future yield levels, as well as management's projections as to the short term demand for funds to be used in the Bank's loan origination and other activities. The Bank classifies its investments as securities available for sale or investment securities held to maturity in accordance with SFAS No. 115. At December 31, 1998, the Bank's investment portfolio policy allowed investments in instruments such as U.S. Treasury obligations, U.S. federal agency or federally sponsored agency obligations, municipal obligations, mortgage-backed securities, banker's acceptances, certificates of deposit, federal funds, including FHLB overnight and term deposits, as well as investment grade corporate bonds, commercial paper and the mortgage derivative products described below. The Board of Directors may authorize additional investments.

The Bank's investment securities available for sale and investment securities held to maturity portfolios at December 31, 1998 did not contain securities of any issuer with an aggregate book value in excess of 10% of the Bank's equity, excluding those issued by the United States Government or its agencies.

Mortgage-Backed Securities. To supplement lending activities, the Bank has invested in residential mortgage-backed securities. Mortgage-backed securities can serve as collateral for borrowings and, through repayments, as a source of liquidity. Mortgage-backed securities represent a participation interest in a pool of single-family or other type of mortgages, the principal and interest payments on

which are passed from the mortgage originators, through intermediaries (generally quasi-governmental agencies) that pool and repackage the participation interests in the form of securities, to investors such as the Bank. Such quasi-governmental agencies, which guarantee the payment of principal and interest to investors, primarily include Federal Home Loan Mortgage Corporation ("FHLMC"), Government National Mortgage Association ("GNMA"), Federal National Mortgage Association ("FNMA"), and Small Business Administration ("SBA").

Mortgage-backed securities typically are issued with stated principal amounts and the securities are backed by pools of mortgages that have loans with interest rates that are within a range and have varying maturities. The underlying pool of mortgages can be composed of either fixed-rate or adjustable-rate mortgage loans. Mortgage-backed securities are generally referred to as mortgage participation certificates or pass-through certificates. As a result, the interest rate risk characteristics of the underlying pool of mortgages (i.e., fixed-rate or adjustable-rate), as well as prepayment risk, are passed on to the certificate holder. The life of a mortgage-backed pass-through security is equal to the life of the underlying mortgages. Expected maturities will differ from contractual maturities due to scheduled repayments and because borrowers may have the right to call or prepay obligations with or without prepayment penalties.

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Real Estate Mortgage Investment Conduits ("REMIC") are typically issued by a special purpose entity, which may be organized in a variety of legal forms, such as a trust, a corporation or a partnership. The entity aggregates pools of pass-through securities or mortgage loans, which are used to collateralize the mortgage related securities. Once combined, the cash flows can be divided into "tranches" or "classes" of individual securities, thereby creating more predictable average lives for each security than the underlying pass-through pools of mortgage loans. Accordingly, under this security structure, all principal paydowns from the various mortgage pools or mortgage loans are allocated to a mortgage-related securities' class or classes structured to have priority until it has been paid off. These securities generally have fixed interest rates, and as a result, changes in interest rates generally would affect the market value and possibly the prepayment rates of such securities. The characterization of a mortgage-related security as a REMIC relates solely to the tax treatment of the mortgage related security under the Internal Revenue Code.

Investment Activities

Investment Portfolio. The following table sets forth the carrying value of the Bank's securities at the dates indicated.

	At December 31, 1997	At December 31, 1998
	(Dollars in Thousands)	
U.S. government and agency securities available for sale	$1,148	$2,327
U.S. government securities	418	440
Political subdivision notes	159	718
Mortgage-backed securities available for sale	5,030	3,502
FHLB Stock	423	454
Total	$7,178	$7,441

The following table sets forth information regarding the scheduled maturities, carrying values, market value and weighted average yields for the Bank's investment securities portfolio at December 31, 1998. The following table does not take into consideration the effects of scheduled repayments or the effects of possible prepayments.
<TABLE>
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	At December 31, 1998										
	Less than 1 year		1 to 5 years		Over 5 to 10 years		Over 10 years		Total Securities		
	Carrying Value	Average Yield	Carrying Value	Average Yield	Carrying Value	Average Yield	Carrying Value	Average Yield	Carrying Value	Yield	Market Value
	(Dollars in Thousands)										
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
U.S. government and Agencies securities Available for sale	$ 250	5.50%	$2,077	5.59%	$ -	-%	$ -	-%	$ 2,327	5.58%	$ 2,327
U.S. government Securities	-	-	-	-	-	-	429	5.37	429	5.37	429
Political subdivision Notes	-	-	718	4.56	-	-	-	-	718	4.56	718
Mortgage-backed Securities available For sale:											
GNMA	-	-	-	-	-	-	521	6.94	521	6.93	521
FHLMC	-	-	2	7.00	-	-	55	7.83	57	7.80	57
FHLMC Remic	-	-	63	5.60	638	5.47	174	5.40	875	5.47	875

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FNMA..................	-	-	4	11.00	-	-	508	6.52	512	6.55	512
FNMA Remic............	-	-	-	-	490	5.78	1,047	4.98	1,537	5.23	1,537
FHLB stock (1)..........	-	-	-	-	-	-	454	6.88	454	6.88	454
Total.................	$ 250	5.50%	$2,864	5.34%	$1,128	5.61%	$3,188	5.94%	$ 7,430	5.64%	$ 7,430

</TABLE>

(1) Recorded at cost.

Sources of Funds

General. Deposits are the major external source of the Bank's funds for lending and other investment purposes. The Bank derives funds from amortization and prepayment of loans and, to a much lesser extent, maturities of investment securities, borrowings, mortgage-backed securities and operations. Scheduled loan principal repayments are a relatively stable source of funds, while deposit inflows and outflows and loan prepayments are significantly influenced by general interest rates and market conditions.

Deposits. Consumer and commercial deposits are attracted principally from within the Bank's primary market area through the offering of a selection of deposit instruments including regular savings accounts, money market accounts, and term certificate accounts. Deposit account terms vary according to the minimum balance required, the time period the funds must remain on deposit, and the interest rate, among other factors. At December 31, 1998, the Bank had no brokered accounts.

Time Deposits. The following table indicates the amount of the Bank's time deposits of $100,000 or more by time remaining until maturity as of December 31, 1998.

Maturity Period	Time Deposits (Dollars in Thousands)
Within three months....................	$1,615
More than three through six months.....	1,918
More than six through nine months......	950
Over nine months.......................	2,988
Total.........................	$7,471

Borrowings

The Bank may obtain advances from the FHLB of Cincinnati to supplement its supply of lendable funds. Advances from the FHLB of Cincinnati are typically secured by a pledge of the Bank's stock in the FHLB of Cincinnati and a portion of the Bank's first mortgage loans and certain other assets. Each FHLB credit program has its own interest rate, which may be fixed or variable, and range of maturities. The Bank, if the need arises, may also access the Federal Reserve Bank discount window to supplement its supply of lendable funds and to meet deposit withdrawal requirements.

Employees

At December 31, 1998 the Bank had 16 full-time and 3 part-time employees. None of the Bank's employees are represented by a collective bargaining group. The Bank believes that its relationship with its employees is good.

Regulation

Set forth below is a brief description of certain laws which related to the regulation of the Company and the Bank. The description does not purport to

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be complete and is qualified in its entirety by reference to applicable laws and regulations.

Company Regulation

General. The Company is a unitary savings and loan holding company subject to regulatory oversight by the OTS. As such, the Company is required to register and file reports with the OTS and is subject to regulation and examination by the OTS. In addition, the OTS has enforcement authority over the Company and its non-savings association subsidiaries, should such subsidiaries be formed, which also permits the OTS to restrict or prohibit activities that are determined to be a serious risk to the subsidiary savings association. This regulation and oversight is intended primarily for the protection of the depositors of the Bank and not for the benefit of stockholders of the Company.

Qualified Thrift Lender Test. As a unitary savings and loan holding company, the Company generally is not subject to activity restrictions, provided the Bank satisfies the Qualified Thrift Lender ("QTL") test. If the Company acquires control of another savings association as a separate subsidiary, it would become a multiple savings and loan holding company, and the activities of the Company and any of its subsidiaries (other than the Bank or any other SAIF-insured savings association) would become subject to restrictions applicable to bank holding companies unless such other associations each also qualify as a QTL and were acquired in a supervisory acquisition. See "-Regulation of the Bank Qualified Thrift Lender Test."

Regulation of the Bank

General. As a federally chartered, SAIF-insured savings association, the Bank is subject to extensive regulation by the OTS and the FDIC. Lending activities and other investments must comply with various federal statutory and regulatory requirements. The Bank is also subject to certain reserve requirements promulgated by the Federal Reserve Board.

The OTS, in conjunction with the FDIC, regularly examines the Bank and prepares reports for the consideration of the Bank's Board of Directors on any deficiencies that are found in the Bank's operations. The Bank's relationship with its depositors and borrowers is also regulated to a great extent by federal and state law, especially in such matters as the ownership of savings accounts and the form and content of the Bank's mortgage documents.

The Bank must file reports with the OTS and the FDIC concerning its activities and financial condition, in addition to obtaining regulatory approvals prior to entering into certain transactions such as mergers with or acquisitions of other savings institutions. This regulation and supervision establishes a comprehensive framework of activities in which an institution can engage and is intended primarily for the protection of the SAIF and depositors. The regulatory structure also gives the regulatory authorities extensive discretion in connection with their supervisory and enforcement activities and examination policies, including policies with respect to the classification of assets and the establishment of adequate loan loss reserves for regulatory purposes.

Under separate proposed legislation, Congress is considering the elimination of the federal thrift charter and the separate federal regulation of thrifts. As a result, the Bank might have to convert to a different financial institution charter and be regulated under federal law as a bank, including being subject to the more restrictive activity limitations imposed on national banks. The Bank cannot predict the impact of its conversion to, or regulation as, a bank until the legislation requiring such change is enacted.

Insurance of Deposit Accounts. The Bank's deposit accounts are insured by the Savings Association Insurance Fund (the "SAIF") to a maximum of $100,000 for each insured member (as defined

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by law and regulation). Insurance of deposits may be terminated by the FDIC upon a finding that the institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC or the institution's primary regulator.

As a member of the SAIF, the Bank is required to pay insurance premiums to the FDIC ranging from 0 to 27 basis points of its total assessable deposits. The FDIC also maintains another insurance fund, the Bank Insurance Fund ("BIF"), which primarily insures commercial bank deposits. Assessment rates for BIF members also range from 0 to 27 basis points. A separate levy is imposed on all FDIC insured institutions for repayment of bonds sold by the Financing Corporation ("FICO") from 1987 to 1989 in support of the Savings and Loan Insurance Corporation. However, BIF members rates for FICO are one-fifth the rate paid by SAIF members until January 1, 2000. FICO rates are subject to quarterly adjustments. The lower premium for BIF members places SAIF members at a competitive disadvantage to BIF members.

Effective September 30, 1996, federal law was revised to mandate a one-time special assessment on SAIF members such as the Bank of approximately $.657 per $100 of SAIF deposits held on March 31, 1995. Beginning January 1, 1997, the deposit insurance assessment for most SAIF members was reduced to .064% of deposits on an annual basis through the end of 1999. During this same period, BIF members will be assessed approximately .013% of deposits. After 1999, assessments for BIF and SAIF members should be the same. It is expected that these continuing assessments for both SAIF and BIF members will be used to repay outstanding Financing Corporation bond obligations. As a result of these changes, beginning January 1, 1997, the rate of deposit insurance assessed the Bank declined annually by approximately 70%.

Regulatory Capital Requirements. OTS capital regulations require savings institutions to maintain minimum capital amounts and ratios. The Bank is required to meet three capital standards: (1) tier I capital to adjusted total assets of 4%, (2) tier I capital to risk weighted assets of 4%, and (3) total capital to risk weighted assets of 8%. Management believes, as of December 31, 1998, that the Bank meets all capital adequacy requirements to which it is subject.

Dividend and Other Capital Distribution Limitations. OTS regulations require the Bank to give the OTS 30 days advance notice of any proposed declaration of dividends to the Company, and the OTS has the authority under its supervisory powers to prohibit the payment of dividends to the Company.

OTS regulations impose limitations upon all capital distributions by savings institutions, such as cash dividends, payments to repurchase or otherwise acquire its shares, payments to shareholders of another institution in a cash-out merger and other distributions charged against capital. The rule establishes three tiers of institutions, based primarily on an institution's capital level. An institution that exceeds all fully phased-in capital requirements before and after a proposed capital distribution ("Tier 1 institution") and has not been advised by the OTS that it is in need of more than the normal supervision can, after prior notice but without the approval of the OTS, make capital distributions during a calendar year equal to the greater of (i) 100% of its net income to date during the calendar year plus the amount that would reduce by one-half its "surplus capital ratio" (the excess capital over its fully phased-in capital requirements) at the beginning of the calendar year, or (ii) 75% of its net income over the most recent four quarter period. Any additional capital distributions require prior regulatory approval. As of December 31, 1998, the Bank was a Tier 1 institution. In the event the Bank's capital fell below its fully phased-in requirement or the OTS notified it that it was in need of more than normal supervision, the Bank's ability to make capital distributions could be restricted. In addition, the OTS could prohibit a

proposed capital distribution by any institution, which would otherwise be permitted by the regulation, if the OTS determines that such distribution would constitute an unsafe or unsound practice.

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Qualified Thrift Lender Test. Savings institutions must meet a QTL test. If the Bank maintains an appropriate level of Qualified Thrift Investments (primarily residential mortgages and related investments, including certain mortgage-related securities) ("QTIs") and otherwise qualifies as a QTL, it will continue to enjoy full borrowing privileges from the FHLB of Cincinnati. The required percentage of QTIs is 65% of portfolio assets (defined as all assets minus intangible assets, property used by the institution in conducting its business and liquid assets equal to 10% of total assets). Certain assets are subject to a percentage limitation of 20% of portfolio assets. In addition, savings associations may include shares of stock of the FHLBs, FNMA and FHLMC as qualifying QTIs. An association must be in compliance with the QTL test on a monthly basis in nine out of every 12 months. As of December 31, 1998, the Bank was in compliance with its QTL requirement with 80.13% of its assets invested in QTIs.

Liquidity Requirements. All savings associations are required to maintain an average daily balance of liquid assets in each calendar quarter equal to a certain percentage of the sum of its net withdrawable deposit accounts and borrowings payable in one year or less at the end of the preceding quarter, or the average daily balance of its net withdrawable deposit accounts and borrowings payable in one year or less during the preceding quarter. At December 31, 1998, the Bank's required liquidity ratio was 4.00%, and its actual ratio was 10.48%.

Federal Home Loan Bank System. The Bank is a member of the FHLB of Cincinnati, which is one of 12 regional FHLBs that administers the home financing credit function of savings associations. Each FHLB serves as a reserve or central bank for its members within its assigned region. It is funded 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 Bank is required to purchase and maintain stock in the FHLB of Cincinnati 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.

Federal Reserve System. The Federal Reserve Board requires all depository institutions to maintain non-interest bearing reserves at specified levels against their transaction accounts (primarily checking, NOW, and Super NOW checking accounts) and non-personal time deposits. The balances maintained to meet the reserve requirements imposed by the Federal Reserve Board may be used to satisfy the liquidity requirements that are imposed by the OTS. At December 31, 1998, the Bank was in compliance with these Federal Reserve Board requirements.

Item 2. Description of Property

Location	Leased or Owned	Year Leased or Acquired
MAIN OFFICE:		
632 East Elk Avenue Elizabethton, Tennessee	Owned	1980
BRANCH OFFICE:		
510 Wallace Avenue Elizabethton, Tennessee	Owned	1989

On June 30, 1998, the Bank purchased for $135,000 land and an existing building for the branch office which is to be located in nearby Mountain City, Tennessee. Management estimates that costs incidental to renovating and equipping the building to be approximately $200,000. As of December 31, 1998, the Bank had invested approximately $96,000 toward the renovation and equipping of this branch facility. The branch has not opened as of December 31, 1998.

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In addition the Bank owns property at the intersection of Riverside Drive and Hattie Avenue, Elizabethton, Tennessee which consists of a single-family dwelling that the Bank rents for $400 per month and a paved parking area for the Bank's customers and employees.

(b) Investment Policies.

See "Item 1. Business" above for a general description of the Bank's investment policies and any regulatory or Board of Directors' percentage of assets limitations regarding certain investments. The Bank's investments are primarily acquired to produce income, and to a lesser extent, possible capital gain.

(1) Investments in Real Estate or Interests in Real Estate. See "Item 1. Business - Lending Activities and - Regulation of the Bank," and "Item 2. Description of Property."

(2) Investments in Real Estate Mortgages. See "Item 1. Business - Lending Activities and Regulation of the Bank."

(3) Investments in Securities of or Interests in Persons Primarily Engaged in Real Estate Activities. See "Item 1. Business - Lending Activities and - Regulation of the Bank."

(c) Description of Real Estate and Operating Data.

Not Applicable.

Item 3. Legal Proceedings

There are various claims and lawsuits in which the Company or the Bank are periodically involved, such as claims to enforce liens, condemnation proceedings on properties in which the Bank holds security interests, claims involving the making and servicing of real property loans, and other issues incident to the Bank's business. In the opinion of management, no material loss is expected from any of such pending claims or lawsuits.

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

No matter was submitted to a vote of security holders during the fourth quarter of the fiscal year.

PART II

Item 5. Market for Common Equity and Related Stockholder Matters

The information contained under the section captioned "Stock Market Information" of the Company's Annual Report to stockholders for the fiscal year ended December 31, 1998 (the "Annual Report") is incorporated herein by reference.

Item 6. Management's Discussion and Analysis or Plan of Operation

The information contained in the section captioned "Management's Discussion and Analysis of Financial Condition and Results of Operations" in the Annual Report is incorporated herein by reference.

Item 7. Financial Statements

The Registrant's financial statements listed under Item 13 are incorporated herein by reference.

Item 8. Changes in and Disagreements with Accountants On Accounting and

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Financial Disclosure.

Not applicable.

PART III

Item 9. Directors, Executive Officers, Promoters and Control Persons: Compliance with Section 16(a) of the Exchange Act.

The information contained under the sections captioned "Section 16(a) Beneficial Ownership Reporting Compliance" and "Proposal I - Information with Respect to Nominees for Director, Directors Continuing in Office, and Executive Officers - Election of Directors" and " - Biographical Information" in the "Proxy Statement" is incorporated herein by reference.

Item 10. Executive Compensation

The information contained in the section captioned "Director and Executive Officer Compensation" in the Proxy Statement is incorporated herein by reference.

Item 11. Security Ownership of Certain Beneficial Owners and Management

(a) Security Ownership of Certain Beneficial Owners

Information required by this item is incorporated herein by reference to the first chart in the section captioned "Proposal I - Information with Respect to Nominees for Director, Directors Continuing in Office, and Executive Officers" in the Proxy Statement.

(b) Security Ownership of Management

Information required by this item is incorporated herein by reference to the first chart in the section captioned "Proposal I - Information with Respect to Nominees for Director, Directors Continuing in Office, and Executive Officers" in the Proxy Statement.

(c) Changes in Control

Management of the Registrant knows of no arrangements, including any pledge by any person of securities of the Registrant, the operation of which may at a subsequent date result in a change in control of the Registrant.

Item 12. Certain Relationships and Related Transactions

The information required by this item is incorporated herein by reference to the section captioned "Certain Relationships and Related Transactions" in the Proxy Statement.

Item 13. Exhibits, List and Reports on Form 8-K

(a) Listed below are all financial statements and exhibits filed as part of this report.

(1) The consolidated balance sheets of SFB Bancorp, Inc. and subsidiary as of December 31, 1997 and 1998 and the related consolidated statements of income, comprehensive income, changes in stockholders' equity and cash flows for each of the years in the two year period ended December 31, 1998, together with the related notes and the independent

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auditors' report of Crisp Hughes Evans LLP, independent certified public accountants.

(2) Schedules omitted as they are not applicable.

(3) The following exhibits are included in this Report or incorporated herein by reference: (a) List of Exhibits:

3(i) Charter of SFB Bancorp, Inc.*
3(ii) Bylaws of SFB Bancorp, Inc.*
4 Specimen Stock Certificate*
10 Employment Agreement between the Bank and Peter W. Hampton*
10.1 1998 Stock Option Plan**
10.2 Restricted Stock Plan and Trust Agreement**
13 Portions of the 1998 Annual Report to Stockholders
21 Subsidiaries of the Registrant (See "Item 1- Description of Business)
27 Financial Data Schedule (electronic filing only)

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* Incorporated by reference to the registration statement on Form SB-2 (File No. 333-23505) declared effective by the SEC on April 14, 1997.

(footnotes continued on next page)

** Incorporated by reference to the proxy statement for the annual meeting of stockholders on June 1, 1998 and filed with the SEC on April 17, 1998.

(b) Not applicable.

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 March 26, 1999.

SFB BANCORP, INC.

By: /s/ Peter W. Hampton

Peter W. Hampton
President and Director
(Duly Authorized Representative)

Pursuant to the requirement of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities indicated as of March 26, 1999.

/s/ Peter W. Hampton Peter W. Hampton President and Director (Principal Executive Officer)	/s/ Donald W. Tetrick Donald W. Tetrick Director
/s/ Peter W. Hampton, Jr. Peter W. Hampton, Jr. Secretary and Director	/s/ John R. Crockett, Jr. John R. Crockett, Jr. Treasurer and Director
/s/ Julian T. Caudill, Jr. Julian T. Caudill, Jr. Director	/s/ Michael L. McKinney Michael L. McKinney Director

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/s/ Bobby Hyatt

Bobby Hyatt
Assistant Vice President
(Principal Accounting Officer)

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Corporate Profile

SFB Bancorp, Inc. (the "Company") is a Tennessee corporation organized in March 1997 at the direction of Security Federal Bank (the "Bank") to acquire all of the capital stock that the Bank issued in its conversion from the mutual to stock form of ownership (the "Conversion"). On May 29, 1997, the Bank completed the Conversion and became a wholly owned subsidiary of the Company. The Company is a unitary savings and loan holding company which, under existing laws, generally is not restricted in the types of business activities in which it may engage provided that the Bank retains a specified amount of its assets in housing-related investments. The Company conducts no significant business or operations of its own other than holding all of the outstanding stock of the Bank and investing the Company's portion of the net proceeds obtained in the Conversion.

The Bank, chartered in 1963 under the name Security Federal Savings and Loan Association, is a federally chartered stock savings bank headquartered in Elizabethton, Tennessee. The Bank is subject to examination and comprehensive regulation by the Office of Thrift Supervision ("OTS") and its deposits are federally insured by the Savings Association Insurance Fund ("SAIF") of the Federal Deposit Insurance Corporation (the "FDIC"). The Bank is a member of and owns capital stock in the FHLB of Cincinnati, which is one of the 12 regional banks in the FHLB System. The Bank operates a traditional savings bank business, attracting deposit accounts from the general public and using those deposits, together with other funds, primarily to originate and invest in loans secured by single-family residential real estate primarily in Carter County, Tennessee and the adjacent Tennessee counties of Johnson, Unicoi, Washington and Sullivan.

Stock Market Information

The table below reflects the stock trading and dividend payment frequency of the Company for each quarter completed in the period June 1, 1997 through December 31, 1998. Since its issuance on May 29, 1997, the Company's common stock has been traded on the OTC Bulletin Board under the trading symbol "SFBK". The quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission, and may not represent actual transactions.

Date	High	Low	Dividend Declared
June 1, 1997 - June 30, 1997	$14.00	$13.38	$ -
July 1, 1997 - September 30, 1997	$15.50	$14.00	$ -
October 1, 1997 - December 31, 199	$15.63	$14.00	$ -
January 1, 1998 - March 31, 1998	$16.50	$15.50	$ -
April 1, 1998 - June 30, 1998	$17.25	$16.61	$ 0.10
July 1, 1998 - September 30, 1998	$17.25	$13.75	$ -
October 1, 1998 - December 31, 1998	$13.00	$11.50	$ 0.10

The number of shareholders of record as of March 15, 1999, was approximately 165. This does not reflect the number of persons or entities who held stock in "street" name through various brokerage firms. At March 15, 1999, there were 692,217 shares outstanding.

The Company's ability to pay dividends to stockholders is subject to the requirements of Tennessee law, which generally limits the payment of dividends to amounts that will not affect the ability of the Company to pay its debts as they become due in the normal course of business. Further, the Company's ability to pay dividends is also dependent upon the dividends it receives from the Bank. Generally, the Bank may not declare or pay a cash dividend if the effect thereof would cause the Bank's regulatory capital to be reduced below (1) the amount required for the liquidation account established in connection with the Conversion, or (2) the regulatory capital requirements imposed by the OTS.

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

General

The Private Securities Litigation Reform Act to 1995 contains safe harbor provisions regarding forward-looking statements. When used in this discussion, the words "believes", "anticipates", "contemplates" "expects", and similar expressions are intended to identify forward-looking statements. Such statements are subject to certain risks and uncertainties which could cause actual results to differ materially from those projected. Those risks and uncertainties include changes in interest rates, risk associated with the effect of opening a new branch, the ability to control costs and expenses, and general economic conditions. The Company undertakes no obligation to publicly release the results of any revisions to those forward looking statements which may be made to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

The following discussion and analysis is intended to assist in understanding the financial condition and the results of operations of the Company. References to the "Company" include SFB Bancorp, Inc. and/or the Bank as appropriate.

Asset/Liability Management

The Bank's net interest income is sensitive to changes in interest rates, as the rates paid on interest-bearing liabilities generally change faster than the rates earned on interest-earning assets. As a result, net interest income will frequently decline in periods of rising interest rates and increase in periods of decreasing interest rates.

The Board of Directors reviews the Bank's asset/liability policy and meets quarterly to review interest rate risk and trends, as well as liquidity and capital ratios requirements. Rates on deposits are primarily based on the Bank's need for funds and a review of rates offered by other financial institutions in the Bank's market area. Interest rates on loans are primarily based on the interest rates offered by other financial institutions in the Bank's primary market area as well as the Bank's cost of funds. The Bank's principal strategy is to manage the interest rate sensitivity of interest-earning assets and to attempt to match the maturities of interest-earning assets with interest-bearing liabilities, while allowing for a mismatch in an effort to increase net interest income.

Because of the lack of customer demand for adjustable rate loans in the Bank's market area, the Bank primarily originates fixed-rate real estate loans which approximated 77% of the loan portfolio at December 31, 1998. To manage the interest rate risk of this type of loan portfolio, the Bank limits maturities of fixed-rate loans to no more than 15 years and maintains a portfolio of liquid assets. Maintaining liquid assets tends to reduce potential net income because liquid assets usually provide a lower yield than less liquid assets. At December 31, 1998, the estimated average weighted term to maturity of the Bank's mortgage loan portfolio was slightly over 11 years and the estimated average weighted term of the Bank's deposits was slightly less than 6 months.

Net Portfolio Value

The Bank computes amounts by which the net present value of cash flow from assets, liabilities and off balance sheet items ("net portfolio value" or "NPV") would change in the event of a range of assumed changes in market interest rates. These computations estimate the effect on the Bank's NPV from an instantaneous and permanent 1% to 4% (100 to 400 basis points) increases and decreases in market interest rates. Based upon OTS assumptions, the following table presents the Bank's NPV at December 31, 1998.

Changes in Rates	NPV Ratio %(1)	Change(2)
+400 bp	13.97	-502 bp
+300 bp	15.46	-352 bp
+200 bp	16.90	-208 bp
+100 bp	18.13	- 85 bp
0 bp	18.98	0 bp
-100 bp	19.50	+ 51 bp
-200 bp	19.99	+101 bp
-300 bp	20.64	+166 bp
-400 bp	21.22	+224 bp

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(1) Calculated as the estimated NPV divided by present value of total assets.
(2) Calculated as the excess (deficiency) of the NPV ratio assuming the indicated change in interest rates over the estimated NPV ratio assuming no change in interest rates.

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These calculations indicate that the Bank's net portfolio value could be adversely affected by increases in interest rates but could be favorably affected by decreases in interest rates. In addition, the Bank would be deemed to have more than a normal level of interest rate risk under applicable regulatory capital requirements.

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. Although certain assets and liabilities may have similar maturity or periods of repricing, they may react at different times and in different degrees to changes in the market interest rates. The interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while rates on other types of assets and liabilities may lag behind changes in market interest rates. Certain assets, such as adjustable rate mortgages, generally have features which restrict changes in interest rates on a short term basis and over the life of the asset. In the event of a change in interest rates, prepayments and early withdrawal levels could deviate significantly from those assumed in making calculations set forth above. Additionally, an increased credit risk may result as the ability of many borrowers to service their debt may decrease in the event of an interest rate increase.

Average Balance Sheet

The following table sets forth certain information relating to the Company's average balance sheet and reflects the average yield on assets and average cost of liabilities for the periods indicated. Such yields and costs are derived by dividing income or expense by the average balance of assets or liabilities, respectively, for the periods presented. Average balances are derived from month-end balances. Management does not believe that the use of month-end balances instead of daily average balances has caused any material differences in the information presented.
<TABLE>
<CAPTION>

	For the Years Ended December 31,					
	1997			1998		
	Average Balance	Interest	Average Yield/ Cost	Average Balance	Interest	Average Yield/ Cost
	(Dollars in Thousands)					
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Interest-earning assets:						
Loans receivable(1)......................	$38,701	$3,253	8.41%	$40,608	$3,409	8.39%
Investment securities	1,293	81	6.26	2,971	154	5.18
Interest-earning deposits...............	3,426	175	5.11	3,053	158	5.18
Federal Home Loan Bank stock............	407	29	7.13	437	31	7.14
Mortgage-backed securities..............	5,392	312	5.79	4,287	237	5.53
Total interest-earning assets.............	49,219	3,850	7.82	51,356	3,989	7.77
Non-interest-earning assets...............	1,701			1,549		
Total assets	$50,920			$52,905		
Interest-bearing liabilities:						
Interest-bearing demand deposits.........	$10,245	262	2.56	$9,667	249	2.58
Certificates of deposit.................	30,869	1,722	5.58	30,427	1,710	5.62
Short-term borrowings...................	50	3	6.00	-	-	-
Total interest-bearing liabilities.........	41,164	1,987	4.83	40,094	1,959	4.89
Non-interest-bearing liabilities..........	906			1,046		
Total liabilities.........................	42,070			41,140		
Total stockholders' equity................	8,850			11,765		
Total liabilities and stockholders' equity.	$50,920			$52,905		
Net interest income.......................		$1,863			$2,030	
Interest rate spread (2)..................			3.00%			2.88%

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Net yield on interest-earning assets(3)....	3.79%	3.95%
Ratio of average interest-earning assets to average interest-bearing liabilities.....	119.57%	128.09%

</TABLE>

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(1) Average balances include non-accrual loans.
(2) Interest rate spread represents the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities.
(3) Net yield on interest-earning assets represents net interest income as a percentage of average interest-earning assets.

Rate/Volume Analysis

The table below sets forth certain information regarding changes in interest income and interest expense of the Company for 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 (changes in average volume multiplied by old rate); (ii) changes in rates (changes in rate multiplied by old average volume); (iii) changes in rate-volume (changes in rate multiplied by the change in average volume).

<TABLE>
<CAPTION>

	Year Ended December 31,							
	1997 vs. 1996				1998 vs. 1997			
	Increase (Decrease) Due to				Increase (Decrease) Due to			
	Volume	Rate	Rate/ Volume	Net	Volume	Rate	Rate/ Volume	Net
	(Dollars in Thousands)							
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
Interest income:								
Loans receivable..............	$311	$ 4	$(2)	$313	$160	$ (8)	$ 4	$ 156
Mortgage-backed securities.....	(67)	1	(1)	(67)	105	(14)	(18)	(75)
Investment securities..........	(2)	22	-	20	(64)	(14)	3	73
Other interest-earning assets..	111	-	(1)	110	(18)	4	(1)	(15)
Total interest income.........	$ 353	$ 27	$ (4)	$376	$ 183	$ (32)	$ (12)	$ 139
Interest expense:								
Savings accounts..............	$29	$ (16)	$ (4)	$ 9	$ (49)	$ 16	$ 8	$ (25)
Other liabilities.............	1	-	-	1	(3)	-	-	(3)
Total interest expense.......	$ 30	$ (16)	$ (4)	$ 10	$ (52)	$ (16)	$ 8	$ (28)
Net change in interest income...	$ 323	$ 43	$ -	$366	$ 235	$ (48)	$ (20)	$ 167

</TABLE>

Comparison of Financial Condition

The Company's total consolidated assets decreased by approximately $1.5 million or 2.8% from $53.3 million at December 31, 1997 to $51.9 million at December 31, 1998. The decrease in assets for the year was primarily due to funds used for the stock repurchase programs, net deposit withdrawals, and stock purchased in the open market for the restricted stock plan. Total cash and interest-earning deposits decreased approximately $1.8 million to $2.8 million at December 31, 1998, as funds were shifted to investment securities which increased by approximately $1.7 million to $3.5 million at December 31, 1998. Mortgage backed securities decreased approximately $1.5 million to $3.5 million at December 31, 1998, as the portfolio continues to mature.

Stockholders' equity decreased $911,000 to approximately $11.3 million at December 31, 1998 from $12.2 million at December 31, 1997. The decrease was attributable to the

repurchase of approximately $1.0 million of the Company's outstanding capital

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stock, payment of cash dividends in the amount of $138,000, and the recognition of $524,000 in unearned compensation for the Bank's Restricted Stock Plan, offset by comprehensive income of $526,000.

Comparison of the Results of Operations for the Years Ended December 31, 1998 and 1997

Net Income. Net income decreased $92,000, or 15.6%, in 1998 as compared to 1997. The decrease was primarily the result of an increase of $271,000 in non-interest expenses and an increase in provision for loan losses of $21,000, offset by an increase of $167,000 in net interest income and a decrease in income tax expense of $24,000.

Net Interest Income. Net interest income is the most significant component of the Company's income from operations. Net interest income is the difference between interest received on interest-earning assets (primarily loans and investment securities) and interest paid on interest-bearing liabilities (primarily deposits and borrowed funds). Net interest income depends on the volume and rate earned on interest-earning assets and the volume and interest rate paid on interest-bearing liabilities.

Net interest income increased $167,000, or 9.0%, to approximately $2.0 million in 1998, compared to approximately $1.9 million in 1997. The increase was primarily due to the growth in average interest-earning assets and a decrease in interest bearing liabilities. Average interest-earning assets increased to approximately $51.4 million in 1998 from approximately $49.3 million in 1997, while average interest bearing liabilities decreased $1.1 million. This net growth offset the 12 basis points decrease in the interest rate spread. The interest rate spread declined to 2.88% in 1998 from 3.00% in 1997. The net interest margin increased 16 basis points to 3.95% in 1998 from 3.79% in 1997.

The 12 basis point decline in the interest rate spread in 1998 compared to 1997 was primarily due to the combination of a decrease in the yield on average interest-earning assets of 5 basis points from 7.82% in 1997 to 7.77% in 1998, and a 6 basis point increase in the average cost of interest-bearing liabilities from 4.83% in 1997 to 4.89% in 1998.

Interest income. Interest income increased $139,000, or 3.6%, from approximately $3.9 million in 1997, to approximately $4.0 million for 1998. This overall increase in interest income was primarily the result of an increase in average interest-earning assets of approximately $2.0 million for 1998, as compared to 1997. Interest income on loans increased by $156,000, as average loans outstanding increased by $1.9 million in 1998. Loans receivable are the largest earning asset held in the Company's portfolio. For 1998, the average yield on loans receivable was 8.39% compared to 8.41% for 1997.

Interest income on investment securities increased by $73,000, as the average balance invested increased by $1.7 million in 1998. Interest income on interest-earning deposits and mortgage-backed securities decreased by $92,000. Funds invested in these interest-earning

assets were used to fund the stock repurchases, benefit plans and dividend payments.

Interest Expense. Interest expense decreased $28,000 from approximately $1.97 million for the year ended December 31, 1997 to approximately $1.96 million for the year ended December 31, 1998. The decrease for 1998 was the result of an approximate $1.1 million decrease in average interest-bearing liabilities, partially offset by a 6 basis point increase in the average cost of funds. The Bank reflected an increase in both the average cost of funds for interest-bearing demand deposits and certificates of deposits of 2 basis points and 4 basis points, respectively.

Provision for Loan Losses. The provision for loan losses was $10,000 for year ended December 31, 1997 and $31,000 for the year ended December 31, 1998. The increase in the provision for loan losses in 1998 was mainly attributable to the increase in the Bank's nonperforming loan portfolio. Nonperforming assets were $437,000 at December 31, 1998, compared to $209,000 at December 31, 1997. The ratio of the allowance for loan losses to non-performing loans at December 31, 1998 was 75.0% compared to 144.0% at December 31, 1997. The allowance for loan losses as a percent of total loans outstanding was .79% and .72% at December 31, 1998 and 1997, respectively.

Historically, management has emphasized loss experience over other factors in establishing the provision for loan losses. Management reviews the allowance for loan losses in relation to (i) past loan loss experience, (ii) known and inherent risks in the portfolio, (iii) adverse situations that may affect the borrower's ability to repay, (iv) the estimated value of any underlying collateral, and (v) current economic conditions. There can be no assurances, however, that future losses will not exceed estimated amounts or that additional provisions for loan losses will not be required in future periods. At December

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31, 1998, the allowance for loan losses was at a level deemed adequate by management to provide for losses in the portfolio.

Non-Interest Expense. Non-interest expense increased by $271,000 from approximately $1.0 million for the year ended December 31, 1997 to approximately $1.3 million for the year ended December 31, 1998. The increase was primarily the result of increased compensation expense of $179,000 and $70,000 of other expense incurred during the period. The increase in compensation expense for the year ended December 31, 1998, was primarily attributable to the recognition of additional compensation expense associated with the stockholder approved Restricted Stock Plan (RSP). On June 1, 1998, the plan's approval resulted in an immediate recognition of 20% of the value of shares granted and for the remainder of 1998 subsequent monthly accruals for the vesting benefits as earned. The expenses recognized for the RSP the year ended December 31, 1998 was approximately $166,000. The increase in other non-interest expense was mainly attributable to professional fees and expenses incurred by the Company in connection with its first annual meeting, SEC filings, and proxy material preparation and mailing. Employee benefits, net occupancy, deposit insurance premiums, and data processing expenses remained relatively stable during the year ended December 31, 1998 as compared to 1997.

As discussed herein, the Bank plans to open an additional branch office in nearby Mountain City, Tennessee, during the first half of 1999. The Company expects that non-interest expense will increase during 1999 due to the costs associated with opening and maintaining this additional branch office. See "Liquidity and Capital Resources".

Income Taxes. Income tax expense decreased $24,000 or 6.50%, to $345,000 for the year ended December 31, 1998 from $369,000 for the year ended December 31, 1997. The decrease was principally the result of $116,000 in lower pre-tax income for 1998 compared to 1997. The effective tax rate for both twelve months periods in 1998 and 1997 was approximately 39.0%.

Liquidity and Capital Resources

The primary sources of funds are deposits, repayments of loans and mortgage-backed securities, maturities of investments and interest-bearing deposits, funds provided from operations and advances from the FHLB of Cincinnati. While scheduled repayments of loans and mortgage-backed securities and maturities of investment securities are predictable sources of funds, deposit flows and loan prepayments are greatly influenced by the general level of interest rates, economic conditions and competition. The Bank uses its sources of funds to fund existing and future loan commitments, to fund maturing certificates of deposit and demand deposit withdrawals, to invest in other interest-earning assets, to maintain liquidity, and to meet operating expenses.

Net cash provided by operating activities for the year ended December 31, 1998 totaled $187,000 as compared to $856,000 for the year ended December 31, 1997. The decrease was primarily the result of the purchase of the restricted stock plan shares for $524,000.

Net cash used by investing activities for the year ended December 31, 1998 totaled $276,000, a decrease of approximately $3.2 million as compared to 1997. The decrease was primarily attributable to a net decrease in loans funded of approximately $3.6 million, proceeds from maturities, sales, and repayments of investment and mortgage-backed securities of approximately $1.6 million, offset by an increase in net purchases of investment securities of approximately $2.2 million.

Net cash used by financing activities for 1998 totaled approximately $1.7 million. This was primarily the result of approximately $1.0 million of common stock repurchases, $138,000 in dividends paid, and a decrease in deposits of $481,000.

Liquidity may be adversely affected by unexpected deposit outflows, excessive interest rates paid by competitors, adverse publicity relating to the savings and loan industry and similar matters. Management monitors projected liquidity needs and determines the level desirable, based in part on the Bank's commitments to make loans and management's assessment of the Bank's ability to generate funds.

The Bank during the quarter ended June 30, 1998, filed a notice with the OTS for the

establishment of a branch office. The Bank purchased for $135,000 land and an existing building for the branch office which is to be located in nearby

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Mountain City, Tennessee. Management estimates that costs incidental to renovating and equipping the building to be approximately $200,000. As of December 31, 1998, the Bank had invested approximately $96,000 toward the renovation and equipping of this branch facility. The branch has not opened as of December 31, 1998.

At December 31, 1998, management had no knowledge of any trends, events or uncertainties that will have or are reasonably likely to have material effects on the liquidity, capital resources or operations of the Company. Further at December 31, 1998, management was not aware of any current recommendations by the regulatory authorities which, if implemented, would have such an effect.

Year 2000 Compliance. A great deal of information has been disseminated about the Year 2000 as it relates to computer systems. Many computer programs that can only distinguish the final two digits of the year entered (a common programming practice in earlier years) are expected to read entries for the Year 2000 as the Year 1900 and compute payment, interest or delinquency based on the wrong date or are expected to be unable to compute payment, interest or delinquency. Rapid and accurate data processing is essential to the Bank's operations. Data processing is also essential to most other financial institutions and many other companies. Substantially all of the Bank's material data processing that could be affected by this problem is provided by a third party service bureau. The service bureau has informed the Bank that it will not be assessing special charges for the renovation and testing of its hardware and software in preparation for Year 2000. However, if the service bureau is unable to resolve this potential problem in time, the Bank would likely experience significant data processing delays, mistakes or failures. These delays, mistakes or failures could have a significant adverse impact on our financial condition and results of operation.

The Bank has formulated a Year 2000 Compliance Plan and a Year 2000 Contingency Plan. The Year 2000 Compliance Plan is structured in accordance with the Office of Thrift Supervision's Year 2000 Examination Checklist, Version 2. It addresses the identified phases of: Awareness, Assessment, Renovation, Validation and Implementation. The purpose of the plan is to outline the procedures necessary for assuring that the Bank is in readiness for the century date change. Execution of the plan is currently on target. The Bank's Year 2000 Contingency Plan is designed to prepare the institution for returning to operation in the event that systems do not perform as planned either before or after the century date change. The plan addresses vital mission critical applications and states both the plans in the event of noncompliance and dates for when the plan will be put into effect.

The Company has contacted other material vendors and supplier regarding their Year 2000 state of readiness. The Company has obtained written assurance from these third party vendors indicating that they expect to be Year 2000 compliant prior to the Year 2000.

The Bank's third party service bureau during October 1998, converted the Bank to its new state of the art core account processing platform. This new technology was built with Year

2000 compatible components. The service bureau during October 1998, conducted Year 2000 proxy testing on this new platform. The Bank expects to commence testing in May 1999. In addition, each application of the system has been renovated to run on the new platform and date fields expanded to a four digit year. Other service bureau products and services utilized by the Bank are expected to be brought Year 2000 compliant by June 1999.

The Bank is planning to upgrade its teller operating system during the first quarter of 1999. This upgrade will further ensure Year 2000 readiness by using Year 2000 certified software and hardware. The Company's management estimates costs incidental to the upgrade to be approximately $100,000. The Company's management anticipates that substantially all of such costs will be capitalized. These costs should not be material to the Company in any single year. As of December 31, 1998, the Company capitalized approximately $30,000 in regard to Year 2000 compliance.

The Company's successful and timely completion of the Year 2000 project is based on estimates derived by management on assumptions of future events, which are inherently uncertain, including the progress and results of the Company's third party service provider, testing plans, and all vendors, suppliers and customer readiness.

Impact of Inflation and Changing Prices

Unlike most industrial companies, substantially all the assets of the Company are monetary in nature. As a result, interest rates have a greater impact on the Company's performance than do the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or to the same extent as the price for goods and services.

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[LOGO] Crisp
Hughes
Evans
LLP Certified Public Accountants & Consultants

Affiliated worldwide through AGN International

Independent Auditors' Report

To the Board of Directors
SFB Bancorp, Inc. and Subsidiary

We have audited the accompanying consolidated balance sheets of SFB Bancorp, Inc. and Subsidiary (the "Company") as of December 31, 1997 and 1998, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for the years then ended. 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 1997 and 1998, and the results of their operations and their cash flows for the years then ended, in conformity with generally accepted accounting principles.

/s/ Crisp Hughes Evans LLP

Asheville, North Carolina
January 22, 1999

32 Orange Street 704 254 2254
PO Box 3049 Fax 704 254 6859
Asheville, NC 28802 www.che-llp.com

SFB BANCORP, INC.
AND SUBSIDIARY

Consolidated Balance Sheets
(in thousands, except share data)

<TABLE>
<CAPTION>

Assets	December 31, 1997	December 31, 1998
<S>	<C>	<C>
Cash on hand	$ 453	$ 467
Interest earning deposits	4,139	2,372
Investment securities:		
Held to maturity (market value of $526 in 1997 and $1,147 in 1998)	577	1,158
Available for sale (amortized cost of $1,149 in 1997 and $2,325 in 1998)	1,148	2,327

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Loans receivable, net	40,648	40,449
Mortgage-backed securities:		
Available for sale (amortized cost of $5,117 in 1997 and $3,544 in 1998)	5,030	3,502
Premises and equipment, net	575	849
Federal Home Loan Bank stock	423	454
Accrued interest receivable	316	265
Prepaid expenses and other assets	28	23
Total assets	$ 53,337	$ 51,866
Liabilities and Stockholders' Equity		
Deposits	$ 40,587	$ 40,106
Advance payments by borrowers for taxes and insurance	199	188
Accrued expenses and other liabilities	144	221
Income taxes payable:		
Current	164	-
Deferred	62	81
Total liabilities	41,156	40,596
Stockholders' equity:		
Preferred stock ($.10 par value, 1,000,000 shares authorized; none outstanding)	-	-
Common stock ($.10 par value, 4,000,000 shares authorized; 767,000 shares issued; 767,000 and 694,150 outstanding at December 31, 1997 and 1998, respectively)	77	77
Paid-in capital	7,336	7,368
Retained income, substantially restricted	5,373	5,732
Treasury stock at cost (72,850 shares)	-	(1,034)
Accumulated other comprehensive income	(53)	(24)
Unearned compensation:		
Employee stock ownership plan	(552)	(491)
Restricted stock plan	-	(358)
Total stockholders' equity	12,181	11,270
Total liabilities and stockholders' equity	$ 53,337	$ 51,866

</TABLE>

The accompanying notes are an integral part of these consolidated financial statements.

SFB BANCORP, INC.
AND SUBSIDIARY

Consolidated Statements of Income
(in thousands, except per share data)

<TABLE>
<CAPTION>

	Years Ended December 31,	
	1997	1998
Interest income:		
Loans	$ 3,253	$ 3,409
Mortgage-backed securities	312	237
Investments	110	185
Interest earning deposits	175	158
Total interest income	3,850	3,989
Interest expense:		
Deposits	1,984	1,959
Federal Home Loan Bank advances	3	-
Total interest expense	1,987	1,959

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Net interest income	1,863	2,030
Provision for loan losses	10	31
Net interest income after provision for loan losses	1,853	1,999
Noninterest income:		
Loan fees and service charges	149	157
Other	10	11
Total noninterest income	159	168
Noninterest expenses:		
Compensation	498	677
Employee benefits	122	125
Net occupancy expense	75	82
Deposit insurance premiums	21	24
Data processing	74	83
Other	264	334
Total noninterest expenses	1,054	1,325
Income before income taxes	958	842
Income tax expense	369	345
Net income	$ 589	$ 497
Net income per common share:		
Basic	See Note 1	$ .71
Diluted		.71
Weighted-average shares:		
Basic		699
Diluted		699

</TABLE>

The accompanying notes are an integral part of these consolidated financial statements.

SFB BANCORP, INC.
AND SUBSIDIARY

Consolidated Statements of Comprehensive Income
(in thousands)

<TABLE>
<CAPTION>

	Years Ended December 31,	
	1997	1998
<S>	<C>	<C>
Net income	$ 589	$ 497
Other comprehensive income:		
Net unrealized gains on securities available for sale, net of tax expense of $32 and $19, respectively	55	29
Comprehensive income	$ 644	$ 526

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</TABLE>

The accompanying notes are an integral part of these consolidated financial statements.

SFB BANCORP, INC.
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Consolidated Statements of Stockholders' Equity
(in thousands, except share data)

<TABLE>
<CAPTION>

	Common Stock	Paid-In Capital	Retained Income	Treasury Stock	Accumulated Other Comprehensive Income	Unearned Compensation for ESOP	Unearned Compensation for RSP	Total
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
Balance at December 31, 1996	$ -	$ -	$ 4,784	$ -	$ (108)	$ -	$ -	$ 4,676
Comprehensive income:								
Net income	-	-	589	-	-	-	-	589
Unrealized gain on securities available for sale, net of income tax expense	-	-	-	-	55	-	-	55
Sale of common stock, net of issuance cost (767,000 shares)	77	7,307	-	-	-	(614)	-	6,770
Compensation earned	-	29	-	-	-	62	-	91
Balance at December 31, 1997	77	7,336	5,373	-	(53)	(552)	-	12,181
Comprehensive income:								
Net income	-	-	497	-	-	-	-	497
Unrealized gain on securities available for sale, net of income tax expense	-	-	-	-	29	-	-	29
Common stock purchased for RSP (30,680 shares)	-	-	-	-	-	-	(524)	(524)
Cash dividends declared ($.20 share)	-	-	(138)	-	-	-	-	(138)
Treasury stock purchased (72,850 shares)	-	-	-	(1,034)	-	-	-	(1,034)
Compensation earned	-	32	-	-	-	61	166	259
Balance at December 31, 1998	$ 77	$ 7,368	$ 5,732	$ (1,034)	$ (24)	$ (491)	$(358)	$ 11,270

</TABLE>

The accompanying notes are an integral part of these consolidated financial statements.

SFB BANCORP, INC.
AND SUBSIDIARY

Consolidated Statements of Cash Flows
(in thousands)

<TABLE>
<CAPTION>

	Years Ended December 31,	
	1997	1998

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<S> <C> <C>

Operating activities:		
Net income	$ 589	$ 497
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	53	56
Provision for loan losses	10	31
Loss on sale of real estate owned	9	-
Deferred income taxes (benefit)	29	-
Net decrease in deferred loan fees	(4)	(9)
Accretion of discounts on investment securities, net	(21)	(23)
Amortization of premiums on mortgage-backed securities	10	14
Amortization of unearned compensation	91	259
Purchase of RSP shares	-	(524)
FHLB stock dividends	(29)	(31)
(Increase) decrease in other assets	5	5
(Increase) decrease in accrued interest receivable	(59)	51
Increase in accrued expenses and other liabilities	22	25
Increase (decrease) in current income taxes	151	(164)
Net cash provided by operating activities	856	187
Investing activities:		
Purchase of investment securities held to maturity	-	(710)
Maturities of investment securities held to maturity	159	151
Purchase of investment securities available for sale	(1,350)	(2,875)
Maturities of investment securities available for sale	800	1,700
Principal payments on mortgage-backed securities available for sale	814	1,559
Proceeds from sale of real estate	10	-
Net (increase) decrease in loans	(3,805)	177
Purchase of premises and equipment	(95)	(278)
Net cash used by investing activities	(3,467)	(276)

</TABLE>

(continued)

SFB BANCORP, INC.
AND SUBSIDIARY

Consolidated Statements of Cash Flows, Continued
(in thousands)

<TABLE>
<CAPTION>

<S> <C> <C>

	Years Ended December 31,	
	1997	1998
Financing activities:		
Net decrease in deposits	$ (178)	$ (481)
Decrease in advance payments by borrowers for taxes and insurance	(3)	(11)
Proceeds from FHLB advances	400	-
Repayment of FHLB advances	(1,200)	-
Treasury stock purchased	-	(1,034)
Dividends paid	-	(138)
Net proceeds from issuance of common stock	6,770	-
Net cash provided (used) by financing activities	5,789	(1,664)
Increase (decrease) in cash and cash equivalents	3,178	(1,753)
Cash and cash equivalents at beginning of year	1,414	4,592
Cash and cash equivalents at end of year	$ 4,592	$ 2,839

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Supplemental disclosures of cash flow information:		
Cash paid during the year for:		
Interest	$ 1,975	$ 1,946
Income taxes	189	517
Noncash transactions:		
Unrealized gains on securities and mortgage-backed securities available for sale, net of deferred taxes	$ 55	$ 29
Non-cash acquisition of premises and equipment	-	52
Loan to facilitate sale of real estate owned	41	-

</TABLE>

The accompanying notes are an integral part of these consolidated financial statements.

SFB BANCORP, INC.
AND SUBSIDIARY

Notes to Consolidated Financial Statements

December 31, 1997 and 1998
(Tabular amounts in thousands)

1. Summary of Significant Accounting Policies

The accounting and reporting policies of SFB Bancorp, Inc. ("Bancorp") and its subsidiary, Security Federal Bank (the "Bank"), conform, in all material respects, to generally accepted accounting principles and to general practices within the savings bank industry. The following summarize the more significant of these policies and practices.

Nature of Operations - Bancorp was incorporated under the laws of the state of Tennessee for the purpose of becoming the holding company of the Bank in connection with the Bank's conversion from a federally chartered mutual savings bank to a federally chartered stock savings bank, pursuant to its Plan of Conversion. A Subscription Offering of its shares in connection with the conversion of the Savings Bank (the "Conversion") was completed on May 29, 1997 (see Note 10). The transaction was accounted for using the "pooling of interests" method.

Bancorp's only line of business is investing in its bank subsidiary. The Bank's principal line of business is originating single-family mortgage, consumer, and commercial loans, and accepting deposits from the general public.

Estimates - The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that effect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues during the reporting period. Actual results could differ from those estimates.

Principles of Consolidation - The consolidated financial statements include the accounts of the Bancorp, the Bank, and the Bank's wholly-owned subsidiary, SFS, Inc. (SFS), herein collectively referred to as the Company. The impact of SFS on the consolidated financial statements is insignificant. SFS has no operating activity other than to own stock in a third-party service bureau. Intercompany balances and transactions have been eliminated.

Comprehensive Income - The Company adopted Financial Accounting Standards Board No. 130, "Reporting Comprehensive Income" (SFAS 130), effective December 31, 1997. SFAS No. 130 establishes standards for reporting comprehensive income and its components (revenues, expenses, gains and

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losses). Components of comprehensive income are net income and all other non-owner changes in equity. The statement requires that an enterprise (a) classify items of other comprehensive income by their nature in a financial statement and (b)

display the accumulated balance of other comprehensive income separately from common stock or retained income in the equity section of a balance sheet. Reclassification of financial statements for earlier periods provided for comparative purposes is required.

The Company has chosen to disclose comprehensive income in a separate statement.

The only component of other comprehensive income consists of unrealized holding gains on securities.

Loans Receivable - Loans receivable are carried at their unpaid principal balance less, where applicable, net deferred loan fees and allowances for losses. Additions to the allowances for losses are based on management's evaluation of the loan portfolio under current economic conditions and such other factors which, in management's judgment, deserve recognition in estimating losses. Interest accrual is discontinued when a loan becomes 90 days delinquent unless, in management's opinion, the loan is well secured and in process of collection. Interest income on impaired loans is recognized on a cash basis.

Loan Fees - Loan fees result from the origination of loans. Such fees and certain direct incremental costs related to origination of such loans are deferred ("net deferred loan fees") and reflected as a reduction of the carrying value of loans. The net deferred loan fees (or costs) are amortized using the interest method over the contractual lives of the loans. Unamortized net deferred loan fees on loans sold prior to maturity are credited to income at the time of sale.

Investment Securities and Mortgage-Backed Securities - Investment securities held to maturity are stated at amortized cost since the Company has both the ability and positive intent to hold such securities to maturity. Premiums and discounts on the investment securities are amortized or accreted into income over the contractual terms of the securities using a level yield interest method. Gains and losses on the sale of these securities are calculated based on the specific identification method.

Investment securities and mortgage-backed securities available for sale are carried at fair value. The Company has identified their holdings in certain debt securities and all mortgage-backed securities as available for sale. The unrealized holding gains or losses on securities available for sale are reported, net of related income tax effects, as accumulated other comprehensive income. Changes in unrealized holding gains or losses are included as a component of other comprehensive income until realized. Gains or losses on sales of securities available for sale are based on the specific identification method.

Real Estate - Real estate properties acquired through loan foreclosure are initially recorded at fair value at the date of foreclosure. Subsequent to foreclosure, real estate is recorded at the lower of initial fair value or existing fair value less estimated costs to sell (net realizable value). Real estate property held for investment is carried at the lower of cost, including cost of property improvements incurred subsequent to acquisition less depreciation, or net realizable

value. Costs relating to development and improvement of properties are capitalized, whereas costs relating to the holding of property are expensed.

Valuations are periodically performed by management, and an allowance for losses is established by a charge to income if the carrying value of a property exceeds its estimated net realizable value.

Premises and Equipment - Land is carried at cost. Office properties and equipment are carried at cost less accumulated depreciation. Depreciation is computed on a straight-line method over the estimated useful lives of

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the assets ranging from 5 to 40 years. The cost of maintenance and repairs is charged to expense as incurred while expenditures which materially increase property lives are capitalized.

Federal Home Loan Bank Stock - Investment in stock of a Federal Home Loan Bank is required by law of every federally insured savings and loan or savings bank. The investment is carried at cost. No ready market exists for the stock, and it has no quoted market value.

Income Taxes - The Bank and its subsidiary follow the practice of filing consolidated income tax returns. Income taxes are allocated to the Bank and subsidiary as though separate returns are being filed. Bancorp files separate income tax returns.

The Company utilizes the liability method of computing income taxes in accordance with Statement of Financial Accounting Standard No. 109, "Accounting for Income Taxes" (SFAS 109). Under the liability method, deferred tax liabilities and assets are established for future tax return effects of temporary differences between the stated value of assets and liabilities for financial reporting purposes and their tax bases. The focus is on accruing the appropriate balance sheet deferred tax amount, with the statement of income effect being the result of changes in balance sheet amounts from period to period. Current income tax expense is provided based upon the actual tax liability incurred for tax return purposes.

Cash Flow Information - As presented in the consolidated statements of cash flows, cash and cash equivalents include cash on hand and interest-earning deposits in other banks. The Company considers all highly liquid instruments with original maturities of three months or less to be cash equivalents.

Earnings Per Share - Basic and dilutive earnings per share amounts for 1998 are computed in accordance with the Statement of Financial Accounting Standards No 128, "Earnings per Share" (SFAS 128). Unallocated ESOP shares are not considered as outstanding for purposes of this calculation. Diluted income per share includes the effect of dilution for stock options and stock awards. Since the initial public offering was on May 29, 1997 and no common stock had been issued prior to that time, management believes that presentation of earnings per share information would not be meaningful for 1997.

For the year ended December 31, 1998, net income available to the common stockholders in both the basic and diluted computations was equal to net income. For purposes of the diluted income per share calculation, additional common stock equivalents for the stock option plan of 153 were included as weighted average common shares outstanding for the year ended December 31, 1998.

Operating Segments - The Company adopted Financial Accounting Standards Board Statement No. 131, "Disclosures About Segments of an Enterprise and Related Information" (SFAS No. 131), effective December 31, 1997. This statement establishes standards for reporting information about segments in annual and interim financial statements. SFAS No. 131 introduces a new model for segment reporting called the "management approach." The management approach is based on the way the chief operation decision-maker organizes segments within the Company for making operating decisions and assessing performance. Reportable segments are based on products and services, geography, legal structure, management structure and any other in which management disaggregates a company. Based on the "management approach" model, the Company has determined that its business is comprised of a single operating segment and that SFAS No. 131, therefore, has no impact on its financial statements.

2. Investment Securities

The amortized cost and estimated market values of investment securities are summarized as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value
Securities to be held to maturity:				
December 31, 1997:				
U.S. government security	$ 418	$ -	$ 51	$ 367
Municipal securities	159	-	-	$ 159

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	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value
	$ 577	$ -	$ 51	$ 526
December 31, 1998:				
U.S. government security	$ 440	$ -	$ 11	$ 429
Municipal securities	718	-	-	$ 718
	$ 1,158	$ -	$ 11	$ 1,147
Securities available for sale:				
December 31, 1997:				
U.S. government and agency securities	$ 1,149	$ -	$ 1	$ 1,148
December 31, 1998:				
U.S. government and agency securities	$ 2,325	$ 2	$ -	$ 2,327

The amortized cost and estimated market values of debt securities by contractual maturity are as follows:

	Amortized Cost		Estimated Market Value	
	1997	1998	1997	1998
Securities to be held to maturity:				
Due in one year	$ 34	$ -	$ 34	$ -
Due after one year through five years	125	718	125	718
Due after ten years	418	440	367	429
	$ 577	$ 1,158	$ 526	$ 1,147
Securities available for sale:				
Due in one year	900	250	899	250
Due after one year through five years	249	2,075	249	2,077
	$ 1,149	$ 2,325	$ 1,148	$ 2,327

The Bank had investment securities with an amortized cost of approximately $1,068,000 and $1,265,000 pledged against deposits at December 31, 1997 and 1998, respectively.

The Bank had no sales of investment securities to be held to maturity or available for sale for the years ended December 31, 1997 and 1998.

The net unrealized gains (losses) on investment securities available for sale, net of related income tax expense (benefit), are approximately $(600) and $1,200 at December 31, 1997 and 1998, respectively, and are reported as accumulated other comprehensive income.

3. Loans Receivable

Loans receivable are summarized as follows:

	December 31,	
	1997	1998
Real estate first mortgage loans:		
One-to-four-family	$ 31,382	$ 30,054
Construction	1,600	1,216
Commercial real estate	1,433	1,566
Multi-family residential	687	1,011
Land	2,982	3,997
Total real estate loans	38,084	37,844

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(continued)

	December 31,	
	1997	1998
Consumer and commercial loans:		
Commercial business	$ 425	$ 573
Auto loans	2,119	2,294
Share loans	351	322
Other	517	470
Total consumer and commercial loans	3,412	3,659
Total loans	41,496	41,503
Less:		
Undisbursed portion of loans in process	429	619
Net deferred loan fees	118	109
Allowance for loan losses	301	326
	848	1,054
	$ 40,648	$ 40,449

The Bank's primary lending area for the origination of mortgage loans includes Carter County and adjoining counties. The Bank limits uninsured loans to 85% of the appraised value of the property securing the loan. Generally, the Bank allows loans covered by private mortgage insurance up to 97% of the appraised value of the property securing the loan.

The general policy is to limit loans on commercial real estate to 80% of the lesser of appraised value or construction cost of the property securing the loan.

The Bank's policy requires that consumer and other installment loans be supported primarily by the borrower's ability to repay the loan and secondarily by the value of the collateral securing the loan, if any.

Management of the Bank believes that its allowances for losses on its loan portfolio are adequate. However, the estimates used by management in determining the adequacy of such allowances are susceptible to significant changes due primarily to changes in economic and market conditions. In addition, various regulatory agencies periodically review the Bank's allowance for losses as an integral part of their examination processes. Such agencies may require the Bank to recognize additions to the allowances based on their judgments of information available to them at the time of their examinations.

In accordance with SFAS No. 114, "Accounting by Creditors for Impairment of a Loan", no loans in non-homogenous groups were determined to be impaired for the year ended or as of

December 31, 1998. Commercial real estate, multi-family residential and land loans are included in the non-homogenous group.

First mortgage loans which are contractually past due ninety days or more total approximately $209,000 at December 31, 1997 and $437,000 at December 31, 1998. The amount the Bank will ultimately realize from these loans could differ materially from their carrying value because of unanticipated future developments affecting the underlying collateral or the borrower's ability to repay the loans. If collection efforts are unsuccessful, these loans will be subject to foreclosure proceedings in the ordinary course of business. Management believes that the Bank has adequate collateral on these loans and that the Bank will not incur material losses in the event of foreclosure.

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At December 31, 1998, the Bank had loans pledged against public deposits of approximately $904,000.

The changes in the allowance for loan losses are summarized as follows:

	Years Ended December 31, 1997	1998
Beginning balance	$ 304	$ 301
Provision charged to income	10	31
Charge-offs, net of recoveries	(13)	(6)
Ending balance	$ 301	$ 326

4. Mortgage-Backed Securities

Mortgage-backed securities are summarized as follows:

<TABLE>
<CAPTION>

<S>	Amortized Cost <C>	Gross Unrealized Gains <C>	Gross Unrealized Losses <C>	Estimated Market Value <C>
Securities available for sale:				
December 31, 1997:				
GNMA	$ 685	$ 5	$ 2	$ 688
FHLMC	67	2	-	69
FHLMC REMIC's	1,765	-	28	1,737
FNMA	624	2	12	614
FNMA REMIC's	1,976	-	54	1,922
	$ 5,117	$ 9	$ 96	$ 5,030

</TABLE>

(continued)

<TABLE>
<CAPTION>

<S>	Amortized Cost <C>	Gross Unrealized Gains <C>	Gross Unrealized Losses <C>	Estimated Market Value <C>
Securities available for sale:				
December 31, 1998:				
GNMA	$ 525	$ 2	$ 5	$ 521
FHLMC	56	1	-	57
FHLMC REMIC's	880	-	5	875
FNMA	519	1	9	512
FNMA REMIC's	1,564	-	27	1,537
	$ 3,544	$ 4	$ 46	$ 3,502

</TABLE>

Although mortgage-backed securities are initially issued with a stated maturity date, the underlying mortgage collateral may be prepaid by the mortgagee and, therefore, such securities may not reach their maturity date.

The Bank had mortgage-backed securities with an amortized cost of approximately $2,232,000 and $1,148,000 pledged against deposits and available FHLB advances at December 31, 1997 and 1998, respectively.

There were no sales of mortgage-backed securities for the years ended December 31, 1997 and 1998.

The net unrealized losses, net of related income tax benefits, are approximately $52,000 and $25,000, respectively at December 31, 1997 and 1998, and are reported as accumulated other comprehensive income.

5. Premises and Equipment

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Premises and equipment are summarized as follows:

	December 31, 1997	December 31, 1998
Land and improvements	$ 202	$ 237
Buildings	840	875
Vehicles	17	17
Furniture, fixtures and equipment	586	650
Construction in progress	-	196
	1,645	1,975
Less accumulated depreciation	1,070	1,126
	$ 575	$ 849

6. Interest Receivable

Interest receivable consists of the following:

	December 31, 1997	December 31, 1998
Loans receivable	$ 258	$ 239
Investments	21	31
Mortgage-backed securities	25	17
Interest earning deposits	22	3
	326	290
Less allowance for uncollectible interest	10	25
	$ 316	$ 265

7. Deposits

Deposit account balances are summarized as follows:

	December 31, 1997	December 31, 1998	Weighted Average Interest Rates December 31, 1997	Weighted Average Interest Rates December 31, 1998
Noninterest bearing accounts	$ 1,969	705	-%	-%
NOW accounts	2,669	2,770	2.03%	1.27%
Money Market accounts	1,983	1,598	4.28%	3.69%
Passbook accounts	4,351	4,548	3.05%	2.97%
Certificates of deposit	29,615	30,485	5.69%	5.47%
	$ 40,587	$ 40,106	4.80%	4.72%

Contractual maturities of certificate accounts are summarized as follows:

	December 31, 1997	December 31, 1998
12 months or less	$ 25,223	$ 24,925
After 1 but within 3 years	4,150	5,055
After 3 years	242	505
	$ 29,615	$ 30,485

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The Bank had deposit accounts in amounts of $100,000 or more of approximately $10.1 million and $9.7 million at December 31, 1997 and 1998, respectively.

Interest expense on deposits consisted of the following:

	Years Ended December 31, 1997	Years Ended December 31, 1998
NOW, money market, and passbook accounts	$ 262	$ 249
Certificate accounts	1,726	1,713
	1,988	1,962
Less: penalties for early withdrawal	4	3
Total interest on deposits	$ 1,984	$ 1,959

8. Federal Home Loan Bank Advances

The Bank had no advances from the Federal Home Loan Bank (FHLB) outstanding at December 31, 1997 or 1998.

The Bank pledges as collateral for these borrowings its FHLB stock, selected qualifying mortgage loans (as defined) and certain mortgage-backed securities (see Note 4) under an agreement with the FHLB. Loans pledged at December 31, 1998, were approximately $500,000.

The Bank has total credit availability with the FHLB of up to $2.5 million.

9. Income Taxes

Income tax expense (benefit) is summarized as follows:

	1997 Federal	1997 State	1997 Total	1998 Federal	1998 State	1998 Total
Current	$ 303	$ 37	$ 340	$ 309	$ 36	$ 345
Deferred	(2)	31	29	(20)	20	-
Total	$ 301	$ 68	$ 369	$ 289	$ 56	$ 345

The differences between actual income tax expense and the amount computed by applying the federal statutory income tax rate of 34% to income before income taxes are reconciled as follows:

	Years Ended December 31, 1997	Years Ended December 31, 1998
Computed income tax expense	$ 326	$ 286
Increase (decrease) resulting from:		
State income tax, net of federal tax benefit	45	37
Non-taxable income	-	(11)
Non-deductible expenses	-	37
Other	(2)	(4)
Actual income tax expense	$ 369	$ 345

The components of net deferred tax liabilities are as follows:

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	December 31,	
	1997	1998
Deferred tax liabilities:		
Tax bad debts	$ 145	$ 143
Excess tax depreciation	13	14
FHLB stock dividends	43	54
Purchased discounts on mortgage-backed securities	9	9
	210	220
Deferred tax assets:		
Financial statement bad debt reserves	104	111
Accrued sick leave	5	6
Unrealized losses on securities available for sale	35	16
Other	4	6
Valuation allowance	-	-
	148	139
Net deferred tax liability	$ 62	$ 81

The Bank's annual addition to its reserve for bad debts allowed under the Internal Revenue Code may differ significantly from the bad debt experience used for financial statement purposes. Such bad debt deductions for income tax purposes are included in taxable income of later years only if the bad debt reserves are used for purposes other than to absorb bad debt losses. Since the Bank does not intend to use the reserve for purposes other than to absorb losses, no deferred income taxes have been provided on the amount of bad debt reserves for tax purposes that arose in tax years beginning before December 31, 1987, in accordance with

SFAS No. 109. Therefore, retained income at December 31, 1997 and 1998, includes approximately $825,000, representing such bad debt deductions for which no deferred income taxes have been provided.

Beginning in 1998, the Bank began to recapture into taxable income post-1987 excess reserves over a six-year period. The remaining amount of the post-1987 excess is approximately $205,000. Since the tax effect of this excess had been previously recorded as deferred income taxes, the Bank will have no material impact on its results of operations when the remaining excess reserves are recaptured.

10. Stockholders' Equity

Bancorp was incorporated under Tennessee law in March 1997 to acquire and hold all the outstanding common stock of the Bank, as part of the Bank's conversion from a federally chartered mutual savings bank to a federally chartered stock savings bank. In connection with the conversion, which was consummated on May 29, 1997, Bancorp issued and sold 767,000 shares of common stock at a price of $10.00 per share for total net proceeds of approximately $6.8 million after conversion expenses of approximately $286,000 and excluding the shares purchased by the ESOP. Bancorp retained approximately $3.1 million of the proceeds and used the remaining proceeds to purchase the newly issued capital stock of the Bank in the amount of $3.7 million. Bancorp issued $614,000 of common stock to the ESOP for a note receivable.

At the time of conversion, the Bank established a liquidation account in an amount equal to its retained income as reflected in the latest consolidated balance sheet used in the final conversion prospectus. The liquidation account is maintained for the benefit of eligible account holders who continue to maintain their deposit accounts in the Bank after conversion. In the event of a complete liquidation of the Bank (and only in such an event), eligible depositors who continue to maintain accounts shall be entitled to receive a distribution from the liquidation account before any liquidation may be made with respect to common stock.

The Bank may not declare or pay a cash dividend if the effect thereof would cause its net worth to be reduced below either the amounts required for the liquidation account discussed above or the regulatory capital requirements

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imposed by federal and state regulations.

11. Regulatory Matters

The Bank is subject to various regulatory capital requirements administered by the Office of Thrift Supervision (OTS). Failure to meet minimum capital requirements can initiate certain mandatory, and possible additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The

Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of Tier I capital (as defined in the regulations) to adjusted total assets (as defined), and of Tier I and risk-based capital (as defined) to risk-weighted assets (as defined). Management believes, as of December 31, 1998, that the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 1998, the most recent notification from the OTS categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized the Bank must maintain minimum (Tier I leverage, Tier I risk-based, total risk-based capital) ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed the institution's category.

The Bank's actual capital amounts (in thousands) and ratios are also presented in the following table. No deduction from capital for interest-rate risk was required.

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 1997:						
Tier I Capital (to adjusted total assets)	$ 8,471	16.9%	$ 2,011	>4.0%	$ 2,513	>5.0%
Tier I Capital (to risk weighted assets)	$ 8,471	29.9%	$ 1,135	>4.0%	$ 1,702	>6.0%
Total Capital (to risk-weighted assets)	$ 8,772	30.9%	$ 2,271	>8.0%	$ 2,839	>10.0%
As of December 31, 1998:						
Tier I Capital (to adjusted total assets)	$ 8,639	17.2%	$ 2,004	>4.0%	$ 2,505	>5.0%
Tier I Capital (to risk weighted assets)	$ 8,639	29.2%	$ 1,185	>4.0%	$ 1,778	>6.0%
Total Capital (to risk-weighted assets)	$ 8,965	30.3%	$ 2,370	>8.0%	$ 2,963	>10.0%

12. Employee Stock Ownership Plan (ESOP)

As part of the conversion discussed in Note 10, an Employee Stock Ownership Plan (ESOP) was established for all employees who have attained the age of 21 and have been credited with at least 1,000 hours of service during a 12-month period. The ESOP borrowed approximately $614,000 from Bancorp and used the funds to purchase 61,360 shares of common stock of Bancorp issued in the offering. The loan will be repaid principally from the Bank's discretionary contributions to the ESOP over a period of 10 years. On December 31, 1998, the

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loan had an outstanding balance of approximately $480,000 and an interest rate of 8.5%. The loan obligation of the ESOP is considered unearned compensation and, as such, recorded as a reduction of the Company's stockholders' equity. Both the loan obligation and the unearned compensation are reduced by an amount of the loan repayments made by the ESOP. Shares purchased with the loan proceeds are held in a suspense account for allocation among participants as the loan is repaid. Contributions to the ESOP and shares released from the suspense account are allocated among participants on the basis of compensation in the year of allocation. Benefits become fully vested at the end of seven years of service under the terms of the ESOP Plan. Benefits may be payable upon retirement, death, disability, or separation from service. Since the Bank's annual contributions are discretionary, benefits payable under the ESOP cannot be estimated. Compensation expense is recognized to the extent of the fair value of shares committed to be released.

For the years ending December 31, 1997 and 1998, compensation related to the ESOP of approximately $91,000 and $93,000, respectively, was expensed. Compensation is recognized at the average fair value of the ratably released shares during the accounting period as the employees performed services. At December 31, 1998, the ESOP had approximately 12,000 allocated shares and 49,000 unallocated shares. The fair value of unallocated ESOP shares at December 31, 1998 was approximately $601,000.

The ESOP administrators determine whether dividends on allocated and unallocated shares are used for debt service. Any allocated dividends used will be replaced with common stock of equal value. For the purpose of computing earnings per share, all ESOP shares committed to be released are considered outstanding.

13. Restricted Stock Plan

In June 1998, the Company adopted a restricted stock plan ("RSP") which approved 30,680 shares of common stock for granting. The shares can be granted to certain employees, officers, and directors of the Company. The initial grants began vesting on June 1, 1998, and will be fully vested by December 31, 2004. The Company purchased 30,680 shares of common stock in the open market to fund the RSP. Compensation expense in the amount of the fair value of the common stock at the date of grant will be recognized during the periods the participants become vested. The unamortized balance of unearned compensation is reflected as a reduction of stockholders' equity. For the year ended December 31, 1998, approximately $166,000 has been recognized as compensation expense.

14. Stock Incentive Plans

In June 1998, the Company adopted stock incentive plans. The Plans permit the grant of qualified incentive stock options and non-qualified options to certain employees and directors. The Stock Option Committee of the Board of Directors determines which individuals are eligible to receive awards.

The option price for each grant of a stock option will not be less than the fair market value on the date the option is granted. The Committee may determine the restrictions and conditions under which options may be exercised. Options must be exercised within ten years of the date granted. Vesting is in accordance with the terms of each particular grant.

Options Granted - On June 1, 1998, the Board of Directors granted 73,630 options having an exercise price of $16.69 per share, the estimated fair market value of the Company's common stock on the date granted. The weighted average contractual life of the options is 113 months and no options were exercisable as of December 31, 1998.

Activity under Bank's plans during the year ended December 31, 1998, is summarized below:

	Qualified Plan		Non-Qualified Plan	
	Available For Grant	Granted	Available For Grant	Granted
Adoption of plan,				

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June 1, 1998	53,692	-	23,008	-
Granted	(50,622)	50,622	(23,008)	23,008
Exercised	-	-	-	-
Forfeited	-	-	-	-
Balance, December 31, 1998	3,070	50,622	-	23,008

Proforma information regarding the net income and net income per share is required by SFAS No. 123 and has been determined as if the Company had accounted for its stock options under the fair value method of that statement. The fair value for these options was estimated at the date of the grant using the Black-Scholes option-pricing model with the following assumptions for the period ended December 31, 1998:

Risk-free interest rate	4.52%
Dividend yield	1.19%
Average expected life in years	5

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options, which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions. Because the Company's stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of stock options.

For purposes of proforma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting period. The Company's proforma net income (in thousands) and net income per share for the year ended December 31, 1998, is as follows:

	As Reported	Proforma
Net income	$ 497	$ 492
Net income per share	$ .71	$ .70

15. Employment and Change of Control Agreement

The Bank entered into an employment agreement with a key officer in 1996. The employment agreement provides for three-year terms. Commencing on the first anniversary date and continuing each anniversary date thereafter, the board of directors may extend the agreement for an additional year so that the remaining term shall be three years, unless written notice of termination of the agreement is given by the executive officer. The agreement provides for severance payments and other benefits in the event of involuntary termination of employment in connection with any change in control of the Bank. A severance payment will also be provided on a similar basis in connection with voluntary termination of employment where, subsequent to a change in control, the officer is assigned duties inconsistent with their position, duties, responsibilities and status immediately prior to such change in control. The severance payment will equal 2.99 times the executive officer's base amount of annual compensation as defined under the Internal Revenue Code. The payment of amounts under the agreement may be paid within 30 days of such termination, discounted at an agreed upon rate, or in equal installments over thirty-six months. The Bank has not accrued any benefits under this postemployment agreement.

16. Financial Instruments with Off-Balance-Sheet Risk

The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and lines of credit. Those instruments involve, to varying degrees, elements of credit and interest-rate risk in excess of the amount recognized in the statement of financial position. The contract or notional amounts of those instruments reflect the extent of the Bank's involvement in particular classes of financial instruments.

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

Financial instruments, the contract amounts of which represent credit risk for lines and letters of credit, the balances outstanding and amounts available for use at December 31, 1998, were approximately as follows (in thousands):

	Financial Instruments	Balance Outstanding	Available For Use
Consumer and other lines	$ 1,574	$ 967	$ 607
Letters of credit	142	-	142
	$ 1,716	$ 967	$ 749

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness. The amount of collateral obtained, if it is deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral may include first and second mortgages; property, plant, and equipment; accounts receivable; deposit accounts; and income-producing commercial properties. The Bank does not anticipate any losses as a result of these transactions.

The Bank had outstanding commitments to originate mortgage and consumer loans of approximately $490,000 and $1,440,000 at December 31, 1997 and 1998, respectively. The commitments to originate mortgage and consumer loans at December 31, 1997, were composed of fixed rate loans of $390,000 and a variable rate loan of $100,000. The fixed rate loans had interest rates ranging from 7.5% to 9.25% and terms ranging from 7 to 15 years. The commitments to originate mortgage and consumer loans at December 31, 1998, were composed of fixed rate loans. The fixed rate loans had interest rates ranging from 6.9% to 9.0% and terms ranging from 30 days to 15 years.

17. Financial Instruments

The approximate stated and estimated fair value of financial instruments are summarized below (in thousands):

<TABLE>
<CAPTION>

	December 31,			
	1997		1998	
	Stated Amount	Estimated Fair Value	Stated Amount	Estimated Fair Value
<S>	<C>	<C>	<C>	<C>
Financial assets:				
Cash and cash equivalents	$ 4,592	$ 4,592	$ 2,839	$ 2,839
Investment and mortgage-backed securities	6,755	6,704	6,987	6,976
Loans receivable, net	40,648	41,502	40,449	41,553
Federal Home Loan Bank stock	423	423	454	454
Other assets	294	294	265	265

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	$ 52,712	$ 53,515	$ 50,994	$ 52,087
Financial liabilities:				
Deposits:				
Demand accounts	$ 10,972	$ 10,972	$ 9,621	$ 9,621
Certificate accounts	29,615	29,674	30,485	30,683
Other liabilities	263	263	265	265
	$ 40,850	$ 40,909	$ 40,371	$ 40,569

</TABLE>

The Bank had off-balance sheet financial commitments at December 31, 1998, which include approximately $2,189,000 of commitments to originate and fund loans and unused consumer lines of credit and letters of credit. Since these commitments are based on current market rates, the commitment amount is considered to be a reasonable estimate of fair market value.

Statement of Financial Accounting Standards No. 107, "Disclosures about Fair Value of Financial Instruments" (SFAS 107), requires disclosure of fair value information about financial instruments, whether or not recognized in the balance sheet, for which it is practicable to estimate that value. The following methods and assumptions were used by the Bank in estimating its fair value disclosures for financial instruments:

Cash and Cash Equivalents - The carrying amount of such instruments is deemed to be a reasonable estimate of fair value.

Investments - Fair values for investment securities are based on quoted market prices.

Loans - Fair values for loans held for investment are estimated by segregating the portfolio by type of loan and discounting scheduled cash flows using interest rates currently being offered for loans with similar terms, reduced by an estimate of credit losses inherent in the portfolio. A

prepayment assumption is used as an estimate of the portion of loans that will be repaid prior to their scheduled maturity.

Federal Home Loan Bank Stock - No ready market exists for this stock and it has no quoted market value. However, redemption of this stock has historically been at par value. Accordingly, the carrying amount is deemed to be a reasonable estimate of fair value.

Deposits - The fair values disclosed for demand deposits are, as required by SFAS 107, equal to the amounts payable on demand at the reporting date (i.e., their stated amounts). The fair value of certificates of deposit are estimated by discounting the amounts payable at the certificate rates using the rates currently offered for deposits of similar remaining maturities.

Other Assets and Other Liabilities - Other assets represent accrued interest receivable; other liabilities represent advances from borrowers for taxes and insurance and accrued interest payable. Since these financial instruments will typically be received or paid within three months, the carrying amounts of such instruments are deemed to be a reasonable estimate of fair value.

Fair value estimates are made at a specific point of time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale the Bank's entire holdings of a particular financial instrument. Because no active market exists for a significant portion of the Bank's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, current interest rates and prepayment trends, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in any of these assumptions used in calculating fair value also would affect significantly the estimates. Further, the fair value estimates were calculated as of December 31, 1997 and 1998. Changes in market interest rates and prepayment assumptions could change significantly the estimated fair value.

Fair value estimates are based on existing on and off-balance sheet

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financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. For example, the Bank has significant assets and liabilities that are not considered financial assets or liabilities including deposit franchise value, loan servicing portfolio, real estate, deferred tax liabilities, and premises and equipment. In addition, the tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of these estimates.

18. Condensed Parent Company Only Financial Statements

The following condensed balance sheets as of December 31, 1997 and 1998, and condensed statements of income and cash flows for the period ended December 31, 1997 and for the year ended December 31, 1998, for SFB Bancorp, Inc. should be read in conjunction with the consolidated financial statements and the notes thereto.

Parent Company Only Condensed Balance Sheets (in thousands)	December 31, 1997	December 31, 1998
Assets:		
Cash and cash equivalents	$ 2,673	$ 668
Investment securities available for sale	500	1,501
ESOP loan receivable	552	480
Equity in net assets of bank subsidiary	8,418	8,614
Other assets	46	17
Total assets	$ 12,189	$ 11,280
Liabilities		
Accrued liabilities	$ 8	$ 10
Stockholders' equity:		
Common stockholders' equity	12,181	11,270
Total liabilities and stockholders' equity	$ 12,189	$ 11,280

Parent Company Only Condensed Statements of Income (in thousands)	Period Ended December 31, 1997	Year Ended December 31, 1998
Interest income	$ 122	$ 195
Noninterest expense	26	92
Income before taxes	96	103
Income tax expense	25	40
Income before equity earnings	71	63
Equity earnings of bank subsidiary	357	434
Net income	$ 428	$ 497

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Parent Company Only Condensed Statements of Cash Flows (in thousands)	Period Ended December 31, 1997	Year Ended December 31, 1998

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Operating activities:		
Net income	$ 428	$ 497
Adjustments to reconcile net income to net cash provided by operating activities:		
Undistributed equity earnings of bank subsidiary	(357)	(434)
(Increase) decrease in other assets	(46)	30
Increase in accrued liabilities	8	2
Net cash provided by operating activities	33	95
Investing activities:		
Loan to ESOP	(614)	-
Purchase of treasury stock	-	(1,034)
Principal repayment by ESOP	62	72
Purchase of investment securities	(500)	(2,000)
Maturities of investment securities	-	1,000
Purchase of capital stock of bank subsidiary	(3,078)	-
Net cash used by investing activities	(4,130)	(1,962)
Financing activities:		
Net proceeds from issuance of common stock	6,770	-
Payment of cash dividends	-	(138)
Net cash provided by financing activities	6,770	(138)
Net increase in cash and cash equivalents	2,673	(2,005)
Cash and cash equivalents at beginning of period	-	2,673
Cash and cash equivalents at end of period	$ 2,673	$ 668

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