

BankFinancial CORP  
Form 10-Q  
November 01, 2007  
Table of Contents

---

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

\_\_\_\_\_  
**FORM 10-Q**  
\_\_\_\_\_

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the Quarterly Period ended September 30, 2007

or

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 0-51331

\_\_\_\_\_  
**BANKFINANCIAL CORPORATION**  
\_\_\_\_\_

(Exact Name of Registrant as Specified in Charter)

Maryland  
(State or Other Jurisdiction of Incorporation)

75-3199276  
(I.R.S. Employer Identification No.)

15W060 North Frontage Road, Burr Ridge, Illinois  
(Address of Principal Executive Offices)

60527  
(Zip Code)

Registrant's telephone number, including area code: (800) 894-6900

Edgar Filing: BankFinancial CORP - Form 10-Q

**Not Applicable**

**(Former name or former address, if changed since last report)**

---

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No .

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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate the number of shares outstanding of each of the Issuer's classes of common stock as of the latest practicable date.

22,527,577 shares of Common Stock, par value \$0.01 per share, were issued and outstanding as of October 26, 2007.

---

**Table of Contents**

**BANKFINANCIAL CORPORATION**

Form 10-Q Quarterly Report

Table of Contents

	<b>Page Number</b>
<b><u>PART I</u></b>	
Item 1. <u>Financial Statements</u>	3
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	17
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	36
Item 4. <u>Controls and Procedures</u>	38
<b><u>PART II</u></b>	
Item 1. <u>Legal Proceedings</u>	39
Item 1A. <u>Risk Factors</u>	39
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	39
Item 3. <u>Defaults Upon Senior Securities</u>	40
Item 4. <u>Submission of Matters to a Vote of Security Holders</u>	40
Item 5. <u>Other Information</u>	40
Item 6. <u>Exhibits</u>	40
<u>Signatures</u>	41

**Table of Contents****PART I****ITEM 1. FINANCIAL STATEMENTS****BANKFINANCIAL CORPORATION****CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION**

September 30, 2007 and December 31, 2006

(In thousands, except share and per share data)

(Unaudited)

	September 30, 2007	December 31, 2006
<b>ASSETS</b>		
Cash and due from other financial institutions	\$ 30,694	\$ 38,286
Interest-bearing deposits in other financial institutions	14,003	29,051
Cash and cash equivalents	44,697	67,337
Securities available-for-sale, at fair value	67,686	117,853
Loans held-for-sale	2,031	298
Loans receivable, net of allowance for loan losses:		
September 30, 2007, \$11,080; and December 31, 2006, \$10,622	1,276,129	1,329,915
Stock in Federal Home Loan Bank, at cost	15,598	15,598
Premises and equipment, net	34,171	35,005
Accrued interest receivable	7,427	7,869
Goodwill	22,566	22,579
Core deposit intangible	8,233	9,648
Investment in Bank-Owned Life Insurance	19,354	
Other assets	6,730	7,020
Total assets	\$ 1,504,622	\$ 1,613,122
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Liabilities		
Deposits	1,098,541	1,129,585
Borrowings	81,138	138,148
Advance payments by borrowers for taxes and insurance	11,197	8,285
Accrued interest payable and other liabilities	10,125	11,089
Total liabilities	1,201,001	1,287,107
Commitments and contingent liabilities		
Stockholders' equity		
Preferred Stock, \$0.01 par value, 25,000,000 shares authorized, none issued or outstanding		
Common Stock, \$0.01 par value, shares authorized: 100,000,000; shares issued at September 30, 2007, 22,569,377 and at December 31, 2006, 24,304,950	226	243
Additional paid-in capital	202,602	227,741
Retained earnings	114,451	113,128
Unearned Employee Stock Ownership Plan shares	(17,373)	(18,105)
Accumulated other comprehensive income	3,715	3,008

Edgar Filing: BankFinancial CORP - Form 10-Q

Total stockholders' equity	303,621	326,015
Total liabilities and stockholders' equity	\$ 1,504,622	\$ 1,613,122

See accompanying notes to consolidated financial statements.

**Table of Contents****BANKFINANCIAL CORPORATION****CONSOLIDATED STATEMENTS OF INCOME**

Three months and nine months ended September 30, 2007 and 2006

(In thousands, except share and per share data) - (Unaudited)

	Three months ended		Nine months ended	
	September 30, 2007	September 30, 2006	September 30, 2007	September 30, 2006
<b>Interest and dividend income:</b>				
Loans, including fees	\$ 21,709	\$ 21,625	\$ 64,792	\$ 61,679
Securities	1,092	2,250	4,010	7,677
Other	323	369	1,226	863
<b>Total interest income</b>	<b>23,124</b>	<b>24,244</b>	<b>70,028</b>	<b>70,219</b>
<b>Interest expense:</b>				
Deposits	8,835	7,987	25,610	21,713
Borrowings	1,064	1,805	3,814	5,922
<b>Total interest expense</b>	<b>9,899</b>	<b>9,792</b>	<b>29,424</b>	<b>27,635</b>
<b>Net interest income</b>	<b>13,225</b>	<b>14,452</b>	<b>40,604</b>	<b>42,584</b>
<b>Provision for loan losses</b>	<b>460</b>	<b>49</b>	<b>687</b>	<b>401</b>
<b>Net interest income after provision for loan losses</b>	<b>12,765</b>	<b>14,403</b>	<b>39,917</b>	<b>42,183</b>
<b>Noninterest income:</b>				
Deposit service charges and fees	938	1,142	2,691	3,176
Other fee income	495	466	1,455	1,409
Insurance commissions and annuities income	251	363	720	943
Gain on sale of loans, net	43	95	92	185
Gain on sale of securities available for sale	399	89	399	144
Gain on disposition of premises and equipment			13	394
Loan servicing fees	182	230	607	711
Amortization and impairment of servicing assets	(131)	(120)	(332)	(327)
Operations of real estate owned	(4)	(15)	(4)	(46)
Earnings on bank-owned life insurance	219		354	
Other	385	408	1,151	1,387
<b>Total noninterest income</b>	<b>2,777</b>	<b>2,658</b>	<b>7,146</b>	<b>7,976</b>
<b>Noninterest expense:</b>				
Compensation and benefits	7,773	8,241	24,070	23,795
Office occupancy and equipment	1,428	1,530	4,334	4,186
Advertising and public relations	409	396	1,092	950
Data processing	821	873	2,393	2,486
Supplies, telephone, and postage	485	583	1,537	1,540
Amortization of intangibles	469	496	1,415	1,384
Other	998	776	3,330	2,639
<b>Total noninterest expense</b>	<b>12,383</b>	<b>12,895</b>	<b>38,171</b>	<b>36,980</b>

Edgar Filing: BankFinancial CORP - Form 10-Q

Income before income taxes	3,159	4,166	8,892	13,179
Income tax expense	922	1,371	2,666	4,340
<b>Net income</b>	<b>\$ 2,237</b>	<b>\$ 2,795</b>	<b>\$ 6,226</b>	<b>\$ 8,839</b>
Basic earnings per common share	\$ 0.11	\$ 0.12	\$ 0.30	\$ 0.39
Diluted earnings per common share	\$ 0.11	\$ 0.12	\$ 0.30	\$ 0.39
Weighted average common shares outstanding	20,319,748	22,494,808	20,839,787	22,550,208
Diluted weighted average common shares outstanding	20,417,513	22,507,102	20,936,504	22,554,351

See accompanying notes to consolidated financial statements.

**Table of Contents****BANKFINANCIAL CORPORATION****CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY AND COMPREHENSIVE INCOME**

Nine months ended September 30, 2007 and 2006

(In thousands, except share and per share data) - (Unaudited)

	Common Stock	Additional Paid-in Capital	Retained Earnings	Unearned Employee Stock Ownership Plan ( ESOP ) Shares	Accumulated Other Comprehensive Income (Loss)	Total	Comprehensive Income
Balance at December 31, 2005	\$ 245	\$ 240,235	\$ 107,528	\$ (19,084)	\$ (147)	\$ 328,777	
Comprehensive income:							
Net income			8,839			8,839	\$ 8,839
Change in other comprehensive income, net of tax effects					2,510	2,510	2,510
<b>Total comprehensive income</b>							<b>\$ 11,349</b>
Purchase and retirement of common stock (750,700 shares)	(7)	(13,323)				(13,330)	
Nonvested stock awards:							
Issuance of shares of restricted stock	7	(7)					
Stock-based compensation expense		786				786	
Cash dividends declared on common stock (\$0.12 per share)			(2,980)			(2,980)	
ESOP shares earned		549		732		1,281	
Balance at September 30, 2006	\$ 245	\$ 228,240	\$ 113,387	\$ (18,352)	\$ 2,363	\$ 325,883	
Balance at December 31, 2006	\$ 243	\$ 227,741	\$ 113,128	\$ (18,105)	\$ 3,008	\$ 326,015	
Comprehensive income:							
Net income			6,226			6,226	\$ 6,226
Change in other comprehensive income, net of tax effects					707	707	707
<b>Total comprehensive income</b>							<b>\$ 6,933</b>
Purchase and retirement of common stock (1,742,023 shares)	(17)	(28,667)				(28,684)	
Nonvested stock awards:							
Stock-based compensation expense		3,102				3,102	
Cash dividends declared on common stock (\$0.21 per share)			(4,903)			(4,903)	
ESOP shares earned		426		732		1,158	
Balance at September 30, 2007	\$ 226	\$ 202,602	\$ 114,451	\$ (17,373)	\$ 3,715	\$ 303,621	

See accompanying notes to consolidated financial statements.





**Table of Contents****BANKFINANCIAL CORPORATION****CONSOLIDATED STATEMENTS OF CASH FLOWS**

Nine months ended September 30, 2007 and 2006

(In thousands) - (Unaudited)

	Nine months ended September 30,	
	2007	2006
<b>Cash flows from operating activities</b>		
Net income	\$ 6,226	\$ 8,839
Adjustments to reconcile to net income to net cash from operating activities		
Provision for loan losses	687	401
ESOP shares earned	1,158	1,281
Stock-based compensation expense	3,102	786
Depreciation and amortization	2,892	2,757
Amortization and accretion of premiums and discounts	(285)	112
Amortization of core deposit and other intangible assets	1,415	1,404
Amortization and impairment of servicing assets	332	327
Net change in net deferred loan origination costs	213	64
Net loss on sale of real estate owned		18
Net gain on sale of loans	(92)	(185)
Net gain on sale of securities	(399)	(144)
Net gain on disposition of premises and equipment	(13)	(394)
Loans originated for sale	(21,961)	(19,021)
Proceeds from sale of loans	20,320	19,476
Earnings on bank-owned life insurance	(354)	
Net change in:		
Deferred income tax	(24)	2,356
Accrued interest receivable	442	(336)
Other assets	(1,850)	(1,365)
Accrued interest payable and other liabilities	(951)	(9,897)
Net cash from operating activities	10,858	6,479
<b>Cash flows from investing activities</b>		
Securities available-for-sale		
Proceeds from sales	399	145,154
Proceeds from maturities	1,382,249	51,604
Proceeds from principal repayments	5,047	26,640
Purchase of securities	(1,335,680)	(47,301)
Loans receivable		
Principal payments on loans receivable	631,922	460,593
Purchases	(2,095)	(34,237)
Originated for investment	(576,435)	(489,571)
Purchase of bank owned life insurance	(19,000)	
Proceeds from redemption of stock in Federal Home Loan Bank		6,523
Proceeds from sale of real estate owned		114
Purchase of premises and equipment, net	(1,159)	(868)
Cash paid, net of cash and cash equivalents, in acquisition		(13,380)
Net cash from investing activities	85,248	105,271

(Continued)



**Table of Contents****BANKFINANCIAL CORPORATION****CONSOLIDATED STATEMENTS OF CASH FLOW**

Nine months ended September 30, 2007 and 2006

(In thousands) - (Unaudited)

	<b>Nine months ended September 30,</b>	
	<b>2007</b>	<b>2006</b>
<b>Cash flows from financing activities</b>		
Net change in deposits	(31,061)	(65,138)
Net change in advance payments by borrowers for taxes and insurance	2,912	(4,543)
Net change in borrowings	(57,010)	(26,306)
Repurchase and retirement of common stock	(28,684)	(13,330)
Cash dividends paid on common stock	(4,903)	(2,980)
<b>Net cash from financing activities</b>	<b>(118,746)</b>	<b>(112,297)</b>
Net change in cash and cash equivalents	(22,640)	(547)
Beginning cash and cash equivalents	67,337	38,026
<b>Ending cash and cash equivalents</b>	<b>\$ 44,697</b>	<b>\$ 37,479</b>
<b>Supplemental Disclosures of Cashflow Information:</b>		
Interest paid	\$ 28,615	\$ 27,486
Income taxes paid	2,655	3,670
Loans transferred to other real estate	252	
<b>Supplemental Disclosures of Noncash Investing Activities:</b>		
<b>Acquisitions</b>		
<b>Noncash assets acquired:</b>		
Investment securities available for sale	\$	\$ 81,014
Loans, net		17,782
Premises and equipment, net		2,878
Goodwill, net		11,726
Other intangible assets, net		3,272
Other assets		999
<b>Total noncash assets acquired</b>		<b>117,671</b>
<b>Liabilities assumed:</b>		
Deposits	\$	\$ 103,485
Accrued expenses and other liabilities		806
<b>Total liabilities assumed</b>		<b>104,291</b>
<b>Cash paid, net of cash and cash equivalents, in acquisition</b>	<b>\$</b>	<b>\$ 13,380</b>
Cash and cash equivalents acquired	\$	\$ 10,728
See accompanying notes to consolidated financial statements.		



**Table of Contents**

BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Table amounts in thousands, except share and per share data)

(unaudited)

**Note 1 Basis of Presentation.**

BankFinancial Corporation, a Maryland corporation headquartered in Burr Ridge, Illinois (the Company), became the owner of all of the issued and outstanding capital stock of BankFinancial, F.S.B. (the Bank) on June 23, 2005, when the Company consummated a plan of conversion and reorganization that the Bank and its predecessor holding companies, BankFinancial MHC, Inc. (BankFinancial MHC) and BankFinancial Corporation, a federal corporation, adopted on August 25, 2004. BankFinancial Corporation, the Maryland corporation, was organized in 2004 to facilitate the mutual-to-stock conversion and to become the holding company for the Bank upon its completion.

As part of the mutual-to-stock conversion, BankFinancial Corporation, the Maryland corporation, sold 24,466,250 shares of common stock in a subscription offering for \$10.00 per share. The separate corporate existences of BankFinancial MHC and BankFinancial Corporation, the federal corporation, ceased upon the completion of the mutual-to-stock conversion. For a further discussion of the mutual-to-stock conversion, see our Prospectus as filed on April 29, 2005 with the Securities and Exchange Commission pursuant to Rule 424(b)(3) of the Rules and Regulations of the Securities Act of 1933 (File Number 333-119217).

As used in this Quarterly Report on Form 10-Q, the words Company, we and our are intended to refer to BankFinancial Corporation, the Maryland corporation, and the above subsidiary, with respect to matters and time periods occurring on and after June 23, 2005, including the information presented for the three-month and nine-month periods ended September 30, 2007.

The interim unaudited consolidated financial statements reflect all normal and recurring adjustments that are, in the opinion of management, considered necessary for a fair presentation of the financial condition and results of operations for the periods presented. All significant intercompany accounts and transactions have been eliminated. The results of operations for the three-month and nine-month periods ended September 30, 2007, are not necessarily indicative of the results of operations that may be expected for the year ending December 31, 2007.

Certain information and note disclosures normally included in financial statements and prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission.

To prepare financial statements in conformity with U.S. generally accepted accounting principles, management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and the disclosures provided, and future results could differ. The allowance for loan losses, mortgage loan servicing rights, impairment of securities and the fair value of investment securities and financial instruments are particularly subject to change.

Certain reclassifications have been made in the prior period's financial statements to conform them to the current period's presentation.

These unaudited consolidated financial statements should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2006, and all amendments thereto, as filed with the Securities and Exchange Commission.

**Table of Contents**

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Table amounts in thousands, except share and per share data)

(unaudited)

**Note 2 Earnings per share**

Amounts reported in earnings per share reflect earnings available to common stockholders for the period divided by the weighted average number of shares of common stock outstanding during the period, exclusive of unearned ESOP shares and unvested restricted stock shares. Stock options and restricted stock are regarded as potential common stock and are considered in the diluted earnings per share calculations to the extent that they would have a dilutive effect if converted to common stock, computed using the treasury stock method.

	Three months ended September 30,		Nine months ended September 30,	
	2007	2006	2007	2006
Net income	\$ 2,237	\$ 2,795	\$ 6,226	\$ 8,839
<b>Basic earnings per common share:</b>				
Average common shares outstanding	22,692,613	24,556,236	23,242,682	24,496,575
Less: Unearned ESOP shares	(1,753,480)	(1,851,346)	(1,777,674)	(1,875,570)
Unvested restricted stock shares	(619,385)	(210,082)	(625,221)	(70,797)
Weighted average common shares outstanding	20,319,748	22,494,808	20,839,787	22,550,208
<b>Basic earnings per common share</b>	<b>\$ 0.11</b>	<b>\$ 0.12</b>	<b>\$ 0.30</b>	<b>\$ 0.39</b>
<b>Dilutive earnings per common share:</b>				
Weighted average common shares outstanding	20,319,748	22,494,808	20,839,787	22,550,208
Net effect of dilutive stock options and unvested restricted stock	97,765	12,294	96,717	4,143
Weighted average dilutive common shares outstanding	20,417,513	22,507,102	20,936,504	22,554,351
<b>Dilutive earnings per common share</b>	<b>\$ 0.11</b>	<b>\$ 0.12</b>	<b>\$ 0.30</b>	<b>\$ 0.39</b>
Number of anti-dilutive stock options excluded from the diluted earnings per share calculation	1,576,200	1,140,000	1,576,200	1,140,000
Weighted average exercise price of anti-dilutive option shares	\$ 17.34	\$ 17.62	\$ 17.34	\$ 17.62

**Table of Contents**

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Table amounts in thousands, except share and per share data)

(unaudited)

**Note 3 Securities**

The fair value of securities available-for-sale and the related gross unrealized gains and losses recognized in accumulated other comprehensive income are as follows:

	Fair Value	Gross Unrealized Gains	Gross Unrealized Losses
<b>September 30, 2007</b>			
Municipal	\$ 2,395	\$ 45	\$
Mortgage-backed securities	16,251	54	(116)
Collateralized mortgage obligations	4,002	30	(7)
SBA-guaranteed loan participation certificates	600	1	(5)
Equity securities	44,438	6,163	
	\$ 67,686	\$ 6,293	\$ (128)
<b>December 31, 2006</b>			
Municipal	\$ 2,711	\$ 52	\$ (1)
Mortgage-backed securities	19,803	161	(69)
Collateralized mortgage obligations	5,881	41	(1)
SBA-guaranteed loan participation certificates	623	1	(6)
Corporate bonds and other securities	45,723		(23)
Equity securities	43,112	4,837	
	\$ 117,853	\$ 5,092	\$ (100)

At September 30, 2007, our debt securities consisted of mortgage-backed pass-through securities issued or sponsored by Fannie Mae, Freddie Mac or Ginnie Mae, collateralized mortgage obligations and real estate mortgage investment conduits guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae, SBA guaranteed loan participation certificates, and municipal securities. Our equity securities consisted entirely of shares of two floating rate and one fixed rate preferred stocks issued by Freddie Mac. All of our investment securities reflected in the preceding table were classified as available-for-sale at September 30, 2007.

Interest income on securities is recognized under the interest method, and includes amortization of purchase premium and discount. Gains and losses on sales of securities are based on the amortized cost of the securities sold.

Securities with declines in fair value are evaluated on a quarterly basis to determine whether they should be considered other-than-temporarily impaired under Securities and Exchange Commission Codification of Staff Accounting Bulletins, Topic 5: Miscellaneous Accounting Item M, Other Than Temporary Impairment of Certain Investments in Debt and Equity Securities, which provides that if a marketable security is in an unrealized loss position, whether due to general market conditions or industry or issuer specific factors, the holder must assess whether the impairment is other-than-temporary. The Company evaluated those securities with unrealized losses in its investment portfolio at September 30, 2007 and December 31, 2006, respectively, and concluded that the declines in fair value were not significant and were primarily attributable to market interest rates rather than credit quality or other industry or issuer-specific factors. Since the Company had the ability and intent at September 30, 2007 and December 31, 2006, respectively, to hold these securities until a recovery occurred or the securities matured, the



## Edgar Filing: BankFinancial CORP - Form 10-Q

declines in fair value were not considered significant and the carrying cost was expected to recover as market interest rates change, the Company did not consider the declines in fair value to be other-than-temporary impairments. No unrealized losses existed at September 30, 2007 and December 31, 2006, respectively, with respect to the Company's marketable equity securities, including the Freddie Mac floating rate preferred stocks.

**Table of Contents**

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Table amounts in thousands, except share and per share data)

(unaudited)

**Note 4 Loans Receivable**

Loans originated are identified as either held for sale or held for investment and are accounted for accordingly upon their origination. Loans that are classified as held for sale are recorded at the lower of their aggregate cost or market value. The Company sells a portion of its mortgage loan production in the secondary market. The Company obtains sales commitments on certain of these loans immediately prior to making the origination commitment. Net unrealized losses are recognized by charges to income. Mortgage loans held for sale are generally sold with servicing rights retained. The carrying value of mortgage loans sold is reduced by the cost allocated to the servicing rights. Gains and losses on sales of mortgage loans are based on the difference between the selling price and the carrying value of the loan sold.

Premiums and discounts associated with loans purchased are amortized over the expected life of the loan using the level-yield method.

Interest income is reported on the interest method and includes amortization of net deferred loan fees and costs over the contractual loan term, adjusted for prepayments. Interest income is discontinued at the time the loan is 90 days delinquent unless the loan is well-secured and in process of collection. Past due status is based on the contractual terms of the loan. In all cases, loans are placed on nonaccrual status or charged off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not received for loans on nonaccrual status is reversed against interest income. Interest received on such loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual status. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Loans receivable are as follows:

	September 30, 2007	December 31, 2006
One- to four-family residential real estate loans	\$ 373,830	\$ 397,545
Multi-family mortgage loans	288,883	297,131
Nonresidential real estate loans	326,368	320,729
Construction and land loans	61,482	85,222
Commercial loans	80,358	89,346
Commercial leases	145,761	139,164
Consumer loans	3,835	3,869
Other loans (including municipal)	4,544	4,959
<b>Total loans</b>	<b>1,285,061</b>	<b>1,337,965</b>
Loans in process	(63)	148
Net deferred loan origination costs	2,211	2,424
Allowance for loan losses	(11,080)	(10,622)
<b>Loans, net</b>	<b>\$ 1,276,129</b>	<b>\$ 1,329,915</b>

**Table of Contents**

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Table amounts in thousands, except share and per share data)

(unaudited)

**Note 4 Loans Receivable (Continued)**

Activity in the allowance for loan losses is as follows:

	<b>Nine months ended September 30,</b>	
	<b>2007</b>	<b>2006</b>
Beginning balance	\$ 10,622	\$ 11,514
Allowance of acquired bank		212
Provision for loan losses	687	401
Loans charged off	(259)	(205)
Recoveries	30	2
Ending balance	\$ 11,080	\$ 11,924

Impaired loans are as follows:

	<b>September 30, 2007</b>	<b>December 31, 2006</b>
Loans with allocated allowance for loan losses	\$ 6,567	\$ 4,639
Loans with no allocated allowance for loan losses	15,336	17,481
Total impaired loans	\$ 21,903	\$ 22,120
Amount of the allowance for loan losses allocated to impaired loans	\$ 711	\$ 402
Average of impaired loans during the period	\$ 21,457	\$ 16,409

Interest income received on impaired loans was approximately \$1.7 million and \$768,000 for the nine-month periods ended September 30, 2007 and 2006, respectively. Interest income received on impaired loans was approximately \$649,000 and \$273,000 for the three-month periods ended September 30, 2007 and 2006, respectively.

Nonperforming loans are as follows:

	<b>September 30, 2007</b>	<b>December 31, 2006</b>
Nonaccrual loans	\$ 9,557	\$ 9,226
90 days delinquent, still accruing	1,697	

Nonperforming loans and impaired loans are defined differently. Some loans may be included in both categories, and some may only be included in one category. Nonperforming loans include both smaller balance homogeneous loans that are collectively evaluated for impairment

## Edgar Filing: BankFinancial CORP - Form 10-Q

and individually classified impaired loans.

Of the \$1.7 million in loans classified as 90 days delinquent, still accruing, one loan with an outstanding principal balance of \$1.2 million was repaid in full in October of 2007. The majority of the remaining \$462,000 in loans classified as 90 days delinquent, still accruing, represent well-secured equipment leases, on which the initial payments were not received and processed until October 2007, due to administrative issues by the lessee. Generally, the Bank does not utilize this category of loan classification unless: (1) the loan is repaid in full shortly

---

**Table of Contents**

BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Table amounts in thousands, except share and per share data)

(unaudited)

**Note 4 Loans Receivable (Continued)**

after period end date or; (2) the loan is well secured and there are no asserted or pending legal barriers to its collection or; (3) the borrower has remitted all scheduled payments and is otherwise in substantial compliance with the terms of the loan, but the processing of loan payments actually received or the renewal of the loan has not occurred for administrative reasons.

At September 30, 2007, the Company's loans included approximately \$3.9 million of commercial real estate loans and \$13.0 million of one- to four-family residential mortgages that the Bank purchased from a loan servicing company that filed a Chapter 11 bankruptcy petition in late December, 2006. The Bankruptcy Court appointed a Trustee on January 22, 2007, and the case was converted to a Chapter 7 bankruptcy proceeding on March 2, 2007. The Bank received court approval to terminate its loan servicing arrangements with the debtor effective March 2, 2007, and thereafter transferred the servicing of the purchased loans to a substitute loan servicing company. The substitute loan servicing company has been collecting all payments that have been received from the borrowers on the purchased loans since that time.

During the first quarter of 2007, the Bank made a specific reserve allocation to its allowance for loan and lease losses for \$428,000 in principal payments and \$104,000 in interest payments, and charged-off \$101,000 in escrow payments, that the debtor had collected on the purchased loans prior to the Trustee's appointment and did not remit to the Bank. In addition, the Bank classified \$1.1 million of the purchased loans as nonperforming, which consisted of the \$428,000 in principal payments that we understood the debtor had collected on the purchased loans prior to the Trustee's appointment, and the amount of principal payments that we understood the Trustee had collected on the purchased loans before the servicing of the loans was transferred to the substitute loan servicing company. This classification was maintained at September 30, 2007 pending further developments in the bankruptcy proceeding, resulting in an increase in the amount of purchased loans that were classified as nonperforming at September 30, 2007 to \$1.3 million, compared to \$507,000 at December 31, 2006.

The Trustee subsequently completed an accounting of all loan payments that he had collected and deposited in a trust account following his appointment, and requested the Bankruptcy Court to authorize him to remit these funds to the owners of the loans, subject to a pro rata reduction of the remittances to cover certain court-approved expenditures and debtor checks that had cleared against the trust account before the Trustee was able to stop payment on all debtor checks. The Bankruptcy Court entered an order on September 28, 2007, authorizing the Trustee, without prejudice to any competing claims that may be asserted to the funds, to make the requested remittances, including an \$811,000 remittance to the Bank that represents approximately 88% of the loan payments that the Trustee had collected on the purchased loans. The Bank has not yet received this remittance, although the Trustee is required to pay it within 60 days of the date of the Bankruptcy Court order. We anticipate that the Bank will receive the remittance from the Trustee during the fourth quarter of 2007.

The Bank also filed a claim with its fidelity bond carrier seeking recovery of the unremitted principal, interest and escrow payments that the debtor collected on the purchased loans prior to the Trustee's appointment, the remaining 12% of the loan payments that the Trustee collected on the purchased loans and lacked sufficient funds to remit, and legal expenses. Subsequent to September 30, 2007, the fidelity bond carrier advised the Bank that the documentation submitted in connection with the claim was acceptable and proposed to settle the claim for the net amount of \$646,000. This net amount represents the amount of the collected but unremitted loan payments and certain legal expenses minus the \$250,000 retention under the bond. The Bank advised its fidelity bond carrier that the proposed settlement amount was acceptable; however the Bank does not intend to execute documents approving the proposed settlement until it receives clarification from the fidelity bond carrier as to whether the proposed settlement would preclude the Bank from amending its bond claim if future adverse developments were to occur in the bankruptcy proceeding.

Based on this subsequent event, during the fourth quarter management will evaluate the need to reclassify the specific loan loss reserves previously allocated to the purchased loans as a reserve for loss due to fraud, and the



**Table of Contents**

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Table amounts in thousands, except share and per share data)

(unaudited)

**Note 4 Loans Receivable (Continued)**

collected but unremitted payments on the purchased loans as accounts receivable included in Other Assets. Any payments that the Bank may receive from the fidelity bond carrier or the Trustee will directly reduce Other Assets and any excess will be applied to the loss due to fraud. Currently, we expect these matters to be fully resolved by December 31, 2007.

The allowance for loan losses is a valuation allowance for probable incurred credit losses inherent in the loan portfolio. In determining the level of the allowance for loan losses, management considers past and current loss experience, evaluations of collateral, current economic conditions, volume and type of lending, adverse situations that may affect a borrower's ability to repay a loan, the levels of nonperforming and other classified loans, and other relevant factors. The amount of the allowance is based on estimates and the ultimate losses may vary from such estimates as more information becomes available, or as later events occur or circumstances change. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged-off. The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired or loans otherwise classified as substandard or doubtful. The general component covers nonclassified loans and is based on historical loss experience adjusted for current factors.

A loan is impaired when full payment under the loan terms is not expected. Commercial and commercial real estate loans are individually evaluated for impairment. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Large groups of smaller balance homogeneous loans, such as consumer loans and residential real estate loans, are collectively evaluated for impairment, and accordingly, they are not separately identified for impairment disclosures.

**Note 5 Deposits**

Deposits are as follows:

	September 30, 2007	December 31, 2006
Non-interest-bearing demand	\$ 111,772	\$ 134,097
Interest-bearing NOW	297,589	274,391
Money market accounts	266,737	260,796
Savings	101,176	114,851
Certificates of deposit	321,267	345,450
	\$ 1,098,541	\$ 1,129,585

Certificates of deposit include wholesale deposits of \$6.8 million and \$21.5 million at September 30, 2007 and December 31, 2006, respectively.

**Table of Contents**

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Table amounts in thousands, except share and per share data)

(unaudited)

**Note 5 Deposits (Continued)**

Interest expense on deposit accounts is summarized as follows for the periods indicated:

	Three months ended September 30,		Nine months ended September 30,	
	2007	2006	2007	2006
Interest-bearing NOW	\$ 1,916	\$ 1,127	\$ 5,171	\$ 2,795
Money market accounts	2,994	2,661	8,541	7,315
Savings	205	251	638	781
Certificates of deposit	3,720	3,948	11,260	10,822
	\$ 8,835	\$ 7,987	\$ 25,610	\$ 21,713

**Note 6 Other Comprehensive Income**

Other comprehensive income components were as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2007	2006	2007	2006
Net income	\$ 2,237	\$ 2,795	\$ 6,226	\$ 8,839
Other comprehensive income:				
Unrealized holding gains on securities available for-sale	833	952	1,571	4,312
Tax effect	(331)	(378)	(624)	(1,715)
Unrealized holding gains on securities available for-sale, net of tax effect	502	574	947	2,597
Less reclassification adjustment for gains recognized in Income	(399)	(89)	(399)	(144)
Tax effect	159	35	159	57
Less reclassification adjustment for gains recognized in income, net of tax	(240)	(54)	(240)	(87)
Total other comprehensive income	262	520	707	2,510
Total comprehensive income	\$ 2,499	\$ 3,315	\$ 6,933	\$ 11,349

**Note 7 New Accounting Standards**



## Edgar Filing: BankFinancial CORP - Form 10-Q

The Company adopted FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes ( FIN 48 ), as of January 1, 2007. A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, presuming that a tax examination will occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely to be realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded. The adoption had no material effect on the Company's financial statements.

The Company and its subsidiary are subject to U.S. federal income tax as well as income tax of the State of Illinois. The Company is no longer subject to examination by these taxing authorities for years before 2003 for federal income tax and 2002 for the State of Illinois. The Company does not expect the total amount of unrecognized tax benefits to significantly increase in the next twelve months.

**Table of Contents**

BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Table amounts in thousands, except share and per share data)

(unaudited)

**Note 7 New Accounting Standards (Continued)**

The Company recognizes interest and/or penalties related to income tax matters in income tax expense. At September 30, 2007, the Company had recorded a cumulative accrual of \$44,700 pursuant to FIN 48 for potential interest and penalties.

---

**Table of Contents**

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**  
**Cautionary Statement Regarding Forward-Looking Information**

**Forward-Looking Statements**

This Quarterly Report on Form 10-Q, including this Item 2, contains, and other periodic and special reports and press releases of BankFinancial Corporation may contain, forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, that involve significant risks and uncertainties. We intend such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995, and are including this statement for purposes of invoking these safe harbor provisions. These forward-looking statements, which are based on certain assumptions and describe our future plans, strategies and expectations, are generally identifiable by use of the words believe, expect, intend, anticipate, estimate, project, plan, or expressions. Our ability to predict results or the actual effect of future plans or strategies is inherently uncertain and actual results may differ from those predicted. Factors that could have a material adverse effect on operations and could affect management's outlook or our future prospects include, but are not limited to: higher than expected overhead, infrastructure and compliance costs, changes in market interest rates, a flattening or inversion of the yield curve, less than anticipated balance sheet growth, lack of demand for loan products, unanticipated changes in secondary mortgage market conditions, deposit flows, pricing, underwriting and other forms of competition, adverse federal or state legislative or regulatory developments, monetary and fiscal policies of the U.S. Government, including policies of the U.S. Treasury and Federal Reserve Board, deteriorating economic conditions that could result in increased delinquencies in our loan portfolio, the quality or composition of our loan or investment portfolios, demand for financial services and multi-family, commercial and residential real estate loans in our market area, the possible short-term dilutive effect of potential acquisitions or de novo branches, if any, changes in accounting principles, policies and guidelines, future adverse developments in legal and bankruptcy proceedings, and future adverse developments concerning Freddie Mac or the Federal Home Loan Bank of Chicago. These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. We do not undertake any obligation to update any forward-looking statement to reflect circumstances and events that occur after the date on which the forward-looking statement was made.

**Critical Accounting Policies**

Critical accounting policies are defined as those that are reflective of significant judgments and uncertainties, and could potentially result in materially different results under different assumptions and conditions. We believe that the critical accounting policies upon which our financial condition and results of operation depend, and which involve the most complex subjective decisions or assessments, are included in the discussion entitled Critical Accounting Policies in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2006, and all amendments thereto, as filed with the Securities and Exchange Commission. There are no material changes to the critical accounting policies disclosed in the Annual Report on Form 10-K.

**Overview**

Business conditions improved slightly in the third quarter, 2007. Originations of targeted commercial loan categories improved from the previous quarter, but the activity was effectively offset by higher commercial lines of credit and loan repayments, especially within the residential construction and the multifamily portfolios due in part to the Company's credit pricing and underwriting standards. We continued to reduce our securities and wholesale funding portfolios consistent with our focus on optimizing the performance of the Company's entire balance sheet.

Our asset quality was essentially stable during the quarter. We resolved several small problem credits and expect to resolve several other classified credits during the fourth quarter of 2007 as we continue to vigorously pursue resolutions of classified assets, particularly in the health care portfolio. Overall portfolio quality trends

**Table of Contents**

remained relatively constant; however, consistent with our predictions early in 2007, we expect that we may elect not to renew certain residential construction loans and to pursue our legal remedies if the borrower is unable to continue scheduled debt service or proposes unfeasible exit solutions. Though not representative of overall portfolio trends, we are beginning to see isolated instances of multifamily and small commercial real estate borrowers having difficulty maintaining tenant occupancy levels due to their inability to effectively manage neighborhood safety issues. Generally, these situations can be resolved through various methods, including the strengthening of building management or the sale of the collateral, but the possibility exists that some of these loans may be classified as nonperforming if the borrowers do not execute an appropriate remedy. As we expected, the Company's required loan loss reserves increased slightly due to the changes in national and local economic risk factors as measured by our SFAS No. 5 loan loss reserve model. We continue to believe that adherence to our historical loan underwriting standards remains appropriate, despite persistent market pressures resulting from international, national and local competitors.

Competition for deposits was stable, though certain national competitors intensified competition for certificates of deposit late in the quarter. Deposit balances remained essentially constant from the previous quarter; however, declines in our title insurance agency escrow deposits offset modest increases in core deposits. Depending on the behavior of interest rates and competitors, we expect to reduce high-balance indexed money market deposit accounts in situations where we have superior funding alternatives and anticipate little or no impact on valuable customer relationships.

Our net interest margin and net interest spread were relatively stable during the quarter. Nonetheless, we believe that such behavior may not necessarily continue because the Company's lower credit risk profile, narrowing commercial credit spreads and continued deposit migration into higher-yielding accounts could offset the benefits of a changing interest rate environment. In addition, on a comparative basis, other factors affecting net interest margin include the cumulative effects of the Company's share repurchase program and the fact that our recent investment in Bank-Owned Life Insurance produces non-interest income rather than interest income. We expect that these factors will continue to affect our net interest margin in future quarters; however, we are also focused on generating positive influences through the further diversification of our commercial credit portfolio, optimization of the overall mix of the loan portfolio and gathering non-interest bearing deposits from local small businesses.

Non-interest income increased modestly during the quarter; however, title insurance sales and Wealth Management operations declined consistent with our expectations. Changes in the residential mortgage market and expectations concerning interest rates will be among the principal factors affecting title insurance and Wealth Management revenues in future quarters. Future product development activities have the potential to gradually improve deposit-related fee income during the remainder of the year.

Non-interest expense remained well contained. We continue to reduce expenses and staffing levels consistent with the results of our functional reviews. We expect expenses for marketing (especially retail deposits and small business customers), commercial business development personnel and audit/compliance functions to increase as we respond to market conditions and changes in applicable laws and regulations.

**Table of Contents****Selected Financial Data**

The following tables summarize the major components of the changes in our balance sheet at September 30, 2007 and December 31, 2006, and in our income statement for the three-month and nine-month periods ended September 30, 2007 and September 30, 2006.

	September 30, 2007	December 31, 2006	Percent Change
(Dollars in thousands)			
<b>Selected Financial Condition Data:</b>			
Total assets	\$ 1,504,622	\$ 1,613,122	(6.7)%
Loans receivable, net	1,276,129	1,329,915	(4.0)
Deposits	1,098,541	1,129,585	(2.7)
Borrowings	81,138	138,148	(41.3)
Stockholders' equity	303,621	326,015	(6.9)

	Three months ended September 30, 2007		Percent Change	Nine months ended September 30, 2006		Percent Change
(Dollars in thousands)						
<b>Selected Operating Data:</b>						
Interest income	\$ 23,124	\$ 24,244	(4.6)%	\$ 70,028	\$ 70,219	(0.3)%
Interest expense	9,899	9,792	1.1	29,424	27,635	6.5
Net interest income	13,225	14,452	(8.5)	40,604	42,584	(4.7)
Provision for loan losses	460	49	838.8	687	401	71.3
Net interest income after provision for loan losses	12,765	14,403	(11.4)	39,917	42,183	(5.4)
Noninterest income	2,777	2,658	(4.5)	7,146	7,976	(10.4)
Noninterest expense	12,383	12,895	(4.0)	38,171	36,980	3.2
Income before income taxes	3,159	4,166	(24.2)	8,892	13,179	(32.5)
Provision for income taxes	922	1,371	(32.8)	2,666	4,340	(38.6)
Net income	\$ 2,237	\$ 2,795	(20.0)%	\$ 6,226	\$ 8,839	(29.6)%

	Three Months Ended September 30, 2007		Nine Months Ended September 30, 2006	
<b>Selected Financial Ratios and Other Data:</b>				
<b>Performance Ratios:</b>				
Return on assets (ratio of net income to average total assets) (1)	0.59%	0.68%	0.54%	0.71%
Return on equity (ratio of net income to average equity) (1)	2.90	3.34	2.64	3.53
Net interest rate spread (1) (2)	2.91	2.86	2.92	2.88
Net interest margin (1) (3)	3.76	3.71	3.78	3.66
Average equity to average assets	20.28	20.37	20.31	20.24
Efficiency ratio (4)	77.38	75.37	79.94	73.14
Noninterest expense to average total assets (1)	3.26	3.14	3.29	2.99
Average interest-earning assets to average interest-bearing liabilities	130.11	133.87	131.25	133.04

Footnotes for tables on following page



**Table of Contents****Selected Financial Data (continued)**

(Footnotes for tables on previous page)

- (1) Ratios are annualized.
- (2) The net interest rate spread represents the difference between the yield on average interest-earning assets and the cost of average interest-bearing liabilities for the period.
- (3) The net interest margin represents net interest income divided by average total interest-earning assets for the period.
- (4) The efficiency ratio represents noninterest expense divided by the sum of net interest income and noninterest income.

	At September 30, 2007	At December 31, 2006
<b>Selected Financial Ratios and Other Data:</b>		
<b>Asset Quality Ratios:</b>		
Nonperforming assets to total assets	0.65%	0.57%
Nonperforming loans to total loans	0.74	0.69
Allowance for loan losses to nonperforming loans	115.94	115.13
Allowance for loan losses to total loans	0.86	0.79
<b>Capital Ratios:</b>		
Equity to total assets at end of period	20.18	20.21
Tier 1 leverage ratio (Bank only)	15.16	15.05
<b>Other Data:</b>		
Number of full service offices	18	18
Employees (full-time equivalent basis)	416	438

**Comparison of Financial Condition at September 30, 2007 and December 31, 2006**

Total assets decreased \$108.5 million, or 6.7%, to \$1.505 billion at September 30, 2007, from \$1.613 billion at December 31, 2006, due primarily to the combined effect of a \$53.8 million net decrease in loans, the maturity of investment securities available-for-sale, and cash expenditures to fund stock repurchases and dividends and to repay maturing Federal Home Loan Bank ( FHLB ) of Chicago advances and retire wholesale deposits.

Net loans receivable decreased by \$53.8 million, or 4.0%, to \$1.276 billion at September 30, 2007, from \$1.330 billion at December 31, 2006, primarily due to construction loan repayments resulting from project sales activities. Construction and land loans decreased \$23.7 million, or 27.9%, consistent with our decreased emphasis on originating new loans in this loan category. We received \$52.3 million in loan repayments on construction and land loans during the nine months ended September 30, 2007, compared to \$44.2 million during the same period in 2006. Non-residential real estate loans increased \$5.6 million, or 1.8%. One- to four-family residential mortgage loans decreased by \$23.7 million, or 6.0%, due in substantial part to lessening demand for one- to four-family residential mortgage loans. Multi-family mortgage loans decreased \$8.2 million, or 2.8%, and commercial loans decreased \$9.0 million, or 10.1%. Commercial leases increased \$6.6 million, or 4.7%.

Net securities available for sale decreased by \$50.2 million, or 42.6%, to \$67.7 million at September 30, 2007, from \$117.9 million at December 31, 2006, primarily due to the net maturity of \$46.6 million of investment securities and our decision to use a significant portion of their proceeds to repay maturing FHLB of Chicago advances. We continue to evaluate the securities available-for-sale-portfolio for opportunities to improve yields and reduce liquidity volatility.

The Company owned \$15.6 million of common stock of the FHLB of Chicago at September 30, 2007. On October 10, 2007 the FHLB of Chicago entered into a consensual cease and desist order with the Federal Housing Finance Board ( Finance Board ). Under the terms of the order, capital stock redemptions are prohibited unless the FHLB of Chicago receives approval from the Director of the Office of Supervision of the Finance Board ( OS Director ), and future dividend declarations are subject to the prior written approval of the OS Director as well.

**Table of Contents**

Cash and cash equivalents decreased \$22.6 million to \$44.7 million at September 30, 2007, from \$67.3 million at December 31, 2006. Cash expenditures during the nine-months ended September 30, 2007 included \$66.0 million to repay maturing FHLB of Chicago advances and \$33.6 million to fund stock repurchases and dividends.

The Company purchased \$19.0 million of Bank-Owned Life Insurance ( BOLI ) during the nine months ended September 30, 2007. Other assets decreased by \$290,000, to \$6.7 million at September 30, 2007, from \$7.0 million at December 31, 2006.

Deposits decreased \$31.0 million, or 2.7%, to \$1.099 billion at September 30, 2007, from \$1.130 billion at December 31, 2006. Total core deposits (savings, money market, noninterest bearing demand and NOW accounts) increased slightly as a percentage of total deposits during this period, and represented 70.8% of total deposits at September 30, 2007, compared to 69.4% of total deposits at December 31, 2006. Wholesale deposits decreased \$14.7 million, or 68.3% to \$6.8 million at September 30, 2007, compared to \$21.5 million at December 31, 2006.

Borrowings decreased \$57.0 million, or 41.3%, to \$81.1 million at September 30, 2007, from \$138.1 million at December 31, 2006, primarily due to our decision to repay \$66.0 million in maturing FHLB of Chicago advances.

Total stockholders' equity decreased \$22.4 million to \$303.6 million at September 30, 2007, compared to \$326.0 million at December 31, 2006, primarily due to the impact of stock repurchases and the declaration of cash dividends, which was partially offset by net income and unrealized gains on securities available for sale during the same period. We repurchased and retired 1,742,023 shares of common stock at an aggregate cost of \$28.7 million during the nine months ended September 30, 2007, and declared and paid three cash dividends during this nine month period in the aggregate amount of \$4.9 million. The impact of the stock repurchases and cash dividends was partially offset by net income of \$6.2 million for the nine months ended September 30, 2007, and an unrealized gain on securities available for sale of \$707,000, net of tax, at September 30, 2007, compared to an unrealized gain of \$3.0 million, net of tax, at December 31, 2006. The unallocated shares of common stock that are owned by our ESOP were reflected as a \$17.4 million reduction to stockholders' equity at September 30, 2007, compared to an \$18.1 million reduction to equity at December 31, 2006.

**Comparison of Operating Results for the Three Months Ended September 30, 2007 and 2006**

**Net Income.** We had net income of \$2.2 million for the three months ended September 30, 2007, compared to net income of \$2.8 million for the three months ended September 30, 2006. Our operating results for the third quarter of 2007 reflected \$1.3 million in expenses for equity-based compensation and benefits, compared to \$996,000 for the third quarter of 2006, relating to the ESOP that we established in connection with our mutual-to-stock conversion in June of 2005 and awards that were granted under the 2006 Equity Incentive Plan that our stockholders approved in June of 2006. Our earnings per share of common stock for the three months ended September 30, 2007 were \$0.11 per share, compared to \$0.12 per share for the three-month period ending September 30, 2006.

**Net Interest Income.** Net interest income decreased by \$1.2 million, or 8.5%, to \$13.2 million for the three months ended September 30, 2007, from \$14.5 million for the three months ended September 30, 2006. The decrease in net interest income was due in substantial part to an \$848,000, or 10.6%, increase in interest expense on deposits to \$8.8 million for the three months ended September 30, 2007 from \$8.0 million for the same period in 2006, the reduction in interest earning assets that resulted from our share repurchase program, and the fact that our investment in \$19.0 million in Bank-Owned Life Insurance in May of 2007 produces non-interest income rather than interest income. In addition, the decrease to net interest income was partially due to a \$147.1 million decrease in average interest earning assets to \$1.397 billion from \$1.544 billion during the same period in 2006, and a \$79.8 million decrease in average interest-bearing liabilities to \$1.074 billion, from \$1.154 billion during the same period in 2006. The decrease in average interest-bearing liabilities included a 48.6% decrease in average borrowings. Our net interest rate spread increased by 5 basis points to 2.91% for the three months ended September 30, 2007, from 2.86% for the same period in 2006. Our net interest margin increased by 5 basis points to 3.76% for the three months ended September 30, 2007, from 3.71% for the same period in 2006.



---

**Table of Contents**

Interest income decreased \$1.1 million, or 4.6%, to \$23.1 million for the three months ended September 30, 2007, from \$24.2 million for the three months ended September 30, 2006. The decrease in interest income reflected a \$147.1 million, or 9.5%, decrease in total average interest-earning assets, to \$1.397 billion for the three months ended September 30, 2007, from \$1.544 billion for the same period in 2006. The decrease in total average interest earning assets was due in substantial part to a \$119.7 million decrease in average investment securities available-for-sale, cash expenditures for share repurchases, and our investment of \$19.0 million in Bank-Owned Life Insurance. The impact of the decrease in total average interest earning assets on interest income was partially offset by a 34 basis point improvement in the average yield on interest-earning assets to 6.57% for the three months ended September 30, 2007, from 6.23% for the same period ended September 30, 2006. Interest income was also reduced due to the \$28.7 million reduction in interest-earning assets resulting from the Company's share repurchase program.

Interest income from loans, the most significant portion of interest income, increased \$84,000, or 0.4%, to \$21.7 million for the three months ended September 30, 2007, from \$21.6 million for the three months ended September 30, 2006. The increase in interest income on loans resulted primarily from a 17 basis point increase in the average yield on loans to 6.67% for the three months ended September 30, 2007, from 6.50% for the same period in 2006, due to higher market interest rates, which was partially offset by a \$28.4 million, or 2.2%, decrease in the average balance of loans outstanding to \$1.292 billion for the three months ended September 30, 2007, from \$1.320 billion for the same period in 2006.

Interest income from securities available for sale decreased by \$1.2 million, or 51.5%, to \$1.1 million for the three months ended September 30, 2007, from \$2.3 million for the three months ended September 30, 2006, due in substantial part to a \$119.7 million decrease, or 62.0%, in the average outstanding balance of securities available for sale to \$73.4 million for the three months ended September 30, 2007, from \$193.1 million for the same period in 2006. We decided in 2006 to reduce our portfolio of investment securities available-for-sale to eliminate certain lower yielding securities and to configure our balance sheet in a way that was better positioned for a flat or inverted yield curve environment. Partially offsetting the decrease in average balances in securities available-for-sale was a 128 basis point increase in the yield on securities available-for-sale to 5.90% for the three months ended September 30, 2007, from 4.62% for the same period in 2006.

Income from cash dividends on our FHLB of Chicago common stock totaled \$109,000 for the three months ended September 30, 2007, compared to cash dividends of \$190,000 for the three months ended September 30, 2006. The decrease was primarily attributable to the redemption of \$9.8 million of our excess FHLB of Chicago common stock throughout 2006. Of this amount, \$3.3 million was redeemed in the fourth quarter of 2006.

Interest income from cash that we maintained in interest earning deposits totaled \$214,000 for the three months ended September 30, 2007, compared to \$179,000 for the three months ended September 30, 2006. The increase was primarily due to a \$4.4 million increase in the average balances of cash maintained in interest earning deposits, which was partially offset by a 67 basis point decrease in the yield on interest earning deposits to 5.08% for the three months ended September 30, 2007, from 5.75% for the same period in 2006.

Interest expense increased \$107,000, or 1.1%, to \$9.9 million for the three months ended September 30, 2007, from \$9.8 million for the three months ended September 30, 2006. This increase reflected an increase in the weighted average interest rates that we paid on deposit accounts and an increase in the average interest rates that we paid on our FHLB advances, which together resulted in an overall increase of 29 basis points in the cost of average interest-bearing liabilities to 3.66% for the three months ended September 30, 2007, from 3.37% for the same period in 2006. The effect of the increase in interest expense was mitigated by a \$79.8 million, or 6.9%, decrease in our average interest bearing liabilities to \$1.074 billion for the three months ended September 30, 2007, from \$1.154 billion for the same period in 2006.

---

**Table of Contents**

Interest expense on deposits increased \$848,000, or 10.6%, to \$8.8 million for the three months ended September 30, 2007, from \$8.0 million for the three months ended September 30, 2006. The increase reflected a 33 basis point increase in the average rate paid on interest-bearing deposits to 3.55% for the three months ended September 30, 2007, from 3.22% for same period in 2006, and a \$3.3 million, or 0.3%, increase in average interest-bearing deposits to \$986.1 million for the three months ended September 30, 2007, from \$982.9 million for the same period in 2006.

Interest expense on money market account deposits increased \$333,000, or 12.5%, reflecting an increase of \$19.0 million, or 7.6%, in the average balance of money market account deposits to \$269.5 million for the three months ended September 30, 2007, from \$250.5 million for the same period in 2006, and a 20 basis point increase in the interest rate paid on money market account deposits to 4.41%, from 4.21% for same period in 2006. Indexed money market accounts deposits had average balances totaling \$201.5 million during the three months ended September 30, 2007, compared to \$173.3 million for the same period in 2006. The interest rates paid on money market account deposits, certain NOW account deposits and savings account deposits increased due to increasing short-term market interest rates during a substantial part of the quarter, changes in applicable indices and increases in rates paid by our competitors. Rates on other selected money market account deposits and certificates of deposit also increased due to market conditions and competitive factors.

Interest expense on NOW account deposits increased \$789,000, or 70.0%, reflecting an 82 basis point increase in the interest rates paid on NOW account deposits to 2.65% for the three months ended September 30, 2007, from 1.83% for the same period in 2006, and an increase of \$42.5 million, or 17.4%, in the average balance of NOW account deposits to \$287.0 million for the three months ended September 30, 2007, from \$244.5 million for the same period in 2006.

Interest expense on certificates of deposit decreased \$228,000, or 5.8%, reflecting a decrease of \$38.9 million, or 10.7%, in the average balance of certificates of deposit to \$325.1 million for the three months ended September 30, 2007, from \$364.0 million for the same period in 2006. This decrease was partially offset by a 24 basis point increase in the interest rates paid on certificates of deposit to 4.54% for the three months ended September 30, 2007, from 4.30% for the same period in 2006. Average balances of wholesale and retail certificates of deposits declined for the third quarter 2007, compared to the same period in 2006. Wholesale certificates of deposit declined by \$23.0 million, or 73.4%, and retail certificates of deposit decreased by \$15.9 million, or 4.8%.

Interest expense on borrowings decreased by \$741,000, or 41.1%, to \$1.1 million for the three months ended September 30, 2007, from \$1.8 million for the three months ended September 30, 2006. The decrease was due to an \$83.0 million, or 48.6%, reduction of our average borrowings to \$87.8 million for the three months ended September 30, 2007, from \$170.8 million for the same period in 2006, which was partially offset by a 62 basis point increase in interest rates paid on borrowings to 4.81% for the three months ended September 30, 2007, from 4.19% for the same period in 2006.

**Table of Contents****Average Balances and Net Interest Margin**

The following table sets forth average balance sheets, average yields and costs, and certain other information for the periods indicated. No tax-equivalent yield adjustments were made, as the effect of these adjustments would not be material. Average balances are daily average balances. Nonaccrual loans have been included in the computation of average balances, but have been reflected in the table as loans carrying a zero yield. The yields set forth below include, where applicable, the effect of deferred fees and expenses, discounts and premiums, and purchase accounting adjustments that are amortized or accreted to interest income or expense.

	For the three months ended September 30,					
	2007			2006		
	Average Outstanding Balance	Interest	Yield/Rate (1)	Average Outstanding Balance	Interest	Yield/Rate (1)
	(Dollars in thousands)					
<b>Interest-earning assets:</b>						
Loans	\$ 1,291,593	\$ 21,709	6.67%	\$ 1,320,016	\$ 21,625	6.50%
Securities available-for-sale	73,370	1,092	5.90	193,081	2,250	4.62
Stock in FHLB	15,598	109	2.77	18,911	190	3.99
Other	16,725	214	5.08	12,348	179	5.75
Total interest-earning assets	1,397,286	23,124	6.57	1,544,356	24,244	6.23
Noninterest-earning assets	121,384			99,948		
Total assets	\$ 1,518,670			\$ 1,644,304		
<b>Interest-bearing liabilities:</b>						
Savings deposits	\$ 104,472	205	0.78	\$ 123,778	251	0.80
Money market deposits	269,510	2,994	4.41	250,535	2,661	4.21
NOW deposits	287,032	1,916	2.65	244,534	1,127	1.83
Certificates of deposit	325,099	3,720	4.54	364,012	3,948	4.30
Total deposits	986,113	8,835	3.55	982,859	7,987	3.22
Borrowings	87,782	1,064	4.81	170,804	1,805	4.19
Total interest-bearing liabilities	1,073,895	9,899	3.66	1,153,663	9,792	3.37
Noninterest-bearing deposits	113,983			131,727		
Other liabilities	22,751			23,899		
Total liabilities	1,210,629			1,309,289		
Equity	308,041			335,015		
Total liabilities and equity	\$ 1,518,670			\$ 1,644,304		
Net interest income		\$ 13,225			\$ 14,452	
Net interest rate spread (2)			2.91%			2.86%
Net interest-earning assets (3)	\$ 323,391			\$ 390,693		
Net interest margin (4)			3.76%			3.71%
Ratio of interest-earning assets to interest-bearing liabilities	130.11%			133.87%		

## Edgar Filing: BankFinancial CORP - Form 10-Q

- (1) Annualized
- (2) Net interest rate spread represents the difference between the yield on average interest-earning assets and the cost of average interest-bearing liabilities.
- (3) Net interest-earning assets represents total interest-earning assets less total interest-bearing liabilities.
- (4) Net interest margin represents net interest income divided by average total interest-earning assets.

---

**Table of Contents**

***Provision for Loan Losses.*** We establish provisions to our allowance for loan losses, which are charged to operations in order to maintain the allowance for loan losses at a level we consider necessary to absorb probable incurred credit losses in the loan portfolio. In determining the level of the allowance for loan losses, we consider past and current loss experience, evaluations of collateral, current economic conditions, volume and type of lending, adverse situations that may affect a borrower's ability to repay a loan and the levels of nonperforming and other classified loans. The amount of the allowance is based on estimates and the ultimate losses may vary from such estimates as more information becomes available or later events change. We assess the allowance for loan losses on a quarterly basis and make provisions for loan losses in order to maintain the allowance.

Based on our evaluation of the above factors, we recorded a provision to our allowance for loan losses of \$460,000 for the three months ended September 30, 2007, compared to a provision for loan losses of \$49,000 for the three months ended September 30, 2006. Of this amount, \$319,000 was attributable to changes in the national and local economic risk factors that we use in our SFAS No. 5 loan loss reserve model to calculate the level of loan loss reserves that we maintain. The portion of the allowance for loan losses allocated to impaired loans pursuant to SFAS No. 114 increased \$141,000 to \$711,000 at September 30, 2007. We established specific reserves for five loans with a total principal balance of \$1.1 million due to our evaluation of the borrower's ability to repay, the estimated net realizable value of collateral or the expected results of judicial collection or federal bankruptcy legal proceedings. Of these loans, the largest loan relationship was \$556,000, for which we established a contingent reserve of \$91,000 pending the results of updated collateral valuation information.

At September 30, 2007, the Company's loans included approximately \$3.9 million of commercial real estate loans and \$13.0 million of one- to four-family residential mortgages that the Bank purchased from a loan servicing company that filed a Chapter 11 bankruptcy petition in late December, 2006. The Bankruptcy Court appointed a Trustee on January 22, 2007, and the case was converted to a Chapter 7 bankruptcy proceeding on March 2, 2007. The Bank received court approval to terminate its loan servicing arrangements with the debtor effective March 2, 2007, and thereafter transferred the servicing of the purchased loans to a substitute loan servicing company. The substitute loan servicing company has been collecting all payments that have been received from the borrowers on the purchased loans since that time.

During the first quarter of 2007, the Bank made a specific reserve allocation to its allowance for loan and lease losses for \$428,000 in principal payments, and \$104,000 in interest payments, and charged-off \$101,000 in escrow payments, that the debtor collected on the purchased loans prior to the Trustee's appointment and did not remit to the Bank. In addition, the Bank classified \$1.1 million of the purchased loans as nonperforming, which consisted of the \$428,000 in principal payments that we understood the debtor had collected on the purchased loans prior to the Trustee's appointment, and the amount of principal payments that we understood the Trustee had collected on the purchased loans before servicing was transferred to the substitute loan servicing company. This classification was maintained at September 30, 2007 pending further developments in the bankruptcy proceeding, resulting in an increase in the amount of purchased loans that were classified as nonperforming at September 30, 2007 to \$1.3 million, compared to \$507,000 at December 31, 2006.

The Trustee subsequently completed an accounting of all loan payments that he had collected and deposited in a trust account following his appointment, and requested the Bankruptcy Court to authorize him to remit these funds to the owners of the loans, subject to a pro rata reduction of the remittances to cover certain court-approved expenditures and debtor checks that had cleared against the trust account before the Trustee was able to stop payment on all debtor checks. The Bankruptcy Court entered an order on September 28, 2007, authorizing the Trustee, without prejudice to any competing claims that may be asserted to the funds, to make the requested remittances, including an \$811,000 remittance to the Bank that represents approximately 88% of the loan payments that the Trustee had collected on the purchased loans. The Bank has not yet received this remittance, although the Trustee is required to pay it within 60 days of the date of the Bankruptcy Court order. We anticipate that the Bank will receive the remittance from the Trustee during the fourth quarter of 2007.

The Bank also filed a claim with its fidelity bond carrier seeking recovery of the unremitted principal, interest and escrow payments that the debtor collected on the purchased loans prior to the Trustee's appointment, the remaining 12% of the loan payments that the Trustee collected on the purchased loans and lacked sufficient funds to

**Table of Contents**

remit, and legal expenses. Subsequent to September 30, 2007, the fidelity bond carrier advised the Bank that the documentation submitted in connection with the claim was acceptable and proposed to settle the claim for the net amount of \$646,000. This net amount represents the amount of the collected but unremitted loan payments and certain legal expenses minus the \$250,000 retention under the bond. The Bank advised its fidelity bond carrier that the proposed settlement amount was acceptable; however the Bank does not intend to execute documents approving the proposed settlement until it receives clarification from the fidelity bond carrier as to whether the proposed settlement would preclude the Bank from amending its bond claim if future adverse developments were to occur in the bankruptcy proceeding.

Based on this subsequent event, during the fourth quarter management will evaluate the need to reclassify the specific loan loss reserves previously allocated to the purchased loans as a reserve for loss due to fraud, and the collected but unremitted payments on the purchased loans as accounts receivable included in Other Assets. Any payments that the Bank may receive from the fidelity bond carrier or the Trustee will directly reduce Other Assets and any excess will be applied to the loss due to fraud. Currently, we expect these matters to be fully resolved by December 31, 2007.

Collection and resolution efforts continue to be a priority and future decisions may include non-renewal of credits and potential cessation of borrower relationships where the progress toward resolution is unsatisfactory. Asset quality trends and conditions in the other segments of the loan portfolio generally remained stable.

Nonperforming assets are as follows:

	September 30, 2007	June 30, 2007	\$ Change	% Change
	(Dollars in thousands)			
<b>Nonperforming assets:</b>				
Nonperforming loans	\$ 9,557	\$ 9,720	\$ (163)	(1.7%)
Real estate owned	252		252	100.0
Nonperforming assets	\$ 9,809	\$ 9,720	\$ 89	0.9%

Our allowance for loan losses totaled \$11.1 million, or 0.86% of total loans, at September 30, 2007, compared to \$10.8 million, or 0.83% of total loans, at June 30, 2007. We used the same general methodology in evaluating the allowance for loan losses at both dates. Our allowance for loan losses represented 115.9% of non-performing loans at September 30, 2007 and 110.9% of non-performing loans at June 30, 2007. To the best of our knowledge, we have recorded all losses that are both probable and reasonable to estimate for each reporting period.

**Noninterest Income.** Our noninterest income increased \$119,000, or 4.5%, to \$2.8 million for the three months ended September 30, 2007, compared to \$2.7 million for the same period in 2006. Deposit service charges and fees decreased \$204,000, or 17.9%, to \$938,000 for the quarter ended September 30, 2007, from \$1.1 million for the same period in 2006. Income from insurance commissions and annuities decreased by \$112,000 or 30.9%, to \$251,000, from \$363,000 for the same period in 2006. Gains on sales of loans decreased \$52,000, or 54.7%, to \$43,000, from \$95,000 for the same period in 2006. Loan servicing fees decreased \$48,000, or 20.9%, to \$182,000, from \$230,000 for the same period in 2006. Mortgage servicing rights amortization expense increased \$11,000, or 9.2%, to \$131,000, compared to \$120,000 for the same period in 2006. These decreases were partially offset by \$219,000 in income from Bank-Owned Life Insurance for the quarter ended September 30, 2007, compared to no such income for the same period in 2006. Gains on the sale of securities available for sale increased \$310,000, to \$399,000, from \$89,000 for the same period in 2006, representing the gain on the redemption of MasterCard Class B common stock. Net expenses from real estate owned in the 2007 period were \$4,000, compared to \$15,000 for the same period in 2006. Other income decreased \$23,000, or 5.6%, to \$385,000 for the three months ended September 30, 2007, from \$408,000 for the same period in 2006.

**Table of Contents**

The following table summarizes noninterest income for the periods ended September 30, 2007 and 2006:

	Three months ended September 30,		Change	
	2007	2006	\$	%
(Dollars in thousands)				
<b>Noninterest income:</b>				
Deposit service charges and fees	\$ 938	\$ 1,142	\$ (204)	(17.9)%
Other fee income	495	466	29	6.2
Insurance commissions and annuities income	251	363	(112)	(30.9)
Gain on sale of loans	43	95	(52)	(54.7)
Gain on sale of investments	399	89	310	348.3
Loan servicing fees	182	230	(48)	(20.9)
Amortization and impairment of servicing assets	(131)	(120)	(11)	9.2
Operations of real estate owned	(4)	(15)	11	(73.3)
Earnings on bank owned life insurance	219		219	N.M.
Other	385	408	(23)	(5.6)
<b>Total noninterest income</b>	<b>\$ 2,777</b>	<b>\$ 2,658</b>	<b>\$ 119</b>	<b>4.5</b>

N.M. = not meaningful

**Noninterest Expense.** Our noninterest expense was \$12.4 million for the three months ended September 30, 2007, compared to noninterest expense of \$12.9 million for same period in 2006, a decrease of \$512,000, or 4.0%. Compensation and benefits expense totaled \$7.8 million for the three-month period ended September 30, 2007, compared to \$8.2 million for the same period in 2006. Expense relating to equity-based compensation and benefits was \$1.3 million for the three months ended September 30, 2007, compared to \$996,000 during the third quarter of 2006. The increase in expense relating to equity-based compensation related to expenses for the ESOP that we established in connection with our mutual-to-stock conversion in June of 2005, and awards that were made under the Equity Incentive Plan that our stockholders approved in June of 2006. Excluding the equity-based compensation and benefits, compensation and benefits expense decreased \$783,000, or 10.8%, primarily due to a decrease in full time equivalent employees resulting from the implementation of functional staffing reviews. Data processing expense decreased \$52,000, or 6.0%, to \$821,000 for the three months ended September 30, 2007, compared to \$873,000 for the same period in 2006. Office occupancy and equipment expenses decreased by \$102,000, or 6.7% to \$1.4 million for the three months ended September 30, 2007, compared to \$1.5 million for the same period in 2006. Advertising and public relations expenditures increased by \$13,000, or 3.3%, to \$409,000 in the third quarter of 2007, from \$396,000 in the same period in 2006. Other general and administrative expenses increased \$222,000, or 28.6%, to \$998,000 for the three months ended September 30, 2007, from \$776,000 for the same period in 2006.

The following table summarizes noninterest expense for the periods ended September 30, 2007 and 2006:

	Three months ended September 30,		Change	
	2007	2006	\$	%
(Dollars in thousands)				
<b>Noninterest Expense:</b>				
Compensation and benefits	\$ 7,773	\$ 8,241	\$ (468)	(5.7)%
Office occupancy and equipment	1,428	1,530	(102)	(6.7)
Advertising and public relations	409	396	13	3.3
Data processing	821	873	(52)	(6.0)
Supplies, telephone and postage	485	583	(98)	(16.8)
Amortization of intangibles	469	496	(27)	(5.4)
Other	998	776	222	28.6
<b>Total noninterest expense</b>	<b>\$ 12,383</b>	<b>\$ 12,895</b>	<b>\$ (512)</b>	<b>(4.0)</b>





**Table of Contents**

**Income Tax Expense.** We recorded income tax expense of \$922,000 for the three months ended September 30, 2007, compared to \$1.4 million in income tax expense for the same period in 2006. Our effective tax rate for the three-months ended September 30, 2007 was 29.2%, compared to 32.9% for the same period in 2006. Lower pre-tax income resulted in a greater percentage of tax-exempt income and a lower effective federal tax rate for 2007 versus 2006.

**Comparison of Operating Results for the Nine Months Ended September 30, 2007 and 2006**

**Net Income.** We had net income of \$6.2 million for the nine months ended September 30, 2007, compared to net income of \$8.8 million for the nine months ended September 30, 2006. The principal factors impacting the decrease in net income from year to year included a \$1.8 million, or 6.5% increase in our interest expense and a \$1.2 million increase in our noninterest expense. Our operating results for the nine months ended September 30, 2007 reflected \$3.9 million in expenses for equity-based compensation and benefits, compared to \$1.8 million for the same period of 2006, relating to the ESOP that we established in connection with our mutual-to-stock conversion in June of 2005 and awards granted under the 2006 Equity Incentive Plan that our stockholders approved in June of 2006. Our earnings per share of common stock for the nine months ended September 30, 2007 were \$0.30 per share compared to \$0.39 per share for the nine-month period ending September 30, 2006.

**Net Interest Income.** Net interest income decreased by \$2.0 million, or 4.7%, to \$40.6 million for the nine months ended September 30, 2007, from \$42.6 million for the nine months ended September 30, 2006. The decrease in net interest income was due in substantial part to a \$3.9 million, or 17.9%, increase in interest expense on deposits to \$25.6 million for the nine months ended September 30, 2007 from \$21.7 million for the nine months ended September 30, 2006, the reduction in interest earning assets that resulted from our share repurchase program, and the fact that our investment in \$19.0 million in Bank-Owned Life Insurance in May of 2007 produces non-interest income rather than interest income. Our net interest rate spread increased by 4 basis points to 2.92% for the first nine months of 2007, from 2.88% for the same period in 2006. The increase in interest expense resulted primarily from the increasing competition in the Chicago banking market for deposits. Our net interest margin increased by 12 basis points to 3.78% for the nine months ended September 30, 2007, from 3.66% for the nine months ended September 30, 2006.

Interest income decreased \$191,000, or 0.3%, to \$70.0 million for the nine months ended September 30, 2007, from \$70.2 million for the nine months ended September 30, 2006. The decrease in interest income reflected a 47 basis point improvement in the average yield on interest-earning assets to 6.51% at September 30, 2007, from 6.04%, at September 30, 2006, partially offset by a \$118.9 million, or 7.6%, decrease in total average interest-earning assets, to \$1.437 billion for the nine-months ended September 30, 2007, from \$1.556 billion for the nine-months ended September 30, 2006. The decrease in total average interest earning assets was due in substantial part to a \$140.9 million decrease in average investment securities available-for-sale, cash expenditures for share repurchases, and our investment of \$19.0 million in Bank-Owned Life Insurance.

Interest income from loans, the most significant portion of interest income, increased \$3.1 million, or 5.0%, to \$64.8 million for the nine months ended September 30, 2007, from \$61.7 million for the same period in 2006. The increase reflected earnings on a \$14.2 million, or 1.1%, increase in average net loans receivable to \$1.304 billion for the nine months ended September 30, 2007, from \$1.290 billion for the same period in 2006, and a 25 basis point increase in the average yield on loans to 6.64% for the nine months ended September 30, 2007, from 6.39% for the nine months ended September 30, 2006.

Interest income from securities available for sale decreased by \$3.7 million, or 47.8%, to \$4.0 million for the nine months ended September 30, 2007, from \$7.7 million for the nine months ended September 30, 2006, primarily due to a decrease of \$140.9 million, or 59.8%, in the average outstanding balance of securities available for sale to \$94.6 million for the nine-months ended September 30, 2007, from \$235.5 million for the nine-months ended September 30, 2006. Partially offsetting the decrease in average balances in securities available-for-sale was a 130 basis point increase in the average yield on securities available for sale to 5.66% for the nine-months ended September 30, 2007, from 4.36% for the nine-months ended September 30, 2006.

---

**Table of Contents**

Income from cash dividends on our FHLB of Chicago common stock totaled \$359,000 for the nine months ended September 30, 2007, compared to \$576,000 for the nine months ended September 30, 2006. The decrease was primarily due to the redemption of \$9.8 million of our excess FHLB of Chicago common stock throughout 2006. The average balance of FHLB of Chicago common stock decreased \$7.4 million, or 32.2%, to \$15.6 million for the nine month period ended September 30, 2007, compared to \$23.0 million for the nine months ended September 30, 2006.

Interest income from cash that we maintained in interest earning deposits totaled \$867,000 for the nine months ended September 30, 2007, compared to \$287,000 for the nine months ended September 30, 2006. The increase was primarily due to a \$15.2 million increase in the average balances of cash maintained in interest earning deposit accounts offset by a 19 basis point decrease in yield on interest earning deposits to 5.18% for the nine months ended September 30, 2007, from 5.37% for the same period in 2006.

Interest expense increased \$1.8 million, or 6.5%, to \$29.4 million for the nine months ended September 30, 2007, from \$27.6 million for the nine months ended September 30, 2006. This increase reflected an increase in the weighted average interest rates that we paid on deposit accounts, and an increase in the average interest rates that we paid on our FHLB of Chicago advances and other borrowings. The increase in interest expense reflected an overall increase of 43 basis points in the cost of average interest-bearing liabilities, to 3.59% for the nine months ended September 30, 2007, from 3.16% for the nine months ended September 30, 2006, which was partially offset by a reduction of \$74.6 million, or 6.4%, in our average interest bearing liabilities to \$1.095 billion for the nine-months ended September 30, 2007, from \$1.169 billion for the nine-months ended September 30, 2006.

Interest expense on deposits increased \$3.9 million, or 17.9%, to \$25.6 million for the nine months ended September 30, 2007, from \$21.7 million for the same period in 2006. The increase reflected a 51 basis point increase in the average rate paid on deposits to 3.49% for the nine months ended September 30, 2007, from 2.98% for the nine months ended September 30, 2006. This increase in interest expense also reflected a \$7.9 million, or 0.8%, increase in average interest-bearing deposits to \$982.2 million for the nine months ended September 30, 2007, from \$974.4 million for the same period in 2006. The increase in interest expense in non-savings deposits was primarily due to increases in short-term market interest rates predominant in most of the nine-month period ended September 30, 2007 and the effect of those increases on the interest rates paid on deposits, including competitive market conditions and increased average balances for money market and NOW deposits.

Interest expense on money market accounts increased \$1.2 million, or 16.8%, reflecting an increase of \$11.6 million, or 4.6%, in the average balance of money market account deposits to \$261.3 million for the nine months ended September 30, 2007, from \$249.8 million for the nine months ended September 30, 2006, and a 45 basis point increase in the interest rate paid on these accounts to 4.37% from 3.92%. We had \$190.3 million in indexed money market accounts at September 30, 2007, and have increased the interest rates paid on money market accounts, certain NOW accounts and savings accounts due to changes in applicable indices, and in response to increasing short-term market interest rates and anticipated increases in rates paid by our competitors. Rates on other selected money market products and certificates of deposit were also increased for competitive reasons.

Interest expense on NOW deposits increased \$2.4 million, or 85.0%, reflecting a 90 basis point increase in the interest rates paid on NOW deposits to 2.48% for the nine months ended September 30, 2007, from 1.58% for the same period in 2006, and an increase of \$42.7 million, or 18.1%, in the average balance of NOW deposits to \$278.7 million for the nine months ended September 30, 2007, from \$236.1 million for the nine months ended September 30, 2006.

**Table of Contents**

Interest expense on certificates of deposit increased \$438,000, or 4.1%, reflecting a 54 basis point increase in the interest rates paid on certificates of deposit to 4.53% for the nine months ended September 30, 2007, from 3.99% for the same period in 2006. This increase was partially offset by a \$30.0 million, or 8.3%, decrease in the average balance of certificates of deposit to \$332.6 million for the nine months ended September 30, 2007, from \$362.6 million for the nine months ended September 30, 2006. Average balances of wholesale certificates of deposits declined by \$27.0 million, or 66.6%, in the nine months ended September 30, 2007, compared to the same period in 2006, while average balances for retail certificates of deposit increased by \$3.1 million, or 0.9%, for the nine months ended September 30, 2007, compared to the same period in 2006.

Interest expense on borrowings decreased by \$2.1 million, or 35.6%, to \$3.8 million for the nine months ended September 30, 2007, from \$5.9 million for the same period in 2006. The decrease was due in part to an \$82.5 million, or 42.3%, reduction of our total average borrowings from \$194.8 million for the nine month period ended September 30, 2006, to \$112.4 million for the nine month period ended September 30, 2007. The reduction was partially offset by a 48 basis point increase in the average cost of borrowings to 4.54% for the nine months ended September 30, 2007, compared to 4.06% for the nine months ended September 30, 2006.

**Table of Contents****Average Balances and Net Interest Margin**

The following table sets forth average balance sheets, average yields and costs, and certain other information for the periods indicated. No tax-equivalent yield adjustments were made, as the effect of these adjustments would not be material. Average balances are daily average balances. Nonaccrual loans were included in the computation of average balances, but have been reflected in the table as loans carrying a zero yield. The yields set forth below include the effect of deferred fees and expenses, discounts and premiums, and purchase accounting adjustments that are amortized or accreted to interest income or expense.

	For the Nine Months ended September 30,					
	2007			2006		
	Average Outstanding Balance	Interest	Yield/Rate (1)	Average Outstanding Balance	Interest	Yield/Rate (1)
	(Dollars in thousands)					
<b>Interest-earning assets:</b>						
Loans	\$ 1,304,057	\$ 64,792	6.64%	\$ 1,289,863	\$ 61,679	6.39%
Securities available-for-sale	94,647	4,010	5.66	235,533	7,677	4.36
Stock in FHLB	15,598	359	3.08	22,997	576	3.35
Other	22,386	867	5.18	7,151	287	5.37
Total interest-earning assets	1,436,688	70,028	6.51	1,555,544	70,219	6.04
Noninterest-earning assets	112,262			94,371		
Total assets	\$ 1,548,950			\$ 1,649,915		
<b>Interest-bearing liabilities:</b>						
Savings deposits	\$ 109,597	638	0.78	\$ 125,933	781	0.83
Money market deposits	261,344	8,541	4.37	249,790	7,315	3.92
NOW deposits	278,741	5,171	2.48	236,065	2,795	1.58
Certificates of deposit	332,556	11,260	4.53	362,588	10,822	3.99
Total deposits	982,238	25,610	3.49	974,376	21,713	2.98
Borrowings	112,386	3,814	4.54	194,840	5,922	4.06
Total interest-bearing liabilities	1,094,624	29,424	3.59	1,169,216	27,635	3.16
Noninterest-bearing deposits	118,105			122,283		
Other liabilities	21,597			24,555		
Total liabilities	1,234,326			1,316,054		
Equity	314,624			333,861		
Total liabilities and equity	\$ 1,548,950			\$ 1,649,915		
Net interest income		\$ 40,604			\$ 42,584	
Net interest rate spread (2)			2.92%			2.88%
Net interest-earning assets (3)	\$ 342,064			\$ 386,328		
Net interest margin (4)			3.78%			3.66%
Ratio of interest-earning assets to interest-bearing liabilities	131.25%			133.04%		

- 
- (1) Annualized
  - (2) Net interest rate spread represents the difference between the yield on average interest-earning assets and the cost of average interest-bearing liabilities.
  - (3) Net interest-earning assets represents total interest-earning assets less total interest-bearing liabilities.
  - (4) Net interest margin represents net interest income divided by average total interest-earning assets.

**Table of Contents**

**Provision for Loan Losses.** We recorded a provision for loan losses of \$687,000 for the nine months ended September 30, 2007, compared to a provision for loan losses of \$401,000 to our allowance for loan losses for the nine months ended September 30, 2006. The portion of the allowance for loan losses allocated to impaired loans pursuant to SFAS No. 114 increased \$309,000 to \$711,000 at September 30, 2007, from \$402,000 at December 31, 2006. We established specific reserves for five loans with a total principal balance of \$1.1 million due to our evaluation of the borrower's ability to repay, the estimated net realizable value of collateral or the expected results of judicial collection or federal bankruptcy legal proceedings. Of these loans, the largest loan relationship was \$556,000, for which we established a contingent reserve of \$91,000 pending the results of updated collateral valuation information.

Non-performing loans increased \$331,000 to \$9.6 million at September 30, 2007, from \$9.2 million at December 31, 2006. The net increase is a combination of loans added in the multi-family and commercial sectors, partially offset by a \$1.8 million decrease in non-residential property loans. The non-performing loans at September 30, 2007 included \$1.1 million of principal payments that borrowers on certain loans made to the loan servicing company discussed above or the Trustee subsequent to the filing of the bankruptcy proceeding. These payments were classified as nonperforming pending further developments in the bankruptcy proceeding. Please refer to **Comparison of Operating Results for the Three Months Ended September 30, 2007 and 2006, Provision for Loan Losses**, for further discussion of the status of the bankruptcy proceeding. These additions were partially offset by the resolution of two well-secured commercial real estate loans to a single borrower totaling \$2.2 million; one loan was repaid in full during the second quarter and a second loan for \$1.2 million was paid in full in October 2007.

Nonperforming assets are as follows:

	September 30, 2007	December 31, 2006	\$ Change	% Change
	(Dollars in thousands)			
<b>Nonperforming assets:</b>				
Nonperforming loans	\$ 9,557	\$ 9,226	\$ 331	3.6%
Real estate owned	252		252	100.0
Nonperforming assets	\$ 9,809	\$ 9,226	\$ 583	6.3%

Our allowance for loan losses totaled \$11.1 million, or 0.86% of total loans, at September 30, 2007, compared to \$10.6 million, or 0.79%, of total loans, at December 31, 2006. We used the same general methodology in evaluating the allowance for loan losses at both dates. Our allowance for loan losses represented 115.9% of non-performing loans at September 30, 2007, and 115.1% of non-performing loans at December 31, 2006. To the best of our knowledge, we have recorded all losses that are both probable and reasonable to estimate for each reporting period.

**Noninterest Income.** Our noninterest income decreased \$830,000, or 10.4%, to \$7.1 million for the nine-month period ended September 30, 2007, compared to \$8.0 million for the same nine-month period in 2006. Deposit service charges and fees were \$2.7 million for the nine months ended September 30, 2007, a decrease of \$485,000, or 15.3%, compared to the September 30, 2006 results. Other fee income increased \$46,000, or 3.3%, to \$1.5 million for the nine months ended September 30, 2007, compared to \$1.4 million for the same period in 2006. Income from insurance commissions and annuities decreased by \$223,000, or 23.7%, to \$720,000 for the nine months ended September 30, 2007, compared to \$943,000 for the same period in 2006, due to decreased activity. Gain on sales of loans decreased by \$93,000, or 50.3%, to \$92,000 for the nine months ended September 30, 2007, from \$185,000 for the same nine-month period in 2006, primarily due to lower volumes present in the residential loan market. We recorded a \$399,000 gain on the redemption of MasterCard Class B common stock in the third quarter of 2007 compared to a \$55,000 gain on the redemption of MasterCard Class B common stock and \$89,000 in net gains on the sale of investment securities during the nine months ended September 30, 2006. Loan servicing fees decreased \$104,000, or 14.6%, to \$607,000 for the nine months ended September 30, 2007, compared to \$711,000 for the same nine-month period in 2006. Mortgage servicing rights amortization expense increased \$5,000, or 1.5% to \$332,000 for the nine months ended September 30, 2007, compared to \$327,000 for the same nine-month period.

**Table of Contents**

in 2006. These decreases were partially offset by \$354,000 in income from Bank-Owned Life Insurance for the quarter ended September 30, 2007, compared to no such income for the same period in 2006, and a \$5,000, or 1.5%. Other income decreased \$236,000, or 17.0%, to \$1.2 million for the nine months ended September 30, 2007, from \$1.4 million for the nine months ended September 30, 2006. The decrease is primarily due to \$106,000 in fees that we recorded in connection with the sale of surplus real estate, and a recovery of \$42,000 in connection with a prior fraud loss for the nine months results for 2006.

The following table summarizes noninterest income for the periods ended September 30, 2007 and 2006:

	Nine Months Ended		Change	
	September 30, 2007	2006	\$	%
	(Dollars in thousands)			
<b>Noninterest income:</b>				
Deposit service charges and fees	\$ 2,691	\$ 3,176	\$ (485)	(15.3)%
Other fee income	1,455	1,409	46	3.3
Insurance commissions and annuities income	720	943	(223)	(23.7)
Gain on sale of loans	92	185	(93)	(50.3)
Gain on sale of investments	399	144	255	177.1
Gain on disposition of premises and equipment	13	394	(381)	(96.7)
Loan servicing fees	607	711	(104)	(14.6)
Amortization and impairment of servicing assets	(332)	(327)	(5)	1.5
Operations of real estate owned	(4)	(46)	42	(91.3)
Earnings on bank owned life insurance	354		354	N.M.
Other	1,151	1,387	(236)	(17.0)
<b>Total noninterest income</b>	<b>\$ 7,146</b>	<b>\$ 7,976</b>	<b>\$ (830)</b>	<b>(10.4)</b>

N.M. = not meaningful

**Noninterest Expense.** Our noninterest expense was \$38.2 million for the nine months ended September 30, 2007; compared to noninterest expense of \$37.0 million for the nine months ended September 30, 2006, an increase of \$1.2 million, or 3.2%. Compensation and benefits expense totaled \$24.1 million for the nine-month period ended September 30, 2007, compared to \$23.8 million in compensation and benefits expense for the same period in 2006, an increase of \$275,000, or 1.2%. The increase includes expense relating to equity-based compensation and benefits of \$3.9 million, compared to \$1.8 million for the previous year period. The increase in expense relating to equity-based compensation related to expenses for the ESOP that we established in connection with our mutual-to-stock conversion in June of 2005 and awards made under the Equity Incentive Plan that our stockholders approved in June of 2006. Excluding the equity-based compensation and benefits, compensation and benefits expense decreased \$1.8 million or 8.0%, primarily due to the decrease in full-time equivalent employees resulting from the implementation of functional staffing reviews. Office occupancy and equipment expenses increased by \$148,000, or 3.5% to \$4.3 million for the nine months ended September 30, 2007, compared to \$4.2 million for the same period in 2006, primarily due to increased real estate taxes and energy costs, snow removal and rental expense. Data processing expense decreased \$93,000, or 3.7%, to \$2.4 million for the nine months ended September 30, 2007. Advertising and public relations expenditures increased by \$142,000, or 15.0%, to \$1.1 million in the first nine months of 2007, from \$950,000 in the first nine months of 2006. Other general and administrative expenses increased \$691,000, or 26.2%, to \$3.3 million for the nine months ended September 30, 2007, from \$2.6 million for the nine months ended September 30, 2006. The increase in noninterest expense included a \$70,000 loan servicing transition fee paid in connection with the bankruptcy of a loan servicing company, a \$101,000 reserve on the uncollected escrow fund payments relating to the bankruptcy, and approximately \$145,000 in legal fees associated with the bankruptcy.

**Table of Contents**

The following table summarizes noninterest expense for the periods ended September 30, 2007 and 2006:

	Nine Months Ended September 30,		Change	
	2007	2006	\$	%
(Dollars in thousands)				
<b>Noninterest Expense:</b>				
Compensation and benefits	\$ 24,070	\$ 23,795	\$ 275	1.2%
Office occupancy and equipment	4,334	4,186	148	3.5
Advertising and public relations	1,092	950	142	15.0
Data processing	2,393	2,486	(93)	(3.7)
Supplies, telephone and postage	1,537	1,540	(3)	(0.2)
Amortization of intangibles	1,415	1,384	31	2.2
Other	3,330	2,639	691	26.2
<b>Total noninterest expense</b>	<b>\$ 38,171</b>	<b>\$ 36,980</b>	<b>\$ 1,191</b>	<b>3.2</b>

**Income Tax Expense.** We recorded income tax expense of \$2.7 million for the nine months ended September 30, 2007, compared to \$4.3 million in income tax expense for the same period of 2006. Our effective tax rate for the first three quarters of 2007 was 30.0% compared to 32.9% for the same period in 2006. Lower pre-tax income resulted in a greater percentage of tax-exempt income and a lower effective federal tax rate for 2007 versus 2006.

**Liquidity and Capital Resources**

**Liquidity.** The overall objective of our liquidity management is to ensure the availability of sufficient cash funds to meet all financial commitments and to take advantage of lending and investment opportunities. We manage liquidity in order to meet deposit withdrawals on demand or at contractual maturity, to repay borrowings as they mature, and to fund new loans and investments as opportunities arise.

Our primary sources of funds are deposits, principal and interest payments on loans and securities, and, to a lesser extent, wholesale borrowings, the proceeds from maturing securities and short-term investments, and the proceeds from the sales of loans and securities. The scheduled amortization of loans and securities, as well as proceeds from borrowings, are predictable sources of funds. Other funding sources, however, such as deposit inflows, mortgage prepayments and mortgage loan sales are greatly influenced by market interest rates, economic conditions and competition. The Bank is a member of the FHLB of Chicago, which provides an additional source of short-term and long-term funding. Outstanding borrowings from the FHLB of Chicago were \$64.0 million at September 30, 2007, at a weighted average interest rate of 4.93%. A total of \$39.0 million of these borrowings will mature in less than one year. Outstanding borrowings were \$130.0 million at December 31, 2006.

The liquidity needs of the Company on an unconsolidated basis consist primarily of operating expenses, dividends to stockholders and stock repurchases. The primary source of liquidity for the Company currently is \$28.6 million in cash and cash equivalents as of September 30, 2007, and cash dividends from our subsidiary, BankFinancial, F.S.B. During the nine months ended September 30, 2007, the Bank distributed \$25.5 million of dividends to the Company. On September 26, 2007 the Board of Directors of the Bank declared an \$18.0 million dividend, which was paid to the Company on September 29, 2007, following the OTS' non-objection to the Bank's notification that it may declare and pay special dividends to the Company in an aggregate amount not to exceed \$38 million.

As of September 30, 2007, we were not aware of any known trends, events or uncertainties that have or are reasonably likely to have a material impact on our liquidity. As of September 30, 2007, we had no other material commitments for capital expenditures.



**Table of Contents**

**Capital Resources.** Stockholders' equity totaled \$303.6 million at September 30, 2007, compared to \$326.0 million at December 31, 2006, a decrease of \$22.4 million, or 6.9%. This decrease was primarily due to the declaration of \$4.9 million in cash dividends and the repurchase and retirement of 1,742,023 shares of common stock at an aggregate cost of \$28.7 million during the first nine months of 2007, which was partially offset by net income of \$6.3 million and a \$707,000 increase in accumulated other comprehensive income.

On September 28, 2007, we announced that our Board of Directors (the Board) extended the expiration date of its current share repurchase authorization from September 30, 2007 to March 31, 2008. As of September 30, 2007, the Company had repurchased 2,719,323 shares of its common stock out of the 3,605,384 shares that have been authorized for repurchase.

As previously disclosed, the Board's authorization permits shares to be repurchased in open market or negotiated transactions, and pursuant to any trading plan that may be adopted in accordance with Rule 10b5-1 of the Securities and Exchange Commission. The authorization will be utilized at management's discretion, subject to the limitations set forth in Rule 10b-18 of the Securities and Exchange Commission and other applicable legal requirements, and to price and other internal limitations established by the Board. The authorization may be suspended, terminated or modified at any time prior to March 31, 2008 for any reason, including market conditions, the cost of repurchasing shares, the availability of alternative investment opportunities, liquidity, and other factors deemed relevant. These factors will also affect the timing and amount of share repurchases. For additional information, see Part II, Item 2. Unregistered Sales of Equity Securities and Use of Proceeds. (c) Repurchases of Our Equity Securities.

At September 30, 2007, the actual regulatory capital ratios and minimum required regulatory ratios for the Bank were:

	Actual Ratio	Minimum Required for Capital Adequacy Purposes	Minimum Required to Be Well Capitalized Under Prompt Corrective Action Provisions
<b>September 30, 2007</b>			
Total capital (to risk-weighted assets)	19.07%	8.00%	10.00%
Tier 1 (core) capital (to risk-weighted assets)	18.22	4.00	6.00
Tier 1 (core) capital (to adjusted total assets)	15.16	4.00	5.00
<b>December 31, 2006</b>			
Total capital (to risk-weighted assets)	20.09%	8.00%	10.00%
Tier 1 (core) capital (to risk-weighted assets)	19.26	4.00	6.00
Tier 1 (core) capital (to adjusted total assets)	15.05	4.00	5.00

As of September 30, 2007 and December 31, 2006, the Office of Thrift Supervision categorized the Bank as well-capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since those notifications that management believes have changed the institution's capitalization category.

---

**Table of Contents****ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

**Qualitative Analysis.** We believe that our most significant form of market risk is interest rate risk. Interest rate risk results from timing differences in the maturity or repricing of our assets, liabilities and off balance sheet contracts (e.g., forward loan commitments), the effect of loan prepayments and deposit withdrawals, the difference in the behavior of lending and funding rates arising from the use of different indices and yield curve risk arising from changing rate relationships across the spectrum of maturities for constant or variable credit risk investments. In addition to directly affecting net interest income, changes in market interest rates can also affect the amount of new loan originations, the ability of borrowers to repay variable rate loans, the volume of loan prepayments and refinancings, the carrying value of investment securities classified as available-for-sale and the flow and mix of deposits.

The general objective of our interest rate risk management is to determine the appropriate level of risk given our business strategy and then manage that risk in a manner that is consistent with our policy to reduce, to the extent possible, the exposure of our net interest income to changes in market interest rates. Our Asset Liability Management Committee (ALCO), which consists of certain members of senior management, evaluates the interest rate risk inherent in certain assets and liabilities, our operating environment and capital and liquidity requirements, and modifies our lending, investing and deposit gathering strategies accordingly. The Board of Directors Asset Liability Management Committee then reviews the ALCO's activities and strategies, the effect of those strategies on our net interest margin, and the effect that changes in market interest rates would have on the economic value of our loan and securities portfolios as well as the intrinsic value of our deposits and borrowings, and reports to the full Board of Directors.

We actively evaluate interest rate risk in connection with our lending, investing and deposit activities. In an effort to manage interest-rate risk, depending on market interest rates and our capital and liquidity position, we generally sell all or a portion of our longer-term, fixed-rate residential loans, usually on a servicing-retained basis. Further, we primarily invest in shorter-duration securities, which generally have lower yields compared to longer-term investments. Shortening the average maturity of our interest-earning assets by increasing our investments in shorter-term loans and securities, as well as loans with variable rates of interest, helps to better match the maturities and interest rates of our assets and liabilities, thereby reducing the exposure of our net interest income to changes in market interest rates. We have also classified all of our investment portfolio as available-for-sale so as to provide flexibility in liquidity management.

We utilize a combination of analyses to monitor our exposure to changes in interest rates. The economic value of equity analysis is a model that estimates the change in net portfolio value (NPV) over a range of interest rate scenarios. NPV is the discounted present value of expected cash flows from assets, liabilities and off-balance sheet contracts. In calculating changes in NPV, we assume estimated loan prepayment rates, reinvestment rates and deposit decay rates that seem most likely based on historical experience during prior interest rate changes.

Our net interest income analysis utilizes the data derived from the dynamic GAP analysis, described below, and applies several additional elements, including actual interest rate indices and margins, contractual limitations such as interest rate floors and caps and the U. S. Treasury yield curve as of the balance sheet date. In addition, we apply consistent parallel yield curve shifts (in both directions) to determine possible changes in net interest income if the theoretical yield curve shifts occurred instantaneously. Net interest income analysis also adjusts the dynamic GAP repricing analysis based on changes in prepayment rates resulting from the parallel yield curve shifts.

Our dynamic GAP analysis determines the relative balance between the repricing of assets and liabilities over multiple periods of time (ranging from overnight to five years). Dynamic GAP analysis includes expected cash flows from loans and mortgage-backed securities, applying prepayment rates based on the differential between the current interest rate and the market interest rate for each loan and security type. This analysis identifies mismatches in the timing of asset and liability repricing but does not necessarily provide an accurate indicator of interest rate risk because it omits the factors incorporated into the net interest income analysis.

**Table of Contents**

The table below sets forth, as of September 30, 2007, the estimated changes in the Bank's NPV and net interest income that would result from the designated instantaneous parallel shift in the U. S. Treasury yield curve. Computations of prospective effects of hypothetical interest rate changes are based on numerous assumptions including relative levels of market interest rates, loan prepayments and deposit decay, and should not be relied upon as indicative of actual results.

Change in Interest Rates (basis points)	Estimated NPV	NPV Increase (Decrease) in		Estimated Net Interest Income	Net Interest Income Increase (Decrease) in	
		Estimated NPV Amount (Dollars in thousands)	Percent		Estimated Net Interest Income Amount	Percent
+300	\$ 288,167	\$ (6,838)	(2.32)%	\$ 42,572	\$ (7,187)	(14.44)%
+200	288,267	(6,738)	(2.28)	45,117	(4,642)	(9.33)
+100	293,490	(1,515)	(0.51)	47,522	(2,237)	(4.50)
0	295,005			49,759		
-100	302,609	7,604	2.58	51,894	2,135	4.29
-200	303,962	8,957	3.04	53,227	3,468	6.97
-300	304,192	9,187	3.11	53,885	4,126	8.29

The table presented above projects that, at September 30, 2007, we would be expected to experience a 3.04% increase in NPV and an \$3.5 million increase in net interest income in the event of an immediate and parallel 200 basis point decrease in interest rates. In the event of an immediate and parallel 200 basis point increase in interest rates, we would be expected to experience a 2.28% decrease in NPV and a \$4.6 million decrease in net interest income. This data does not reflect any actions that we may undertake in response to changes in interest rates, such as changes in rates paid on certain deposit accounts based on local competitive factors, which could reduce the actual impact on NPV and net interest income, if any. The Company is considering possible actions to return its interest rate risk posture to recent historical norms by adjusting for recent reductions in short-term assets due to construction loan repayments and reductions in capital due to stock repurchases.

Certain shortcomings are inherent in the methodology used in the above interest rate risk measurements. Modeling changes in NPV and net interest income requires that we make certain assumptions that may or may not reflect the manner in which actual yields and costs respond to changes in market interest rates. The NPV and net interest income table presented above assumes that the composition of our interest-rate sensitive assets and liabilities existing at the beginning of a period remains constant over the period being measured and, accordingly, the data does not reflect any actions that we may undertake in response to changes in interest rates, such as changes in rates paid on certain deposit accounts based on local competitive factors. The table also assumes that a particular change in interest rates is reflected uniformly across the yield curve regardless of the duration to maturity or the repricing characteristics of specific assets and liabilities. Accordingly, although the NPV and net interest income table provides an indication of our sensitivity to interest rate changes at a particular point in time, such measurements are not intended to and do not provide a precise forecast of the effect of changes in market interest rates on our net interest income and will differ from actual results.

**Table of Contents**

**ITEM 4. CONTROLS AND PROCEDURES**

An evaluation was performed under the supervision and with the participation of the Company's management, including the Chairman, Chief Executive Officer and President and the Executive Vice President and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) promulgated under the Securities and Exchange Act of 1934, as amended) as of September 30, 2007. Based on that evaluation, the Company's management, including the Chairman, President, and Chief Executive Officer and the Executive Vice President and Chief Financial Officer, concluded that the Company's disclosure controls and procedures were effective.

During the quarter ended September 30, 2007, there have been no changes in the Company's internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**Table of Contents****PART II****ITEM 1. LEGAL PROCEEDINGS**

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

**ITEM 1A. RISK FACTORS**

There are no material changes to the risk factors disclosed in the Annual Report on Form 10-K filed for the fiscal year ended December 31, 2006.

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

(a) **Unregistered Sale of Equity Securities.** Not applicable.

(b) **Use of Proceeds.** Not applicable

(c) **Repurchases of Equity Securities.**

The following table sets forth information in connection with purchases of our common stock made by, or, on behalf of us, during the third quarter of 2007:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet be Purchased under the Plans or Programs (1)
July 1, 2007 through July 31, 2007	210,000	\$ 14.947	210,000	1,053,467
August 1, 2007 through August 31, 2007	119,600	14.550	119,600	933,867
September 1, 2007 through September 30, 2007	47,806	15.595	47,806	886,061
Total	377,406	14.903	377,406	

(1)

## Edgar Filing: BankFinancial CORP - Form 10-Q

On September 28, 2007, our Board extended the expiration date of its current share repurchase authorization from September 30, 2007 to March 31, 2008. As of September 30, 2007, the Company had repurchased 2,719,323 shares of its common stock out of the 3,605,384 shares that were previously authorized.

**Table of Contents**

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None

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

None

**ITEM 5. OTHER INFORMATION**

None

**ITEM 6. EXHIBITS**

The exhibits required by Item 601 of Regulation S-K are included with this Form 10-Q and are listed on the [Index to Exhibits](#) immediately following the Signatures.

**Table of Contents**

**SIGNATURES**

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

Date: November 1, 2007

**BANKFINANCIAL CORPORATION**  
(Registrant)

/s/ F. MORGAN GASIOR  
F. Morgan Gasior  
Chairman of the Board, Chief Executive Officer, and President

/s/ PAUL A. CLOUTIER  
Paul A. Cloutier  
Executive Vice President and Chief Financial Officer



**Table of Contents**

INDEX TO EXHIBITS

<b>Exhibit Number</b>	<b>Description</b>
31.1	Certification of F. Morgan Gasior, Chairman of the Board, Chief Executive Officer and President, Pursuant to Rule 13a-14(a) and Rule 15d-14(a).
31.2	Certification of Paul A. Cloutier, Executive Vice President and Chief Financial Officer, Pursuant to Rule 13a-14(a) and Rule 15d-14(a).
32.1	Certification of F. Morgan Gasior, Chairman of the Board, Chief Executive Officer and President, Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Paul A. Cloutier, Executive Vice President and Chief Financial Officer, Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.