

NATIONAL HOLDINGS CORP
Form 10-Q
August 16, 2010

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 Quarter Ended June 30, 2010

Commission File Number 001-12629

NATIONAL HOLDINGS CORPORATION
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

36-4128138
(I.R.S. Employer
Identification No.)

120 Broadway, 27th Floor, New York, NY 10271
(Address including zip code of principal executive offices)
Registrant's telephone number, including area code: (212) 417-8000

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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large Accelerated Filer Accelerated Filer

Non-Accelerated Filer Smaller Reporting
Company

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

As of August 13, 2010 there were 17,289,204 shares of the registrant's common stock outstanding.

NATIONAL HOLDINGS CORPORATION
FORM 10-Q
QUARTERLY PERIOD ENDED JUNE 30, 2010

INDEX

PART I – FINANCIAL INFORMATION

Item 1 – Financial Statements

Unaudited Condensed Consolidated Statements of Financial Condition
as of June 30, 2010 and September 30, 2009 4

Unaudited Condensed Consolidated Statements of Operations for the
Three and Nine months ended June 30, 2010 and 2009 5

Unaudited Condensed Consolidated Statements of Cash Flows for the
Nine months ended June 30, 2010 and 2009 6

Notes to Unaudited Condensed Consolidated Financial Statements 7

Item 2 – Management’s Discussion and Analysis of Financial Condition and Results of Operations 26

Item 3 – Quantitative & Qualitative Disclosures About Market Risk 34

Item 4 – Controls and Procedures 35

PART II – OTHER INFORMATION

Item 1 – Legal Proceedings 36

Item 1a– Risk Factors 36

Item 2 – Unregistered Sales of Equity Securities and Use of Proceeds 36

Item 3 – Defaults Upon Senior Securities 37

Item 4 – Submission of Matters to a Vote of Security Holders 37

Item 5 – Other Information 37

Item 6 – Exhibits 37

Signatures 38

FORWARD-LOOKING STATEMENTS

The following information provides cautionary statements under the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 (the Reform Act). We identify important factors that could cause our actual results to differ materially from those projected in forward-looking statements we make in this report or in other documents that reference this report. All statements that express or involve discussions as to: expectations, beliefs, plans, objectives, assumptions or future events or performance (often, but not always, identified through the use of words or phrases such as we or our management believes, expects, anticipates or hopes and words or phrases such as will result, are expected to, will continue, is anticipated, estimated, projection and outlook, and words of similar import) are not statements of historical facts and may be forward-looking. These forward-looking statements are based largely on our expectations and are subject to a number of risks and uncertainties including, but not limited to, economic, competitive, regulatory, growth strategies, available financing and other factors discussed elsewhere in this report and in the documents filed by us with the Securities and Exchange Commission ("SEC"). Many of these factors are beyond our control. Actual results could differ materially from the forward-looking statements we make in this report or in other documents that reference this report. In light of these risks and uncertainties, there can be no assurance that the results anticipated in the forward-looking information contained in this report or other documents that reference this report will, in fact, occur.

These forward-looking statements involve estimates, assumptions and uncertainties, and, accordingly, actual results could differ materially from those expressed in the forward-looking statements. These uncertainties include, among others, the following: (i) the inability of our broker-dealer operations to operate profitably in the face of intense competition from larger full service and discount brokers; (ii) a general decrease in merger and acquisition activities and our potential inability to receive success fees as a result of transactions not being completed; (iii) increased competition from business development portals; (iv) technological changes; (v) our potential inability to implement our growth strategy through acquisitions or joint ventures; and (vi) our potential inability to secure additional debt or equity financing.

Any forward-looking statement speaks only as of the date on which such statement is made, and we undertake no obligation to update any forward-looking statement or statements to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of unanticipated events. New factors emerge from time to time and it is not possible for our management to predict all of such factors, nor can our management assess the impact of each such factor on the business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.

PART I. FINANCIAL INFORMATION

ITEM I. FINANCIAL STATEMENTS

NATIONAL HOLDINGS CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

ASSETS	June 30, 2010	September 30, 2009 (see note below)
Current Assets	(unaudited)	
Cash	\$4,398,000	\$6,493,000
Deposit with clearing organizations	1,159,000	1,212,000
Receivables from broker dealers and clearing organizations	3,126,000	4,910,000
Other receivables, net of allowance for uncollectible accounts of \$372,000 and \$402,000 at June 30, 2010 and September 30, 2009 respectively	519,000	332,000
Advances to registered representatives - Current portion	1,530,000	1,784,000
Securities owned: marketable – at market value	794,000	631,000
Securities owned: nonmarketable – at fair value	75,000	60,000
Total Current Assets	11,601,000	15,422,000
Advances to registered representatives - Long term portion	164,000	1,096,000
Fixed assets, net	966,000	1,163,000
Secured demand note	500,000	500,000
Intangible assets, net	1,863,000	2,329,000
Other assets	1,172,000	1,132,000
Total Assets	\$16,266,000	\$21,642,000
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)		
Current Laibilities		
Payable to broker dealers and clearing organizations	\$373,000	\$299,000
Securities sold, but not yet purchased, at market	163,000	4,000
Accounts payable, accrued expenses and other liabilities - Current portion	9,786,000	14,162,000
Notes payable	500,000	500,000
Total Current Liabilities	10,822,000	14,965,000
Accrued expenses and other liabilities - Long term portion	665,000	719,000
Convertible notes payable, net of debt discount of \$740,000 and \$1,036,000 at June 30, 2010 and September 30, 2009 respectively	5,260,000	4,964,000
Total Liabilities	16,747,000	20,648,000
Subordinated borrowings	2,550,000	850,000
Stockholders' Equity		
Preferred stock, \$.01 par value, 200,000 shares authorized; 50,000 shares designated as Series A and 20,000 shares designated as Series B	-	-
Series A 9% cumulative convertible preferred stock, \$.01 par value, 50,000 shares authorized; 46,050 shares issued and outstanding (liquidation preference: \$4,605,000) at June 30, 2010 and 37,550 shares issued and outstanding (liquidation preference: \$3,755,000) at September 30, 2009	-	-
	-	-

Edgar Filing: NATIONAL HOLDINGS CORP - Form 10-Q

Series B 10% cumulative convertible preferred stock, \$.01 par value, 20,000 shares

authorized; 0 shares issued and outstanding (liquidation preference: \$0 at June 30, 2010 and September 30, 2009, respectively)

Common stock, \$.02 par value, 50,000,000 shares authorized; 17,276,704 and 16,422,538 shares issued and outstanding, at June 30, 2010 and September 30, 2009, respectively	346,000	343,000
Additional paid-in capital	42,139,000	41,195,000
Accumulated deficit	(45,516,000)	(41,394,000)
Total Stockholders' Equity (Deficit)	(3,031,000)	144,000
Total Liabilities and Stockholders' Equity (Deficit)	\$16,266,000	\$21,642,000

Note: The balance sheet at September 30, 2009 has been derived from the audited consolidated financial statements at that date.

See accompanying notes to unaudited condensed consolidated financial statements

NATIONAL HOLDINGS CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	----- Three Months Ended		----- Nine Months Ended	
	June 30, 2010	June 30, 2009	June 30, 2010	June 30, 2009
Revenues:				
Commissions	\$ 19,759,000	\$ 22,337,000	\$ 57,346,000	\$ 53,168,000
Net dealer inventory gains	3,336,000	5,077,000	11,199,000	16,157,000
Investment banking	1,056,000	896,000	4,095,000	2,046,000
Total commission and fee revenues	24,151,000	28,310,000	72,640,000	71,371,000
Interest and dividends	746,000	252,000	1,856,000	1,285,000
Transfer fees and clearing services	1,912,000	2,726,000	6,672,000	6,997,000
Other	1,673,000	1,121,000	4,534,000	3,783,000
Total Revenues	28,482,000	32,409,000	85,702,000	83,436,000
Expenses:				
Commissions	22,451,000	26,061,000	66,067,000	64,526,000
Employee compensation and related expenses	2,923,000	2,985,000	9,063,000	9,029,000
Clearing fees	576,000	402,000	982,000	1,371,000
Communications	1,023,000	1,245,000	3,025,000	3,137,000
Occupancy and equipment costs	1,191,000	954,000	3,859,000	3,786,000
Professional fees	763,000	548,000	2,129,000	1,917,000
Interest	459,000	291,000	1,056,000	925,000
Taxes, licenses, registration	443,000	414,000	1,306,000	1,016,000
Other administrative expenses	684,000	377,000	1,951,000	1,667,000
Total Expenses	30,513,000	33,277,000	89,438,000	87,374,000
Net loss	(2,031,000)	(868,000)	(3,736,000)	(3,938,000)
Preferred stock dividends	(103,000)	(96,000)	(391,000)	(265,000)
Net loss attributable to common stockholders	\$(2,134,000)	\$(964,000)	\$(4,127,000)	\$(4,203,000)
Net loss per common share				
Basic:				
Net loss attributable to common stockholders	\$(0.12)	\$(0.06)	\$(0.24)	\$(0.25)
Diluted:				
Net loss attributable to common stockholders	\$(0.12)	\$(0.06)	\$(0.24)	\$(0.25)
Weighted average number of shares outstanding				
Basic	17,276,704	16,930,924	17,209,396	16,635,442
Diluted	17,276,704	16,930,924	17,209,396	16,635,442

See accompanying notes to unaudited condensed consolidated financial statements

NATIONAL HOLDINGS CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Nine Months Ended June 30,	
	2010	2009
Cash flows from operating activities		
Net loss	\$(3,736,000)	\$(3,938,000)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation and amortization	1,005,000	1,017,000
Amortization of deferred financing costs	22,000	41,000
Amortization of note discount	796,000	296,000
Compensatory element of common stock options issuance	409,000	678,000
Compensatory element of warrant issuance	152,000	-
Provision for bad debt	(30,000)	-
Unrealized gain on securities owned	44,000	(142,000)
Changes in assets and liabilities		
Deposits with clearing organizations	52,000	(51,000)
Receivables from broker-dealers, clearing organizations and others	1,784,000	(651,000)
Other receivables	(156,000)	(333,000)
Advances to registered representatives	1,186,000	934,000
Securities owned: marketable, at market value	(207,000)	541,000
Securities owned: non-marketable, at fair value	(16,000)	(7,000)
Other assets	(63,000)	295,000
Accounts payable and accrued expenses	(4,429,000)	1,022,000
Payable to broker dealers and clearing organizations	74,000	(451,000)
Securities sold, but not yet purchased, at market	159,000	13,000
Net cash used in operating activities	(2,954,000)	(736,000)
Cash flows from investing activities		
Purchase of fixed assets	(341,000)	(598,000)
Net cash used in investing activities	(341,000)	(598,000)
Cash flows from financing activities		
Repayment of notes payable	(500,000)	(500,000)
Net proceeds from subordinated borrowings	1,700,000	100,000
Proceeds from issuance of common stock	-	502,000
Fees associated with issuance of common stock	-	(234,000)
Net cash used in provided by financing activities	1,200,000	(132,000)
Net decrease in cash	(2,095,000)	(1,466,000)
Cash balance		
Beginning of the period	6,493,000	7,387,000
End of the period	\$4,398,000	\$5,921,000
Supplemental disclosures of cash flow information		
Cash paid during the period for:		
Interest	\$578,000	\$574,000

Edgar Filing: NATIONAL HOLDINGS CORP - Form 10-Q

Income taxes	\$-	\$80,000
Supplemental disclosures of noncash financing activities		
Preferred stock dividends	\$391,000	\$265,000

See accompanying notes to unaudited condensed consolidated financial statements

NATIONAL HOLDINGS CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2010
(UNAUDITED)

NOTE 1. BASIS OF PRESENTATION

The accompanying condensed consolidated financial statements of National Holdings Corporation (“National” or the “Company”) have been prepared in accordance with generally accepted accounting principles for interim financial statements and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and disclosures required for annual financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. The condensed consolidated financial statements as of June 30, 2010 and for the periods ended June 30, 2010 and June 30, 2009 are unaudited. The results of operations for the interim periods are not necessarily indicative of the results of operations for the fiscal year. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related footnotes included thereto in the Company’s Annual Report on Form 10-K for the fiscal year ended September 30, 2009.

NOTE 2. CONSOLIDATION

The condensed consolidated financial statements include the accounts of National and its wholly owned subsidiaries. National operates primarily through National Securities Corporation (“National Securities”), vFinance Investments, Inc. (“vFinance Investments”) and EquityStation, Inc. (“EquityStation”) (collectively, the “Broker Dealer Subsidiaries”). The Broker Dealer Subsidiaries conduct a national securities brokerage business through its main offices in New York, New York, Boca Raton, Florida, and Seattle, Washington.

Through its Broker Dealer Subsidiaries, the Company offers (1) full service retail brokerage to approximately 45,000 high net worth and institutional clients, (2) provides investment banking, merger, acquisition and advisory services to micro, small and mid-cap high growth companies, and (3) engages in trading securities, including making markets in over 4,000 micro-cap, small-cap, NASDAQ and listed stocks and provides liquidity in the United States Treasury marketplace. The Broker Dealer Subsidiaries are introducing brokers and clear all transactions through clearing organizations on a fully disclosed basis. They are registered with the Securities and Exchange Commission (“SEC”), are members of the Financial Industry Regulatory Authority, Inc. (“FINRA”) (formerly the National Association of Securities Dealers) and Securities Investor Protection Corporation (“SIPC”). vFinance Investments is also a member of the National Futures Association (“NFA”).

In July 1994, National Securities formed a wholly owned subsidiary, National Asset Management, Inc., a Washington corporation (“NAM”). NAM is a federally-registered investment adviser providing asset management advisory services to high net worth clients for a fee based upon a percentage of assets managed. In March 2008, all of the issued and outstanding stock of NAM was transferred from National Securities to National. National formed a new wholly owned subsidiary, National Insurance Corporation, a Washington corporation (“National Insurance”) in the third quarter of fiscal year 2006. National Insurance provides fixed insurance products to its clients, including life insurance, disability insurance, long term care insurance and fixed annuities. National Insurance finalized certain requisite state registrations during the second quarter of fiscal year 2007 and commenced business operations that to date have been de minimus. vFinance Lending Services, Inc. (“vFinance Lending”), originally formed as a wholly owned subsidiary of vFinance, Inc. was established in May 2002. It is a mortgage lender focused primarily on the commercial sector, providing bridge loans and commercial mortgages through its nationwide network of lenders. Its operations to date have been de minimus. All significant inter-company accounts and transactions have been eliminated in consolidation.

NOTE 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The consolidated financial statements include the accounts of National and its wholly owned subsidiaries. All significant inter-company accounts and transactions have been eliminated in consolidation.

Estimates

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

Reclassifications

Certain items in the 2009 financial statements have been reclassified to conform to the presentation in the 2010 financial statements. Such reclassifications did not have a material impact on the presentation of the overall financial statements.

Revenue Recognition

The Company generally acts as an agent in executing customer orders to buy or sell listed and over-the-counter securities in which it may or may not make a market, and charges commissions based on the services the Company provides to its customers. In executing customer orders to buy or sell a security in which the Company makes a market, the Company may sell to, or purchase from, customers at a price that is substantially equal to the current inter-dealer market price plus or minus a mark-up or mark-down. The Company may also act as agent and execute a customer's purchase or sale order with another broker-dealer market-maker at the best inter-dealer market price available and charge a commission. Mark-ups, mark-downs and commissions are generally priced competitively based on the services it provides to its customers. In each instance the commission charges, mark-ups or mark-downs, are in compliance with guidelines established by FINRA.

Customer security transactions and the related commission income and expense are recorded on a trade date basis. Customers who are financing their transaction on margin are charged interest. The Company's margin requirements are in accordance with the terms and conditions mandated by its clearing firms, National Financial Services LLC ("NFS"), Penson Financial Services, Inc. ("Penson"), Legent Clearing LLC ("Legent"), Fortis Securities, LLC ("Fortis") and Rosenthal Collins Group, LLC. ("Rosenthal"). The interest is billed on the average daily balance of the margin account.

Investment banking revenues include gains, losses, and fees, net of syndicate expenses, arising from securities offerings in which the Company acts as an underwriter or agent. Investment banking revenues also include fees earned from providing financial advisory services. Investment banking management fees are recorded on the offering date, sales concessions on the settlement date, and underwriting fees at the time the underwriting is completed and the income is reasonably determinable.

Net trading profits result from mark-ups and mark-downs in securities transactions entered into for the account of the Company. Some of these transactions may involve the Company taking a position in securities that may expose the company to losses. Net trading profits are recorded on a trade date basis.

Clearing and other brokerage income are fees charged to the broker on customer's security transactions and are recognized as of the trade date.

Other revenue consists primarily of investment advisory fees which are account management fees for high net worth clients. These fees are determined based on a percentage of the customers assets under management, are billed quarterly and recognized when collected.

Cash and Cash Equivalents

The Company considers all highly liquid temporary cash investments with an original maturity of three months or less when purchased to be cash equivalents.

Fixed Assets

Fixed assets are recorded at cost. Depreciation is calculated using the straight-line method based on the estimated useful lives of the related assets, which range from three to five years. Leasehold improvements are amortized using the straight-line method over the shorter of the estimated useful lives of the assets or the terms of the leases. Maintenance and repairs are charged to expense as incurred; costs of major additions and betterments that extend the useful life of the asset are capitalized. When assets are retired or otherwise disposed of, the costs and related accumulated depreciation or amortization are removed from the accounts and any gain or loss on disposal is recognized.

Income Taxes

The Company recognizes deferred tax assets and liabilities based on the difference between the financial statements carrying amounts and the tax basis of assets and liabilities, using the effective tax rates in the years in which the differences are expected to reverse. A valuation allowance related to deferred tax assets is also recorded when it is more likely than not that some or all of the deferred tax asset may not be realized.

Fair Value of Financial Instruments

The carrying amounts reported in the balance sheet for cash, receivables, accounts payable, accrued expenses and other liabilities approximates fair value based on the short-term maturity of these instruments.

Impairment of Long-Lived Assets

The Company reviews long-lived assets for impairment at least once a year or earlier if circumstances and situations change such that there is an indication that the carrying amounts may not be recovered, in accordance with professional standards. In such circumstances, the Company will estimate the future cash flows expected to result from the use of the asset and its eventual disposition. Future cash flows are the future cash inflows expected to be generated by an asset less the future outflows expected to be necessary to obtain those inflows. If the sum of the expected future cash flows (undiscounted and without interest charges) is less than the carrying amount of the asset, the Company will recognize an impairment loss to adjust to the fair value of the asset.

Common Stock Purchase Warrants

The Company accounts for the issuance of common stock purchase warrants issued in connection with capital financing transactions in accordance with professional standards for "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock". In accordance with professional standards, the

Company classifies as equity any contracts that (i) require physical settlement or net-share settlement or (ii) gives the Company a choice of net-cash settlement or settlement in its own shares (physical settlement or net-share settlement). The Company classifies as assets or liabilities any contracts that (i) require net-cash settlement (including a requirement to net-cash settle the contract if an event occurs and if that event is outside the control of the Company) or (ii) gives the counterparty a choice of net-cash settlement or settlement in shares (physical settlement or net-share settlement).

The Company assessed the classification of its derivative financial instruments as of June 30, 2010, which consist of common stock purchase warrants, and determined that such derivatives are accounted for in accordance with accounting standards.

Convertible Instruments

The Company evaluates and accounts for conversion options embedded in its convertible instruments in accordance with professional standards for “Accounting for Derivative Instruments and Hedging Activities”.

Professional standards generally provides three criteria that, if met, require companies to bifurcate conversion options from their host instruments and account for them as free standing derivative financial instruments. These three criteria include circumstances in which (a) the economic characteristics and risks of the embedded derivative instrument are not clearly and closely related to the economic characteristics and risks of the host contract, (b) the hybrid instrument that embodies both the embedded derivative instrument and the host contract is not re-measured at fair value under otherwise applicable generally accepted accounting principles with changes in fair value reported in earnings as they occur and (c) a separate instrument with the same terms as the embedded derivative instrument would be considered a derivative instrument. Professional standards also provide an exception to this rule when the host instrument is deemed to be conventional as defined under professional standards as “The Meaning of “Conventional Convertible Debt Instrument”.

The Company accounts for convertible instruments (when it has determined that the embedded conversion options should not be bifurcated from their host instruments) in accordance with professional standards when “Accounting for Convertible Securities with Beneficial Conversion Features,” as those professional standards pertain to “Certain Convertible Instruments.” Accordingly, the Company records, when necessary, discounts to convertible notes for the intrinsic value of conversion options embedded in debt instruments based upon the differences between the fair value of the underlying common stock at the commitment date of the note transaction and the effective conversion price embedded in the note. Debt discounts under these arrangements are amortized over the term of the related debt to their earliest date of redemption. The Company also records when necessary deemed dividends for the intrinsic value of conversion options embedded in preferred shares based upon the differences between the fair value of the underlying common stock at the commitment date of the note transaction and the effective conversion price embedded in the note.

The Company evaluated the conversion option embedded in the convertible preferred stock and determined, in accordance with the provisions of these statements, that such conversion option does not meet the criteria requiring bifurcation of these instruments. The characteristics of the common stock that is issuable upon a holder’s exercise of the conversion option embedded in the convertible preferred stock are deemed to be clearly and closely related to the characteristics of the preferred shares. Additionally, the Company’s conversion options, if free standing, would not be considered derivatives subject to the accounting guidelines prescribed in accordance with professional standards.

Net Income (Loss) per Common Share

Basic net income (loss) per share is computed on the basis of the weighted average number of common shares outstanding. Diluted net income (loss) per share is computed on the basis of the weighted average number of common shares outstanding plus the potential dilution that could occur if securities or other contracts to issue common shares were exercised or converted.

	Three Months Ended	
	June 30, 2010	June 30, 2009
Numerator:		
Net loss	\$ (2,031,000)	\$ (868,000)
Preferred stock dividends	(103,000)	(96,000)
Numerator for basic earnings per share-net income (loss) attributable to common stockholders - as reported	(2,134,000)	(964,000)
Effect of dilutive securities:		
Series A preferred stock	-	-
Numerator for diluted earnings per share-net income (loss) attributable to common stockholders - as adjusted	\$ (2,134,000)	\$ (964,000)
Denominator:		
Denominator for basic earnings per share--weighted average shares	17,276,704	16,930,924
Effect of dilutive securities:		
Assumed conversion of Series A preferred stock	-	-
Stock options	-	-
Warrants	-	-
Dilutive potential common shares	-	-
Denominator for diluted earnings per share--adjusted weighted-average shares and assumed conversions	17,276,704	16,930,924
Net loss available to common stockholders		
Basic and diluted	\$ (0.12)	\$ (0.06)

Edgar Filing: NATIONAL HOLDINGS CORP - Form 10-Q

	Nine Months Ended	
	June 30, 2010	June 30, 2009
Numerator:		
Net loss	\$ (3,736,000)	\$ (3,938,000)
Preferred stock dividends	(391,000)	(265,000)
Numerator for basic earnings per share-net income (loss) attributable to common stockholders - as reported	(4,127,000)	(4,203,000)
Effect of dilutive securities:		
Series A preferred stock	-	-
Numerator for diluted earnings per share-net income (loss) attributable to common stockholders - as adjusted	\$ (4,127,000)	\$ (4,203,000)
Denominator:		
Denominator for basic earnings per share--weighted average shares	17,209,396	16,635,442
Effect of dilutive securities:		
Assumed conversion of Series A preferred stock	-	-
Stock options	-	-
Warrants	-	-
Dilutive potential common shares	-	-
Denominator for diluted earnings per share--adjusted weighted-average shares and assumed conversions	17,209,396	16,635,442
Net loss available to common stockholders		
Basic and diluted	\$ (0.24)	\$ (0.25)

For the three and nine month periods ended June 30, 2010, 12,941,757 common share equivalents were excluded from the calculation of diluted net loss per share because their inclusion would have been anti-dilutive. For the three and nine month periods ended June 30, 2009, 12,163,057 common share equivalents were excluded from the calculation of diluted net loss per share because their inclusion would have been anti-dilutive.

The following table sets forth the common share equivalents that were excluded from the calculation as of June 30, 2010 and 2009:

	June 30, 2010	June 30, 2009
Stock options	3,445,507	3,373,524
Warrants	2,437,250	1,977,973
Assumed conversion of:		
Series A Preferred Stock	3,684,000	3,436,560

Edgar Filing: NATIONAL HOLDINGS CORP - Form 10-Q

Notes	3,375,000	3,375,000
Dilutive potential common shares	12,941,757	12,163,057

Stock-Based Compensation

Effective October 1, 2005, the Company adopted ASC Topic 718 accounting for “Share Based Payment.” This topic addresses all forms of share based payment (“SBP”) awards including shares issued under employee stock purchase plans, stock options, restricted stock and stock appreciation rights. Under Topic 718, SBP awards will result in a charge to operations that will be measured at fair value on the awards grant date, based on the estimated number of awards expected to vest over the service period. During the three months ended June 30, 2010, the Company did not grant any stock options. During the nine months ended June 30, 2010, the Company granted 340,000 options including 40,000 to outside directors. Options granted by the Company to outside directors vest in full after six months from issuance. Other options granted to employees typically vest over four years and have a 5-year life and are exercisable at the closing share price on the date of grant. A charge of approximately \$113,000 and \$237,000 was recorded for the three months ended June 30, 2010 and 2009, respectively, and a charge of approximately \$409,000 and \$678,000 was recorded in the nine months ended June 30, 2010 and 2009, respectively, relating to the amortization of the fair value associated with all remaining stock option grants and restricted stock grants.

The Black-Scholes option valuation model is used to estimate the fair value of the options granted. The model includes subjective input assumptions that can materially affect the fair value estimates. The model was developed for use in estimating the fair value of traded options that have no vesting restrictions and that are fully transferable. For example, the expected volatility is estimated based on the most recent historical period of time equal to the weighted average life of the options granted. Options issued under the Company's option plans have characteristics that differ from traded options. In management's opinion, this valuation model does not necessarily provide a reliable single measure of the fair value of its employee stock options.

A summary of the stock option activity as of June 30, 2010, and changes during the nine month period then ended is presented below:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at September 30, 2009	5,912,165	\$ 1.55	3.21	\$ 2,500
Granted	340,000	0.70	4.19	-
Terminated and Expired	992,572	1.33	0.18	-
Outstanding at June 30, 2010	5,259,593	\$ 1.54	3.06	\$ -
Exercisable at June 30, 2010	3,485,507	\$ 1.54	2.54	\$ -

As of June 30, 2010, there was approximately \$508,000 of total unrecognized deferred compensation costs related to share-based compensation arrangements. The Company has experienced a historic forfeiture rate of approximately 26% on previously granted stock options and expects that future forfeitures will be consistent with this experience.

A summary of the status of the Company's nonvested shares as of June 30, 2010, and changes during the nine month period then ended is presented below:

Nonvested Shares	Shares	Weighted Average Grant Date Fair Value
Nonvested at September 30, 2009	1,916,741	\$ 0.61
Granted	340,000	\$ 0.50
Vested	383,933	\$ 1.94
Expired	58,775	\$ 1.08
Nonvested at June 30, 2010	1,814,033	\$ 0.77

Concentrations of Credit Risk

The Company is engaged in trading and providing a broad range of securities brokerage and investment services to a diverse group of retail and institutional clientele, as well as corporate finance and investment banking services to corporations and businesses. Counterparties to the Company's business activities include broker-dealers and clearing organizations, banks and other financial institutions. The Company primarily uses clearing brokers to process transactions and maintain customer accounts on a fee basis for the Company. The Company uses three clearing brokers for substantially all of its business. The Company permits the clearing firms to extend credit to its clientele secured by cash and securities in the client's account. The Company's exposure to credit risk associated with the non-performance by its customers and counterparties in fulfilling their contractual obligations can be directly impacted by volatile or illiquid trading markets, which may impair the ability of customers and counterparties to satisfy their obligations to the Company. The Company has agreed to indemnify the clearing brokers for losses they incur while extending credit to the Company's clients. It is the Company's policy to review, as necessary, the credit standing of its customers and counterparty. Amounts due from customers that are considered uncollectible by the clearing broker are charged back to the Company by the clearing broker when such amounts become determinable. Upon notification of a charge back, such amounts, in total or in part, are then either (i) collected from the customers, (ii) charged to the broker initiating the transaction and included in other receivables in the accompanying consolidated statements of financial condition, and/or (iii) charged as an expense in the accompanying consolidated statements of financial condition, based on the particular facts and circumstances.

The Company maintains cash with major financial institutions. All interest bearing accounts are insured up to \$250,000. On October 14, 2008 the FDIC announced its temporary Transaction Account Guarantee Program, which provides full coverage for non-interest bearing transaction deposit accounts at FDIC-insured institutions that agree to participate in the program. The transaction account guarantee applies to all personal and business checking deposit accounts that do not earn interest at participating institutions. As of July 2010 this unlimited insurance coverage was made permanent. As a result of this coverage the Company believes it is not presently exposed to any significant credit risks for cash.

Other Receivables

The Company extends unsecured credit in the normal course of business to its registered representatives. The determination of the amount of uncollectible accounts is based on the amount of credit extended and the length of time

each receivable has been outstanding, as it relates to each individual registered representative. The allowance for doubtful accounts reflects the amount of loss that can be reasonably estimated by management, and is included in other expenses in the accompanying consolidated statements of operations.

Advances to Registered Representatives

Advances are given to certain registered representatives as an incentive for their affiliation with the Broker Dealer Subsidiaries. The representative signs an independent contractor agreement with the Broker Dealer Subsidiaries for a specified term, typically a three-year period. The advance is then amortized on a straight-line basis over the life of the broker's agreement with the Broker Dealer Subsidiaries, and is included in commission expense in the accompanying consolidated statements of operations. In the event a representative's affiliation terminates prior to the fulfillment of their contract, the representative is required to repay the unamortized balance.

Securities Owned

Marketable securities which consist of publicly traded unrestricted common stock and bonds are valued at the closing price on the valuation date. Non-marketable securities which consist partly of restricted common stock and of non-tradable warrants exercisable into freely trading common stock of public companies are carried at fair value as determined in good faith by management.

Other Assets

Other assets consist primarily of prepaid expenses and lease deposits.

Legal and Other Contingencies

The outcomes of legal proceedings and claims brought against us are subject to significant uncertainty. SFAS No. 5, Accounting for Contingencies, requires that an estimated loss from a loss contingency such as a legal proceeding or claim should be accrued by a charge to income if it is probable that an asset has been impaired or a liability has been incurred and the amount of the loss can be reasonably estimated. Disclosure of a contingency is required if there is at least a reasonable possibility that a loss has been incurred. In determining whether a loss should be accrued we evaluate, among other factors, the degree of probability of an unfavorable outcome and the ability to make a reasonable estimate of the amount of loss. Changes in these factors could materially impact our results of operations, financial position, or our cash flows.

Recent Accounting Pronouncements

In addition to those pronouncements shown below, other pronouncements may have been issued but deemed by management to be outside the scope of relevance to the Company.

In October 2009, the FASB issued ASU No. 2009-13, "Multiple-Deliverable Revenue Arrangements." This ASU establishes the accounting and reporting guidance for arrangements including multiple revenue-generating activities. This ASU provides amendments to the criteria for separating deliverables, measuring and allocating arrangement consideration to one or more units of accounting. The amendments in this ASU also establish a selling price hierarchy for determining the selling price of a deliverable. Significantly enhanced disclosures are also required to provide information about a vendor's multiple-deliverable revenue arrangements, including information about the nature and terms, significant deliverables, and its performance within arrangements. The amendments also require providing information about the significant judgments made and changes to those judgments and about how the application of the relative selling-price method affects the timing or amount of revenue recognition. The amendments in this ASU are effective prospectively for revenue arrangements entered into or materially modified in the fiscal years beginning on or after June 15, 2010. Early application is permitted. The Company is currently evaluating this new ASU.

In October 2009, the FASB issued ASU No. 2009-14, "Certain Revenue Arrangements That Include Software Elements." This ASU changes the accounting model for revenue arrangements that include both tangible products and software elements that are "essential to the functionality," and scopes these products out of current software revenue guidance. The new guidance will include factors to help companies determine what software elements are considered "essential to the functionality." The amendments will now subject software-enabled products to other revenue guidance and disclosure requirements, such as guidance surrounding revenue arrangements with multiple-deliverables. The amendments in this ASU are effective prospectively for revenue arrangements entered into or materially modified in the fiscal years beginning on or after June 15, 2010. Early application is permitted. The Company is currently evaluating this new ASU.

In November 2009, the FASB issued an ASU regarding accounting for stock dividends, including distributions to shareholders with components of stock and cash. This ASU clarifies that the stock portion of a distribution to shareholders that contains components of cash and stock and allows shareholders to select their preferred form of the distribution (with a limit on the amount of cash that will be distributed in total) should be considered a stock dividend and included in EPS calculations as a share issuance. The adoption of this guidance did not have a material impact on the Company's consolidated financial statements.

In December 2009, FASB issued ASU No. 2009-16, Accounting for Transfers of Financial Assets. This Accounting Standards Update amends the FASB Accounting Standards Codification for the issuance of FASB Statement No. 166, Accounting for Transfers of Financial Assets—an amendment of FASB Statement No. 140. The amendments in this Accounting Standards Update improve financial reporting by eliminating the exceptions for qualifying special-purpose entities from the consolidation guidance and the exception that permitted sale accounting for certain mortgage securitizations when a transferor has not surrendered control over the transferred financial assets. In addition, the amendments require enhanced disclosures about the risks that a transferor continues to be exposed to because of its continuing involvement in transferred financial assets. Comparability and consistency in accounting for transferred financial assets will also be improved through clarifications of the requirements for isolation and limitations on portions of financial assets that are eligible for sale accounting. The Company does not expect the adoption of this ASU to have a material impact on its consolidated financial statements.

In December 2009, FASB issued ASU No. 2009-17, Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities. This Accounting Standards Update amends the FASB Accounting Standards Codification for the issuance of FASB Statement No. 167, Amendments to FASB Interpretation No. 46(R). The amendments in this Accounting Standards Update replace the quantitative-based risks and rewards calculation for determining which reporting entity, if any, has a controlling financial interest in a variable interest entity with an approach focused on identifying which reporting entity has the power to direct the activities of a variable interest entity that most significantly impact the entity's economic performance and (1) the obligation to absorb losses of the entity or (2) the right to receive benefits from the entity. An approach that is expected to be primarily qualitative will be more effective for identifying which reporting entity has a controlling financial interest in a variable interest entity. The amendments in this Update also require additional disclosures about a reporting entity's involvement in variable interest entities, which will enhance the information provided to users of financial statements. The Company is currently evaluating the impact of this ASU, however, the Company does not expect the adoption of this ASU to have a material impact on its consolidated financial statements.

In January 2010, FASB issued ASU No. 2010-01- Accounting for Distributions to Shareholders with Components of Stock and Cash. The amendments in this Update clarify that the stock portion of a distribution to shareholders that allows them to elect to receive cash or stock with a potential limitation on the total amount of cash that all shareholders can elect to receive in the aggregate is considered a share issuance that is reflected in EPS prospectively and is not a stock dividend for purposes of applying Topics 505 and 260 (Equity and Earnings Per Share). The amendments in this update are effective for interim and annual periods ending on or after December 15, 2009, and

should be applied on a retrospective basis. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

In January 2010, FASB issued ASU No. 2010-02 – Accounting and Reporting for Decreases in Ownership of a Subsidiary – a Scope Clarification. The amendments in this Update affect accounting and reporting by an entity that experiences a decrease in ownership in a subsidiary that is a business or nonprofit activity. The amendments also affect accounting and reporting by an entity that exchanges a group of assets that constitutes a business or nonprofit activity for an equity interest in another entity. The amendments in this update are effective beginning in the period that an entity adopts SFAS No. 160, “Non-controlling Interests in Consolidated Financial Statements – An Amendment of ARB No. 51.” If an entity has previously adopted SFAS No. 160 as of the date the amendments in this update are included in the Accounting Standards Codification, the amendments in this update are effective beginning in the first interim or annual reporting period ending on or after December 15, 2009. The amendments in this update should be applied retrospectively to the first period that an entity adopted SFAS No. 160. The adoption of this ASU did not have any material impact on the Company’s consolidated financial statements.

In January 2010, FASB issued ASU No. 2010-06 – Improving Disclosures about Fair Value Measurements. This update provides amendments to Subtopic 820-10 that requires new disclosure as follows: 1) Transfers in and out of Levels 1 and 2. A reporting entity should disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers. 2) Activity in Level 3 fair value measurements. In the reconciliation for fair value measurements using significant unobservable inputs (Level 3), a reporting entity should present separately information about purchases, sales, issuances, and settlements (that is, on a gross basis rather than as one net number). This update provides amendments to Subtopic 820-10 that clarifies existing disclosures as follows: 1) Level of disaggregation. A reporting entity should provide fair value measurement disclosures for each class of assets and liabilities. A class is often a subset of assets or liabilities within a line item in the statement of financial position. A reporting entity needs to use judgment in determining the appropriate classes of assets and liabilities. 2) Disclosures about inputs and valuation techniques. A reporting entity should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements. Those disclosures are required for fair value measurements that fall in either Level 2 or Level 3. The new disclosures and clarifications of existing disclosures are effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. These disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. The Company is currently evaluating the impact of this ASU, however, the Company does not expect the adoption of this ASU to have a material impact on its consolidated financial statements.

NOTE 4. CLEARING AGREEMENTS

On February 1, 2010, National Securities Corporation and vFinance Investments, Inc. entered into separate but coterminous clearing agreements with National Financial Services, LLC. NFS remains our primary clearing firm, and as a result of these agreements, National Securities Corporation’s existing agreement, which was not due to expire until April 2013, has been terminated and is replaced by this new agreement with a termination date of February 1, 2015. vFinance Investments, Inc. clearing agreement ended on March 14, 2009, but the Company had been operating under that agreement while negotiating this new agreement. The Company expects these new agreements to have a favorable effect on its clearing costs. The clearing agreement includes a termination fee if either broker dealer terminates the agreement without cause. The Broker Dealer Subsidiaries currently have clearing agreements with NFS, Penson, Legent, Fortis and Rosenthal.

NOTE 5. BROKER-DEALERS AND CLEARING ORGANIZATIONS RECEIVABLES AND PAYABLES

At June 30, 2010 and September 30, 2009, the receivables of \$3,126,000 and \$4,910,000, respectively, from broker-dealers and clearing organizations represent net amounts due for fees and commissions. At June 30, 2010 and September 30, 2009, the amounts payable to broker-dealers and clearing organizations of \$373,000 and \$299,000, respectively, represent amounts owed to clearing firms or other broker dealers for fees on transactions and payables to other broker dealers associated with tri-party clearing agreements.

NOTE 6. SECURITIES OWNED AND SECURITIES SOLD, BUT NOT YET PURCHASED

The following table shows the quoted market values of securities owned by the Company, and securities sold but not yet purchased by the Company, as of June 30, 2010:

	Securities owned	Securities sold, but not yet purchased
Corporate stocks	\$ 109,000	\$ 162,000
Corporate bonds	5,000	-
Government obligations	680,000	-
Non-marketable securities	75,000	1,000
	\$ 869,000	\$ 163,000

The following table shows the quoted market values of securities owned by the Company, and securities sold but not yet purchased by the Company, as of September 30, 2009:

	Securities owned	Securities sold, but not yet purchased
Corporate stocks	\$ 86,000	\$ 4,000
Corporate bonds	3,000	-
Government obligations	542,000	-
Non-marketable securities	60,000	-
	\$ 691,000	\$ 4,000

Fair Value Measurements

Securities owned at Fair Value as of June 30, 2010

Securities owned at fair value	Level 1	Level 2	Level 3	Total
Corporate stocks	\$ 109,000	\$ -	\$ -	\$ 109,000
Corporate bonds	5,000	-	-	5,000
Government obligations	680,000	-	-	680,000
Non-marketable securities	-	75,000	-	75,000
	\$ 794,000	\$ 75,000	\$ -	\$ 869,000

Securities owned at Fair Value as of September 30, 2009

Securities owned at fair value	Level 1	Level 2	Level 3	Total
Corporate stocks	\$ 86,000	\$ -	\$ -	\$ 86,000
Corporate bonds	3,000	-	-	3,000
Government obligations	542,000	-	-	542,000
Non-marketable securities	-	60,000	-	60,000
	\$ 631,000	\$ 60,000	\$ -	\$ 691,000

Securities sold, but not yet purchased at Fair Value as of June 30, 2010

Securities sold, but not yet purchased at fair value	Level 1	Level 2	Level 3	Total
Corporate stocks	\$ 162,000	\$ -	\$ -	\$ 162,000
Corporate bonds	-	-	-	-
Government obligations	-	-	-	-
Non-marketable securities	-	1,000	-	1,000
	\$ 162,000	\$ 1,000	\$ -	\$ 163,000

Securities sold, but not yet purchased at Fair Value as of September 30, 2009

Securities sold, but not yet purchased at fair value	Level 1	Level 2	Level 3	Total
Corporate stocks	\$ 4,000	\$ -	\$ -	\$ 4,000
Corporate bonds	-	-	-	-
Government obligations	-	-	-	-
Non-marketable securities	-	-	-	-
	\$ 4,000	\$ -	\$ -	\$ 4,000

NOTE 7. INTANGIBLE ASSETS

To determine the fair value of the intangible assets, the Company used the guidance provided by professional standards defining Fair Value Measurements. These professional standards provide a fair value hierarchy which gives priority to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. There is no active market for assets identical to the Company's acquired customer relationships nor has the Company been able to identify, as defined. Additionally, the Company was unable to identify the following Level 2 inputs: 1) quoted prices for similar assets in active markets, 2) quoted prices for similar or identical assets in markets that are not active, or 3) inputs other than quoted prices that are observable for the asset. Accordingly, the Company used mostly unobservable inputs, consisting of estimated future net cash flows generated specifically from the acquired customer relationships. However, the Company did use certain Level 1 and 2 inputs to substantiate certain assumptions that helped determine the discount rate it used in deriving the fair value of the intangible assets.

Amortization of the Company's intangible asset for the three months and nine months ended June 30, 2010 was \$155,000 and \$465,000, respectively, and amortization of the Company's intangible asset for the three months and nine months ended June 30, 2009 was \$155,000 and \$465,000, respectively.

NOTE 8. OTHER ASSETS

Other assets as of June 30, 2010 and September 30, 2009, respectively, consist of the following:

	30-Jun-10	September 30, 2009
Pre-paid expenses	\$ 744,000	\$ 659,000
Deposits	183,000	184,000
Investments in unaffiliated entity	162,000	162,000
Deferred financing costs	82,000	114,000
Other	1,000	13,000
Total	\$ 1,172,000	\$ 1,132,000

NOTE 9. ACCOUNTS PAYABLE, ACCRUED EXPENSES AND OTHER LIABILITIES

Accounts payable, accrued expenses and other liabilities as of June 30, 2010 and September 30, 2009, respectively, consist of the following:

	June 30, 2010	September 30, 2009
Commissions payable	\$ 4,856,000	\$ 7,745,000
Deferred clearing fee credits	223,000	484,000
Telecommunications vendors payable	97,000	82,000
Legal payable	595,000	663,000
Deferred rent payable	372,000	140,000
Accrued compensation	695,000	757,000
Capital lease liability	491,000	703,000
Other vendors	3,122,000	4,307,000
Total	\$ 10,451,000	\$ 14,881,000

NOTE 10. CONVERTIBLE NOTES PAYABLE

On March 31, 2008, the Company completed a financing transaction under which an investor made an investment in the Company by purchasing a convertible promissory note in the principal amount of \$3.0 million, with a warrant to purchase 375,000 shares of common stock at an exercise price of \$2.50 per share. The promissory note matures in March 2012, is convertible into common stock at a price of \$2.00 per share and has a stated interest rate of 10% per annum. Using professional standards, the relative fair value of the warrant was calculated using the Black-Scholes Option Valuation Model. The Company also recorded an additional debt discount for the beneficial conversion feature of the instrument. These amounts, totaling approximately \$791,000, have been recorded as a debt discount that will be charged to interest expense over the life of the promissory note.

On June 30, 2008, the Company completed a financing transaction under which the same investor made an additional investment in the Company by purchasing a convertible promissory note in the principal amount of \$3.0 million, with a warrant to purchase 468,750 shares of common stock at an exercise price of \$2.00 per share. The promissory note matures in June 2012, is convertible into common stock at a price of \$1.60 per share and has a stated interest rate of 10% per annum. Under professional standards, the relative fair value of the warrant was calculated using the Black-Scholes Option Valuation Model. The Company also recorded an additional debt discount for the beneficial conversion feature of the instrument. These amounts, totaling approximately \$789,000, have been recorded as a debt discount that will be charged to interest expense over the life of the promissory note.

During June 2010, the lender agreed to waive certain covenants associated with its prior financings in consideration of the issuance of warrants to purchase an aggregate 500,000 shares of common stock at an exercise price of \$0.50 per share. The warrants expire in June 2015. In the event the Company does not prepay the notes, the lender is only entitled to exercise 250,000 warrants.

The following table summarizes convertible notes payable at June 30, 2010 and September 30, 2009:

	June 30, 2010	September 30, 2009
10% convertible notes payable	\$ 6,000,000	\$ 6,000,000
Less: Debt discount	(740,000)	(1,036,000)
	\$ 5,260,000	\$ 4,964,000

The Company incurred interest expense related to its convertible notes of approximately \$148,000 and \$299,000 for the three and nine months ended June 30, 2010 and June 30, 2009, respectively.

NOTE 11. NOTES PAYABLE – RELATED PARTY

In February 2007, the Company completed a financing transaction under which certain investors purchased 10% promissory notes in the principal amount of \$1.0 million, with warrants to purchase an aggregate of 250,000 shares of common stock at an exercise price of \$1.40 per share. The promissory notes matured in February 2009, and had a stated interest rate of 10% per annum. The Company obtained forbearance agreements from the lenders and as a result, re-priced some of the warrants down to an exercise price of \$0.75 per share. The Company recalculated the fair value of the warrants and took an incremental charge of approximately \$46,000 recorded as interest expense, in accordance with professional standards.

During 2009 the Company repaid \$500,000 of the notes payable and the other \$500,000 was extended to a maturity of June 2010 at a reduced interest rate of 7%. During June 2010, the lender extended the maturity of the note to March 2011 in consideration of a warrant to purchase 225,000 shares of common stock at an exercise price of \$0.50 per share. The warrant expires in June 2015.

The Company has fully amortized the debt discount associated with these notes and an expense of \$41,000 was charged to interest expense in 2009. Such amortization had been included in “Interest” in previous years, in the accompanying consolidated financial statements.

The following table summarizes notes payable at June 30, 2010 and September 30, 2009:

	June 30, 2010	September 30, 2009
7% promissory notes payable	\$ 500,000	\$ 500,000
	\$ 500,000	\$ 500,000

This note outstanding on June 30, 2010 matures on March 31, 2011. This indebtedness is owned by Christopher Dewey, who serves as a member of our Board of Directors. The Company incurred interest expense related to its note of approximately \$9,000 and \$17,000 for the three and nine months ended June 30, 2010, respectively, and approximately \$12,000 and \$24,000 for the three and nine months ended June 30, 2009, respectively.

During June 2010, the lender extended the maturity of the note to March 2011 in consideration of the issuance of a warrant to purchase 225,000 shares of common stock at an exercise price of \$0.50 per share. The warrant expires in June 2015.

NOTE 12. SECURED DEMAND NOTE / SUBORDINATED BORROWINGS

Subordinated borrowings represent a secured demand note that was entered into by National Securities, a registered broker-dealer. The secured demand note was entered into in accordance with the form prescribed by the FINRA, and it is accounted for in accordance with broker-dealer accounting SEC rule 15c3-1d. Accordingly, our balance sheet includes both an asset (“Secured demand note”) and the corresponding liability (“Subordinated borrowings”) in an identical amount. The secured demand note is available to compute net capital under SEC rule 15c3-1. The borrowings are subordinated to the claims of present and future creditors of the Company and cannot be repaid where such repayment will cause the Company to fail to meet its minimum net capital requirements in accordance with SEC rule 15c3-1.

National Securities entered into a secured demand note collateral agreement with an employee of National Securities and a former Director of the Company, to borrow securities that can be used by the Company for collateral agreements. These securities have been pledged through an unrelated broker-dealer, and have a borrowing value totaling \$500,000. This note bears interest at 5% per annum with interest paid monthly. In fiscal year 2009, upon the maturity of the aforementioned note, the lender opted to not renew the note and as such, the note is presently in "Suspended Repayment" status, as defined in the original note. Certain of the securities, totaling \$168,000, have been pledged as collateral for security deposits for office leases under two letters of credit. No amounts have been drawn on either of these letters of credit. The holder also entered into a warrant agreement to purchase 150,000 shares of common stock at a price of \$1.25 per share. This warrant expires on July 31, 2010.

In June 2009, National Securities was approved by the FINRA to receive a Subordinated loan from Legent for \$100,000. This loan was granted subsequent to National Securities signing a clearing agreement with Legent to clear a portion of the business. This loan is forgivable after one year and National Securities bringing over a certain number of assets to the Legent clearing platform. In August 2010, National Securities received formal notification of the forgiveness of this debt.

In July 2009, National Securities was approved by the FINRA to receive an additional Subordinated loan from Legent for \$250,000, also bearing interest at the rate of 4.5% payable monthly. This loan was granted subsequent to National Securities signing a clearing agreement with Legent to clear a portion of the business. This loan is scheduled to begin principal repayment at a minimum of \$10,000 per month or \$10 per transaction, whichever is greater, starting July 31, 2010. Some or all of this repayment may be funded by transactional credits depending on the amount of business conducted through Legent on a monthly basis.

NOTE 13. SUBORDINATED BORROWINGS-Related Parties

In June 2010, the Company generated proceeds of \$1.7 million in consideration from issuing notes payable bearing interest at an annual rate of 5%. The notes mature in July 2010 are unsecured and subordinated to existing senior indebtedness of the Company. The Notes were convertible into units of the Company (the "Units") consisting of (a) a new class of Preferred Stock of the Company convertible into shares of our common stock, \$0.02 par value per share (the "Common Stock") at \$0.50 per share and (b) a warrant exercisable at \$0.50 for shares of Common Stock equal to 100% of the shares of Common Stock underlying the Preferred Stock issued in a subsequent financing of the Company.

In July 2010, the Company issued a total of 34,617 shares of Series C preferred stock in consideration of the conversion of the principal and accrued interest underlying such subordinated borrowing. The Series C preferred stock is convertible into 3,416,691 shares of the Company's common stock. The Series C preferred stock bears a liquidation preference of approximately \$1,731,000 upon liquidation or sale. In connection with the issuance of the Series C preferred stock, the Company issued warrants to purchase 3,416,692 shares of common stock, with an exercise price of \$0.50 per share. The warrants vested 33 1/3% on the date of grant and continue to vest at a rate of a 33 1/3% per year on the first and second anniversary thereafter. The warrants expire five years from the date of exercisability.

NOTE 13. COMMITMENTS AND CONTINGENCIES

During the quarter ended June 30, 2010, there were no significant developments in the Company's legal proceedings. For a detailed discussion of the Company's legal proceedings, please refer to the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2009.

The Company's subsidiaries are defendants in various arbitrations and administrative proceedings, lawsuits and claims together alleging damages of approximately \$10,157,000. Additionally, the Company has been named in four class actions lawsuits which have no specific damages alleged, and the Company is in the process of determining its exposure in these matters. The Company believes all such claims are substantially without merit and estimates, to the extent that it can, that its aggregate liability from these pending actions is less than \$900,000 (exclusive of fees, costs and unspecified punitive damages related to certain claims and inclusive of expected insurance coverage). The Company intends to vigorously defend itself in these actions and arbitrations, and believes that the eventual outcome of these matters will not have a material adverse effect on the Company. However, the ultimate outcome of these matters cannot be determined at this time. The amounts related to such matters that are reasonably estimable and which have been accrued at June 30, 2010 and 2009, is \$319,000 and \$290,000 (primarily legal fees), respectively, and have been included in "Accounts Payable, Accrued Expenses and Other Liabilities" in the accompanying consolidated statements of financial condition. The Company has included in "Professional fees" litigation and FINRA related expenses of \$311,000 and \$176,000 for the third quarter of fiscal year 2010 and 2009, respectively, and \$655,000 and \$460,000 for the first nine months of fiscal year 2010 and 2009, respectively.

NOTE 14. DIVIDENDS ON CONVERTIBLE PREFERRED STOCK

The holders of the Company's Series A convertible preferred stock, that are convertible into the Company's common stock at \$1.25 per share, are entitled to receive dividends on a quarterly basis at a rate of 9% per annum, per share. Such dividends are cumulative and accumulate whether or not declared by the Company's Board of Directors, but are payable only when and if declared by the Company's Board of Directors. In March 2010, the Company's Board of Directors declared an in-kind dividend in the aggregate of 3,093 shares of Series A preferred stock, in payment of approximately \$387,000 of dividends accrued through March 31, 2010. At June 30, 2010, the accumulated dividend on the Company's 46,050 issued and outstanding shares of Series A preferred stock was \$103,000.

NOTE 15. NET CAPITAL REQUIREMENTS

National Securities, as a registered broker-dealer, is subject to the SEC's Uniform Net Capital Rule 15c3-1 that requires the maintenance of minimum net capital. National Securities has elected to use the alternative standard method permitted by the rule. This requires that National Securities maintain minimum net capital equal to the greater of \$250,000 or a specified amount per security based on the bid price of each security for which National Securities is a market maker. At June 30, 2010, National Securities had net capital of approximately \$570,000 which exceeded its requirement by approximately \$320,000.

In addition to the net capital requirements, each of vFinance Investments and EquityStation are required to maintain a ratio of aggregate indebtedness to net capital, as defined, of not more than 15 to 1 (and the rule of the "applicable" exchange also provides that equity capital may not be withdrawn or cash dividends paid if the resulting net capital ratio would exceed 10 to 1). At June 30, 2010, vFinance Investments had net capital of approximately \$1,332,000 which was approximately \$332,000 over the minimum required net capital of \$1,000,000 and its percentage of aggregate indebtedness to net capital was 360%. At June 30, 2010, EquityStation had net capital of approximately \$281,000 which was approximately \$181,000 in excess of its required net capital of \$100,000 and its percentage of aggregate indebtedness to net capital was 207%. Each of the Broker Dealer subsidiaries qualifies under the exemptive provisions of Rule 15c3-3 under Section (k)(2)(ii) of the Rule, as none of them carry the accounts of their customers on their books nor perform custodial functions related to customer securities.

Advances, dividend payments and other equity withdrawals from its broker dealer subsidiaries are restricted by the regulations of the SEC, and other regulatory agencies. These regulatory restrictions may limit the amounts that a subsidiary may dividend or advance to the Company.

NOTE 16. SUBSEQUENT EVENTS

In June 2010, the Company received gross proceeds of \$1.7 million in consideration from issuing notes payable bearing interest at an annual rate of 5% to eight accredited investors. The notes mature in July 2010 are unsecured and subordinated to existing senior indebtedness of the Company. The Notes were convertible into units of the Company (the "Units") consisting of (a) a newly created class of Series C preferred stock of the Company convertible into shares of our common stock, \$0.02 par value per share at \$0.50 per share and (b) a warrant exercisable at \$0.50 for shares of common stock equal to 100% of the shares of Common Stock underlying the Preferred Stock issued in a subsequent financing of the Company

In July 2010, the Company issued a total of 34,617 shares of Series C preferred stock in consideration of the conversion of the principal and accrued interest of such subordinated borrowing. The Series C preferred stock is convertible into 3,416,691 shares of the Company's common stock. The Preferred C stock bears a liquidation preference of approximately \$1,731,000 upon liquidation or sale. In connection with the issuance of the Series C preferred stock, the company issued warrants to purchase 3,416,692 shares of common stock, with an exercise price of \$0.50 per share. The warrants vested 33 1/3% on the date of grant and continue to vest at a rate of a 33 1/3 % per year on the first and second anniversary thereafter. The warrants expire five years from the date of exercisability.

On June 21, 2010, vFinance Investments Holdings, Inc., a subsidiary of the Company, completed a sale of a minority equity interest in EquityStation, pursuant to the terms of a Share Purchase Agreement, dated July 21, 2010, by and among vFinance Investments Holdings, Inc, Equity Station, Inc and Osage, LLC, an Osage Nation limited liability company ("Osage"). Pursuant to the Purchase Agreement, vFinance Investments Holdings, Inc. sold 249 shares of its EquityStation common stock to Osage, equal to 24.9% of the issued and outstanding Common Stock of EquityStation, at an aggregate purchase price of \$800,000. A 12-month option was also granted to Osage to purchase an additional 301 shares of EquityStation Common Stock for the lesser of (i) \$1,700,000 or (ii) such other amount as may be agreed to between the parties, subject to certain adjustments. In the event that the Option is exercised, Osage would own 55% of EquityStation.

Pursuant to the terms of the Purchase Agreement, each of EquityStation, vFinance Investments Holdings, Inc. and Osage have a right of first refusal in the event either vFinance Investments Holdings, Inc. or Osage seek to transfer their shares of EquityStation Common Stock. In addition, vFinance Investments Holdings and Osage have co-sale rights in the event that all of the Offered Shares are not purchased by EquityStation or the non-transferring holder and have been granted piggy-back registration rights in the event EquityStation Common Stock becomes registered under the Securities Act of 1933, as amended. EquityStation has agreed to elect one designee of Osage to its Board of Directors

The Series C Preferred Shares and the warrants issued in connection with the financing consummated in July 2010 contain certain price protection anti-dilution provisions in the event the Company issues shares at an effective price per share lower than \$0.50. Such provisions expire on March 31, 2011 and exempts transactions in which the Company issues share pursuant to, among other things, a merger, equity based compensation to employees and contractors, conversion or exercise of existing convertible securities, and equipment financing with financial institutions.

The Company may recognize a derivative liability in its future financial statements triggered by the anti-dilution price protection provisions in its future quarterly reports, until such obligation is satisfied.

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

The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements. This Quarterly Report may contain certain statements of a forward-looking nature relating to future events or future business performance. Any such statements that refer to the Company's estimated or anticipated future results or other non-historical facts are forward-looking and reflect the Company's current perspective of existing trends and information. These statements involve risks and uncertainties that cannot be predicted or quantified and, consequently, actual results may differ materially from those expressed or implied by such forward-looking statements. Such risks and uncertainties include, among others, risks and uncertainties detailed in the Company's Annual Report on Form 10-K, filed with the Securities and Exchange Commission on December 29, 2009. Any forward-looking statements contained in or incorporated into this Quarterly Report speak only as of the date of this Quarterly Report. The Company undertakes no obligation to update publicly any forward-looking statement, whether as a result of new information, future events or otherwise.

OVERVIEW

We are engaged in investment banking, equity research, institutional sales and trading, independent brokerage and advisory services and asset management services through our principal subsidiaries, National Securities Corporation ("National Securities"), vFinance Investments, Inc. ("vFinance Investments") and EquityStation, Inc. ("EquityStation", and collectively with National Securities and vFinance Investments, the "Broker Dealer Subsidiaries"). We are committed to establishing a significant presence in the financial services industry by meeting the varying investment needs of our retail, corporate and institutional clients.

Each of the Broker Dealer Subsidiaries is subject to regulation by, among others, the Securities and Exchange Commission ("SEC"), the Financial Industry Regulatory Authority ("FINRA"), the Municipal Securities Rulemaking Board ("MSRB") and is a member of the Securities Investor Protection Corporation ("SIPC"). vFinance Investments is also subject to regulation by the National Futures Association ("NFA"). In addition, each of the Broker Dealer Subsidiaries is licensed to conduct its brokerage activities in all 50 states, plus the District of Columbia and Puerto Rico, with vFinance Investments also being licensed in the U.S. Virgin Islands.

As of June 30, 2010, we had approximately 922 associated personnel serving retail and institutional customers, trading and investment banking clients. With the exception of our New York, New Jersey, Florida, Washington and Illinois branches, our approximately 116 other registered offices are owned and operated by independent owners who maintain all appropriate licenses and are responsible for all office overhead and expenses. Because these independent operators, many of whom are financial planners, are required to pay their own expenses, we generally pay them a much greater percentage of the commissions and fee income they generate, typically 70% - 90%.

Our registered representatives offer a broad range of investment products and services. These products and services allow us to generate both commissions (from transactions in securities and other investment products) and fee income (for providing investment advisory services, namely managing a client's account). The investment products and services offered include but are not limited to stocks, bonds, mutual funds, annuities, insurance, and managed money accounts.

Business Environment in the Third Fiscal Quarter of 2010

The financial markets remained volatile during the third quarter of our fiscal year, as US economic critical data indicated a less than robust economic recovery, together with uncertainties with certain European sovereign debt, such as Greece, Spain and Portugal. While merger and acquisitions markets have begun to rebound, the extent and timing of a significant rise in transactions is uncertain.

Instability in the financial markets remain due to uncertainties related to bank regulation, the Federal Reserve's plans to end its various economic stimulus programs and risks of inflation which may lead to higher interest rates. The potential tightening of credit and proposed reforms to regulation of banks and other financial institutions will have an unknown impact on the markets.

The results of our operations during the third quarter of 2010 were impacted from the uncertainties in the financial markets. As these results are highly dependent on the environment in which our businesses operate, our quarterly results may not necessarily be indicative of what may be recognized in the future.

Growth Strategy

We continue to evaluate opportunities to grow our businesses, including potential acquisitions or mergers with other securities, investment banking and investment advisory firms, and by adding to our base of independent representatives organically. These acquisitions may involve payments of material amounts of cash, the incurrence of a significant amount of debt or the issuance of significant amounts of our equity securities, which may be dilutive to our existing shareholders and/or may increase our leverage. We cannot assure you that we will be able to consummate any such potential acquisitions at all or on terms acceptable to us or, if we do, that any acquired business will be profitable. There is also a risk that we will not be able to successfully integrate acquired businesses into our existing business and operations.

Key Indicators of Financial Performance for Management

Management periodically reviews and analyzes our financial performance across a number of measurable factors considered to be particularly useful in understanding and managing our business. Key metrics in this process include productivity and practice diversification of representatives, top line commission and advisory services revenues, gross margins, operating expenses, legal costs, taxes and earnings per share.

RESULTS OF OPERATIONS

Three Months Ended June 30, 2010 Compared to Three Months Ended June 30, 2009

The Company's third quarter of fiscal year 2010 resulted in a decrease in revenues, with a slightly lesser decrease in expenses compared to the same period last year. As a result, the Company reported a net loss of \$2,031,000 compared with a net loss of \$3,736,000 for the third quarters of fiscal years 2010 and 2009, respectively.

	Three Months Ended		Increase (Decrease)	
	2010	2009	Amount	Percent
Commissions	\$ 19,759,000	\$ 22,337,000	\$ (2,578,000)	-12 %
Net dealer inventory gains	3,336,000	5,077,000	(1,741,000)	-34 %
Investment banking	1,056,000	896,000	160,000	18 %
Interest and dividends	746,000	252,000	494,000	196 %
Transfer fees and clearance services	1,912,000	2,726,000	(814,000)	-30 %
Other	1,673,000	1,121,000	552,000	49 %
	\$ 28,482,000	\$ 32,409,000	\$ (3,927,000)	-12 %

Total revenues decreased \$3,927,000, or 12%, in the third quarter of fiscal year 2010 to \$28,482,000 from \$32,409,000 in the third quarter of fiscal year 2009. The decrease in revenues is primarily due to less favorable market conditions in retail brokerage and trading activity. Commission revenue decreased \$2,578,000, or 12%, to \$19,759,000 from \$22,337,000 during the third quarter of fiscal year 2010 compared with the same period in fiscal year 2009, which is attributable to generally less favorable market conditions. Net dealer inventory gains, which

includes profits on proprietary trading, market making activities and customer mark-ups and mark-downs, decreased \$1,741,000, or 34%, to \$3,336,000 from \$5,077,000 during the third quarter of fiscal year 2010 compared with the same period in fiscal year 2009. The decrease is primarily due to less favorable trading conditions affecting nearly all trading activities in the quarter ended June 30, 2010 as compared to the same quarter in 2009.

Investment banking revenue increased \$160,000, or 18% to \$1,056,000 from \$896,000 during the third quarter of 2010 compared to the same period in fiscal year 2009. This increase was attributable to generally better market conditions for investment banking activity resulting in greater success, advisory and consulting fees for services provided during the quarter. Interest and dividend income increased by \$494,000 or 196%, to \$746,000 from \$252,000 in the third quarter of fiscal year 2010 compared with the same period in fiscal year 2009. The increase in interest income is attributable to somewhat higher customer margin account balances and higher customer free cash balances during the quarter as well as more favorable credit terms from our primary clearing firm. Transfer fees decreased \$814,000 or 30%, to \$1,912,000 in the third quarter of fiscal year 2010 from \$2,726,000 in the third quarter of fiscal year 2009. The decrease is due primarily to lower total transactional volume quarter over quarter related to retail brokerage revenue.

Other revenue, consisting of asset management fees, miscellaneous transaction fees and trading fees and other investment income, increased \$552,000, or 49%, to \$1,673,000 from \$1,121,000 during the third quarter of fiscal year 2010 compared to the third quarter of fiscal year 2009. The increase is due primarily to slightly higher assets under management.

In comparison with the 12% decrease in total revenues, total expenses decreased 8%, or \$2,764,000 to \$30,513,000 for the third quarter of fiscal year 2010 compared to \$33,277,000 in the third quarter of fiscal year 2009. This decrease was primarily driven by the decrease in revenues causing a corresponding decrease in commissions.

	Three Months Ended		Increase (Decrease)	
	2010	2009	Amount	Percent
Commissions	\$ 22,451,000	\$ 26,061,000	\$ (3,610,000)	-14 %
Employee compensation	2,923,000	2,985,000	(62,000)	-2 %
Clearing fees	576,000	402,000	174,000	43 %
Communications	1,023,000	1,244,000	(221,000)	-18 %
Occupancy and equipment costs	1,191,000	954,000	237,000	25 %
Professional fees	763,000	548,000	215,000	39 %
Interest	459,000	292,000	167,000	57 %
Taxes, licenses and registration	443,000	414,000	29,000	7 %
Other administrative expenses	684,000	377,000	307,000	81 %
	\$ 30,513,000	\$ 33,277,000	\$ (2,764,000)	-8 %

Commission expense, which includes expenses related to commission revenue, net dealer inventory gains and investment banking, decreased \$3,610,000, or 14%, to \$22,451,000 in the third quarter of fiscal year 2010 from \$26,061,000 in the third quarter of fiscal year 2009. The decrease is primarily attributable to a decrease in the related commission revenues. Commission expense also includes the amortization of advances to registered representatives of \$187,000 and \$391,000 for the third quarter of fiscal years 2010 and 2009, respectively. These amounts fluctuate based upon the amounts of advances outstanding and the time period for which the registered representatives have agreed to be affiliated with National Securities.

Employee compensation expense decreased \$62,000, or 2%, to \$2,923,000 in the third quarter of fiscal year 2010 from \$2,985,000 in the third quarter of fiscal year 2009. Employee compensation includes the amortization of the fair value associated with stock based compensation of \$113,000 and \$237,000 in the third quarter of fiscal years 2010

and 2009, respectively. Combined commission and employee compensation expense, as a percentage of revenue, increased to 89% from 87% in the third quarter of fiscal year 2010 and 2009, respectively.

Clearing fees increased \$174,000 or 43%, to \$576,000 in the third quarter of fiscal year 2010 from \$402,000 in the third quarter of fiscal year 2009. The increase in clearing fees is due to a slightly higher average cost per transaction due to product mix, and the decrease in total transactional revenue.

Communication expenses decreased \$221,000 or 18%, to \$1,023,000 from \$1,244,000 in the third quarter of fiscal year 2010 compared to the third quarter of fiscal year 2009. The decrease is due to the Company beginning to reduce some of its older communications services now that newer, faster and more stable services have been implemented as a result of the merger. Occupancy costs increased \$237,000, or 25%, to \$1,191,000 from \$954,000 in the third quarter of fiscal year 2010 compared to the third quarter of fiscal year 2009 due to the write off of a deferred rental expense as a result of the cancellation of an office lease in 2009 by the Company.

Professional fees increased \$215,000, or 39%, to \$763,000 from \$548,000 in the third quarter of fiscal year 2010 compared to the third quarter of fiscal year 2009. The increase in professional fees is primarily a result of higher legal costs associated with the defense of arbitrations in fiscal year 2010 that were not incurred in the third quarter of fiscal year 2009.

Interest expense increased \$167,000, or 7%, to \$459,000 from \$292,000 in the third quarter of fiscal year 2010 compared to the third quarter of fiscal year 2009. The increase in interest expense is attributable to the fair value of warrants issued in June 2010 to two lenders in consideration of waiving certain covenants and extending the terms of a note. Included in interest expense is the amortization of deferred financing costs of \$11,000 and \$13,000 the third quarter of fiscal years 2010 and 2009, respectively. Taxes, licenses and registration increased \$29,000, or 7%, to \$443,000 from \$414,000 in the second quarter of fiscal year 2010 compared to the second quarter of fiscal year 2009. The increase in taxes, licenses and registration is due to a general increase in fees paid to regulators and other governmental agencies. Other administrative expenses increased \$307,000 or 81% to \$684,000 from \$377,000 in the third quarter of fiscal year 2010 compared to the third quarter of fiscal year 2009. The increase is due to primarily to the addition of new email, email compliance, and continuing education programs to ensure the Company remains in compliance with rules and regulations.

The Company reported a net loss of \$2,031,000 in the third quarter of fiscal year 2010 compared to a net loss of \$868,000 in the third quarter of fiscal year 2009. The net loss attributable to common stockholders in the third quarter of fiscal year 2010 was \$2,134,000, or \$0.12 per common share, as compared to a net loss attributable to common stockholders in the third quarter of fiscal year 2009 of \$964,000, or \$0.06 per common share. The net loss attributable to common stockholders for the third quarter of fiscal year 2010 and 2009 reflects \$103,000 and \$96,000, respectively of cumulative preferred stock dividends on the Company's preferred stock.

Nine Months Ended June 30, 2010 Compared to Nine Months Ended June 30, 2009

The Company's first nine months of fiscal year 2010 resulted in an increase in revenues, with a lower increase in expenses compared to the same period last year. As a result, the Company reported a net loss of \$3,736,000 compared with a net loss of \$3,938,000 for the first nine months of fiscal years 2010 and 2009, respectively.

	Nine Months Ended		Increase (Decrease)	
	2010	2009	Amount	Percent
Commissions	\$ 57,346,000	\$ 53,168,000	\$ 4,178,000	8 %
Net dealer inventory gains	11,199,000	16,157,000	(4,958,000)	-31 %
Investment banking	4,095,000	2,046,000	2,049,000	100 %
Interest and dividends	1,856,000	1,285,000	571,000	44 %
Transfer fees and clearance services	6,672,000	6,997,000	(325,000)	-5 %
Other	4,534,000	3,783,000	751,000	20 %
	\$ 85,702,000	\$ 83,436,000	\$ 2,266,000	3 %

Total revenues increased \$2,266,000, or 3%, in the first nine months of fiscal year 2010 to \$85,702,000 from \$83,436,000 in the first nine months of fiscal year 2010. The increase in revenues is primarily due to slightly more favorable market conditions in the first nine months of the year over all with an emphasis on retail brokerage and investment banking offset by a decrease in trading revenue. Commission revenue increased \$4,178,000, or 8%, to \$57,346,000 from \$53,168,000 during the first nine months of fiscal year 2010 compared with the same period in fiscal year 2009, which is attributable to generally more favorable market conditions for the nine months ended. Net dealer inventory gains, which includes profits on proprietary trading, market making activities and customer mark-ups and mark-downs, decreased \$4,958,000, or 31%, to \$11,199,000 from \$16,157,000 during the first nine months of fiscal year 2010 compared with the same period in fiscal year 2009. The decrease is primarily due to less favorable trading conditions affecting nearly all products within our trading activities in the third quarter of fiscal year 2010 as compared to the same quarters in 2009.

Investment banking revenue increased \$2,049,000, or 100% to \$4,095,000 from \$2,046,000 during the first nine months of 2010 compared to the same period in fiscal year 2009. This increase was attributable to substantially better market conditions for investment banking activity resulting in greater success, advisory and consulting fees for services provided during the nine month period. Interest and dividend income increased by \$571,000 or 44%, to \$1,856,000 from \$1,285,000 in the first nine months of fiscal year 2010 compared with the same period in fiscal year 2009. The increase in interest income is attributable to somewhat higher customer margin account balances and higher customer free cash balances as well as more favorable credit terms from our primary clearing firm. Transfer fees decreased \$325,000 or 5%, to \$6,672,000 in the first nine months of fiscal year 2010 from \$6,997,000 in the first nine months of fiscal year 2009. The increase is due primarily to slightly lower transaction volume for the nine month period.

Other revenue, consisting of asset management fees, miscellaneous transaction fees and trading fees and other investment income, increased \$751,000, or 20%, to \$4,534,000 from \$3,783,000 during the first nine months of fiscal year 2010 compared to the first nine months of fiscal year 2009. The increase is due primarily to slightly higher assets under management.

In comparison with the 3% increase in total revenues, total expenses only increased by \$2,064,000 or 2% to \$89,438,000 for the first nine months of fiscal year 2010 compared to \$87,374,000 in the first nine months of fiscal year 2009. This increase was primarily driven by the increase in revenues causing a corresponding increase in commissions, along with higher taxes, license and registration fees and other administrative expenses, offset by a reduction in clearing fees.

	Nine Months Ended		Increase (Decrease)	
	2010	2009	Amount	Percent
Commissions	\$ 66,067,000	\$ 64,526,000	\$ 1,541,000	2 %
Employee compensation	9,063,000	9,029,000	34,000	0 %
Clearing fees	982,000	1,371,000	(389,000)	-28 %
Communications	3,025,000	3,137,000	(112,000)	-4 %
Occupancy and equipment costs	3,859,000	3,786,000	73,000	2 %
Professional fees	2,129,000	1,917,000	212,000	11 %
Interest	1,056,000	925,000	131,000	14 %
Taxes, licenses and registration	1,306,000	1,016,000	290,000	29 %
Other administrative expenses	1,951,000	1,667,000	284,000	17 %
	\$ 89,438,000	\$ 87,374,000	\$ 2,064,000	2 %

Commission expense, which includes expenses related to commission revenue, net dealer inventory gains and investment banking, increased \$1,541,000, or 2%, to \$66,067,000 in the first nine months of fiscal year 2010 from \$64,526,000 in the first nine months of fiscal year 2009. The increase is primarily attributable to an increase in the related commission revenues and a slightly higher average payout percentage due to product mix. Commission expense also includes the amortization of advances to registered representatives of \$1,106,000 and \$1,158,000 for the first nine months of fiscal years 2010 and 2009, respectively. These amounts fluctuate based upon the amounts of advances outstanding and the time period for which the registered representatives have agreed to be affiliated with National Securities.

Employee compensation expense increased \$34,000, or less than 1%, to \$9,063,000 in the first nine months of fiscal year 2010 from \$9,029,000 in the first nine months of fiscal year 2009. Employee compensation includes the amortization of the fair value associated with stock based compensation of \$409,000 and \$678,000 in the first nine months of fiscal years 2010 and 2009, respectively. Overall, combined commission and employee compensation expense, as a percentage of revenue amounted to 88% and 87% in the first nine months of fiscal year 2010 and 2009, respectively.

Clearing fees decreased \$389,000 or 28%, to \$982,000 in the first nine months of fiscal year 2010 from \$1,371,000 in the first nine months of fiscal year 2009. The decrease in clearing fees is primarily due to the write off of a deferred revenue item caused by the termination of National's clearing agreement with NFS resulting in a reduction of clearing costs of \$456,000.

Communication expenses decreased \$112,000 or 4%, to \$3,025,000 from \$3,137,000 in the first nine months of fiscal year 2010 compared to the first nine months of fiscal year 2009. The increase is due to the Company applying much of its IT infrastructure design across all of its locations due to the merger. Occupancy costs increased \$73,000, or 2%, to \$3,859,000 from \$3,786,000 in the first nine months of fiscal year 2010 compared to the first nine months of fiscal year 2009.

Professional fees increased \$212,000 or 11%, to \$2,129,000 from \$1,917,000 in the first nine months of fiscal year 2010 compared to the first nine months of fiscal year 2009. The increase in professional fees is primarily a result of higher legal costs associated with the defense of arbitrations in fiscal year 2010 that were not incurred in the nine months ended June 2009.

Interest expense increased \$131,000, or 14%, to \$1,056,000 from \$925,000 in the first nine months of fiscal year 2010 compared to the first nine months of fiscal year 2009. The increase in interest expense is attributable to the fair value of warrants issued in June 2010 to two lenders in consideration of waiving certain covenants and extending the term of a note offset by the Company renegotiating a lower interest on its note with Christopher Dewey from an interest rate of 10% to 7%. Included in interest expense is the amortization of deferred financing costs of \$22,000 and \$41,000 for the first nine months of fiscal years 2010 and 2009, respectively. Taxes, licenses and registration increased \$290,000, or 29%, to \$1,306,000 from \$1,016,000 in the first nine months of fiscal year 2010 compared to the first nine months of fiscal year 2009. The increase in taxes, licenses and registration is due to a general increase in fees paid to regulators and other governmental agencies. Other administrative expenses increased \$284,000 or 17% to \$1,951,000 from \$1,667,000 in the first nine months of fiscal year 2010 compared to the first nine months of fiscal year 2009 partly due to the Company paying a \$100,000 judgment for a 2004 Securities and Exchange Commission matter that was closed in June 2010.

The Company reported a net loss of \$3,736,000 in the first nine months of fiscal year 2010 compared to a net loss of \$3,938,000 in the first nine months of fiscal year 2009. The net loss attributable to common stockholders in the first nine months of fiscal year 2010 was \$4,127,000, or \$0.24 per common share, as compared to a net loss attributable to common stockholders in the first nine months of fiscal year 2009 of \$4,203,000, or \$0.25 per common share. The net loss attributable to common stockholders for the first nine months of fiscal year 2010 and 2009 reflects \$391,000 and \$265,000, respectively of cumulative preferred stock dividends on the Company's preferred stock.

NON-G.A.A.P. INFORMATION

Management considers EBITDA, as adjusted, an important indicator in evaluating our business on a consistent basis across various periods. Due to the significance of non-recurring items, EBITDA, as adjusted, enables our board of directors and management to monitor and evaluate our business on a consistent basis. We use EBITDA, as adjusted, as a primary measure, among others, to analyze and evaluate financial and strategic planning decisions regarding future operating investments and potential acquisitions. We believe that EBITDA, as adjusted, eliminates items that are not part of our core operations, such as interest expense and amortization expense associated with intangible assets, or do not involve a cash outlay, such as stock-related compensation. EBITDA, as adjusted should be considered in addition to, rather than as a substitute for, pre-tax income, net income and cash flows from operating activities. For the three and nine months ended June 30, 2010, EBITDA, as adjusted, was \$(881,000) and \$(8,000), respectively. For the three and nine months ended June 30, 2009, EBITDA, as adjusted, was \$431,000 and (\$21,000), respectively. This decline in EBITDA, as adjusted of \$1,312,000 in the three months ended June 30, 2010 over the three months ended June 30, 2009 resulted from a slightly higher average cost of commission expense paid out to brokers due to product mix as well as higher occupancy costs, professional fees, taxes, license and registration fees and other administrative expenses. EBITDA, as adjusted for the nine months ended June 30, 2010 over the nine months ended June 30 2009 improved by \$13,000.

The following table presents a reconciliation of EBITDA, as adjusted, to net income as reported.

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2010	2009	2010	2009
Net income (loss), as reported	\$ (2,031,000)	\$ (868,000)	\$ (3,736,000)	\$ (3,938,000)
Interest expense	459,000	291,000	1,056,000	926,000
Taxes	47,000	29,000	132,000	106,000
Depreciation	182,000	189,000	539,000	551,000

Edgar Filing: NATIONAL HOLDINGS CORP - Form 10-Q

Amortization	162,000	162,000	487,000	466,000
EBITDA	(1,181,000)	(197,000)	(1,522,000)	(1,889,000)
Non-cash compensation expense	113,000	237,000	409,000	710,000
Amortization of forgivable loans	187,000	391,000	1,105,000	1,158,000
EBITDA, as adjusted	\$ (881,000)	\$ 431,000	\$ (8,000)	\$ (21,000)

Earnings before interest, taxes, depreciation and amortization, or EBITDA, adjusted for gains or losses on sales of assets, non-cash compensation expense and loss on extinguishment of debt, is a key metric the Company uses in evaluating its business. EBITDA is considered a non-GAAP financial measure as defined by Regulation G promulgated by the SEC under the Securities Act of 1933, as amended.

Liquidity and Capital Resources

Our Broker Dealer Subsidiaries are subject to the SEC's Uniform Net Capital Rule 15c3-1, which is designed to measure the general financial integrity and liquidity of a broker-dealer and requires the maintenance of minimum net capital. Net capital is defined as the net worth of a broker-dealer subject to certain adjustments. In computing net capital, various adjustments are made to net worth that exclude assets not readily convertible into cash. Additionally, the regulations require that certain assets, such as a broker-dealer's position in securities, be valued in a conservative manner so as to avoid over-inflation of the broker-dealer's net capital. National Securities has elected to use the alternative standard method permitted by the rule. This requires that National Securities maintain minimum net capital equal to the greater of \$250,000 or a specified amount per security based on the bid price of each security for which National Securities is a market maker. At June 30, 2010, National Securities' net capital exceeded the requirement by \$320,000. Due to its market maker status, vFinance Investments is required to maintain a minimum net capital of \$1,000,000 and at June 30, 2010, vFinance Investments' net capital exceeded the requirement by \$332,000. EquityStation is required to maintain \$100,000 and at June 30, 2010, EquityStations' net capital exceeded the requirement by \$181,000.

Advances, dividend payments and other equity withdrawals from the Company's subsidiaries are restricted by the regulations of the SEC and other regulatory agencies. These regulatory restrictions may limit the amounts that a subsidiary may dividend or advance to the Company. During the quarter and nine months ended June 30, 2010 the Company did not have any equity withdrawals.

The Company extends unsecured credit in the normal course of business to its brokers. The determination of the appropriate amount of the reserve for uncollectible accounts is based upon a review of the amount of credit extended, the length of time each receivable has been outstanding, and the specific individual brokers from whom the receivables are due. The objective of liquidity management is to ensure that the Company has ready access to sufficient funds to meet its commitments.

Our primary sources of liquidity include our cash flow from operations, the sale of our securities and other financing activities. We believe that we have sufficient funds from operations to fund our ongoing operating requirements through at least fiscal year 2010. If market conditions should weaken, the Company would need to consider curtailing certain of its business activities, reducing its fixed overhead costs and/or seek additional sources of financing.

Cash used in operating activities for the first nine months of fiscal year 2010 amounted to \$2,954,000, which was primarily due to our net loss of \$3,736,000, reduced by non cash adjustments of \$1,005,000 in depreciation and amortization, \$1,186,000 reduction of loans to registered representatives, \$409,000 in stock compensation expense, \$796,000 in amortization of note discount, a decrease in receivables from our clearing firms of \$1,784,000 offset by an increase in our securities owned; marketable at fair value of \$207,000, a decrease in accounts payable and accrued expenses of \$4,429,000 and an increase in other receivables of \$156,000 further contributed to the reduction in cash used in operations.

Cash used in investing activities for the first nine months of fiscal year 2010 amounted to \$341,000, which was due to the need to purchase fixed assets under mostly capital leases. The majority of these capital purchases were for the ongoing upgrade of technology in our Downtown Manhattan office.

Cash provided by financing activities for the first nine months of fiscal year 2010 amounted to \$1,200,000 resulting from the issuance of subordinated borrowings to certain investors and existing board members offset by a repayment of note payable of \$500,000.

Cash used in operations for the nine months ended June 30, 2009 was \$736,000 which was primarily due to our net loss of \$3,938,000, reduced by non cash adjustments of \$1,017,000 in depreciation and amortization and \$678,000 in stock compensation expense. An increase in receivables from our clearing firms of \$651,000, an increase in other receivables of \$333,000, and a decrease of the payable to broker dealers and clearing organizations of \$451,000 further decreased cash but was offset by an increase in accounts payable and accrued expenses of \$1,022,000, a decrease in advances to brokers of \$934,000 and a decrease in long securities owned at market value of \$541,000.

Cash used in investing activities for the first nine months of 2009 amounted to \$598,000, which was primarily due to the need to purchase fixed assets under mostly capital leases due to the move of our vFinance Boca Raton data center into a co-location in Miami, Florida and the move of our Boca Raton office to a new location.

Cash used in financing activities amounted to \$132,000 due in part to the repayment of indebtedness to certain principal stockholders of \$500,000 but was partially offset by a private placement of our securities (net of costs) and securing a subordinated loan which brought in about \$368,000

OFF-BALANCE SHEET ARRANGEMENTS

We do not have any off-balance sheet arrangements that have or are reasonably likely to have a material current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

NEW ACCOUNTING PRONOUNCEMENTS

See Note 3 of Notes to Consolidated Financial Statements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company's primary market risk arises from the fact that it engages in proprietary trading and historically made dealer markets in equity securities. Accordingly, the Company may be required to maintain certain amounts of inventories in order to facilitate customer order flow. The Company may incur losses as a result of price movements in these inventories due to changes in interest rates, foreign exchange rates, equity prices and other political factors. The Company is not subject to direct market risk due to changes in foreign exchange rates. However, the Company is subject to market risk as a result of changes in interest rates and equity prices, which are affected by global economic conditions. The Company manages its exposure to market risk by limiting its net long or short positions. Trading and inventory accounts are monitored daily by management and the Company has instituted position limits.

Credit risk represents the amount of accounting loss the Company could incur if counterparties to its proprietary transactions fail to perform and the value of any collateral proves inadequate. Although credit risk relating to various financing activities is reduced by the industry practice of obtaining and maintaining collateral, the Company maintains more stringent requirements to further reduce its exposure. The Company monitors its exposure to counterparty risk on a daily basis by using credit exposure information and monitoring collateral values. The Company maintains a credit committee, which reviews margin requirements for large or concentrated accounts and sets higher requirements or requires a reduction of either the level of margin debt or investment in high-risk securities or, in some cases, requiring the transfer of the account to another broker-dealer.

The Company monitors its market and credit risks daily through internal control procedures designed to identify and evaluate the various risks to which the Company is exposed. There can be no assurance, however, that the Company's risk management procedures and internal controls will prevent losses from occurring as a result of such risks.

The following table shows the quoted market values of marketable securities owned ("long") by the Company, securities sold but not yet purchased ("short") the Company, and net positions as of June 30, 2010:

	Long	Short	Net
Corporate stocks	\$ 109,000	\$ 162,000	\$ (53,000)
Corporate bonds	5,000	-	5,000
Government obligations	680,000	-	680,000
Non-marketable securities	75,000	1,000	74,000
	\$ 869,000	\$ 163,000	\$ 706,000

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of disclosure controls and procedures.

Disclosure controls and procedures are our controls and other procedures that are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure and control procedures are also designed to ensure that such information is accumulated and communicated to management, including the chief executive officer and principal accounting officer, to allow timely decisions regarding required disclosures. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act, is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding disclosure.

Based on the evaluation of the Company's disclosure controls and procedures (as defined in the Exchange Act Rules 13a-15(e) and 15d-15(e)) required by the Exchange Act Rules 13a-15(b) or 15d-15(b), the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures were not effective in light of the identification of a material weakness in the Company's internal controls over financial reporting as discussed and reported in the Company's Form 8-K filed June 10, 2010

Changes in internal controls.

We have continually had in place systems relating to internal control over financial reporting. There were no significant changes in the Company's internal controls over financial reporting or in other factors during the last fiscal quarter to which this Quarterly Report on Form 10-Q relates that could significantly affect those controls and procedures subsequent to the date of our evaluation nor any significant deficiencies or material weaknesses in such internal controls and procedures requiring corrective actions.

We have taken steps to remediate the weaknesses in our internal control discovered as a result of our accounting review which led to the correction of certain errors and believe that such weaknesses in internal control for the quarterly periods as of June 30, 2009 have been fully remediated. We are in the process of hiring a third-party consultant who specializes in compliance with SOX and FINRA Net Capital requirements to ensure that controls and procedures are in place.

PART II – OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In early 2009, Vincent Falco commenced a FINRA arbitration against National Securities and two of its representatives. Claimant alleged that National Securities and the registered representatives purchased unsuitable securities, failed to follow instructions regarding the use of margin, made misrepresentations of material fact and/or omitted material facts in connection with the purchase of securities, managed the account negligently, breached their contract with Mr. Falco, breached fiduciaries duties owed to him, and violated FINRA Conduct Rules. Claimant further alleged that National Securities negligently supervised the account. Claimant sought compensatory damages from all respondents in the amount of \$3,000,000, punitive damages of \$9,000,000, plus disgorgement of fees, attorneys' fees, forum fees, costs and interest, all in undisclosed amounts. The Company and Mr. Falco entered into a settlement agreement in February 2010 under which Mr. Falco was to receive \$900,000 plus the issuance of 125,000 shares of the Company's restricted common stock. The Company's insurer paid the \$900,000 to Mr. Falco, the Company issued the shares, and the case was dismissed with prejudice.

In April 2010, Triage Partners, LLC, ("Triage") a preferred stockholder of the Company and an affiliate of Steven B. Sands and Martin S. Sands, former Co-Chairmen and directors of the Company, filed an action in the Supreme Court of the New York, New York County, Index # 601114/10, for a declaratory judgment. Triage seeks a declaration that the Company's 2008 merger with vFinance, Inc. was a Liquidity Event as defined in the Company's Certificate of Designations, Rights and Preferences of its Series A Preferred Stock, and payment in the amount of \$1,070,700, plus accumulated dividends as of July 1, 2008, plus interest, allowable costs and other damages. The Company moved to dismiss this claim, and briefing on this motion continues. The Company intends to defend itself vigorously in this action and believes that the eventual outcome of this matter will not have a materially adverse effect on the Company. However, the ultimate outcome of this matter cannot be determined at this time.

Other than those events described above, during the quarter ended June 30, 2010, there were no significant developments in the Company's legal proceedings. For a detailed discussion of the Company's legal proceedings, please refer to Note 13 herein, and the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2009.

ITEM 1A. RISK FACTORS

On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") into law. The Dodd-Frank Act makes extensive changes to the laws regulating financial services firms and requires significant rule-making. In addition, the legislation mandates multiple studies, which could result in additional legislative or regulatory action. While the full effects of the Dodd-Frank Act on the Company cannot yet be determined, this legislation is generally perceived as negatively impacting the financial services industry. The Dodd-Frank Act may result in higher compliance and other costs, reduced revenues and higher capital and liquidity requirements, among other things, which could adversely affect the business of the Company, perhaps materially.

Other than stated above, there are no material changes from the risk factors previously disclosed in the Company's Form 10-K for the year ended September 30, 2009.

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

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. (REMOVED AND RESERVED)

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

- 4.9 Form of Convertible Note.
- 10.38 Note Purchase Agreement, dated as of June 4, 2010, by and among the Company and the Investors signatory thereto.
- 10.39 Right of First Refusal Agreement, dated as of June 7, 2010, by and between the Company and Frank Plimpton.
- 10.40 Amendment No. 4 to Forbearance and Warrant Modification Agreement, dated as of June 4, 2010, by and between the Company and Christopher C. Dewey.
- 31.1 Chief Executive Officer's Certificate pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Chief Financial Officer's Certificate pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Chief Executive Officer's Certificate pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Chief Financial Officer's Certificate pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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.

NATIONAL HOLDINGS CORPORATION AND SUBSIDIARIES

August 16, 2010

By: /s/ Mark Goldwasser
Mark Goldwasser
Chief Executive Officer

August 16, 2010

By: /s/ Alan B. Levin
Alan B. Levin
Chief Financial Officer

38
condensed combined statements of operations to conform the presentation.

Assumptions relating to the pro forma adjustments set forth in the unaudited pro forma consolidated condensed combined financial statements are summarized as follows:

Estimated fair values for the assets and liabilities of Twin Oaks were obtained as follows:

Cash and Cash Equivalents. The carrying amounts of cash and cash equivalents approximate their fair value.

Investment and Mortgage-Backed Securities. Securities classified as available for sale are recorded at fair value on a recurring basis using pricing obtained from an independent pricing service. Where quoted market prices are available in an active market such pricing is used. If quoted market prices are not available, the pricing service estimates the fair values by using pricing models or quoted prices of securities with similar characteristics. For these securities, the inputs used by the pricing service to determine fair value consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and bonds' terms and conditions.

Stock in Federal Home Loan Bank and Other Restricted Equity Securities. No ready market exists for these stocks and they have no quoted market value; however, redemption of these stocks has historically been at par value. Accordingly, the carrying amount is deemed to be a reasonable estimate of fair value.

Loans. Fair values for loans held for investment and other loans are estimated by segregating the portfolio by type of loan and discounting scheduled cash flows using interest rates currently being offered for loans with similar terms. A prepayment assumption is used as an estimate of the portion of loans that will be repaid prior to their scheduled maturity. The allowance for loan losses as recorded is deemed to be a reasonable estimate of the credit adjustment.

Office Properties and Equipment. The fair value of office properties is estimated based on an independent appraisal. The book value of equipment is deemed to be a reasonable estimate of fair value.

Deposits. The fair values disclosed for demand deposits (*e.g.*, interest and noninterest checking, passbook savings and market accounts) are, by definition, equal to the amount payable on demand at the reporting date (*i.e.*, their carrying amounts). Fair values for fixed-rate certificate accounts are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on certificate accounts.

Other Assets and Other Liabilities. Because these financial instruments will typically be received or paid within three months, the carrying amounts of such instruments are deemed to be a reasonable estimate of fair value. The discount on investments will be accreted to interest income over five years so as to approximate the interest method; the premium on loans will be amortized to interest income over three to ten years so as to approximate a constant yield to maturity. The fair market value adjustment for deposits will be accreted to interest expense over three years so as to approximate a constant yield to maturity. The decrease in premises to fair value will be accreted over a one-year period as a reduction to expense.

B. Acquisition Accounting Adjustments

Acquisition accounting adjustments are estimated as follows (in thousands)

Fair value adjustment on loans:	
Decrease in value of loans relative to historical cost	\$(1,445)
Elimination of Twin Oaks' allowance for loan and lease loss	1,520
Increase in value of loans (net)	75
Core deposit intangible recorded	422
Increase liability for term deposits	(265)
Increase liability for FHLB advances	(63)
Deferred tax liability	(64)
Total	105
Equity of Twin Oaks	6,845
Total value of net assets acquired	\$6,950

C. Calculation of Goodwill

Excess of cost over the fair value of net assets acquired for the merger was calculated as follows (in thousands):

Cost	\$6,500
Anticipated costs after filing ⁽¹⁾	429
Fair value of net assets acquired	(6,950)
Goodwill (bargain purchase price)	\$(21)

Twin Oaks
 anticipated
 costs not
 (1)included
 above are
 estimated
 as follows:

Electronic data processing conversion and termination expenses	\$612
Termination of Directors Retirement Plan	80
Pre-tax expenses	692
Tax benefit of expenses based on a 38% combined state and federal tax rate	(263)
After tax impact of transaction to Twin Oaks	\$429

These anticipated costs between the date of the filing and the anticipated closing date will reduce the capital position.

D. Pro Forma Income Statement Adjustments

Pro forma income statement adjustments that were calculated for the merger are as follows (in thousands):

	For the Year Ended December 31, 2013	For the Six Months Ended June 30, 2014
	Income (Expense)	Income (Expense)
Amortization of premium on loans receivable	\$ (38)	\$ (20)
Accretion of fair value adjustment for term deposits	141	88
Accretion of fair value adjustment for FHLB advances	51	35
Amortization of core deposit intangible	(100)	(50)
Income tax expense	(21)	(20)
	\$ 33	\$ 33

	Net Increase (Decrease) In Net Income of Amortized Amounts
Future impact of recognition of acquisition accounting adjustments:	
Fiscal 2015	\$ 11
Fiscal 2016	(13)
Fiscal 2017	(31)
Fiscal 2018	(35)
Fiscal 2019	(32)
Fiscal 2020 and thereafter	(98)

E. Transfer of Capital

Amounts release from retained earnings and accumulated other comprehensive income represent the recognized value of Twin Oaks.

F. Issuance of Shares to Ottawa Savings Bancorp MHC

Based on the stock valuation of Ottawa Savings Bancorp common stock equal to \$9.00 per share, the issuance of 722,223 shares of common stock to Ottawa Savings Bancorp MHC is reflected by an increase of \$6,493 to additional paid-in capital and \$7 to common stock.

Twin Oaks Savings Bank Management's Discussion and Analysis of Financial Condition and Results of Operations

General

Twin Oaks Savings Bank is a community and customer-oriented savings bank. Twin Oaks' business has historically consisted of attracting deposits from the general public and using those funds to originate and purchase one-to-four family, multi-family and non-residential real estate, construction, commercial and consumer loans, which Twin Oaks primarily holds for investment. The Bank has continually diversified its products to meet the needs of the community.

Comparison of Financial Condition at June 30, 2014 and March 31, 2014

Twin Oaks' total assets decreased \$1.2 million, or 1.8%, to \$66.7 million at June 30, 2014, from \$67.9 million at March 31, 2014. The decrease in assets was primarily due to a decrease in securities available for sale of \$2.4 million, a decline in federal funds sold of \$0.4 million and a decline in investment certificates of deposit of \$0.3 million. The decrease in assets was partially offset by an increase in cash and cash equivalents of \$1.7 million and an increase in other assets of \$0.4 million.

Cash and cash equivalents increased \$1.7 million, or 85.0%, to \$3.7 million at June 30, 2014 from \$2.0 million at March 31, 2014, primarily as a result of cash used in financing activities related to a decrease in investment, to have sufficient cash on hand to cover deposit withdrawals and on-going merger related expenses and to prepare for the repayment of the \$1 million FHLB advance on July 9, 2014.

Federal funds sold decreased \$0.4 million, or 100.0%, to \$0 million at June 30, 2014 from \$0.4 million at March 31, 2014, primarily as a result of the timing of cash flows from the security sales discussed below and at which correspondent bank the cash was at for quarter end.

Securities available for sale decreased \$2.4 million or 7.8% to \$28.2 million at June 30, 2014 as compared to \$30.6 million at March 31, 2014 due to principal pay downs on the MBS portfolio and the sale of 8 investments with a market value of approximately \$1.56 million. On June 2, 2014, a municipal bond with a \$200,000 market value was

called.

Loans, net of the allowance for loan losses, was stable between the periods as it was \$30.3 million at June 30, 2014 from \$30.1 million at March 31, 2014.

Other assets comprised primarily of deferred taxes, deferred director compensation accounts, and cash value of life insurance policies, increased \$0.1 million as the balance as of June 30, 2014 was \$1.0 million as compared to \$0.9 million on March 31, 2014. The increase is related to the increase related to the loss for the three months ended June 30, 2014 that increased the deferred taxes, specifically the income tax receivable.

Total deposits decreased \$1.8 million, or 3.3%, to \$53.6 million at June 30, 2014, from \$55.4 million at March 31, 2014. The decrease is primarily due to a decrease in certificates of deposit of \$1.9 million, or 7.7%. The reduction in certificate of deposit accounts is due to management's strategic initiative to pay competitive rates, but not the highest rates in the market and customers moving their funds into other non-banking investments. The Federal Home Loan Bank Advances remained constant at \$5.2 million at June 30, 2014 and March 31, 2014.

Equity increased \$0.1 million, or 7.3%, to \$6.8 million at June 30, 2014, from \$6.7 million at March 31, 2014. The increase in equity is primarily a result of the increase in other comprehensive income of almost \$0.2 million offset by the \$0.1 million decrease in retained earnings due to the net loss recorded for the three months ended June 30, 2014 of approximately \$42,000.

The ongoing state of economic uncertainty continues to affect asset quality. We continue to experience a decline in the market values of homes in our market area in general and also on specific properties held as collateral. In addition, higher unemployment locally continues to affect some of our borrowers' ability to timely repay their obligations to Twin Oaks. These conditions have resulted in nonperforming loans totaling 5.9% of total loan receivables as of June 30, 2014, up from 2.1% at March 31, 2014.

Comparison of Results of Operation for the Twelve Months Ended June 30, 2014 and 2013

General. Net loss for the three months ended June 30, 2014 was \$42,000 compared to net income of \$27,000 for the three months ended June 30, 2013. A net loss occurred during 2014 due to the elevated level other expenses related to merger costs expensed during the period.

Net interest income increased \$62,000, or 16.0%, to \$450,000 for the three months ended June 30, 2014 compared to \$388,000 for the period ended June 30, 2013. Interest income increased \$36,000 or 6.6% due to improved yield in the securities and mortgage-backed securities portfolios. The decline in the loan portfolios and pressure on the yield on the loan portfolio contributed to a decline in interest income from the loan portfolio. The yield on the loan portfolio declined as the low rate environment continued during 2014 as well as an increase in non-accruing assets. This increase in interest income was augmented by a \$27,000, or 17.3%, reduction in interest expense. Additionally, the balance of interest bearing liabilities declined by \$1.5 million.

Provision for Loan Losses. Management recorded a loan loss provision of \$53,000 for the three months ended June 30, 2014, compared to (\$10,000) for the period ended June 30, 2013. The provision is primarily attributed to the reserves required for the one-to-four family segment as the economic conditions in the local market continue to negatively impact collateral values of real estate and the ability of borrowers to keep current per terms of their obligations. The slow payment activity and continued decline of property values are the result of local economic conditions that are improving, but continuing to lag national indicators. Based on a review of the loans that were in the loan portfolio at June 30, 2014, management believes that the allowance is maintained at a level that represents its best estimate of inherent losses in the loan portfolio that were both probable and reasonably estimable.

Management uses available information to establish the appropriate level of the allowance for loan losses. Future additions or reductions to the allowance may be necessary based on estimates that are susceptible to change as a result of changes in economic conditions and other factors. As a result, our allowance for loan losses may not be sufficient to cover actual loan losses, and future provisions for loan losses could materially adversely affect Twin Oaks' operating results. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Twin Oaks' allowance for loan losses. Such agencies may require Twin Oaks to recognize adjustments to the allowance based on their judgments about information available to them at the time of their examination.

The increase in total other income of \$33,000 was primarily due to the gain on sale of securities which was \$32,000 as compared to \$0 in the same period ended June 30, 2013. All other noninterest income categories were comparable between the periods.

Total noninterest expense increased 43.6% as it was \$0.6 million for the three months ended June 30, 2014 as compared to \$0.4 million for the period ended June 30, 2013. Compensation and benefits declined 5.6% or \$12,000 and occupancy and equipment declined 7.4% or \$4,000. Additionally, data processing costs declined by 24.4% or \$11,000. However, other expense increased 190% or \$213,000 due to merger related expenses (i.e. legal, audit, actuary, valuation, etc.).

Income Taxes. Twin Oaks recorded an income tax benefit of \$82,000 and an expense of \$2,000 for the three months ended June 30, 2014 and 2013, respectively.

Comparison of Financial Condition at March 31, 2014 and March 31, 2013

Twin Oaks' total assets decreased \$5.5 million, or 7.5%, to \$67.9 million at March 31, 2014, from \$73.4 million at March 31, 2013. The decrease in assets was primarily due to a decrease in Federal funds sold of \$2.2 million, a decrease in cash and cash equivalents of \$1.3 million, and a decrease in net loans of \$2.0 million. The decrease in assets was partially offset by an increase in other assets of \$0.6 million.

Cash and cash equivalents decreased \$1.3 million, or 38.8%, to \$2.0 million at March 31, 2014 from \$3.3 million at March 31, 2013, primarily as a result of cash used in financing activities related to a decrease in deposits, which resulted from management strategically pricing deposits based on market conditions, and exceeding the cash provided by operating and investing activities.

Federal funds sold decreased \$2.2 million, or 84.5%, to \$0.4 million at March 31, 2014 from \$2.6 million at March 31, 2013, primarily as a result of cash used in financing activities exceeding the cash provided by operating and investing activities which resulted from management strategically limiting funds in the Bank's low yielding over-night accounts at the Bankers' Bank and Federal Home Loan in order to enhance overall asset yield.

Securities available for sale was unchanged as it was \$30.6 million at March 31, 2014 as compared to \$30.7 million at March 31, 2013.

Loans, net of the allowance for loan losses, decreased \$2.0 million, or 6.2%, to \$30.1 million at March 31, 2014 from \$32.1 million at March 31, 2013. The decrease in loans, net of the allowance for loan losses, was primarily due to normal attrition and pay-downs and principal reductions exceeding the level of originations. Additionally, there were net loan charge-offs during the year of \$409,000.

Other assets comprised primarily of deferred taxes, deferred director compensation accounts, and deposit premium accounts \$0.6 million as the balance as of March 31, 2014 was \$0.9 million as compared to \$0.3 million on March 31, 2013. The increase is related to the deferred taxes from the income tax receivable

Total deposits decreased \$2.8 million, or 4.8%, to \$55.4 million at March 31, 2014, from \$58.2 million at March 31, 2013. The decrease is primarily due to a decrease in certificates of deposit of \$3.5 million, or 12%. The decrease was partially offset by an increase in savings accounts of \$0.9 million, or 4.4%. The reduction in certificate of deposit accounts is due to management's strategic initiative to pay competitive rates, but not the highest rates in the market and customers moving their funds into other non-banking investments. The increase in savings accounts is primarily due to customers moving funds into non-term products as they wait for a better rate environment. Federal Home Loan Bank Advances decreased \$2.0 million to \$5.2 million at March 31, 2014 from \$7.2 million at March 31, 2013 as two \$1 million advances were not renewed when their terms expired, one in April, 2013 and the other in March, 2014.

Equity decreased approximately \$0.5 million, or 7.3%, to \$6.7 million at March 31, 2014, from \$7.2 million at March 31, 2013. The decrease in equity is primarily a result of the net loss recorded for the twelve months ended March 31, 2014 of approximately \$0.3 million and a decrease in other comprehensive income of almost \$0.2 million.

The ongoing state of economic uncertainty continues to affect asset quality. We continue to experience a decline in the market values of homes in our market area in general and also on specific properties held as collateral. In addition, higher unemployment locally continues to affect some of our borrowers' ability to timely repay their obligations to Twin Oaks. These conditions have resulted in nonperforming loans totaling 2.08% of total loan receivables as of March 31, 2014, down slightly from 2.91% at March 31, 2013.

Comparison of Results of Operation for the Twelve Months Ended March 31, 2014 and March 31, 2013

General. Net loss for the twelve months ended March 31, 2014 was \$304,000 compared to net income of \$267,000 for the twelve months ended March 31, 2013. A net loss occurred during 2014 due to the elevated level of provision for loan losses required for the nonperforming loans identified during the period. Additionally, interest income was lower during the year as loan balances were lower and non-accrual loan levels increased.

Net interest income decreased \$241,000, or 13.0%, to \$1.6 million for the twelve months ended March 31, 2014 compared to \$1.9 million for the period ended March 31, 2013. Interest income decreased \$309,000 or 17.4% due to the decline in earning assets of and the yield decreasing on interest earning assets. The decline in the loan portfolios contributed to a significant amount of the decline in earning assets. The yield on the loan portfolio declined as the low rate environment continued during 2014. This decline in interest income was slightly offset by a \$129,000, or 17.5%, reduction in interest expense. The cost of funds declined 13 basis points, or 12.2%, during 2014 as compared to the cost of funds for 2013 as the low rate environment continued. Additionally, the balance of interest bearing liabilities declined by \$4.85 million.

Provision for Loan Losses. Management recorded a loan loss provision of \$874,000 for the twelve months ended March 31, 2014, compared to \$249,000 for the period ended March 31, 2013. The provision is primarily attributed to the reserves required for the one-to-four family segment as the economic conditions in the local market continue to negatively impact collateral values of real estate and the ability of borrowers to keep current per terms of their obligations. The slow payment activity and continued decline of property values are the result of local economic conditions that are improving, but continuing to lag national indicators. Based on a review of the loans that were in the loan portfolio at March 31, 2014, management believes that the allowance is maintained at a level that represents its best estimate of inherent losses in the loan portfolio that were both probable and reasonably estimable.

Management uses available information to establish the appropriate level of the allowance for loan losses. Future additions or reductions to the allowance may be necessary based on estimates that are susceptible to change as a result of changes in economic conditions and other factors. As a result, our allowance for loan losses may not be sufficient to cover actual loan losses, and future provisions for loan losses could materially adversely affect Twin Oaks' operating results. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance for loan losses. Such agencies may require Twin Oaks to recognize adjustments to the allowance based on their judgments about information available to them at the time of their examination.

The decrease in total other income of \$155,000 was primarily due to the decline in volume for loans originated for sale as gains on loans sold declined to \$53,000 as compared to \$204,000 for the period ended March 31, 2013.

Total noninterest expense improved 1.5% as it dropped to \$1.67 million for the twelve months ended March 31, 2014 as compared to \$1.7 million for the period ended March 31, 2013. Compensation and benefits declined 4% or \$35,000 and occupancy and equipment declined 11% or \$23,000. Additionally, other expense improved 4% or \$18,000. These improvements were slightly offset by an increase in data processing costs as they increased 28% or \$51,000.

Income Taxes. Twin Oaks recorded an income tax benefit of \$424,000 and an expense of \$24,000 for the twelve months ended March 31, 2014 and 2013, respectively.

Proposal 2 – Amendment to Our Charter

The second paragraph of Section 5 of the Ottawa Savings Bancorp's current charter provides:

Except for the initial offering of shares of the Holding Company, no shares of capital stock (including shares issuable upon conversion, exchange, or exercise of other securities) shall be issued, directly or indirectly, to officers, directors, or controlling persons of the Holding Company other than as part of a general public offering or as qualifying shares to a director, unless their issuance or the plan under which they would be issued has been approved by a majority of the total votes eligible to be cast at a legal meeting.

This provision is a part of the model charter initially adopted by the Office of Thrift Supervision and currently maintained by the Board of Governors of the Federal Reserve System. It is our understanding that this provision was established to prevent a company and its board and management from unjustly enriching themselves through stock issuances without making simultaneous issuances available to the general public or unless shareholders have previously approved either the stock issuance or the plan under which the stock issuances were contemplated.

In the merger agreement between Ottawa and Twin Oaks, Ottawa Savings Bancorp is required to issue to Ottawa Savings Bancorp MHC a number of additional shares of its common stock equal to the quotient obtained by dividing the appraised value of Twin Oaks by the Ottawa Savings Bancorp common stock market price per share rounded to the nearest whole number of shares, each as determined by an independent appraisal. Notwithstanding that none of the shares to be issued in the merger will be issued to insiders of Ottawa, because Ottawa Savings Bancorp MHC is a controlling person of Ottawa Savings Bancorp, we are required to obtain shareholder approval of the merger agreement, which is the plan under which the shares of stock will be issued. To prevent having to incur the expense of obtaining a shareholder vote in connection with future similarly-structured transactions, if any, the Board of Directors is proposing to amend this charter provision to exclude future stock issuances made solely to Ottawa Savings Bancorp MHC.

To effect this change, the Board of Directors is proposing to amend the second paragraph of Section 5 of the charter to read as follows (changes underlined):

Except for the initial offering of shares of the Holding Company, no shares of capital stock (including shares issuable upon conversion, exchange, or exercise of other securities) shall be issued, directly or indirectly, to officers, directors, or controlling persons of the Holding Company (other than to Ottawa Savings Bancorp MHC) other than as part of a general public offering or as qualifying shares to a director, unless their issuance or the plan under which they would be issued has been approved by a majority of the total votes eligible to be cast at a legal meeting.

The Board of Directors has unanimously approved and recommends to the shareholders the amendment to permit future issuances of our common stock to Ottawa Savings Bancorp MHC without requiring a shareholder vote. The Board of Directors believes that this proposal is in the best interest of the Company and its shareholders and recommends a vote “**FOR**” the proposed amendment.

Proposal 3 - Election of Directors

Ottawa Savings Bancorp’s Board of Directors consists of six members, all of whom are independent under the current listing standards of the Nasdaq Stock Market, except for Mr. Kranov, who is the Company’s and the Bank’s President and Chief Executive Officer. In determining the independence of its directors, the Board considered transactions, relationships or arrangements between the Company, the Bank and its directors that are not required to be disclosed in this proxy statement under the heading “*Transactions with Related Persons.*” The Board is divided into three classes with three-year staggered terms, with one-third of the directors elected each year. Two directors will be elected at the annual meeting to serve for a three-year term, or until their respective successors have been elected and qualified. The Board of Directors’ nominees for election to each serve a three year term is John M. Armstrong and Jon Kranov.

Unless you indicate on the proxy card that your shares should not be voted for the nominees, the Board of Directors intends that the proxies solicited by it will be voted for the election of the Board's nominees. If the nominees are unable to serve, the persons named in the proxy card will vote your shares to approve the election of any substitute proposed by the Board of Directors. Alternatively, the Board of Directors may adopt a resolution to reduce the size of the Board. At this time, the Board of Directors knows of no reason why any nominees might be unable to serve.

The Board of Directors recommends a vote "FOR" the election of John M. Armstrong and

Jon Kranov.

Information regarding the Board of Directors' nominees for election at the annual meeting is provided below. Unless otherwise stated, each director has held his current occupation for the last five years. The age indicated for each individual is as of December 31, 2013. There are no family relationships among the directors or executive officers. The indicated period of service as a director includes service as a director of the Bank.

Nominees for Election of Directors:

John M. Armstrong is a Principal at Armstrong & Associates, a registered investment advisory firm, in Ottawa, Illinois. Age 57. Director since 2012. As a Certified Public Accountant and Certified Financial Planner, Mr. Armstrong provides the Board of Directors with experience regarding accounting and financial matters. Additionally, as a lifelong resident of Ottawa, Mr. Armstrong has been actively involved in various community organizations, having served on the Board of the Ottawa Elementary School and the Illinois Valley Fine Arts Trust and as a committee member with the United Way.

Jon Kranov has been employed with Ottawa Savings Bank since 1978 and has served as President of Ottawa Savings Bank, Ottawa Savings Bancorp and Ottawa Savings Bancorp MHC since May 2010. He is currently the Chairman of the Bank's Board of Directors and attends all committee meetings of the Board of Directors in his capacity as such. Mr. Kranov served as the Senior Vice President and Chief Financial Officer of the Bank from 1996 until May 2010 and 1996 until December 2011, respectively. He served in the positions of Senior Vice President and Chief Financial Officer of Ottawa Savings Bancorp and Ottawa Savings Bancorp MHC from 2005 until May 2010 and 2005 until December 2010, respectively. Age 59. Director since May 2010.

Mr. Kranov's involvement in the Bank's and Company's local community affords the Board valuable insight regarding the business and operation of the Bank and the Company. Mr. Kranov's experience as Chief Financial Officer and knowledge of the various financial and accounting issues facing public companies in the banking sector, as well as his long history with the Bank and the Company, position him well as our President and Chief Executive Officer. Mr.

Kranov has an undergraduate degree in Accountancy from Western Illinois University and has received a Masters Degree from Lewis University.

Directors Continuing in Office:

The following directors have terms ending in 2015:

Arthur C. Mueller is the President of Mueller Funeral Homes, Inc. Age 60. Director since 1987. As a life-long and 6th generation resident of LaSalle County, Mr. Mueller has been actively involved in various community organizations, having served on the Board of Ottawa Regional Hospital and Healthcare Center and the Chamber of Commerce and as a member of Rotary International. With five funeral home locations in LaSalle County, Mr. Mueller has extensive ties to the Bank's and the Company's market area, as well as valuable leadership experience that he brings to the Board of Directors.

Daniel J. Reynolds is the co-owner of H.R. Imaging, Inc., a photography business in Ottawa, Illinois. Age 67. Director since 2003. As a life-long resident of Ottawa, Illinois who is actively involved in various community organizations, Mr. Reynolds has in-depth knowledge of the Bank's and the Company's market area. Additionally, Mr. Reynolds involvement in real estate development has given him knowledge of the local real estate industry, and his experience as a small business owner has given him organizational understanding and management expertise that he brings to the Board of Directors.

The following directors have terms ending in 2016:

James A. Ferrero retired from LaSalle County Housing Authority as of December 31, 2005. He is the owner and president of a package store in Ottawa, Illinois. Age 64. Director since 2000. As a life-long resident of Ottawa, Illinois who is actively involved in various community organizations, like the Chamber of Commerce, Mr. Ferrero has developed extensive ties to the market area in which the Bank and Company operate. Additionally, Mr. Ferrero's education in finance and experience as a small business owner have provided him with financial experience and expertise that is valuable to the Board of Directors.

Keith F. Johnson is the co-owner of Johnson Pattern and Machine Co. in Ottawa, Illinois. Age 60. Director since 2001. As a lifelong resident of Ottawa, Illinois who is actively involved in various community organizations, Mr. Johnson has in-depth knowledge of the market area in which the Bank and Company operate. Mr. Johnson's service as an elected Commissioner of our local government has provided him with leadership and managerial skills, which are valuable to the Board of Directors.

Executive Officers who are not also Directors:

Below is information regarding our officers who are not also directors. Each officer has held his current position for at least the last five years, unless otherwise stated. Ages presented are as of December 31, 2013.

Philip Devermann has served as the Vice President of Ottawa Savings Bank since 1996. Mr. Devermann has served as the Vice President of Ottawa Savings Bancorp and Ottawa Savings Bancorp MHC since 2005. He has been employed with Ottawa Savings Bank since 1979. Mr. Devermann has an undergraduate degree in Finance from Eastern Illinois University. Age 63.

Marc N. Kingry has served as the Chief Financial Officer of Ottawa Savings Bank, Ottawa Savings Bancorp and Ottawa Savings Bancorp MHC since December 2010. Prior to 2010, Mr. Kingry was Senior Vice President and

Controller at a bank in Ottawa, Illinois since 2002. Mr. Kingry has an undergraduate degree in accountancy and has received a Masters Degree in Accounting from Illinois State University. He is a licensed Certified Public Accountant. Age 51.

Proposal 4 - Ratification of Independent Registered Public Accounting Firm

The Audit Committee of the Board of Directors has appointed McGladrey LLP to be the Company's independent registered public accounting firm for the 2014 fiscal year, subject to ratification by shareholders. A representative of McGladrey LLP is expected to be present at the annual meeting to respond to appropriate questions from shareholders and will have the opportunity to make a statement should he or she desire to do so.

If the ratification of the appointment of the auditors is not approved by a majority of the shares represented at the meeting and entitled to vote, the Audit Committee will consider other independent registered public accounting firms.

The Board of Directors recommends a vote “FOR” the ratification of the appointment of McGladrey LLP as the Company’s independent registered public accounting firm.

Audit and Non-Audit Fees

The following table sets forth the fees billed to the Company for the fiscal years ending December 31, 2013 and December 31, 2012 for services provided by McGladrey LLP.

	2013	2012
Audit Fees (1)	\$ 113,800	\$ 108,500
Audit-Related Fees	—	—
Tax Fees (2)	11,600	11,995
All Other Fees	—	—

(1) For 2012 and 2013, includes fees for performance of the audit, review of financial statements for public filings and attendance at the annual meeting.

(2) For 2012 and 2013, represents fees for preparation of federal and state consolidated tax returns, claims for refunds and tax payment-planning services for tax compliance, tax planning and tax advice.

Pre-Approval of Services by the Independent Registered Public Accounting Firm

The Audit Committee is responsible for appointing, setting compensation and overseeing the work of the independent registered public accounting firm. In accordance with its charter, the Audit Committee approves, in advance, all audit and permissible non-audit services to be performed by the independent registered public accounting firm. Such approval process ensures that the independent registered public accounting firm does not provide any non-audit services to the Company that are prohibited by law or regulation.

In addition, the Audit Committee has established a policy regarding pre-approval of all audit and permissible non-audit services provided by the independent registered public accounting firm. Requests for services by the independent registered public accounting firm for compliance with the auditor services policy must be specific as to

the particular services to be provided. The request may be made with respect to either specific services or a type of service for predictable or recurring services.

Any proposed specific engagement may be presented to the Audit Committee for consideration at its next regular meeting or, if earlier consideration is required, to the Audit Committee or one or more of its members. The member or members to whom such authority is delegated shall report any specific approval of services at the next regular meeting of the Audit Committee. The Audit Committee will regularly review summary reports detailing all services being provided to the Company by its independent registered public accounting firm.

During the year ended December 31, 2013, all services were approved, in advance, by the Audit Committee in compliance with these procedures.

Audit Committee Report

The Company's management is responsible for the Company's internal control over financial reporting. The independent registered public accounting firm is responsible for performing an independent audit of the Company's consolidated financial statements and issuing an opinion on the conformity of those financial statements with generally accepted accounting principles. The Audit Committee oversees the Company's internal control over financial reporting on behalf of the Board of Directors.

In this context, the Audit Committee has met and held discussions with management and the independent registered public accounting firm. Management represented to the Audit Committee that the Company's consolidated financial statements were prepared in accordance with generally accepted accounting principles, and the Audit Committee has reviewed and discussed the consolidated financial statements with management and the independent registered public accounting firm. The Audit Committee discussed with the independent registered public accounting firm all communications required by generally accepted accounting standards.

In addition, the Audit Committee has received the written disclosures and the letter from the independent registered public accounting firm required by the applicable requirements of the Public Company Accounting Oversight Board and has discussed with the independent registered public accounting firm the accounting firm's independence from the Company and its management. In concluding that the accounting firm is independent, the Audit Committee considered, among other factors, whether the non-audit services provided by the independent registered public accounting firm were compatible with their independence.

The Audit Committee discussed with the Company's independent registered public accounting firm the overall scope and plans for their audit. The Audit Committee meets with the independent registered public accounting firm, with and without management present, to discuss the results of their examination, their evaluation of the Company's internal control over financial reporting, and the overall quality of the Company's financial reporting process.

In performing all of these functions, the Audit Committee acts only in an oversight capacity. In its oversight role, the Audit Committee relies on the work and assurances of the Company's management, which has the primary responsibility for financial statements and reports, and of the independent registered public accounting firm who, in its report, expresses an opinion on the conformity of the Company's financial statements to generally accepted accounting principles. The Audit Committee's oversight does not provide it with an independent basis to determine that management has maintained appropriate accounting and financial reporting principles or policies, or appropriate internal controls and procedures designed to assure compliance with accounting standards and applicable laws and regulations. Furthermore, the Audit Committee's considerations and discussions with management and the independent registered public accounting firm do not assure that the Company's financial statements are presented in accordance with generally accepted accounting principles, that the audit of the Company's consolidated financial statements has been carried out in accordance with the standards of the Public Company Accounting Oversight Board or that the Company's independent registered public accounting firm is in fact "independent."

In reliance on the reviews and discussions referred to above, the Audit Committee recommended to the Board of Directors, and the Board has approved, that the audited consolidated financial statements be included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013 for filing with the Securities and Exchange Commission. The Audit Committee has appointed, subject to shareholder ratification, the selection of the Company's independent registered public accounting firm for the fiscal year ended December 31, 2014.

AUDIT COMMITTEE OF THE OTTAWA SAVINGS BANCORP BOARD OF DIRECTORS

James A. Ferrero (Chairman)

John M. Armstrong

Keith Johnson

Arthur C. Mueller

Daniel J. Reynolds

Executive Compensation**Summary Compensation Table**

The following information is furnished for all individuals serving as the principal executive officer of the Company for the two most recently completed fiscal years and the next two most highly compensated executive officers of the Company whose total compensation for each of the 2012 and 2013 fiscal years exceeded \$100,000.

Name and Principal Position	Year	Salary (\$)	Bonus (\$)	Nonequity Incentive Plan Compensation (\$)(1)	All Other Compensation (\$)(2)	Total (\$)
Jon Kranov <i>President and Chief Executive Officer</i>	2013	176,500	—	34,258	40,107	250,865
	2012	166,650	—	31,211	35,235	233,096
Philip Devermann <i>Vice President</i>	2013	124,500	—	18,124	15,753	158,377
	2012	120,848	—	16,998	13,050	150,896
Marc Kingry <i>Chief Financial Officer</i>	2013	101,145	—	16,013	12,417	129,575
	2012	93,425	—	13,143	7,891	114,459

(1) Represents payments made pursuant to the Employee Incentive Compensation Plan. Awards earned during 2013 were paid in March 2014.

Details of the amounts reported in “All Other Compensation” for fiscal 2013 are provided in the table below. All (2) perquisites, which in the aggregate were less than \$10,000 for an individual, are excluded from “All Other Compensation.”

	Mr. Kranov	Mr. Devermann	Mr. Kingry
Board of Director fees	\$ 16,800	\$ —	\$ —
Fair market value of employee stock ownership plan allocation	8,613	5,679	4,999
Fair market value of employer contributions to 401(k) Plan	12,462	8,490	6,857
Dollar value of dividends received on unvested restricted stock awards	105	—	—
Auto allowance	1,095	—	—
Life insurance premiums	1,032	1,584	561

Salary Continuation Agreements

Ottawa Savings Bank has entered into a Salary Continuation Agreement with each of Jon Kranov and Philip B. Devermann. Under the Salary Continuation Agreements, if Mr. Kranov's or Mr. Devermann's employment with Ottawa Savings Bank terminates (1) on or after his 65th birthday; (2) subsequent to a change in control (as defined in each agreement); (3) on account of a disability; or (4) because of death, they will be entitled to receive \$25,258 and \$27,480, respectively, per year for 20 years commencing at the later of age 65 or the date of his termination of employment. The executive may elect, subject to the requirements of Section 409A of the Internal Revenue Code, to receive a lump sum payment that is actuarially equivalent to the normal retirement benefit. If the executive terminates employment before his 65th birthday for reasons other than cause, death or disability, and not subsequent to a change in control, he will receive a reduced benefit, which varies depending on the date of termination. The executive will forfeit his entitlement to all benefits under the Salary Continuation Agreement if his employment with the Bank is terminated for cause as specified in his respective agreement.

Employee Incentive Compensation Plan

The Employee Incentive Compensation Plan (the “EIP”) is an annual, variable compensation program designed to encourage participants to produce results that enable the Bank to reach targeted levels of performance for the fiscal year.

Outstanding Equity Awards at Fiscal Year-End

The following table provides information concerning unexercised options and stock awards that have not vested for each named executive officer outstanding as of December 31, 2013.

Name	Option Awards			Option Exercise Price	Option Expiration Date	Stock Awards	
	Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable	Option Price			Number of Shares or Units of Stock That Have Not Vested	Market Value of Shares or Units of Stock That Have Not Vested (1)
Jon Kranov	18,533	—	—	\$ 12.35	11/21/2016	—	—
	5,232	3,490	(2)	\$ 6.00	11/17/2020	1,398	(2) \$11,883
Philip Devermann	17,443	—	—	\$ 12.35	11/21/2016	—	—
Marc Kingry	5,232	7,851	(3)	\$ 4.25	11/16/2021	3,141	(3) \$26,698

(1) Market value is calculated on the basis of \$8.50 per share, which was the closing sales price for our common stock on December 31, 2013.

(2) Stock options and stock awards granted pursuant to the 2006 Equity Incentive Plan vest in five approximately equal installments commencing on November 17, 2011.

(3) Stock options and stock awards granted pursuant to the 2006 Equity Incentive Plan vest in five approximately equal installments commencing on November 19, 2012.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934, as amended, requires the Company's executive officers and directors, and persons who own more than 10% of any registered class of the Company's equity securities, to file reports of ownership and changes in ownership with the Securities and Exchange Commission. Executive officers, directors and greater than 10% shareholders are required by regulation to furnish the Company with copies of all Section 16(a) reports they file.

Based solely on its review of the copies of the reports it has received and written representations provided to the Company from the individuals required to file the reports, the Company believes that each of its executive officers and directors has complied with applicable reporting requirements for transactions in Ottawa Savings Bancorp common stock during the year ended December 31, 2013.

Policies and Procedures for Approval of Related Persons Transactions

We maintain a Policy and Procedures Governing Related Person Transactions, which is a written policy and set of procedures for the review and approval or ratification of transactions involving related persons. Under the policy, related persons consist of directors, director nominees, executive officers, persons or entities known to us to be the beneficial owner of more than five percent of any outstanding class of the voting securities of the Company, or immediate family members or certain affiliated entities of any of the foregoing persons.

Transactions covered by the policy consist of any financial transaction, arrangement or relationship or series of similar transactions, arrangements or relationships, in which:

the aggregate amount involved will or may be expected to exceed \$25,000 in any calendar year;

the Company is, will, or may be expected to be a participant; and

any related person has or will have a direct or indirect material interest.

The policy excludes certain transactions, including:

any compensation paid to an executive officer of the Company if the Compensation Committee of the Board approved (or recommended that the Board approve) such compensation;

any compensation paid to a director of the Company if the Board or an authorized committee of the Board approved such compensation; and

any transaction with a related person involving consumer and investor financial products and services provided in the ordinary course of the Company's business and on substantially the same terms as those prevailing at the time for comparable services provided to unrelated third parties or to the Company's employees on a broad basis (and, in the case of loans, in compliance with the Sarbanes-Oxley Act of 2002).

Related person transactions will be approved or ratified by the Audit Committee. In determining whether to approve or ratify a related person transaction, the Audit Committee will consider all relevant factors, including:

whether the terms of the proposed transaction are at least as favorable to the Company as those that might be achieved with an unaffiliated third party;

the size of the transaction and the amount of consideration payable to the related person;

the nature of the interest of the related person;

whether the transaction may involve a conflict of interest; and

whether the transaction involves the provision of goods and services to the Company that are available from unaffiliated third parties.

A member of the Audit Committee who has an interest in the transaction will abstain from voting on approval of the transaction, but may, if so requested by the chair of the Audit Committee, participate in some or all of the discussion.

Transactions with Related Persons

The Sarbanes-Oxley Act generally prohibits loans by the Bank to its executive officers and directors. However, the Sarbanes-Oxley Act contains a specific exemption from such prohibition for loans by the Bank to its executive officers and directors in compliance with federal banking regulations. Federal regulations require that all loans or extensions of credit to executive officers and directors of insured institutions must be made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons and must not involve more than the normal risk of repayment or present other unfavorable features. Ottawa Savings Bank is therefore prohibited from making any new loans or extensions of credit to executive officers and directors at different rates or terms than those offered to the general public. Notwithstanding this rule, federal regulations permit the Bank to make loans to executive officers and directors at reduced interest rates if the loan is made under a benefit program generally available to all other employees and does not give preference to any executive officer or director over any other employee.

In accordance with banking regulations, the Board of Directors reviews all loans made to a director or executive officer in an amount that, when aggregated with the amount of all other loans to such person and his or her related interests, exceed the greater of \$25,000 or 5% of Ottawa Savings Bancorp's capital and surplus (up to a maximum of \$500,000) and such loan must be approved in advance by a majority of the disinterested members of the Board of Directors. Additionally, pursuant to the Company's Code of Ethics and Business Conduct, all executive officers and directors of the Company must disclose any existing or emerging conflicts of interest to the President and Chief Executive Officer of the Company. Such potential conflicts of interest include, but are not limited to, the following: (i) the Company conducting business with or competing against an organization in which a family member of an executive officer or director has an ownership or employment interest; and (ii) the ownership of more than 1% of the outstanding securities (or that represents more than 5% of the total assets of the employee and/or family member) of any business entity that does business with or is in competition with the Company.

Shareholder Proposals and Nominations

The Company must receive proposals that shareholders seek to have included in the proxy statement for the Company's next annual meeting no later than _____, 2014. If next year's annual meeting is held on a date more than 30 calendar days from December ____, 2015, a shareholder proposal must be received by a reasonable time before the Company begins to print and mail its proxy solicitation materials. Any shareholder proposals will be subject to the requirements of the proxy rules adopted by the Securities and Exchange Commission.

The Company's Bylaws provide that in order for a shareholder to make nominations for the election of directors or proposals for business to be brought before a meeting of shareholders, a shareholder must deliver written notice of such nominations and/or proposals to the Corporate Secretary not less than 30 days before the date of the meeting; provided that if less than 40 days notice or prior public disclosure of the meeting is given or made to shareholders,

such notice must be delivered not later than the close of the tenth day following the day on which notice of the meeting was mailed to shareholders or such public disclosure was made.

Shareholder Communications

The Company encourages shareholder communications to the Board of Directors and/or individual directors. Shareholders who wish to communicate with the Board of Directors or an individual director should send their communications to the care of Laurie Duffell, Assistant Corporate Secretary, Ottawa Savings Bancorp, 925 LaSalle Street, Ottawa, Illinois 61350. Communications regarding financial or accounting policies should be sent to the attention of the Chairperson of the Audit Committee. All other communications should be sent to the attention of the Chairperson of the Nominating and Corporate Governance Committee.

Miscellaneous

The Company will pay the cost of this proxy solicitation. In addition to the solicitation of proxies by mail, _____, a proxy solicitation firm, will assist the Company in soliciting proxies for the annual meeting. The Company will pay a fee of \$_____ for these services. The Company will reimburse brokerage firms and other custodians, nominees and fiduciaries for reasonable expenses incurred by them in sending proxy materials to the beneficial owners of the Company. In addition to soliciting proxies by mail, directors, officers and regular employees of the Company may solicit proxies personally or by telephone. None of these persons will receive additional compensation for these activities.

If you and others who share your address own your shares in “street name,” your broker or other holder of record may be sending only one annual report and proxy statement to your address. This practice, known as “householding,” is designed to reduce our printing and postage costs. However, if a shareholder residing at such an address wishes to receive a separate annual report or proxy statement in the future, he or she should contact the broker or other holder of record. If you own your shares in “street name” and are receiving multiple copies of our annual report and proxy statement, you can request householding by contacting your broker or other holder of record.

A copy of the Company’s Annual Report on Form 10-K, without exhibits, for the year ended December 31, 2013 is being delivered with this proxy statement.

Index to Twin Oaks Savings Bank Financial Statements

Audited Financial Statements for the Year Ended March 31, 2014

Report of Independent Auditors	F-1
Balance Sheet at March 31, 2014	F-2
Statement of Operations for the Year Ended March 31, 2014	F-3
Statement of Comprehensive Income for the Year Ended March 31, 2014	F-4
Statement of Members’ Equity for the Year Ended March 31, 2014	F-5
Statement of Cash Flows for the Year Ended March 31, 2014	F-6
Notes to Financial Statements	F-7

Unaudited Financial Statements for the Period Ended June 30, 2014

Balance Sheet at June 30, 2014	F-24
Statement of Operations for Three Months Ended June 30, 2014	F-25
Statement of Cash Flows for the Three Months Ended June 30, 2014	F-26
Notes to Financial Statements	F-27

REPORT OF INDEPENDENT AUDITORS

Twin Oaks Savings Bank

Marseilles, Illinois

Report on the Financial Statements

We have audited the accompanying financial statements of Twin Oaks Savings Bank, which comprise the balance sheet as of March 31, 2014, and the related statements of operations, members' equity, and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Twin Oaks Savings Bank as of March 31, 2014, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Crowe Horwath LLP

Oak Brook, Illinois

July 16, 2014

F-1

TWIN OAKS SAVINGS BANK

BALANCE SHEET

March 31, 2014

ASSETS

Cash on hand and in banks	\$ 1,878,430
Federal funds sold	409,000
Interest-bearing deposits in other banks	138,949
Total cash and cash equivalents	2,426,379
Investment certificates of deposits	1,999,969
Securities available for sale	30,641,100
Loans, net	30,082,993
Premises and equipment, net	1,052,128
Federal Home Loan Bank and Bankers Bank stock	547,138
Accrued interest receivable	315,447
Other assets	883,098
Total assets	\$67,948,252

LIABILITIES AND MEMBERS' EQUITY

Liabilities	
Deposits	\$55,425,739
Federal Home Loan Bank advances	5,208,496
Advances from borrowers for escrow	233,518
Accrued interest payable and other liabilities	419,002
Total liabilities	61,286,755
Members' equity	
Retained earnings, substantially restricted	6,557,055
Accumulated other comprehensive income	104,442
	6,661,497
Total liabilities and members' equity	\$67,948,252

See accompanying notes to financial statements.

F-2

TWIN OAKS SAVINGS BANK

STATEMENT OF OPERATIONS

Year ended March 31, 2014

Interest income	
Loans	\$1,459,748
Securities	402,993
Mortgage-backed securities	321,576
Other	32,194
Total interest income	2,216,511
Interest expense	
Deposits	413,859
Federal Home Loan Bank advances	191,411
Total interest expense	605,270
Net interest income	1,611,241
Provision for loan losses	874,000
Net interest income after provision for loan losses	737,241
Noninterest income	
Service fees	141,256
Gain on sale of loans	52,706
Loss on sale of securities	(709)
Other	36,390
Total noninterest income	229,643
Noninterest expense	
Compensation and benefits	821,527
Occupancy and equipment	196,561
Data processing	231,133
Other	422,358
Total noninterest expense	1,671,579
Loss before income taxes	(704,695)
Income tax benefit	400,422

Net loss

\$(304,273)

See accompanying notes to financial statements.

F-3

TWIN OAKS SAVINGS BANK

STATEMENT OF COMPREHENSIVE INCOME

Year ended March 31, 2014

Net loss		\$(304,273)
Other comprehensive income (loss):		
Unrealized holding loss arising during the period		(337,617)
Reclassification adjustment for losses included in net loss		709
Tax effect		117,581
Total other comprehensive loss		(219,327)
Comprehensive loss		\$(523,600)

See accompanying notes to financial statements.

F-4

TWIN OAKS SAVINGS BANK

STATEMENT OF MEMBERS' EQUITY

Year ended March 31, 2014

	Retained Earnings	Accumulated Other Comprehensive Income	Total
Balance at April 1, 2013	\$6,861,328	\$ 323,769	\$7,185,097
Net loss	(304,273)	-	(304,273)
Total other comprehensive loss	-	(219,327)	(219,327)
Balance at March 31, 2014	\$6,557,055	\$ 104,442	\$6,661,497

See accompanying notes to financial statements.

TWIN OAKS SAVINGS BANK

STATEMENT OF CASH FLOWS

Year ended March 31, 2014

Cash flows from operating activities

Net loss	\$(304,273)
Adjustments to reconcile net loss to net cash from operating activities	
Depreciation	98,553
Amortization of premiums and discounts	533,174
Provision for loan losses	874,000
Loss on sales of securities	709
Gain on sales of loans	(52,706)
Origination of mortgage loans	(2,026,855)
Proceeds from sales of mortgage loans	2,079,561
Amortization of mortgage servicing rights	19,207
Earnings on bank-owned life insurance	(17,084)
Change in accrued interest receivable and other assets	(563,184)
Change in other liabilities	(169,807)
Net cash from operating activities	471,295

Cash flows from investing activities

Purchase of investments in certificates of deposit	(604,861)
Proceeds from maturities of investments in certificates of deposit	1,101,861
Proceeds from maturities and calls of securities	6,847,510
Purchase of securities	(7,804,353)
Proceeds from sales of securities	242,398
Loan originations, net of principal payments	688,993
Proceeds from sale of other real estate owned	484,500
Expenditures for premises and equipment	(38,867)
Net cash from investing activities	917,181

Cash flows from financing activities

Net change in deposits	(2,776,190)
Proceeds from Federal Home Loan Bank advances	255,000
Maturities of Federal Home Loan Bank advances	(2,276,504)
Net change in advances from borrowers for escrow	(25,719)
Net cash used in financing activities	(4,823,413)
Net decrease in cash and cash equivalents	(3,434,937)

Edgar Filing: NATIONAL HOLDINGS CORP - Form 10-Q

Cash and cash equivalents at beginning of year	5,861,316
Cash and cash equivalents at end of year	\$2,426,379
Supplemental disclosures of cash flow information	
Cash paid during the year for:	
Interest	\$610,354
Income taxes paid	22,656
Non-cash transfer of loans to other real estate owned	\$420,000

See accompanying notes to financial statements.

F-6

TWIN OAKS SAVINGS BANK

NOTES TO FINANCIAL STATEMENTS

March 31, 2014

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations: Twin Oaks Savings Bank (the Bank) is a state-chartered mutual savings bank. Through its main office located in Marseilles, Illinois and a branch located in Morris, Illinois, the Bank provides a variety of financial services to customers in Marseilles and the surrounding area. Financial services consist primarily of checking, savings, term certificates of deposit, and consumer loans secured by residential real estate. There are no concentrations of loans to any one industry or customer. The customers' ability to repay is dependent on the real estate and general economic conditions in the area.

Use of Estimates: To prepare financial statements in conformity with accounting principles generally accepted in the United States of America, 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 and fair values of securities are particularly subject to change.

Subsequent Events: The Bank has evaluated subsequent events for recognition and disclosure through July 16, 2014, which is the date the financial statements were available to be issued.

Interest-Bearing Deposits in Other Financial Institutions: Interest-bearing deposits in other financial institutions mature within one year and are carried at cost.

Securities: Securities are classified as available for sale when they might be sold before maturity. Securities available for sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income net of tax.

Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized on the level-yield method without anticipating prepayments, except for mortgage backed securities where prepayments are anticipated. Gains and losses on sales are recorded on the trade date and determined using the specific identification method.

Management evaluates securities for other-than-temporary impairment on at least a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. For securities in an unrealized loss position, management considers the extent and duration of the unrealized loss, and the financial condition and near-term prospects of the issuer. Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: 1) other-than-temporary impairment related to credit loss, which must be recognized in the income statement and 2) other-than-temporary impairment related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis.

Loans: Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding, net of deferred loan fees and costs, and an allowance for loan losses. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized in interest income using the level-yield method without anticipating prepayments.

(Continued)

F-7

TWIN OAKS SAVINGS BANK

NOTES TO FINANCIAL STATEMENTS

March 31, 2014

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Interest income on mortgage and commercial loans is discontinued at the time the loan is 90 days delinquent unless the loan is well-secured and in process of collection. Consumer and credit card loans are typically charged off no later than 90 days past due. Past due status is based on the contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful. Nonaccrual loans and loans past due 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans. A loan is moved to non-accrual status in accordance with the Bank's policy, typically after 90 days of non-payment.

All interest accrued but not received for loans placed on nonaccrual 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. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Allowance for Loan Losses: The allowance for loan losses is a valuation allowance for probable incurred credit losses. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. 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 when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement. Loans for which the terms have been modified resulting in a concession, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired.

Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

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.

Troubled debt restructurings are separately identified for impairment disclosures and are measured at the present value of estimated future cash flows using the loan's effective rate at inception. If a troubled debt restructuring is considered to be a collateral dependent loan, the loan is reported, net, at the fair value of the collateral. For troubled debt restructurings that subsequently default, the Bank determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses.

(Continued)

F-8

TWIN OAKS SAVINGS BANK

NOTES TO FINANCIAL STATEMENTS

March 31, 2014

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The general component covers non-impaired loans and is based on historical loss experience adjusted for current factors. The historical loss experience is determined by portfolio segment and is based on the actual loss history experienced by the Bank over the most recent three years. This actual loss experience is supplemented with other economic factors based on the risks present for each portfolio segment.

The following portfolio segments have been identified, real estate, automobile, commercial and consumer. The real estate category is further broken down into the following classes: 1-4 family, multifamily, commercial and land loans. The Bank considers loan performance and collateral values in assessing risk as follows:

Real estate loans are affected by the local residential real estate market, the local economy, and movement in interest rates. The Bank evaluates the borrower's repayment ability through a review of credit reports and debt-to-income ratios. Appraisals are obtained to support the loan amount.

Commercial loans are dependent on the strength of the industries of the related borrowers and the success of their businesses. Commercial loans are advanced for equipment purchases or to provide working capital or meet other financing needs of the business. These loans may be secured by accounts receivable, inventory, equipment or other business assets. Financial information is obtained from the borrower to evaluate the debt service coverage and ability to repay the loans.

Automobile loans are secured by the automobile. The Bank evaluates the borrower's ability to repay based on review of credit reports and debt-to-income ratios.

Consumer loans are dependent on the local economy. Consumer loans are generally secured by consumer assets, but may be unsecured. The Bank evaluates the borrower's repayment ability through a review of credit scores and evaluation of debt-to-income ratios.

Transfers of Financial Assets: Transfers of financial assets are accounted for as sales, when control over the assets has been relinquished. Control over transferred assets is deemed to be surrendered when the assets have been isolated from the Bank, the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and the Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Premises and Equipment: Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets. Furniture, fixtures and equipment are depreciated using the straight-line over the estimated useful lives of the assets.

Federal Home Loan Bank (FHLB) and Bankers Bank Stock: The Bank is a member of the FHLB and Bankers Bank. Members are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. FHLB and Bankers Bank stock are carried at cost, classified as a restricted security, and periodically evaluated for impairment based on ultimate recovery of par value. Both cash and stock dividends are reported as income.

(Continued)

F-9

TWIN OAKS SAVINGS BANK

NOTES TO FINANCIAL STATEMENTS

March 31, 2014

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Loan Commitments and Related Financial Instruments: Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and letters of credit, issued to meet customer financing needs. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded.

Income Taxes: Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized

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, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the “more likely than not” test, no tax benefit is recorded.

The Bank recognizes interest and/or penalties related to income tax matters in income tax expense.

Bank-Owned Life Insurance: The Bank has purchased life insurance policies on certain key executives. Bank owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

Other Real Estate Owned: Assets acquired through or instead of loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. If fair value declines subsequent to foreclosure, a valuation allowance is recorded through expense. Operating costs after acquisition are expensed.

Cash Flows: Cash and cash equivalents include cash on hand and amounts due from banks. Net cash flows are reported for customer loan and deposit transactions.

Fair Value of Financial Instruments: Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in a separate note. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect these estimates.

Benefits: Retirement plan expense is the amount of discretionary contributions made to employees' individual retirement accounts. Deferred compensation plan expense allocates the benefits over years of service.

Loss Contingencies: Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Management does not believe that there now are such matters that will have a material effect on the financial statements.

(Continued)

TWIN OAKS SAVINGS BANK

NOTES TO FINANCIAL STATEMENTS

March 31, 2014

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Servicing Rights: Servicing rights are recognized separately when they are acquired through sales of loans. Servicing rights are initially recorded at fair value with the income statement effect recorded in gains on sales of loans. Fair value is based on market prices for comparable mortgage servicing contracts. All classes of servicing assets are subsequently measured using the amortization method, which requires servicing rights to be amortized into non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying loans.

Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to carrying amount. Impairment is recognized through a valuation allowance to the extent that fair value is less than the carrying amount. If the Bank later determines that all or a portion of the impairment no longer exists, a reduction of the allowance may be recorded as an increase to income. The fair values of servicing rights are subject to significant fluctuations as a result of changes in estimated and actual prepayment speeds and default rates and losses.

Servicing fee income is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal. The amortization of mortgage servicing rights is netted against loan servicing fee income. Total loans serviced at March 31, 2014 were \$22,712,743. Servicing fees totaled \$59,349 during the year ended March 31, 2014. Late fees and ancillary fees related to loan servicing are not material.

Comprehensive Income (Loss): Comprehensive income (loss) consists of net income (loss) and other comprehensive income. Other comprehensive income includes unrealized gains and losses on securities available for sale, net of tax, which are also recognized as separate components of members' equity.

NOTE 2 - SECURITIES AVAILABLE FOR SALE

The following table summarizes the amortized cost and fair value of securities available for sale and the corresponding amounts of gross unrealized gains and losses recognized in accumulated other comprehensive income at March 31, 2014:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale:				
U.S. government agencies	\$ 195,237	\$ 809	\$ -	\$ 196,046
State and political subdivisions	13,237,358	286,757	(238,221)	13,285,894
Mortgage-backed: residential	16,145,767	200,179	(91,502)	16,254,444
Collateralized mortgage obligations: residential	902,058	2,658	-	904,716
Total available for sale	\$ 30,480,420	\$ 490,403	\$ (329,723)	\$ 30,641,100

(Continued)

F-11

TWIN OAKS SAVINGS BANK

NOTES TO FINANCIAL STATEMENTS

March 31, 2014

NOTE 2 - SECURITIES AVAILABLE FOR SALE (Continued)

The amortized cost and fair value of debt securities are shown by contractual maturity. Expected maturities may differ from contractual maturities if borrowers have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity date are shown separately.

	Amortized Cost	Fair Value
Due in one year or less	\$412,890	\$414,802
Due after one year through five years	1,980,517	1,998,352
Due after five years through ten years	1,543,712	1,542,047
Due after ten years	9,495,476	9,526,739
Mortgage-backed	16,145,767	16,254,444
Collateralized mortgage obligations	902,058	904,716
	\$30,480,420	\$30,641,100

The proceeds from sales of securities and the associated gains and losses are listed below:

Proceeds	\$242,398
Gross gains	478
Gross losses	(1,187)

At year-end 2014, there were no holdings of securities of any one issuer, other than the U.S. government and its agencies, in an amount greater than 10% of shareholders' equity.

Edgar Filing: NATIONAL HOLDINGS CORP - Form 10-Q

Securities with unrealized losses at March 31, 2014, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, are as follows:

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
State and political subdivisions	\$3,932,905	\$(146,841)	\$1,386,815	\$(91,380)	\$5,319,720	\$(238,221)
Mortgage-backed	4,563,370	(69,228)	1,118,983	(22,274)	5,682,353	(91,502)
Total available for sale	\$8,496,275	\$(216,069)	\$2,505,798	\$(113,654)	\$11,002,073	\$(329,723)

Unrealized losses on securities have not been recognized into income because management does not intend to sell and it is likely that management will not be required to sell the securities prior to their anticipated recovery, and the decline in fair value is largely due to changes in interest rates and other market conditions. The fair value is expected to recover as the bonds approach maturity.

(Continued)

F-12

TWIN OAKS SAVINGS BANK

NOTES TO FINANCIAL STATEMENTS

March 31, 2014

NOTE 3 - LOANS

A summary of loans by major category was as follows at March 31, 2014:

Real estate:	
1-4 family residential	\$25,565,343
Multifamily	315,384
Commercial	3,473,072
Land	875,094
	30,228,893
Automobile	839,858
Commercial	417,851
Consumer	107,586
	1,365,295
Gross loans	31,594,188
Net deferred loan origination fees	(15,260)
Allowance for loan losses	(1,495,935)
Loans, net	\$30,082,993

(Continued)

TWIN OAKS SAVINGS BANK

NOTES TO FINANCIAL STATEMENTS

March 31, 2014

NOTE 3 - LOANS (Continued)

Activity in the allowance for loan losses during the year ended March 31, 2014 was as follows:

	Real Estate 1-4 Family Residential	Multifamily	Commercial	Land	Automobile	Commercial	Consumer	Total
Allowance for loan losses:								
Beginning balance	\$ 332,502	\$ 3,809	\$ 124,233	\$ 577,784	\$ 9,345	\$ 3,864	\$ 4,051	\$ 1,055,588
Provision for loan losses	733,033	(655)	106,471	24,348	(946)	5,257	6,492	874,000
Loans charged-off	-	-	-	(459,482)	-	-	(903)	(460,385)
Recoveries	25,244	-	-	1,455	-	-	33	26,732
Total ending allowance balance	\$ 1,090,779	\$ 3,154	\$ 230,704	\$ 144,105	\$ 8,399	\$ 9,121	\$ 9,673	\$ 1,495,935

The balance in the allowance for loan losses and the recorded investment based on impairment was as follows at March 31, 2014:

	Real Estate 1-4 Family Residential	Multifamily	Commercial	Land	Automobile	Commercial	Consumer	Total
Allowance for loan losses:								

Ending allowance balance attributable to loans:								
Individually evaluated for impairment	\$ 898,739	\$ -	\$ 200,352	\$ 114,440	\$ -	\$ 4,992	\$ 5,490	\$ 1,224,013
Collectively evaluated for impairment	192,040	3,154	30,352	29,665	8,399	4,129	4,183	271,922
Total ending allowance balance	\$ 1,090,779	\$ 3,154	\$ 230,704	\$ 144,105	\$ 8,399	\$ 9,121	\$ 9,673	\$ 1,495,935
Loans:								
Loans individually evaluated for Impairment	\$ 2,411,414	\$ -	\$ 386,266	\$ 152,778	\$ -	\$ 4,992	\$ 5,490	\$ 2,960,940
Loans collectively evaluated for Impairment	23,153,929	315,384	3,086,806	722,316	839,858	412,859	102,096	28,633,248
Total ending loans balance	\$ 25,565,343	\$ 315,384	\$ 3,473,072	\$ 875,094	\$ 839,858	\$ 417,851	\$ 107,586	\$ 31,594,188

(Continued)

TWIN OAKS SAVINGS BANK

NOTES TO FINANCIAL STATEMENTS

March 31, 2014

NOTE 3 - LOANS (Continued)

Information related to loans individually evaluated for impairment was as follows as of and during the year ended March 31, 2014:

	Unpaid		Allowance	Average	Interest	Cash Basis
	Principal	Recorded	for	Recorded	Income	Interest
	Balance	Investment	Loan	Investment	Recognized	Recognized
			Losses			
			Allocated			
With no related allowance recorded:						
1-4 family residential	\$529,149	\$529,149	\$-	\$532,389	\$ 20,577	\$ 20,577
With an allowance recorded:						
1-4 family residential	1,882,265	1,882,265	898,739	2,156,511	91,313	91,313
Commercial real estate	386,266	386,266	200,352	464,721	18,588	18,588
Land	152,778	152,778	114,440	154,096	5,938	5,938
Commercial	4,992	4,992	4,992	10,745	802	802
Consumer	5,490	5,490	5,490	7,781	608	608
	2,431,791	2,431,791	1,224,013	2,793,854	117,249	117,249
Total	\$2,960,940	\$2,960,940	\$1,224,013	\$3,326,243	\$ 137,826	\$ 137,826

The recorded investment in loans excludes accrued interest receivable and loan origination fees, net due to immateriality. For purposes of this disclosure, the unpaid principal balance is not reduced for partial charge-offs.

(Continued)

F-15

TWIN OAKS SAVINGS BANK

NOTES TO FINANCIAL STATEMENTS

March 31, 2014

NOTE 3 - LOANS (Continued)

The recorded investment in nonaccrual and loans past due over 90 days still on accrual at March 31, 2014 was as follows:

	Nonaccrual	Loans Past Due Over 90 Days Still Accruing
1-4 family residential	\$ 384,768	\$ -
Commercial real estate	222,512	-
Land	49,373	-
Total	\$ 656,653	\$ -

The aging of the recorded investment in past due loans at March 31, 2014 was as follows:

	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater than 89 Days Past Due	Total Past Due	Loans Not Past Due	Total
1-4 family residential	\$ 1,395,688	\$ -	\$ 384,768	\$ 1,780,456	\$ 23,784,887	\$ 25,565,343
Multifamily	-	-	-	-	315,384	315,384
Commercial real estate	163,754	-	222,512	386,266	3,086,806	3,473,072
Land	55,445	-	49,373	104,818	770,276	875,094

Edgar Filing: NATIONAL HOLDINGS CORP - Form 10-Q

Automobile	-	-	-	-	839,858	839,858
Commercial	-	-	-	-	417,851	417,851
Consumer	-	-	-	-	107,586	107,586
Total	\$1,614,887	\$ -	\$656,653	\$2,271,540	\$29,322,648	\$31,594,188

Troubled Debt Restructurings

As of March 31, 2014, the Bank had a recorded investment in troubled debt restructurings of \$706,000 with \$256,000 of specific reserves allocated. The Bank has not committed to lend additional amounts to customers with outstanding loans classified as troubled debt restructurings. There were no material troubled debt restructuring modifications that occurred during the year ended March 31, 2014.

The following table presents loans by class modified as troubled debt restructurings for which there was a payment default within twelve months following the modification during the year ending March 31, 2014:

Troubled Debt Restructurings That Subsequently Defaulted	Number of Loans	Recorded Investment
1-4 family residential	1	\$ 201,733
Commercial	1	222,512
Land	1	49,373
Total	3	\$ 473,618

The troubled debt restructurings that subsequently defaulted described above increased the allowance for loan losses by \$211,118 and resulted in charge offs of \$0 during the year ending March 31, 2014.

(Continued)

TWIN OAKS SAVINGS BANK

NOTES TO FINANCIAL STATEMENTS

March 31, 2014

NOTE 3 - LOANS (Continued)

A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms.

In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification. This evaluation is performed under the Bank's internal underwriting policy.

Credit Quality Indicators:

The Bank categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Bank analyzes loans individually by classifying the loans as to credit risk. This analysis includes non-homogeneous loans, such as commercial and commercial real estate loans. This analysis is performed on a periodic basis. The Bank uses the following definitions for risk ratings:

Watch. Loans classified as watch are those requiring more attention to ensure timely and adequate financial information is received and that the business is being prudently managed, given economic and market conditions.

Special Mention. Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the Bank's credit position at some future date.

Substandard. Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Doubtful. Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be pass rated loans.

Based on the most recent analysis performed, the risk category of loans by class of loans was as follows at March 31, 2014:

	Pass	Watch	Special Mention	Substandard	Doubtful	Total
1-4 family residential	\$21,942,412	\$178,296	\$1,033,222	\$2,411,413	\$ -	\$25,565,343
Multifamily	315,384	-	-	-	-	315,384
Commercial real estate	3,034,008	-	52,798	386,266	-	3,473,072
Land	722,315	-	-	152,779	-	875,094
Automobile	828,627	11,231	-	-	-	839,858
Commercial	412,859	-	-	4,992	-	417,851
Consumer	102,096	-	-	5,490	-	107,586
Total	\$27,357,701	\$189,527	\$1,086,020	\$2,960,940	\$ -	\$31,594,188

(Continued)

TWIN OAKS SAVINGS BANK

NOTES TO FINANCIAL STATEMENTS

March 31, 2014

NOTE 4 - PREMISES AND EQUIPMENT

Premises and equipment was as follows at March 31, 2014:

Land	\$350,148
Building and improvements	1,660,768
Furniture and equipment	1,001,654
Total cost	3,012,570
Accumulated depreciation	(1,960,442)
	\$1,052,128

Depreciation expense was \$98,553 during the year ended March 31, 2014.

NOTE 5 - DEPOSITS

Time deposits of \$100,000 or more was \$9,325,000 at March 31, 2014.

Scheduled maturities of time deposits for the next five years were as follows:

2015 \$13,999,906

2016	3,675,502
2017	3,582,731
2018	3,012,486
2019	1,496,335

Total \$25,766,960

Deposits from principal officers, directors, and their affiliates totaled \$1,091,338 at March 31, 2014.

NOTE 6 - FEDERAL HOME LOAN BANK ADVANCES

At year end, advances from the Federal Home Loan Bank were as follows

Matures 7/9/2014 at 5.00%, fixed	\$1,000,000
Matures 10/2/2014 at 5.00%, fixed	1,000,000
Matures 11/28/2014 at 5.00%, fixed	1,000,000
Matures 1/13/2016 at 5.00%, fixed	1,000,000
Matures 3/30/2018 at 5.00%, fixed	500,000
Matures 4/1/2019 at 5.00%, fixed	500,000
Matures 10/3/2022 at 5.00%, fixed	208,496
Total	\$5,208,496

The Bank maintains a collateral pledge agreement covering secured advances whereby the Bank has agreed to at all times keep on hand, free of all other pledges, liens, and encumbrances, whole first mortgage loans on improved residential property not more than 90 days delinquent that aggregate no less than 167% of the outstanding secured advances from the Federal Home Loan Bank of Chicago. The fixed rate advances have a prepayment penalty.

(Continued)

TWIN OAKS SAVINGS BANK

NOTES TO FINANCIAL STATEMENTS

March 31, 2014

NOTE 7 - BENEFITS

The Bank has a 401(k) retirement plan to which employees may contribute a portion of their annual compensation subject to IRS limits. Additionally, at the discretion of the Board of Directors, the Bank contributes a percentage of wages to the employee Individual Retirement Accounts. The expense related to this plan was \$24,709 for the year ended March 31, 2014.

The Bank has established a retirement plan for the benefit of the Directors. At March 31, 2014, the liability for plan benefits totaled \$271,980. Plan expense totaled approximately \$22,000 for the year ended March 31, 2014.

NOTE 8 - INCOME TAXES

The income tax benefit at March 31, 2014 consists of the following:

Current	\$-
Deferred	400,422
	\$400,422

The net deferred tax assets included in other assets in the accompanying statement of financial condition at March 31, 2014 consists of the following:

Gross deferred tax assets	
Operating loss carryforwards	\$376,450
Allowance for loan loss	109,503
Deferred director fees	109,526
	595,479
Gross deferred tax liabilities	
Originated mortgage servicing rights	(45,732)
Unrealized gain on securities	(56,238)
Accrual to cash basis adjustment	(78,090)
Depreciation	(41,216)
FHLB stock dividends	(45,154)
Other, net	(59,468)
	(325,898)
Net deferred tax assets	\$269,581

At March 31, 2014, the income tax benefit differs from the amounts determined by applying the statutory U.S. federal income tax rate as a result of the following items:

Income tax computed at the statutory rate	\$239,596
State income taxes, net of federal benefit	43,629
Tax-exempt interest, net of disallowed interest expense	111,862
Other	5,335
	\$400,422

(Continued)

TWIN OAKS SAVINGS BANK

NOTES TO FINANCIAL STATEMENTS

March 31, 2014

NOTE 8 - INCOME TAXES (Continued)

Under the Internal Revenue Code, the Bank may, for tax purposes, deduct a provision for bad debts in excess of such provisions recorded in the financial statements. Accordingly, retained earnings at March 31, 2014 include approximately \$1,099,000 on which no provision for federal income taxes has been made. The related amount of unrecognized deferred tax liability was approximately \$443,000. If this portion of retained earnings is used for any purpose other than to absorb bad debts, the amount used will be added to future taxable income.

At March 31, 2014, the Bank had \$4,979,797 and \$4,846,894 of federal and state net operating loss carryforwards, respectively. The net operating losses are being carried forward and will be available to reduce future taxable income. The federal and state carryforwards begin expiring in 2033 and 2025, respectively. The Bank does not expect the total amount of unrecognized tax benefits to significantly increase or decrease in the next twelve months.

NOTE 9 - REGULATORY MATTERS

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Capital adequacy guidelines and prompt corrective action regulations involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators about components, risk weightings, and other factors, and the regulators can lower classifications in certain cases. Failure to meet various capital requirements can initiate regulatory action that could have a direct material effect on the financial statements. Management believes as of March 31, 2014, the Bank met all capital adequacy requirements to which it is subject. The prompt corrective action regulations provide five classifications, including well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as are asset growth and expansion, and plans for capital restoration

are required.

At March 31, 2014, the Bank was categorized by its regulatory agency as well capitalized. Management is not aware of any conditions or events since the most recent notification that would change the Bank's category.

The Bank's actual capital amounts (in thousands) and ratios are presented in the following table.

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Correction Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of March 31, 2014						
Total capital (to risk- weighted assets)	\$6,941	22.7 %	\$2,446	8.0 %	\$ 3,058	10.0 %
Tier I capital (to risk- weighted assets)	6,546	21.4	1,223	4.0	1,835	6.0
Tier I capital (to average assets)	6,546	9.6	2,717	4.0	3,396	5.0

(Continued)

F-20

NOTE 10 - FAIR VALUE

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair values:

Level 1 – Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2 – Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3 – Significant unobservable inputs that reflect a bank's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The Bank used the following methods and significant assumptions to estimate fair value:

Securities: The fair values for securities are determined by quoted market prices, if available (Level 1). For securities where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2).

Impaired Loans: The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business, resulting in a Level 3 fair value classification. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

Appraisals for collateral-dependent impaired loans are performed by certified general appraisers (for commercial properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been reviewed and verified by the Bank. Once received, a loan officer reviews the assumptions and approaches utilized in the appraisal as well as the overall resulting fair value in comparison with independent data sources such as recent market data or industry-wide statistics. On an annual basis, the Bank compares the actual selling price of collateral that has been sold to the most recent appraised value to determine what additional adjustment should be made to the appraisal value to arrive at fair value.

There were no transfers between Level 1 and Level 2 during 2014.

(Continued)

F-21

NOTE 10 - FAIR VALUE (Continued)

Assets measured at fair value on a recurring basis are summarized below:

	Fair Value Measurements at March 31, 2014 Using:				
	Quoted Prices in Active Markets for Identical Assets (Level 1)		Other Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Securities available for sale					
U.S. government-agencies	\$-	\$196,046	\$	-	\$196,046
States and political subdivisions	-	13,285,894	-	-	13,285,894
Mortgage-backed	-	16,254,444	-	-	16,254,444
Collateralized mortgage obligations	-	904,716	-	-	904,716
Total	\$-	\$30,641,100	\$	-	\$30,641,100

Assets measured at fair value on a non-recurring basis are summarized below:

	Fair Value Measurements at March 31, 2014 Using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Impaired loans:				
1-4 family residential	\$983,526	\$ -	\$ -	\$ 983,526

Commercial real estate	185,914	-	-	185,914
Land	38,338	-	-	38,338
Total	\$1,207,778	\$ -	\$ -	\$ 1,207,778

The following represent impairment charges recognized during the period:

Impaired loans, which are measured for impairment using the fair value of the collateral for collateral-dependent loans, had a balance of \$2,431,791 with a valuation allowance of \$1,224,013, resulting in an additional provision for loan losses of \$536,000 in 2014.

The following table presents quantitative information about level 3 fair value measurements for impaired loans measured at fair value on a non-recurring basis at March 31, 2014:

Impaired Loans	Fair Value	Range / Weighted Average
1-4 family residential	\$983,526	6.3%-23.3% / 14.5%
Commercial real estate	\$185,914	0% / 0%
Land	\$38,338	0% / 0%

The above fair value measurements used the sales comparison approach valuation technique and unobservable inputs were adjustments for differences between comparable sales.

(Continued)

TWIN OAKS SAVINGS BANK

NOTES TO FINANCIAL STATEMENTS

March 31, 2014

NOTE 11 - FINANCIAL INSTRUMENTS AND COMMITMENTS

The Bank is party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to fund loans and previously approved unused lines of credit. The Bank's exposure to credit loss in the event of nonperformance by the parties to these financial instruments is represented by the contractual amount of the instruments. The Bank uses the same credit policy for commitments as it uses for on-balance-sheet items.

These financial instruments at March 31, 2014 are summarized as follows:

	Contract Amount
Financial instruments whose contract amounts represent credit risk	
Commitments to fund loans	\$254,500
Unused lines of credit	2,999,335
Outstanding letters of credit	18,081

TWIN OAKS SAVINGS BANK

BALANCE SHEET

June 30, 2014

(Unaudited)

ASSETS

Cash on hand and in banks	\$2,415,056
Federal funds sold	-
Interest-bearing deposits in other banks	1,285,540
Total cash and cash equivalents	3,700,596
Investment certificates of deposits	1,652,861
Securities available for sale	28,228,805
Loans, net	30,254,743
Premises and equipment, net	1,030,084
Federal Home Loan Bank and Bankers Bank stock	547,138
Accrued interest receivable	266,631
Other assets	1,013,506
Total assets	\$66,694,364

LIABILITIES AND MEMBERS' EQUITY

Liabilities	
Deposits	\$53,651,657
Federal funds purchased	191,000
Federal Home Loan Bank advances	5,197,624
Advances from borrowers for escrow	138,305
Accrued interest payable and other liabilities	670,699
Total liabilities	59,849,285
Members' equity	
Retained earnings, substantially restricted	6,515,347
Accumulated other comprehensive income	329,732
	6,845,079
Total liabilities and members' equity	\$66,694,364

See accompanying note.

F-24

TWIN OAKS SAVINGS BANK

STATEMENT OF OPERATIONS

Three months ended June 30, 2014

(Unaudited)

Interest income	
Loans	\$ 366,712
Securities	109,041
Mortgage-backed securities	95,220
Other	8,592
Total interest income	579,565
Interest expense	
Deposits	91,983
Federal Home Loan Bank advances	37,283
Total interest expense	129,266
Net interest income	450,299
Provision for loan losses	53,000
Net interest income after provision for loan losses	397,299
Noninterest income	
Service fees	25,496
Gain on sale of loans	27,904
Gain on sale of securities	32,138
Other	5,886
Total noninterest income	91,424
Noninterest expense	
Compensation and benefits	204,786
Occupancy and equipment	48,831
Data processing	33,695
Other	325,360
Total noninterest expense	612,670
Loss before income taxes	(123,947)

Income tax benefit	82,241
Net loss	\$(41,708)

See accompanying note.

F-25

TWIN OAKS SAVINGS BANK

STATEMENT OF CASH FLOWS

Three months ended June 30, 2014

(Unaudited)

Cash Flows from Operating Activities	
Net loss	\$(41,708)
Adjustments to reconcile net loss to net cash from operating activities:	
Depreciation	22,944
Amortization of premiums and discounts	160,074
Provision for loan losses	53,000
Gain on sale of securities	(32,138)
Gain on sale of loans	(27,904)
Origination of mortgage loans	(779,600)
Proceeds from sale of mortgage loans	807,504
Amortization of mortgage servicing rights	2,019
Earnings on bank-owned life insurance	(5,670)
Change in accrued interest receivable and other assets	(199,251)
Change in other liabilities	251,697
Net cash provided by operating activities	210,967
Cash Flows from Investing Activities	
Purchase of investment in certificates of deposit	(1,892)
Proceeds from maturities of investments in certificates of deposit	349,000
Proceeds from maturities and paydowns of securities	1,126,311
Proceeds from sale of securities	1,504,648
Loan originations, net of principal payments	(224,750)
Expenditures for premises and equipment	(900)
Net cash from investing activities	2,752,417
Cash Flows from Financing Activities	
Net change in deposits	(1,774,082)
Proceeds from Fed Funds purchased	191,000
Paydowns on Federal Home Loan Bank advances	(10,872)
Net change in advances from borrowers for escrow	(95,213)
Net cash used in financing activities	(1,689,167)
Net increase in cash and cash equivalents	1,274,217
Cash and cash equivalents at beginning of period	2,426,379
Cash and cash equivalents at end of period	\$3,700,596

Supplemental Disclosures of Cash Flow Information

Cash paid during the year for:

Interest	\$92,917
----------	----------

Income taxes paid	-
-------------------	---

See accompanying note.

F-26

TWIN OAKS SAVINGS BANK

NOTE TO FINANCIAL STATEMENTS

June 30, 2014

(Unaudited)

NOTE 1 – BASIS OF PRESENTATION

The consolidated financial statements presented in this quarterly report include the accounts of the Twin Oaks Savings Bank (the “Bank”). The consolidated financial statements of the Bank have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) for interim financial information and predominant practices followed by the financial services industry, and are unaudited. In the opinion of the Bank’s management, all adjustments, consisting of normal recurring adjustments, which the Bank considers necessary to fairly state the Bank’s financial position and the results of operations and cash flows have been recorded. The interim financial statements should be read in conjunction with the audited financial statements and accompanying notes of the Bank for the year ended March 31, 2014. Certain amounts in the accompanying financial statements and footnotes for June 30, 2014 have been reclassified with no effect on net income or stockholders’ equity to be consistent with the March 31, 2014 classifications. The results of the Bank’s operations for any interim period are not necessarily indicative of the results of the Bank’s operations for any other interim period or for a full fiscal year.

NOTE 2 - LOANS

A summary of loans by major category was as follows at June 30, 2014:

Real estate:	
1-4 family residential	\$26,051,458
Multifamily	298,293
Commercial	3,277,982
Land	763,975
	30,391,708

Automobile	852,567
Commercial	427,208
Consumer	117,896
	1,397,671
Gross loans	31,789,379
Net deferred loan origination fees	(14,348)
Allowance for loan losses	(1,520,288)
Loans, net	\$30,254,743

(Continued)

F-27

TWIN OAKS SAVINGS BANK

NOTE TO FINANCIAL STATEMENTS

June 30, 2014

(Unaudited)

NOTE 2 - LOANS (Continued)

Activity in the allowance for loan losses during the quarter ended June 30, 2014 was as follows:

	Real Estate 1-4 Family Residential	Multifamily	Commercial Land	Automobile	Commercial	Consumer	Total	
Allowance for loan losses:								
Beginning balance	\$ 1,090,779	\$ 3,154	\$ 230,704	\$ 144,105	\$ 8,399	\$ 9,121	\$ 9,673	\$ 1,495,935
Provision for loan losses	25,506	(171)	16,959	(16,328)	127	27,117	(210)	53,000
Loans charged off	-	-	-	-	-	(28,847)	-	(28,847)
Recoveries	-	-	-	-	-	-	200	200
Total ending allowance balance	\$ 1,116,285	\$ 2,983	\$ 247,663	\$ 127,777	\$ 8,526	\$ 7,391	\$ 9,663	\$ 1,520,288

(Continued)

TWIN OAKS SAVINGS BANK

NOTE TO FINANCIAL STATEMENTS

June 30, 2014

(Unaudited)

NOTE 2 - LOANS (Continued)

The recorded investment in nonaccrual and loans past due over 90 days still on accrual at June 30, 2014 was as follows:

	Nonaccrual	Loans Past Due Over 90 Days Still Accruing
1-4 family residential	\$1,493,021	\$ -
Commercial real estate	387,312	-
Total	\$1,880,333	\$ -

The aging of the recorded investment in past due loans at June 30, 2014 was as follows:

	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater than 89 Days Past Due	Total Past Due	Loans Not Past Due	Total
1-4 family residential	\$433,579	\$87,392	\$1,363,521	\$1,884,492	\$24,166,966	\$26,051,458
Multifamily	-	-	-	-	298,293	298,293
Commercial real estate	-	-	387,312	387,312	2,890,670	3,277,982

Edgar Filing: NATIONAL HOLDINGS CORP - Form 10-Q

Land	55,078	-	-	55,078	708,897	763,975
Automobile	-	-	-	-	852,567	852,567
Commercial	3,150	-	-	3,150	424,058	427,208
Consumer	4,856	-	-	4,856	113,040	117,896
Total	\$496,663	\$87,392	\$1,527,275	\$2,111,330	\$29,678,049	\$31,789,379

Credit Quality Indicators:

The Bank categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Bank analyzes loans individually by classifying the loans as to credit risk. This analysis includes non-homogeneous loans, such as commercial and commercial real estate loans. This analysis is performed on a periodic basis. The Bank uses the following definitions for risk ratings:

Watch. Loans classified as watch are those requiring more attention to ensure timely and adequate financial information is received and that the business is being prudently managed, given economic and market conditions.

Special Mention. Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the Bank's credit position at some future date.

TWIN OAKS SAVINGS BANK

NOTE TO FINANCIAL STATEMENTS

June 30, 2014

(Unaudited)

NOTE 2 - LOANS (Continued)

Substandard. Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Doubtful. Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be pass rated loans.

Based on the most recent analysis performed, the risk category of loans by class of loans was as follows at June 30, 2014:

	Pass	Watch	Special Mention	Substandard	Doubtful	Total
1-4 family residential	\$22,573,360	\$177,175	\$1,166,280	\$1,639,904	\$671,914	\$26,051,458
Multifamily	298,293	-	-	-	-	298,293
Commercial real estate	2,838,204	-	52,466	223,558	163,754	3,277,982

Edgar Filing: NATIONAL HOLDINGS CORP - Form 10-Q

Land	661,353	-	-	102,622	-	763,975
Automobile	852,567	10,635	-	-	-	852,567
Commercial	424,058	-	-	3,150	-	427,208
Consumer	113,040	-	-	4,856	-	117,896
Total	\$27,760,875	\$187,810	\$1,218,746	\$1,974,090	\$835,668	\$31,789,379

F-30

APPENDIX A

AGREEMENT AND PLAN OF MERGER

DATED AS OF JUNE 30, 2014

BY AND AMONG

OTTAWA SAVINGS BANCORP MHC,

OTTAWA SAVINGS BANCORP, INC.,

OTTAWA SAVINGS BANK FSB

AND

TWIN OAKS SAVINGS BANK

TABLE OF CONTENTS

<u>Page No.</u>		
	Introductory Statement	1
	ARTICLE I Definitions	2
	ARTICLE II The Merger	7
2.1	The Merger	7
2.2	Closing	8
2.3	Effective Time	8
2.4	Effect on Outstanding Shares of Ottawa Savings Bancorp Common Stock	9
2.5	Alternative Structure	9
	ARTICLE III Representations and Warranties	9
3.1	Disclosure Letters	9
3.2	Representations and Warranties of Twin Oaks	10
3.3	Representations and Warranties of Ottawa	24
	ARTICLE IV Conduct Pending the Merger	36
4.1	Forbearances by Twin Oaks	36
4.2	Forbearances by Ottawa	40
	ARTICLE V Covenants	40
5.1	Acquisition Proposals	40
5.2	Advice of Changes	41
5.3	Access and Information	42
5.4	Applications; Consents	43
5.5	Antitakeover Provisions	44
5.6	Additional Agreements	44
5.7	Publicity	44
5.8	Stockholders Meeting; Members Meeting	44
5.9	Proxy Statements	46
5.10	Notification of Certain Matters	47
5.11	Employee Benefits Matters	48
5.12	Indemnification	50
5.13	Board of Directors and Executive Officers	51
5.14	Registration of Ottawa Savings Bancorp Common Stock	51
5.15	Branches	52
	ARTICLE VI Conditions to Consummation	52
6.1	Conditions to Each Party's Obligations	52
6.2	Conditions to the Obligations of Ottawa	52
6.3	Conditions to the Obligations of Twin Oaks	53
	ARTICLE VII Termination	55
7.1	Termination	55
7.2	Termination Fees	57
7.3	Effect of Termination	58

ARTICLE VIII	Certain Other Matters	58
8.1	Interpretation	58
8.2	Survival	58
8.3	Waiver; Amendment	58
8.4	Counterparts	58
8.5	Governing Law	58
8.6	Expenses	58
8.7	Notices	59
8.8	Entire Agreement; etc.	59
8.9	Successors and Assigns; Assignment	60

Exhibit A: Voting Agreement

Exhibit B: Directors of the Resulting Savings Institution

Exhibit C: Senior Executive Officers of the Resulting Savings Institution

Agreement and Plan of Merger

This is an **Agreement and Plan of Merger**, dated as of the 30th day of June, 2014 (“**Agreement**”), by and among Ottawa Savings Bancorp MHC, a federally chartered mutual holding company (“**Ottawa Savings Bancorp MHC**”), Ottawa Savings Bancorp, Inc., a federally chartered subsidiary holding company (“**Ottawa Savings Bancorp**”), Ottawa Savings Bank FSB, a federally chartered stock savings bank (“**Ottawa Savings Bank**”) (Ottawa Savings Bancorp MHC, Ottawa Savings Bancorp and Ottawa Savings Bank being collectively referred to as “**Ottawa**”), and Twin Oaks Savings Bank, an Illinois chartered mutual savings bank (“**Twin Oaks**”).

Introductory Statement

Ottawa Savings Bancorp MHC is a federally chartered mutual holding company with its principal office located at 925 LaSalle Street, Ottawa, Illinois. Ottawa Savings Bancorp MHC owns approximately 58% of the outstanding common stock of Ottawa Savings Bancorp, a federal corporation with its principal offices located at 925 LaSalle Street, Ottawa, Illinois. Ottawa Savings Bank is a federal stock savings bank with its principal offices located at 925 LaSalle Street, Ottawa, Illinois. Ottawa Savings Bancorp owns 100% of the capital stock of Ottawa Savings Bank.

Twin Oaks is an Illinois chartered mutual savings bank with its principal offices located at 125 West Bluff Street, Marseilles, Illinois.

The Board of Directors of each of Ottawa Savings Bancorp MHC, Ottawa Savings Bancorp, Ottawa Savings Bank and Twin Oaks has determined that this Agreement, the Merger (as defined in Article I) and the related transactions contemplated hereby, are advisable and in the best interests of Ottawa, Twin Oaks, the members of Twin Oaks, the members of Ottawa Savings Bancorp MHC and the stockholders of Ottawa Savings Bancorp.

Ottawa and Twin Oaks each desire to make certain representations, warranties and agreements in connection with the Merger and related transactions provided for herein and to prescribe various conditions to such transactions.

As a condition and inducement to Ottawa’s willingness to enter into this Agreement, each director and executive officer of Twin Oaks has entered into a Voting Agreement dated as of the date hereof in the form of Exhibit A pursuant to which he or she will cast his or her votes in favor of this Agreement and the transactions contemplated hereby.

In consideration of their mutual promises and obligations hereunder, the parties hereto adopt and make this Agreement and prescribe the terms and conditions hereof and the manner and basis of carrying it into effect, which shall be as follows:

A-1

ARTICLE I**Definitions**

The following terms are defined in this Agreement in the Section indicated:

<u>Defined Term</u>	<u>Location of Definition</u>
Audited Financial Statements	Section 5.3(f)
Cause	Section 5.11(b)
Closing	Section 2.2
Closing Date	Section 2.2
Disclosure Letter	Section 3.1
Effective Date	Section 2.3
Effective Time	Section 2.3
Indemnified Party	Section 5.12(a)
Intellectual Property	Section 3.2(m)
Interim Financial Statements	Section 5.3(f)
Maximum Insurance Amount	Section 5.12(c)
Merger	Section 2.1
Ottawa	Preamble
Ottawa Employee Plans	Section 3.3(o)(i)
Ottawa Members Meeting	Section 5.8(c)
Ottawa Pension Plan	Section 3.3(o)(iii)
Ottawa Proxy Statement	Section 5.9(a)
Ottawa Qualified Plan	Section 3.3(o)(iv)
Ottawa Reports	Section 3.3(aa)
Ottawa Savings Bancorp	Preamble
Ottawa Savings Bancorp Financial Statements	Section 3.3(h)
Ottawa Savings Bancorp MHC	Preamble
Ottawa Savings Bank	Preamble
Ottawa Stockholders Meeting	Section 5.8(a)
Twin Oaks	Preamble
Twin Oaks Continuing Employees	Section 5.11(a)
Twin Oaks Employee Plans	Section 3.2(o)(i)
Twin Oaks Financial Statements	Section 3.2(g)
Twin Oaks Members Meeting	Section 5.8(b)
Twin Oaks Pension Plan	Section 3.2(m)(iii)
Twin Oaks Proxy Statement	Section 5.9(b)
Twin Oaks Qualified Plan	Section 3.2(o)(iv)

For purposes of this Agreement:

“Acquisition Proposal” means any proposal or offer with respect to an Acquisition Transaction.

“Acquisition Transaction” means any proposal or offer with respect to the following (other than the transactions contemplated hereunder): (i) any merger, consolidation, share exchange, business combination, or other similar transaction involving Twin Oaks; (ii) any sale, lease, exchange, mortgage, pledge, transfer or other disposition of 20% or more of Twin Oaks’ consolidated assets in a single transaction or series of transactions; or (iii) any public announcement of a proposal, plan or intention to do any of the foregoing or any agreement to engage in any of the foregoing.

“Affiliate” of a person means any person that, directly or indirectly through one or more intermediaries, controls, or is controlled by or is under common control with such person.

“Agreement” means this Agreement, as amended, modified or amended and restated from time to time in accordance with its terms.

“Appraised Value” means the appraised value of Twin Oaks as of the Effective Date, as determined by an Independent Appraisal. The initial Appraised Value shall have been determined as of June 6, 2014. The Appraised Value will be updated as of a date no earlier than 20 calendar days before the Effective Date.

“CRA” means the Community Reinvestment Act, as amended.

“Environmental Law” means any federal, state or local law, statute, ordinance, rule, or regulation relating to (i) the protection, preservation or restoration of the environment (which includes, without limitation, air, water vapor, surface water, groundwater, drinking water supply, soil, surface land, subsurface land, plant and animal life or any other natural resource), or to human health or safety as it relates to Hazardous Materials, or (ii) the exposure to, or the use, storage, recycling, treatment, generation, transportation, processing, handling, labeling, production, release or disposal of, Hazardous Materials, in each case as amended and as now in effect. The term Environmental Law includes, without limitation, the Federal Comprehensive Environmental Response, Compensation and Liability Act of 1980, the Federal Clean Air Act, the Federal Clean Water Act, the Federal Resource Conservation and Recovery Act of 1976, and the Federal Occupational Safety and Health Act of 1970 as it relates to Hazardous Materials, each as amended and as now in effect.

“**ERISA**” means the Employee Retirement Income Security Act of 1974, as amended.

A-3

“**ERISA Affiliate**” means any entity that is considered one employer with Ottawa Savings Bancorp MHC, Ottawa Savings Bancorp or Ottawa Savings Bank under Section 4001(b)(1) of ERISA or Section 414 of the IRC.

“**Exchange Act**” means the Securities Exchange Act of 1934, as amended.

“**FDIC**” means the Federal Deposit Insurance Corporation.

“**Federal Reserve Board**” means the Board of Governors of the Federal Reserve System.

“**GAAP**” means U.S. generally accepted accounting principles.

“**Governmental Entity**” means any court, administrative agency or commission or other governmental authority or instrumentality.

“**Government Regulator**” means any federal or state governmental authority charged with the supervision or regulation of depository institutions or depository institution holding companies or engaged in the insurance of bank deposits.

“**Hazardous Material**” means any substance (whether solid, liquid or gas) which is or could be detrimental to human health or safety or to the environment, currently or hereafter listed, defined, designated or classified as hazardous, toxic, radioactive or dangerous, or otherwise regulated, under any Environmental Law, whether by type or by quantity, including any substance containing any such substance as a component. Hazardous Material includes, without limitation, any toxic waste, pollutant, contaminant, hazardous substance, toxic substance, hazardous waste, special waste, industrial substance, oil or petroleum, or any derivative or by-product thereof, radon, radioactive material, asbestos, asbestos-containing material, urea formaldehyde foam insulation, lead and polychlorinated biphenyl.

“**HOLA**” means the Home Owners’ Loan Act, as amended.

“Illinois Department of Financial and Professional Regulation” means the Illinois Department of Financial and Professional Regulation.

“Independent Appraisal” shall mean the appraisal of the fair market value of Twin Oaks determined by an independent appraisal firm that is expert in valuing mutual savings institutions, such appraisal being acceptable to the OCC and reasonably acceptable to Twin Oaks and Ottawa.

“IRC” means the Internal Revenue Code of 1986, as amended.

“IRS” means the Internal Revenue Service.

A-4

“**knowledge**” means, with respect to a party hereto, actual knowledge of any officer or director of that party with a title of senior vice president or above.

“**Lien**” means any charge, mortgage, pledge, security interest, claim, lien or encumbrance.

“**Loan**” means a loan, lease, advance, credit enhancement, guarantee or other extension of credit.

“**Loan Property**” means any property in which the applicable party (or a Subsidiary of it) holds a security interest and, where required by the context, includes the owner or operator of such property, but only with respect to such property.

“**Material Adverse Effect**” means an effect, circumstance, occurrence or change that is material and adverse to the business, financial condition or results of operations of Ottawa and their Subsidiaries, taken as a whole on the one hand or Twin Oaks on the other hand, as the context may dictate or materially prevents, impairs or threatens the ability of either Ottawa or Twin Oaks, as the context may dictate, to perform its obligations under this Agreement or consummate the transactions contemplated by the Agreement; *provided, however*, that any such effect resulting solely from any (i) changes in laws, rules or regulations or GAAP or regulatory accounting requirements or interpretations thereof that apply to financial and/or depository institutions generally, (ii) changes in economic conditions affecting financial institutions generally, including but not limited to, changes in the general level of market interest rates, (iii) actions and omissions of Ottawa or Twin Oaks required under this Agreement or taken or omitted to be taken with the prior written consent, or at the request, of the other, including expenses incurred by the parties in consummating the transactions contemplated by this Agreement, (iv) changes in national or international political or social conditions including the engagement by the United States in hostilities, whether or not pursuant to the declaration of a national emergency or war, or the occurrence of any military or terrorist attack upon or within the United States and (v) natural disaster or other force majeure event, shall not be considered in determining if a Material Adverse Effect has occurred except, (A) with respect to clauses (i), (ii) and (iv), unless it uniquely affects such party or any of its Subsidiaries as compared to comparable U.S. banking organizations, and (B) with respect to clause (iii), any effect, circumstance, occurrence or change identified as a result of the preparation of the Audited Financial Statements or the Interim Financial Statements, each as defined in Section 5.3(f) of this Agreement.

“**OCC**” means the Office of the Comptroller of the Currency, including as successor to the Office of Thrift Supervision.

“**Ottawa ESOP**” means the Ottawa Savings Bank Employee Stock Ownership Plan and Trust Agreement.

“Ottawa Savings Bancorp Common Stock” means the common stock, par value \$.01 per share, of Ottawa Savings Bancorp.

“Ottawa Savings Bancorp Common Stock Market Price Per Share” shall be the fair market value of a share of Ottawa Savings Bancorp Common Stock as determined by the Ottawa Stock Valuation. The initial Ottawa Savings Bancorp Common Stock Market Price Per Share shall have been determined as of June 6, 2014. The Ottawa Savings Bancorp Common Stock Market Price Per Share will be updated as of a date no earlier than 20 calendar days before the Effective Date.

“Ottawa Stock Valuation” means the fair market value of a share of Ottawa Savings Bancorp Common Stock as determined by a fair valuation of the outstanding shares of Ottawa Savings Bancorp Common Stock prepared by an independent appraisal firm that is expert in preparing stock valuations for financial institutions.

“Participation Facility” means any facility in which the applicable party (or a Subsidiary of it) participates in the management (including all property held as trustee or in any other fiduciary capacity) and, where required by the context, includes the owner or operator of such property, but only with respect to such property.

“person” means an individual, corporation, limited liability company, partnership, association, trust, unincorporated organization or other entity.

“SEC” means the U.S. Securities and Exchange Commission.

“Securities Act” means the Securities Act of 1933, as amended.

“Subsidiary” means a corporation, partnership, joint venture or other entity in which a party hereto has, directly or indirectly, an equity interest representing 50% or more of any class of the capital stock thereof or other equity interests therein.

“Superior Proposal” means an unsolicited, bona fide written offer made by a third party to consummate an Acquisition Proposal that Twin Oaks’ Board of Directors determines in good faith, after consulting with its outside legal counsel and its financial advisors, would, if consummated, result in a transaction that is more favorable to the members of

Twin Oaks than the transactions contemplated hereby (taking into account all legal, financial, regulatory and other aspects of the proposal and the entity making the proposal).

“**Taxes**” means all income, franchise, gross receipts, real and personal property, real property transfer and gains, wage and employment taxes.

A-6

“**Voting Agreement**” means the agreement, in the form of Exhibit A hereto, executed by each of the directors and executive officers of Twin Oaks to cast his or her votes in favor of this Agreement and the Merger.

ARTICLE II

The Merger

2.1 The Merger.

(a) *General.* On the Effective Date, Twin Oaks will merge with and into Ottawa Savings Bank with Ottawa Savings Bank as the resulting institution (the “**Merger**”). At the Effective Time of the Merger, the separate corporate existence of Twin Oaks shall cease. Ottawa Savings Bank shall be the surviving institution in the Merger and shall continue to be governed by the HOLA and the regulations of the OCC thereunder and its name and separate corporate existence, with all of its rights, privileges, immunities, powers and franchises, shall continue unaffected by the Merger. As a result of the Merger, each borrower member of Twin Oaks and each holder of a deposit account in Twin Oaks as of the Effective Time of the Merger shall have the same rights and privileges in Ottawa Savings Bank as if such borrowing and/or deposit account, respectively, had been established at Ottawa Savings Bank, and all deposit accounts established at Twin Oaks prior to the Effective Time of the Merger shall confer on a depositor the same rights and privileges in Ottawa Savings Bank as if such deposit account had been established at Ottawa Savings Bank on the date established at Twin Oaks.

(b) *Federal Reserve Board Approval OCC and Illinois Department of Financial and Professional Regulation Approval.* The Merger shall not be effective until and unless the acquisition of Twin Oaks by Ottawa Savings Bancorp MHC and Ottawa Savings Bancorp is approved by the Federal Reserve Board and the Merger is approved by the OCC and, if required, the Illinois Department of Financial and Professional Regulation. The Effective Date of the Merger shall be the date on which articles of combination for the Merger are endorsed by the OCC.

(c) *Home Office and Branches of Resulting Institutions.* The home office of the resulting institution from the Merger shall be 925 LaSalle Street, Ottawa, Illinois 61350. The branch offices of Ottawa Savings Bank and Twin Oaks that are in lawful operation immediately prior to the Merger shall continue to be operated, at the same locations, as branch offices of the resulting institution; *provided however*, that the branch offices of Twin Oaks located at 125 West Bluff Street, Marseilles, Illinois 61341 and 1508 Creek Drive, Morris, Illinois 60450 will be operated under the name “Twin Oaks Savings Bank, a division of Ottawa Savings Bank,” subject to applicable laws, rules and regulations governing names of divisions of federal savings banks.

(d) *Business of Resulting Institutions.* The business of Ottawa Savings Bank as the resulting institution shall be that of a federally chartered savings bank as provided in its charter. All assets, rights, interests, privileges, powers, franchises and property (real, personal and mixed) of Twin Oaks and Ottawa Savings Bank shall be automatically transferred to and vested in Ottawa Savings Bank as the resulting institution by virtue of the Merger without any deed or other document of transfer. Ottawa Savings Bank as the resulting institution, without any order or action on the part of any court or otherwise and without any documents of assumption or assignment shall hold and enjoy all of the properties, franchises and interests, including appointments, powers, designations, nominations and all other rights and interests as the agent or other fiduciary in the same manner and to the same extent as such rights, franchises, and interests and powers were held or enjoyed by Twin Oaks and Ottawa Savings Bank. Ottawa Savings Bank as the resulting institution shall be responsible for all of the liabilities, restrictions and duties of every kind and description of both Twin Oaks and Ottawa Savings Bank immediately prior to the Merger, including, without limitation, liabilities for all savings accounts, deposits, debts, obligations and contracts of Twin Oaks and Ottawa Savings Bank, matured or unmatured, whether accrued, absolute, contingent or otherwise and whether or not reflected or reserved against on balance sheets, books of accounts or records of Twin Oaks or Ottawa Savings Bank. All rights of creditors and other obligees and all liens on property of either Twin Oaks or Ottawa Savings Bank shall be preserved and shall not be released or impaired. The interests of members, if any, in Twin Oaks and Ottawa Savings Bank shall continue after the Merger in the resulting institution.

(e) *Directors and Officers of Resulting Institution.* In accordance with *Section 5.13(c)* hereof, the directors of Ottawa Savings Bank, as the resulting institution, following the Merger shall be those persons identified in Exhibit B hereto and the senior executive officers of Ottawa Savings Bank, as the resulting institution, following the Merger shall be those persons identified in Exhibit C hereto.

2.2 Closing. The closing of the transactions contemplated by this Agreement (the “**Closing**”) will take place at the offices of Kilpatrick Townsend & Stockton LLP, 607 14th Street, N.W., Washington, DC at 10:00 a.m. on the date designated by Ottawa within thirty days following satisfaction or waiver of the conditions to Closing set forth in Article VI (other than those conditions that by their nature are to be satisfied at the Closing), or at such other location or such later date as the parties may otherwise agree (the “**Closing Date**”).

2.3 Effective Time. In connection with the Closing, the parties hereto shall duly execute and deliver articles of combination to the OCC for filing and endorsement pursuant to the HOLA and the regulations of the OCC thereunder with respect to the Merger. The Merger shall become effective on such date (the “**Effective Date**”) and at such time as the parties hereto agree and specify in the articles of combination (the time such merger becomes effective being the “**Effective Time**”).

2.4 Effect on Outstanding Shares of Ottawa Savings Bancorp Common Stock.

(a) Subject to *Section 2.4(b)* hereof, at and after the Effective Time, each share of Ottawa Savings Bancorp Common Stock issued and outstanding immediately prior to the Effective Time shall remain an issued and outstanding share of common stock of Ottawa Savings Bancorp and shall not be affected by the Merger.

(b) At the Effective Time, Ottawa Savings Bancorp shall issue to Ottawa Savings Bancorp MHC a number of additional shares of Ottawa Savings Bancorp Common Stock equal to the quotient obtained by dividing the Appraised Value of Twin Oaks by the Ottawa Savings Bancorp Common Stock Market Price Per Share rounded to the nearest whole number of shares.

2.5 Alternative Structure. Notwithstanding anything to the contrary contained in this Agreement, prior to the Effective Time, Ottawa may, subject to the filing of all necessary applications, if any, and the receipt of all required regulatory approvals, if any, specify that the structure of the transactions contemplated by this Agreement be revised and the parties shall enter into such alternative transactions or take actions deemed necessary as Ottawa may determine to effect the purposes of this Agreement; *provided, however*, that such revised structure or actions shall not (i) adversely affect the rights of the depositors or members of Twin Oaks; (ii) materially impede or delay the receipt of any regulatory approval in such a manner as could reasonably be expected to delay the Effective Time beyond December 31, 2014; or (iii) change the benefits or other arrangements provided to or on behalf of Twin Oaks' directors, officers or employees in this Agreement. This Agreement and any related documents shall be appropriately amended in order to reflect any such revised structure.

ARTICLE III

Representations and Warranties

3.1 Disclosure Letters. Prior to the execution and delivery of this Agreement, Twin Oaks on the one hand and Ottawa on the other hand have each delivered to the other a letter (each, its "**Disclosure Letter**") setting forth, among other things, facts, circumstances and events the disclosure of which is required or appropriate either in response to an express disclosure requirement contained in a provision hereof or as an exception to one or more of their respective representations and warranties contained in *Sections 3.2 and 3.3*, as applicable, or to one or more of its covenants contained in Articles IV or V (and making specific reference to the section of this Agreement to which they relate). The mere inclusion of a fact, circumstance or event in a Disclosure Letter shall not be deemed an admission by a party that such item represents a material exception or that such item is reasonably likely to result in a Material Adverse Effect. Any matter disclosed pursuant to one section of a party's Disclosure Letter shall be deemed disclosed for all purposes of such party's Disclosure Letter.

A-9

3.2 Representations and Warranties of Twin Oaks. Except as set forth in the Twin Oaks Disclosure Letter, Twin Oaks represents and warrants the following to Ottawa:

(a) *Organization.* Twin Oaks is a savings bank validly existing in the mutual form of organization under the laws of State of Illinois. Twin Oaks has all requisite corporate power and authority to own, lease and operate its properties and to conduct the business currently being conducted by it. Twin Oaks is duly qualified or licensed as a foreign corporation to transact business and is in good standing in each jurisdiction in which the character of the properties owned or leased by it or the nature of the business conducted by it makes such qualification or licensing necessary, except where the failure to be so qualified or licensed and in good standing would not have a Material Adverse Effect on Twin Oaks. Twin Oaks has no direct or indirect subsidiaries.

(b) *Capital Structure.* As of the date of this Agreement, (i) Twin Oaks does not have any authorized or outstanding capital stock, and (ii) Twin Oaks does not have and is not bound by any outstanding subscriptions, options, warrants, calls, rights, convertible securities, commitments or agreements of any character obligating Twin Oaks to issue, deliver or sell, or cause to be issued, delivered or sold, any shares of capital stock of Twin Oaks or obligating Twin Oaks to grant, extend or enter into any such option, warrant, call, right, convertible security, commitment or agreement.

(c) *Authority.* Twin Oaks has all requisite corporate power and authority to enter into this Agreement, to perform its obligations hereunder and, subject to the consents, approvals and filings set forth in *Section 3.2(e)*, to consummate the transactions contemplated by this Agreement. The execution and delivery of this Agreement and the consummation of the transactions contemplated by this Agreement have been duly authorized by all necessary corporate actions on the part of Twin Oaks' Board of Directors, and, except for the approval and adoption of this Agreement by the members of Twin Oaks, no other corporate proceedings on the part of Twin Oaks are necessary to authorize this Agreement or to consummate the transactions contemplated by this Agreement. This Agreement has been duly and validly executed and delivered by Twin Oaks and constitutes a valid and binding obligation of Twin Oaks, enforceable in accordance with its terms, subject to applicable bankruptcy, insolvency and similar laws affecting creditors' rights and remedies generally and to general principles of equity, whether applied in a court of law or a court of equity.

(d) *No Violations.* The execution, delivery and performance of this Agreement by Twin Oaks do not, and the consummation of the transactions contemplated by this Agreement will not, (i) assuming all required member and governmental approvals have been obtained and the applicable waiting periods have expired, violate any law, rule or regulation or any judgment, decree, order, governmental permit or license to which Twin Oaks (or any of its properties) is subject, (ii) violate the chartering documents or bylaws of Twin Oaks or (iii) constitute a breach or violation of, or a default under (or an event which, with due notice or lapse of time or both, would constitute a default under), or result in the termination of, accelerate the performance required by, or result in the creation of any Lien upon any of the properties or assets of Twin Oaks under any of the terms, conditions or provisions of any note, bond, indenture, deed of trust, loan agreement or other agreement, instrument or obligation to which Twin Oaks is a party, or to which any of its properties or assets may be subject, except, in the case of (iii), for any such breaches, violations or

defaults that would not, individually or in the aggregate, have a Material Adverse Effect on Twin Oaks.

A-10

(e) *Consents.* No consents or approvals of, or filings or registrations with, any Governmental Entity or, except for the approval of members referred to in Section 3.2(c), any third party are required to be made or obtained in connection with the execution and delivery by Twin Oaks of this Agreement or the consummation by Twin Oaks of the merger and the other transactions contemplated by this Agreement, except for (i) filings of applications and notices with, receipt of approvals or nonobjections from, and expiration of the related waiting period required by federal and state banking authorities, including filings and notices with the Federal Reserve Board, the OCC and the Illinois Department of Financial and Professional Regulation and (ii) the filing of articles of combination with the OCC. As of the date hereof, Twin Oaks has no knowledge of any reason pertaining to Twin Oaks why any of the approvals referred to in this *Section 3.2(e)* should not be obtained without the imposition of any material condition or restriction described in *Section 6.1(b)*.

(f) *Governmental Filings.* Twin Oaks has filed all material reports, schedules, registration statements and other documents that it has been required to file since January 1, 2011 with the State of Illinois, the FDIC, the Illinois Department of Financial and Professional Regulation and any other Governmental Entity. As of their respective dates, each of such filings complied in all material respects with all laws or regulations under which it was filed (or was amended so as to be in compliance promptly following discovery of such noncompliance).

(g) *Financial Statements.* Twin Oaks has previously provided to Ottawa its balance sheets as of March 31, 2014 and 2013 and related statements of income, for each of the two years in the period ended March 31, 2013 (the “**Twin Oaks Financial Statements**”). The Twin Oaks Financial Statements were prepared from the books and records of Twin Oaks, fairly present the financial position of Twin Oaks at and as of the dates indicated and the results of operations, retained earnings and cash flows of Twin Oaks for the periods indicated.

(h) *Absence of Certain Changes or Events.* Since March 31, 2013, (i) Twin Oaks has conducted its business only in the ordinary and usual course of such business consistent with its past practices, (ii) there has not been any event or occurrence that has had, or is reasonably expected to have, a Material Adverse Effect on Twin Oaks (iii) except as contemplated by Section 5.11 of this Agreement, there has been no increase in the salary, compensation, pension or other benefits payable or to become payable by Twin Oaks to any of its directors, officers or employees, other than in conformity with the policies and practices of Twin Oaks in the usual and ordinary course of its business, (iv) except as contemplated by Section 5.11 of this Agreement, Twin Oaks has not paid or made any accrual or arrangement for payment of bonuses or special compensation of any kind or any severance or termination pay to any of its directors, officers or employees other than in conformity with the policies and practices of Twin Oaks in the usual and ordinary course of its business, and (v) there has been no change in any accounting principles, practices or methods of Twin Oaks other than as required by GAAP.

(i) *Litigation.* There are no suits, actions or legal, administrative or arbitration proceedings pending or, to the knowledge of Twin Oaks, threatened against or affecting Twin Oaks or any property or asset of Twin Oaks that, (i) are seeking damages or declaratory relief against Twin Oaks or (ii) challenge the validity or propriety of the transactions contemplated by the Agreement. To the knowledge of Twin Oaks, there are no investigations, reviews or inquiries by any court or Governmental Entity pending or threatened against Twin Oaks. There are no judgments, decrees, injunctions, orders or rulings of any Governmental Entity or arbitrator outstanding against Twin Oaks.

(j) *Absence of Regulatory Actions.* Since January 1, 2011, Twin Oaks has not been a party to any cease and desist order, written agreement or memorandum of understanding with, or any commitment letter or similar undertaking to, or has been subject to any action, proceeding, order or directive by, any Government Regulator, or has adopted any board resolutions at the request of any Government Regulator, or has been advised by any Government Regulator that it is contemplating issuing or requesting (or is considering the appropriateness of issuing or requesting) any such action, proceeding, order, directive, written agreement, memorandum of understanding, commitment letter, board resolutions or similar undertaking. To the knowledge of Twin Oaks, there are no material unresolved violations, criticisms or exceptions by any Governmental Regulator with respect to any report or statement relating to any examination of Twin Oaks.

(k) *Taxes.* All federal, state, local and foreign tax returns required to be filed by or on behalf of Twin Oaks have been timely filed or requests for extensions have been timely filed and any such extension shall have been granted and not have expired, and all such filed returns are complete and accurate in all material respects. All Taxes shown on such returns, all Taxes required to be shown on returns for which extensions have been granted and all other Taxes required to be paid by Twin Oaks have been paid in full or adequate provision has been made for any such Taxes. Except as set forth in the Twin Oaks Disclosure Letter, as of the date of this Agreement, there is no audit examination, deficiency assessment, tax investigation or refund litigation with respect to any Taxes of Twin Oaks, and no claim has been made by any authority in a jurisdiction where Twin Oaks does not file tax returns that Twin Oaks is subject to taxation in that jurisdiction. All Taxes, interest, additions and penalties due with respect to completed and settled examinations or concluded litigation relating to Twin Oaks have been paid in full or adequate provision has been made for any such Taxes. Twin Oaks has not executed an extension or waiver of any statute of limitations on the assessment or collection of any Tax due that is currently in effect. Twin Oaks has withheld and paid all Taxes required to have been withheld and paid in connection with amounts paid or owing to any employee, independent contractor, creditor, stockholder or other third party, and Twin Oaks has timely complied with all applicable information reporting requirements under Part III, Subchapter A of Chapter 61 of the IRC and similar applicable state and local information reporting requirements. Twin Oaks is not a party to any agreement, contract, arrangement or plan that has resulted or would result, individually or in the aggregate, in connection with this Agreement in the payment to any individual of any “excess parachute payments” within the meaning of Section 280G of the IRC and Twin Oaks has not made any payments and is not a party to any agreement, and does not maintain any plan, program or arrangement, that could require it to make any payments that would not be fully deductible by reason of Section 162(m) of the IRC.

(l) *Agreements.*

(i) Twin Oaks' Disclosure Letter lists any contract, arrangement, commitment or understanding (whether written or oral) to which Twin Oaks is a party or is bound:

(A) with any officer of Twin Oaks the benefits of which are contingent, or the terms of which are materially altered, upon the occurrence of a transaction involving Twin Oaks of the nature contemplated by this Agreement;

(B) with respect to the employment of any directors, officers, employees or consultants;

(C) any of the benefits of which will be increased, or the vesting or payment of the benefits of which will be accelerated, by the occurrence of any of the transactions contemplated by this Agreement, or the value of any of the benefits of which will be calculated on the basis of any of the transactions contemplated by this Agreement;

(D) that (1) contains a non-compete or client or customer non-solicit requirement or any other provision that restricts the conduct of, or the manner of conducting, any line of business of Twin Oaks (or, following the consummation of the transactions contemplated hereby, Ottawa or any of its Subsidiaries), (2) obligates Twin Oaks or any of its affiliates (or, following the consummation of the transactions contemplated hereby, Ottawa or any of its Subsidiaries) to conduct business with any third party on an exclusive or preferential basis, or (3) requires referrals of business or requires Twin Oaks to make available investment opportunities to any person on a priority or exclusive basis;

(E) pursuant to which Twin Oaks may become obligated to invest in or contribute capital to any entity;

(F) that relates to borrowings of money (or guarantees thereof) by Twin Oaks in excess of \$50,000, other than Federal Home Loan Bank borrowings and repurchase agreements with customers entered into in the ordinary course of business;

(G) which is a lease or license with respect to any property, real or personal, whether as landlord, tenant, licensor or licensee, involving a liability or obligation as obligor in excess of \$25,000 on an annual basis;

(H) that was not made in the ordinary course of business which is material to Twin Oaks and is to be performed in whole or in part at or after the execution of this Agreement or was entered into not more than two years before such execution. Only contracts need be identified as to which Twin Oaks is a party or has succeeded to a party by assumption or assignment or in which Twin Oaks has a beneficial interest;

(I) that grants any right of first refusal, right of first offer or similar right with respect to any material assets, rights or properties of Twin Oaks;

(J) that relates to the involvement of Twin Oaks in a joint venture, partnership, limited liability company agreement or other similar agreement or arrangement, or to the formation, creation or operation, management or control of any partnership or joint venture with any third parties;

(K) upon which Twin Oaks' business is substantially dependent, as in the case of continuing contracts to sell the major part of Twin Oaks' products or services or to purchase the major part of Twin Oaks' requirements of goods, services or raw materials or any franchise or license or other agreement to use a patent, formula, trade secret, process or trade name upon which Twin Oaks' business depends to a material extent;

(L) calling for the acquisition or sale of any property, plant or equipment for a consideration exceeding 15% of the fixed assets of Twin Oaks;

(M) which is a consulting agreement or data processing, software programming or licensing contract involving the payment of more than \$25,000 per annum;

(N) which is a management contract or any compensatory plan, contract or arrangement, including but not limited to plans relating to pension, retirement or deferred compensation or bonus, incentive or profit sharing (or if not set forth in any formal document, a written description thereof) in which any director or any of the executive officers of the Twin Oaks participates, and any other management contract or any compensatory plan, contract, or arrangement in which any other executive officer of the Twin Oaks participates shall be identified unless immaterial in amount or significance; and

(O) which is not of the type described in clauses (A) through (N) above and that involved payments by, or to, Twin Oaks in the fiscal year ended March 31, 2014, or which could reasonably be expected to involve such payments during the fiscal year ending March 31, 2015, of more than \$25,000 (excluding Loans or Deposits) or the termination of which would require payment by Twin Oaks in excess of \$25,000.

A-14

(ii) Twin Oaks is not in default under (and, to Twin Oaks' knowledge, no event has occurred which, with due notice or lapse of time or both, would constitute a default under) or is in violation of any provision of any note, bond, indenture, mortgage, deed of trust, loan agreement, lease or other agreement to which it is a party or by which it is bound or to which any of its respective properties or assets is subject and, to the knowledge of Twin Oaks, no other party to any such agreement (excluding any loan or extension of credit made by Twin Oaks) is in default in any respect thereunder, except for such defaults or violations that would not, individually or in the aggregate, have a Material Adverse Effect on Twin Oaks.

(m) *Intellectual Property*. Twin Oaks owns or possesses valid and binding licenses and other rights to use (in the manner and the geographic areas in which they are currently used) without payment all patents, copyrights, trade secrets, trade names, service marks and trademarks material to its business. Twin Oaks' Disclosure Letter sets forth a complete and correct list of all material trademarks, trade names, service marks and copyrights owned by or licensed to Twin Oaks for use in its business, and all licenses and other agreements relating thereto and all agreements relating to third party intellectual property that Twin Oaks is licensed or authorized to use in its business, including without limitation any software licenses but excluding any so-called "shrink-wrap" license agreements and other similar computer software licensed in the ordinary course of business and/or otherwise resident on desktop computers (collectively, the "**Intellectual Property**"). With respect to each item of Intellectual Property owned by the Twin Oaks, the owner possesses all right, title and interest in and to the item, free and clear of any Lien. With respect to each item of Intellectual Property that Twin Oaks is licensed or authorized to use, the license, sublicense or agreement covering such item is legal, valid, binding, enforceable and in full force and effect as to Twin Oaks. Twin Oaks has not received any charge, complaint, claim, demand or notice alleging any interference, infringement, misappropriation or violation with or of any intellectual property rights of a third party (including any claims that Twin Oaks must license or refrain from using any intellectual property rights of a third party). To the knowledge of Twin Oaks, Twin Oaks has not interfered with, infringed upon, misappropriated or otherwise come into conflict with any intellectual property rights of third parties and no third party has interfered with, infringed upon, misappropriated or otherwise come into conflict with any intellectual property rights of Twin Oaks.

(n) *Labor Matters*.

(i) Twin Oaks is in material compliance with all applicable laws respecting employment, retention of independent contractors, employment practices, terms and conditions of employment, and wages and hours. Twin Oaks is not and has never been a party to, been bound by, any collective bargaining agreement, contract or other agreement or understanding with a labor union or labor organization with respect to its employees, and Twin Oaks is not the subject of any proceeding asserting that it has committed an unfair labor practice or seeking to compel it to bargain with any labor organization as to wages and conditions of employment nor, to the knowledge of Twin Oaks, has any such proceeding been threatened, nor is there any strike, other labor dispute or organizational effort involving Twin Oaks pending or, to the knowledge of Twin Oaks, threatened.

(ii) Twin Oaks' Disclosure Letter identifies (A) all present employees (including any leased or temporary employees) of Twin Oaks and any consultants or independent contractors providing services to Twin Oaks; (B) each employee's, consultant's or independent contractor's current rate of compensation; and (C) each employee's accrued vacation, sick leave or personal leave if applicable. There are no unpaid wages, bonuses or commissions owed to any employee (other than those not yet due).

(o) *Employee Benefit Plans.*

(i) Twin Oaks' Disclosure Letter contains a complete and accurate list of all pension, retirement, savings, profit sharing, deferred compensation, consulting, bonus, group insurance, severance and other benefit plans, contracts, agreements and arrangements, including, but not limited to, "employee benefit plans," as defined in Section 3(3) of ERISA, incentive and welfare policies, contracts, plans and arrangements and all trust agreements related thereto with respect to any present or former directors, officers or other employees of Twin Oaks (hereinafter referred to collectively as the "**Twin Oaks Employee Plans**"). There has been no announcement or commitment by Twin Oaks to create an additional Twin Oaks Employee Plan, or to amend any Twin Oaks Employee Plan, except for amendments required by applicable law that do not materially increase the cost of such Twin Oaks Employee Plan. With respect to each Twin Oaks Employee Plan, Twin Oaks has previously made available to Ottawa a true and correct copy of (A) the annual report on the applicable form of the Form 5500 series filed with the IRS for the most recent three plan years, if required to be filed, (B) such Twin Oaks Employee Plan, including amendments thereto, (C) each trust agreement, insurance contract or other funding arrangement relating to such Twin Oaks Employee Plan, including amendments thereto, (D) the most recent summary plan description and summary of material modifications thereto for such Twin Oaks Employee Plan, to the extent available, if the Twin Oaks Employee Plan is subject to Title I of ERISA, and (E) the most recent actuarial report or valuation if such Twin Oaks Employee Plan is a Twin Oaks Pension Plan and any subsequent changes to the actuarial assumptions contained therein. Each Twin Oaks Employee Plan that provides for the payment of "deferred compensation," including any employment agreement between Twin Oaks and any employee, complies in all material respects with Section 409A of the IRC.

(ii) There is no pending or, to Twin Oaks' knowledge, threatened litigation, administrative action or proceeding relating to any Twin Oaks Employee Plan. All of the Twin Oaks Employee Plans comply in all material respects with all applicable requirements of ERISA, the IRC and other applicable laws. To Twin Oaks' knowledge, there has occurred no "prohibited transaction" (as defined in Section 406 of ERISA or Section 4975 of the IRC) with respect to the Twin Oaks Employee Plans that is likely to result in the imposition of any penalties or Taxes upon Twin Oaks under Section 502(i) of ERISA or Section 4975 of the IRC.

(iii) No liability to the Pension Benefit Guarantee Corporation has been or is expected by Twin Oaks to be incurred with respect to any Twin Oaks Employee Plan that is subject to Title IV of ERISA (“**Twin Oaks Pension Plan**”), or with respect to any “single-employer plan” (as defined in Section 4001(a) of ERISA) currently or formerly maintained by Twin Oaks or any ERISA Affiliate. No Twin Oaks Pension Plan had an “accumulated funding deficiency” (as defined in Section 302 of ERISA), whether or not waived, as of the last day of the end of the most recent plan year ending prior to the date hereof; the fair market value of the assets of each Twin Oaks Pension Plan exceeds the present value of the “benefit liabilities” (as defined in Section 4001(a)(16) of ERISA) under such Twin Oaks Pension Plan as of the end of the most recent plan year with respect to the respective Twin Oaks Pension Plan ending prior to the date hereof, calculated on the basis of the actuarial assumptions used in the most recent actuarial valuation for such Twin Oaks Pension Plan as of the date hereof; and no notice of a “reportable event” (as defined in Section 4043 of ERISA) for which the 30-day reporting requirement has not been waived has been required to be filed for any Twin Oaks Pension Plan within the 12-month period ending on the date hereof. Twin Oaks has not provided, and is not required to provide, security to any Twin Oaks Pension Plan or to any single-employer plan of an ERISA Affiliate pursuant to Section 401(a)(29) of the IRC. Neither Twin Oaks, nor any ERISA Affiliate, has contributed to any “multiemployer plan,” as defined in Section 3(37) of ERISA.

(iv) Each Twin Oaks Employee Plan that is an “employee pension benefit plan” (as defined in Section 3(2) of ERISA) and which is intended to be qualified under Section 401(a) of the IRC (an “**Twin Oaks Qualified Plan**”) has received a favorable determination letter from the IRS, and, to the knowledge of Twin Oaks, there are not any circumstances likely to result in revocation of any such favorable determination letter.

(v) Twin Oaks does not have any obligations for post-retirement or post-employment welfare benefits under any Twin Oaks Employee Plan that cannot be amended or terminated upon 60 days’ notice or less without incurring any liability thereunder, except for coverage required by Part 6 of Title I of ERISA or Section 4980B of the IRC, or similar state laws, the cost of which is borne by the insured individuals. Except as set forth in the Twin Oaks’ Disclosure Letter, the execution and delivery of this Agreement and the consummation of the transactions contemplated hereby will not result in any payment or series of payments by Twin Oaks to any person which is an “excess parachute payment” (as defined in Section 280G of the IRC) or is a nondeductible payment under Section 162(m) of the IRC, increase or secure (by way of a trust or other vehicle) any benefits payable under any Twin Oaks Employee Plan or accelerate the time of payment or vesting of any such benefit.

(vi) All contributions required to be made with respect to Twin Oaks Employee Plan by applicable law or regulation or by any plan document or other contractual undertaking, and all premiums due or payable with respect to insurance policies funding any Twin Oaks Employee Plan, for any period through the date hereof have been timely made or paid in full, or to the extent not required to be made or paid on or before the date hereof, have been fully reflected in the financial statements of Twin Oaks. Each Twin Oaks Employee Plan that is an employee welfare benefit plan under Section 3(1) of ERISA either (A) is funded through an insurance company contract and is not a “welfare benefit fund” within the meaning of Section 419 of the IRC or (B) is unfunded.

(vii) Twin Oaks’ Disclosure Letter contains a calculation of the severance payment (estimated where necessary) and a description of other benefits payable to each director, officer or employee of Twin Oaks that is a party to a severance, change in control or employment agreement, assuming that such person’s service with Twin Oaks terminates as of the Effective Time.

(p) *Title to Assets.* The Twin Oaks Disclosure Letter contains a complete and accurate list of all real property owned or leased by Twin Oaks, including all properties of Twin Oaks classified as “Real Estate Owned” or words of similar import. Twin Oaks has good and marketable title to its properties and assets (including any property acquired in a judicial foreclosure proceeding or by way of a deed in lieu of foreclosure or similar transfer) whether real or personal, tangible or intangible, in each case free and clear of any Liens except (i) liens for Taxes not yet due and payable, (ii) pledges to secure deposits and other Liens incurred in the ordinary course of business, and (iii) such easements, restrictions and encumbrances, if any, as are not material in character, amount or extent, and do not materially detract from the value, or materially interfere with the present use of the properties subject thereto or affected thereby. Each lease pursuant to which Twin Oaks is lessee or lessor is valid and in full force and effect and neither Twin Oaks, nor, to the knowledge of Twin Oaks, any other party to any such lease, is in default or in violation of any material provisions of any such lease. Twin Oaks has previously delivered to Ottawa a complete and correct copy of such lease. All real property owned or leased by Twin Oaks is in a good state of maintenance and repair (normal wear and tear excepted), conform in all material respects with all applicable ordinances, regulations and zoning laws and are considered by Twin Oaks to be adequate for the current business of Twin Oaks. To the knowledge of Twin Oaks, none of the buildings, structures or other improvements located on its real property encroaches upon or over any adjoining parcel or real estate or any easement or right-of-way.

(q) *Compliance with Laws.* Twin Oaks conducts its business in compliance with all statutes, laws, regulations, ordinances, rules, judgments, orders or decrees applicable to it or the employees conducting such business, except where noncompliance would not, individually or in the aggregate, reasonably be expected to have a Material Adverse Effect on Twin Oaks. Twin Oaks has all material permits, licenses, certificates of authority, orders and approvals of, and has made all filings, applications and registrations with, all Governmental Entities that are required in order to permit it to carry on its business as it is presently conducted; all such permits, licenses, certificates of authority, orders and approvals are in full force and effect, and no suspension or cancellation of any of them is, to the knowledge of Twin Oaks, threatened. Twin Oaks is not in violation of and Twin Oaks has not been given notice or been charged with any violation of, any law, ordinance, regulation, order, writ, rule, decree or condition to approval of any Governmental Entity which, individually or in the aggregate, would reasonably be expected to have a Material Adverse Effect on Twin Oaks.

A-18

(r) *Environmental Matters.*

(i) Each of Twin Oaks' properties, the Participation Facilities, and, to the knowledge of Twin Oaks, the Loan Properties are, and have been, during the period of Twin Oaks' ownership or operation thereof, in material compliance with all Environmental Laws.

(ii) There is no suit, claim, action, demand, executive or administrative order, directive, investigation or proceeding pending or, to the knowledge of Twin Oaks, threatened, before any court, or Governmental Entity against Twin Oaks or any Participation Facility (A) for alleged noncompliance (including by any predecessor) with, or liability under, any Environmental Law or (B) relating to the presence of or release into the environment of any Hazardous Material, whether or not occurring at or on a site owned, leased or operated by Twin Oaks or any Participation Facility.

(iii) To the knowledge of Twin Oaks, there is no suit, claim, action, demand, executive or administrative order, directive, investigation or proceeding pending or threatened before any court or Governmental Entity relating to or against any Loan Property (or Twin Oaks in respect of such Loan Property) (A) relating to alleged noncompliance (including by any predecessor) with, or liability under, any Environmental Law or (B) relating to the presence of or release into the environment of any Hazardous Material, whether or not occurring at a Loan Property.

(iv) Twin Oaks has not received in writing any notice, demand letter, executive or administrative order, directive or request for information from any Governmental Entity or any third party indicating that it may be in violation of, or liable under, any Environmental Law.

(v) To the knowledge of Twin Oaks, there are no underground storage tanks at any properties owned or operated by Twin Oaks or any Participation Facility and, except as set forth in the Twin Oaks Disclosure Letter, no underground storage tanks have been closed or removed from any properties owned or operated by Twin Oaks or any Participation Facility.

(vi) During the period of (A) the ownership or operation by Twin Oaks of any of its current properties or (B) the participation of Twin Oaks in the management of any Participation Facility, there has been no release of Hazardous Materials in, on, under or affecting such properties. To the knowledge of Twin Oaks, prior to the period of (A) the ownership or operation by Twin Oaks of any of its current properties or (B) the participation of Twin Oaks in the management of any Participation Facility, there was no contamination by or release of Hazardous Material in, on, under or affecting such properties.

(s) *Loan Portfolio; Allowance for Loan Losses; Asset Quality.*

(i) All Loans held by Twin Oaks were made in all material respects for good, valuable and adequate consideration in the ordinary course of the business, and, to the knowledge of Twin Oaks, the Loans are not subject to any defenses, setoffs or counterclaims, including without limitation any such as are afforded by usury or truth in lending laws, except as may be provided by bankruptcy, insolvency or similar laws or by general principles of equity.

(ii) With respect to each Loan owned by Twin Oaks in whole or in part:

(A) the note and the related security documents are each legal, valid and binding obligations of the maker or obligor thereof, enforceable against such maker or obligor in accordance with their terms;

(B) neither Twin Oaks, nor any prior holder of a Loan, has modified the note or any of the related security documents in any material respect or satisfied, canceled or subordinated the note or any of the related security documents except as otherwise disclosed by documents in the applicable Loan file;

(C) Twin Oaks is the sole holder of legal and beneficial title to each Loan (or its participation interest, as applicable), except as otherwise referenced on the books and records of Twin Oaks;

(D) the original note and the related security documents are included in the Loan files, and copies of any documents in the Loan files are true and correct copies of the documents they purport to be and have not been suspended, amended, modified, canceled or otherwise changed except as otherwise disclosed by documents in the applicable Loan file;

(E) with respect to a Loan held in the form of a participation, the participation documentation is legal, valid, binding and enforceable in accordance with its terms, subject to bankruptcy, insolvency, fraudulent conveyance and other laws of general applicability relating to or affecting creditors' rights and to general equity principles;

(F) there is no pending or, to the knowledge of Twin Oaks, threatened, condemnation proceeding or similar proceeding affecting the property that serves as security for a Loan, except as otherwise referenced on the books and records of Twin Oaks; and

A-20

(G) other than foreclosure or other collection proceedings initiated by Twin Oaks in the ordinary course of business, to the knowledge of Twin Oaks, there is no litigation or proceeding pending or, to the knowledge of Twin Oaks, threatened relating to the property that serves as security for a Loan that would have a material adverse effect upon the related Loan.

(iii) Neither the terms of any Loan, any of the documentation for any Loan, the manner in which any Loans have been administered and serviced, nor the practices of approving or rejecting Loan applications, violate in any material respect any federal, state, or local law, rule or regulation applicable thereto, including, without limitation, the Truth In Lending Act, Regulations O and Z of the Federal Reserve Board, the CRA, the Equal Credit Opportunity Act, and any state laws, rules and regulations relating to consumer protection, installment sales and usury.

(iv) The allowance for loan losses reflected in Twin Oaks' balance sheet at March 31, 2014 was, and the allowance for loan losses shown on the balance sheets in Twin Oaks' Reports for periods ending after March 31, 2014, in the opinion of management, was or will be adequate, as of the dates thereof.

(v) Twin Oaks' Disclosure Letter sets forth a true and complete listing, as of March 31, 2014, of:

(A) all Loans that have been classified (whether regulatory or internal) as "Special Mention," "Substandard," "Doubtful," "Loss" or words of similar import listed by category, including the amounts thereof; and

(B) Loans (1) that are contractually past due 90 days or more in the payment of principal and/or interest, (2) that are on a non-accrual status, (3) where the interest rate terms have been reduced and/or the maturity dates have been extended by Twin Oaks due to concerns regarding the borrower's ability to pay in accordance with such initial terms, or (4) where a specific reserve allocation exists in connection therewith, listed by category, including the amounts thereof.

(vi) Twin Oaks is not a party to any Loan that is in violation, in any material respect, of any law, regulation or rule of any Governmental Entity. Any asset of Twin Oaks that is classified as "Real Estate Owned" or words of similar import that is included in any non-performing assets of Twin Oaks is listed in the Twin Oaks Disclosure Letter and is carried net of reserves at the lower of cost or fair value, less estimated selling costs, based on current independent appraisals or evaluations or current management appraisals or evaluations; *provided, however*, that "current" shall mean within the past 12 months.

(vii) (A) Twin Oaks' Disclosure Letter sets forth a list of all Loans as of the date hereof by Twin Oaks to any directors, executive officers and principal stockholders (as such terms are defined in Regulation O of the Federal Reserve Board (12 C.F.R. Part 215)) of Twin Oaks, (B) there are no Loans to any employee, officer, director or affiliate thereof on which the borrower is paying a rate other than that reflected in the note or other relevant credit or security agreement or on which the borrower is paying a rate which was not in compliance with Regulation O and (C) all such Loans are and were originated in compliance in all material respects with all applicable laws.

(t) *Deposits.* The deposit accounts of Twin Oaks are insured by the FDIC to the maximum extent permitted by law. Except as set forth in the Twin Oaks Disclosure Letter, none of the deposits of Twin Oaks is a "brokered" deposit.

(u) *Anti-takeover Provisions Inapplicable.* Twin Oaks has taken all actions required to exempt Ottawa, the Agreement and the transactions contemplated hereby from any provisions of an antitakeover nature contained in its organizational documents, and the provisions of any federal or state "anti-takeover," "fair price," "moratorium," "control share acquisition" or similar laws or regulations.

(v) *Material Interests of Certain Persons.* Except for deposit and loan relationships entered into in the ordinary course of business, no officer or director of Twin Oaks, or any affiliate of any such officer or director, has any material interest, directly or indirectly, in any material contract or property (real or personal), tangible or intangible, used in or pertaining to the business of Twin Oaks.

(w) *Insurance.* In the opinion of management, Twin Oaks is presently insured for amounts deemed reasonable by management against such risks as companies engaged in a similar business would, in accordance with good business practice, customarily be insured. Twin Oaks' Disclosure Letter contains a list of all policies of insurance carried and owned by Twin Oaks showing the name of the insurance company and agent, the nature of the coverage, the policy limit, the annual premiums and the expiration date. All of the insurance policies and bonds maintained by Twin Oaks are in full force and effect, Twin Oaks is not in default thereunder, all premiums and other payments due under such policy have been paid and all material claims thereunder have been filed in due and timely fashion.

(x) *Investment Securities.*

(i) Except for restrictions that exist for securities that are classified as "held to maturity," none of the investment securities held by Twin Oaks is subject to any restriction (contractual or statutory) that would materially impair the ability of the entity holding such investment freely to dispose of such investment at any time.

A-22

(ii) Twin Oaks is not party to and has not agreed to enter into an exchange-traded or over-the-counter equity, interest rate, foreign exchange or other swap, forward, future, option, cap, floor or collar or any other contract that is a derivative contract (including various combinations thereof) or owns securities that (A) are referred to generically as “structured notes,” “high risk mortgage derivatives,” “capped floating rate notes” or “capped floating rate mortgage derivatives” or (B) are likely to have changes in value as a result of interest or exchange rate changes that significantly exceed normal changes in value attributable to interest or exchange rate changes.

(y) *Indemnification.* Except as provided in the charter or bylaws of Twin Oaks, Twin Oaks is not a party to any agreement that provides for the indemnification of any of its present or former directors, officers or employees, or other persons who serve or served as a director, officer or employee of another corporation, partnership or other enterprise at the request of Twin Oaks and, to the knowledge of Twin Oaks, there are no claims for which any such person would be entitled to indemnification under the Articles of Incorporation and bylaws of Twin Oaks, under any applicable law or regulation or under any employment-related agreement.

(z) *Books and Records.* The books and records of Twin Oaks have been, and are being, maintained in accordance with applicable legal and accounting requirements and reflect in all material respects the substance of events and transactions that should be included therein.

(aa) *Corporate Documents.* Twin Oaks has previously furnished or made available to Ottawa a complete and correct copy of its charter and bylaws as in effect as of the date of this Agreement. Twin Oaks is not in violation of its chartering documents, bylaws or similar organizational documents. The minute books of Twin Oaks constitute a complete and correct record of all actions taken by its boards of directors (and each committee thereof) and its members.

(bb) *CRA, Anti-Money Laundering, OFAC and Customer Information Security.* Twin Oaks has received a rating of “Satisfactory” or better in its most recent examination or interim review with respect to the CRA. Twin Oaks does not have knowledge of any facts or circumstances that would cause it: (i) to be deemed not to be in satisfactory compliance in any material respect with the CRA, and the regulations promulgated thereunder, or to be assigned a rating for CRA purposes by federal bank regulators of lower than “Satisfactory”; or (ii) to be deemed to be operating in violation in any material respect of the Bank Secrecy Act, the USA PATRIOT Act, any order issued with respect to anti-money laundering by the U.S. Department of the Treasury’s Office of Foreign Assets Control, or any other applicable anti-money laundering statute, rule or regulation; or (iii) to be deemed not to be in satisfactory compliance in any material respect with the applicable privacy of customer information requirements contained in any federal and state privacy laws and regulations, including without limitation, in Title V of the Gramm-Leach-Bliley Act of 1999 and the regulations promulgated thereunder. To the knowledge of Twin Oaks, no non-public customer information has been disclosed to or accessed by an unauthorized third party in a manner which would cause either to undertake any remedial action. The Board of Directors of Twin Oaks has adopted and implemented, an anti-money laundering program that contains adequate and appropriate customer identification verification procedures that comply with Section 326 of the USA PATRIOT Act and such anti-money laundering program meets the requirements in all

material respects of Section 352 of the USA PATRIOT Act and the regulations thereunder, and Twin Oaks has complied in all material respects with any requirements to file reports and other necessary documents as required by the USA PATRIOT Act and the regulations thereunder.

A-23

(cc) *Undisclosed Liabilities.* Twin Oaks has not incurred any debt, liability or obligation of any nature whatsoever (whether accrued, contingent, absolute or otherwise and whether due or to become due) other than liabilities reflected on or reserved against in the balance sheet of Twin Oaks as of March 31, 2014, except for (i) liabilities incurred since March 31, 2014 in the ordinary course of business consistent with past practice that, either alone or when combined with all similar liabilities, have not had, and would not reasonably be expected to have, a Material Adverse Effect on Twin Oaks, and (ii) liabilities incurred for legal, accounting, financial advising fees and out-of-pocket expenses in connection with the transactions contemplated by this Agreement.

(dd) *Fees.* Neither Twin Oaks nor any of its officers, directors, employees or agents, has employed any broker or finder or incurred any liability for any financial advisory fees, brokerage fees, commissions or finder's fees, and no broker or finder has acted directly or indirectly for Twin Oaks in connection with this Agreement or the transactions contemplated hereby.

3.3 Representations and Warranties of Ottawa. Except as set forth in the Ottawa Disclosure Letter, Ottawa Savings Bancorp MHC, Ottawa Savings Bancorp and Ottawa Savings Bank jointly and severally represent and warrant the following. Any reference to "Ottawa" in this *Section 3.3* shall include each of Ottawa Savings Bancorp MHC, Ottawa Savings Bancorp and/or Ottawa Savings Bank individually, as and to the extent applicable.

(a) *Organization.* Ottawa Savings Bancorp MHC is a mutual holding company duly organized, validly existing and in good standing under the laws of the United States of America and is registered as a savings and loan holding company under the HOLA. Ottawa Savings Bancorp is a subsidiary holding company duly organized, validly existing and in good standing under the laws of the United States of America and is registered as a savings and loan holding company under the HOLA. Ottawa Savings Bank is a stock savings bank, validly existing and in good standing under the laws of the United States of America. Each of Ottawa Savings Bancorp MHC, Ottawa Savings Bancorp and Ottawa Savings Bank has all requisite corporate power and authority to own, lease and operate its properties and to conduct the business currently being conducted by it. Each of Ottawa Savings Bancorp MHC, Ottawa Savings Bancorp and Ottawa Savings Bank is duly qualified or licensed as a foreign corporation to transact business and is in good standing in each jurisdiction in which the character of the properties owned or leased by it or the nature of the business conducted by it makes such qualification or licensing necessary, except where the failure to be so qualified or licensed and in good standing would not have a Material Adverse Effect on Ottawa, considered as a whole.

(b) *Subsidiaries.*

(i) The authorized capital stock of Ottawa Savings Bank consists of 5,000 shares of common stock, par value \$1.00 per share, 100 of which are issued and outstanding and are owned by Ottawa Savings Bancorp and were issued in full compliance with all applicable laws and are owned by Ottawa Savings Bancorp free and clear of all liens and encumbrances.

(ii) Ottawa Savings Bancorp MHC has no Subsidiaries other than Ottawa Savings Bancorp. Ottawa Savings Bancorp has no direct Subsidiaries other than Ottawa Savings Bank. Each of Ottawa Savings Bank's Subsidiaries is a corporation duly organized and validly existing under the laws of its jurisdiction of incorporation, has all requisite corporate power and authority to own, lease and operate its properties and to conduct the business currently being conducted by it and is duly qualified or licensed as a foreign corporation to transact business and is in good standing in each jurisdiction in which the character of the properties owned or leased by it or the nature of the business conducted by it makes such qualification or licensing necessary, except where the failure to be so qualified or licensed and in good standing would not have a Material Adverse Effect on Ottawa considered as a whole.

(iii) The outstanding shares of capital stock of each Ottawa Subsidiary have been validly authorized and are validly issued, fully paid and nonassessable. No shares of capital stock of Ottawa Savings Bank or any Subsidiary of Ottawa Savings Bank are or may be required to be issued by virtue of any options, warrants or other rights, no securities exist that are convertible into or exchangeable for shares of such capital stock or any other debt or equity security of any Subsidiary, and there are no contracts, commitments, agreements or understandings of any kind for the issuance of additional shares of capital stock or other debt or equity security of any Subsidiary or options, warrants or other rights with respect to such securities.

(iv) Ottawa Savings Bank is an "insured depository institution" as defined in the Federal Deposit Insurance Act and the applicable regulations thereunder and no other Subsidiary of Ottawa is an "insured depository institution."

(c) *Capital Structure.*

(i) The authorized capital stock of Ottawa Savings Bancorp consists of 12,000,000 shares of Ottawa Savings Bancorp Common Stock and 1,000,000 shares of preferred stock, par value \$0.01 per share.

(ii) As of March 31, 2014, (A) 2,117,979 shares of Ottawa Savings Bancorp Common Stock were issued and outstanding, all of which are validly issued, fully paid and nonassessable and were issued in full compliance with all applicable laws; (B) no shares of Ottawa Savings Bancorp preferred stock were issued and outstanding; and (C) 4,539 shares of Ottawa Savings Bancorp Common Stock were reserved for issuance pursuant to outstanding grants or awards under Ottawa Savings Bancorp's stock-based benefit plans. Ottawa Savings Bancorp MHC is the record and beneficial owner of 1,223,701 shares of Ottawa Savings Bancorp Common Stock.

(iii) The shares of Ottawa Savings Bancorp Common Stock to be issued to Ottawa Savings Bancorp MHC upon consummation of the Merger in accordance with this Agreement have been duly authorized and when issued in accordance with the terms of this Agreement, will be validly issued, fully paid and nonassessable and subject to no preemptive rights. The issuance of the shares of Ottawa Savings Bancorp Common Stock to Ottawa Savings Bancorp MHC upon consummation of the Merger is exempt from registration under the Securities Act of 1933, as amended.

(d) *Authority.* Each of Ottawa Savings Bancorp MHC, Ottawa Savings Bancorp and Ottawa Savings Bank has all requisite corporate power and authority to enter into this Agreement, to perform its obligations hereunder and, subject to the consents, approvals and filings set forth in *Section 3.3(f)*, to consummate the transactions contemplated by this Agreement. The execution and delivery of this Agreement and the consummation of the transactions contemplated by this Agreement have been duly authorized by all necessary corporate actions on the part of the Board of Directors of each of Ottawa Savings Bancorp MHC, Ottawa Savings Bancorp and Ottawa Savings Bank, and no other corporate proceedings on the part of Ottawa Savings Bancorp MHC, Ottawa Savings Bancorp or Ottawa Savings Bank are necessary to authorize this Agreement or to consummate the transactions contemplated by this Agreement other than (i) the approval and adoption of this Agreement by the holders of the outstanding shares of Ottawa Savings Bancorp Common Stock (ii) if required, the approval and adoption of this Agreement, or any other matters required to be approved or adopted in or to carry out the intentions of this Agreement, by the members of Ottawa Savings Bancorp MHC. This Agreement has been duly and validly executed and delivered by each of Ottawa Savings Bancorp MHC, Ottawa Savings Bancorp and Ottawa Savings Bank and constitutes a valid and binding obligation of each of them, enforceable against each of them in accordance with its terms, subject to applicable bankruptcy, insolvency and similar laws affecting creditors' rights and remedies generally and to general principles of equity, whether applied in a court of law or a court of equity.

(e) *No Violations.* The execution, delivery and performance of this Agreement by Ottawa does not, and the consummation of the transactions contemplated by this Agreement will not, (i) assuming all required stockholder, member and governmental approvals have been obtained and the applicable waiting periods have expired, violate any law, rule or regulation or any judgment, decree, order, governmental permit or license to which Ottawa (or any of its properties) is subject, (ii) violate the charter or bylaws of Ottawa or (iii) constitute a breach or violation of, or a default under (or an event which, with due notice or lapse of time or both, would constitute a default under), or result in the termination of, accelerate the performance required by, or result in the creation of any Lien upon any of the properties or assets of Ottawa under any of the terms, conditions or provisions of any note, bond, indenture, deed of trust, loan agreement or other agreement, instrument or obligation to which Ottawa is a party, or to which any of its properties or assets may be subject except, in the case of (iii), for any such breaches, violations or defaults that would not, individually or in the aggregate, have a Material Adverse Effect on Ottawa considered as a whole.

A-26

(f) *Consents.* No consents or approvals of, or filings or registrations with, any Governmental Entity, except for the approval of members referred to in *Section 3.3(d)*, if required, or any third party are required to be made or obtained in connection with the execution and delivery by Ottawa of this Agreement or the consummation by Ottawa of the Merger and the other transactions contemplated by this Agreement, except for (i) filings of applications and notices with, receipt of approvals or nonobjections from, and expiration of the related waiting period required by, federal and state banking authorities, including filings and notices with the Federal Reserve Board and the OCC and, if applicable, the Illinois Department of Financial and Professional Regulation and (ii) the filing of articles of combination with the OCC. As of the date hereof, Ottawa knows of no reason pertaining to Ottawa why any of the approvals referred to in this *Section 3.3(f)* should not be obtained without the imposition of any material condition or restriction described in *Section 6.1(b)*.

(g) *Governmental Filings.* Ottawa has filed all reports, schedules, registration statements and other documents that it has been required to file since January 1, 2011, with the OCC, FDIC, and any other Governmental Entity, except where the failure to file such report, schedules, registration statements and other documents, either individually or in the aggregate, would not reasonably be expected to have a Material Adverse Effect on Ottawa. As of their respective dates, each of such filings complied in all material respects with all laws or regulations under which it was filed (or was amended so as to be in compliance promptly following discovery of such noncompliance).

(h) *Financial Statements.* Ottawa Savings Bancorp has previously provided to Twin Oaks its audited statements of financial condition as of December 31, 2013 and 2012 and related statements of operations, stockholders' equity and cash flows for each of the two years in the period ended December 31, 2013 together with notes thereto, accompanied by the audit report of Ottawa Savings Bancorp's independent public auditors (the "**Ottawa Savings Bancorp Financial Statements**"). The Ottawa Savings Bancorp Financial Statements were prepared from the books and records of Ottawa Savings Bancorp, fairly present the consolidated financial position of Ottawa Savings Bancorp at and as of the dates indicated and the consolidated results of operations, stockholders' equity and cash flows of Ottawa Savings Bancorp for the periods indicated, and, except as otherwise set forth in the notes thereto, were prepared in accordance with GAAP consistently applied throughout the periods covered thereby.

(i) *Absence of Certain Changes or Events.* Since December 31, 2013, (i) Ottawa has conducted its business only in the ordinary and usual course of such business consistent with its past practices and (ii) there has not been any event or occurrence that has had, or is reasonably expected to have, a Material Adverse Effect on Ottawa considered as a whole.

(j) *Litigation.* There are no suits, actions or legal, administrative or arbitration proceedings pending or, to the knowledge of Ottawa, threatened against or affecting Ottawa or any of its Subsidiaries or any property or asset of Ottawa or any of its Subsidiaries that (i) are seeking damages or declaratory relief against Ottawa or (ii) challenge the validity or propriety of the transactions contemplated by the Agreement. To the knowledge of Ottawa there are no investigations, reviews or inquiries by any court or Governmental Entity pending or threatened against Ottawa or any of its Subsidiaries. There are no judgments, decrees, injunctions, orders or rulings of any Governmental Entity or arbitrator outstanding against Ottawa or any of its Subsidiaries.

(k) *Absence of Regulatory Actions.* Except as set forth in the Ottawa Disclosure Letter, since January 1, 2011, neither Ottawa nor any of its Subsidiaries has been a party to any cease and desist order, written agreement or memorandum of understanding with, or any commitment letter or similar undertaking to, or has been subject to any action, proceeding, order or directive by, any Government Regulator, or has adopted any board resolutions at the request of any Government Regulator, or has been advised by any Government Regulator that it is contemplating issuing or requesting (or is considering the appropriateness of issuing or requesting) any such action, proceeding, order, directive, written agreement, memorandum of understanding, commitment letter, board resolutions or similar undertaking. To the knowledge of Ottawa, there are no material unresolved violations, criticisms or exceptions by any Governmental Regulator with respect to any report or statement relating to any examination of Ottawa.

(l) *Taxes.* All federal, state, local and foreign tax returns required to be filed by or on behalf of Ottawa have been timely filed or requests for extensions have been timely filed and any such extension shall have been granted and not have expired, and all such filed returns are complete and accurate in all material respects. All Taxes shown on such returns, all Taxes required to be shown on returns for which extensions have been granted and all other Taxes required to be paid by Ottawa have been paid in full or adequate provision has been made for any such Taxes. As of the date of this Agreement, there is no audit examination, deficiency assessment, tax investigation or refund litigation with respect to any Taxes of Ottawa, and no claim has been made by any authority in a jurisdiction where Ottawa does not file tax returns that Ottawa is subject to taxation in that jurisdiction. All Taxes, interest, additions and penalties due with respect to completed and settled examinations or concluded litigation relating to Ottawa have been paid in full or adequate provision has been made for any such taxes. Ottawa has not executed an extension or waiver of any statute of limitations on the assessment or collection of any Tax due that is currently in effect. Ottawa and its Subsidiaries have withheld and paid all Taxes required to have been withheld and paid in connection with amounts paid or owing to any employee, independent contractor, creditor, stockholder or other third party, and Ottawa and each of its Subsidiaries has timely complied with all applicable information reporting requirements under Part III, Subchapter A of Chapter 61 of the IRC and similar applicable state and local information reporting requirements.

(m) *Intellectual Property.* Ottawa owns or possesses valid and binding licenses and other rights to use (in the manner and the geographic areas in which they are currently used) without payment all patents, copyrights, trade secrets, trade names, service marks and trademarks material to its business. With respect to each item of Intellectual Property owned by Ottawa, the owner possesses all right, title and interest in and to the item, free and clear of any Lien. With respect to each item of Intellectual Property that Ottawa is licensed or authorized to use, the license, sublicense or agreement covering such item is legal, valid, binding, enforceable and in full force and effect as to Ottawa. Ottawa has not received any charge, complaint, claim, demand or notice alleging any interference, infringement, misappropriation or violation with or of any intellectual property rights of a third party (including any claims that Ottawa must license or refrain from using any intellectual property rights of a third party). To the knowledge of Ottawa, Ottawa has not interfered with, infringed upon, misappropriated or otherwise come into conflict with any intellectual property rights of third parties and no third party has interfered with, infringed upon, misappropriated or otherwise come into conflict with any intellectual property rights of Ottawa.

(n) *Labor Matters.* Ottawa is in material compliance with all applicable laws respecting employment, retention of independent contractors, employment practices, terms and conditions of employment, and wages and hours. Ottawa has not and has never been a party to, or been bound by, any collective bargaining agreement, contract or other agreement or understanding with a labor union or labor organization with respect to its employees, and Ottawa is not the subject of any proceeding asserting that it has committed an unfair labor practice or seeking to compel it to bargain with any labor organization as to wages and conditions of employment nor has any such proceeding been threatened, nor is there any strike, other labor dispute or organizational effort involving Ottawa pending or, to the knowledge of Ottawa, threatened.

(o) *Employee Benefit Plans.*

(i) The Ottawa Disclosure Letter contains a complete and accurate list of all pension, retirement, stock option, stock purchase, stock ownership, savings, stock appreciation right, profit sharing, deferred compensation, consulting, bonus, group insurance, severance and other benefit plans, contracts, agreements and arrangements, including, but not limited to, "employee benefit plans," as defined in Section 3(3) of ERISA, incentive and welfare policies, contracts, plans and arrangements and all trust agreements related thereto with respect to any present or former directors, officers or other employees of Ottawa Savings Bancorp MHC, Ottawa Savings Bancorp and Ottawa Savings Bank which hereinafter referred to collectively as the "**Ottawa Employee Plans.**" The Ottawa Disclosure Letter identifies each Ottawa Employee Plan to which a Twin Oaks employee will be subject or in which such employee will be eligible to participate. There has been no announcement or commitment by Ottawa to create an additional Ottawa Employee Plan, or to amend any Ottawa Employee Plan, except for amendments required by applicable law that do not materially increase the cost of such Ottawa Employee Plan.

(ii) There is no pending or, to Ottawa's knowledge, threatened litigation, administrative action or proceeding relating to any Ottawa Employee Plan. All of the Ottawa Employee Plans comply in all material respects with all applicable requirements of ERISA, the IRC and other applicable laws. There has occurred no "prohibited transaction" (as defined in Section 406 of ERISA or Section 4975 of the IRC) with respect to the Ottawa Employee Plans which is likely to result in the imposition of any penalties or Taxes upon Ottawa under Section 502(i) of ERISA or Section 4975 of the IRC.

(iii) No liability to the Pension Benefit Guarantee Corporation has been or is expected by Ottawa to be incurred with respect to any Ottawa Employee Plan that is subject to Title IV of ERISA ("**Ottawa Pension Plan**"), or with respect to any "single-employer plan" (as defined in Section 4001(a) of ERISA) currently or formerly maintained by Ottawa or any ERISA Affiliate. No Ottawa Pension Plan had an "accumulated funding deficiency" (as defined in Section 302 of ERISA), whether or not waived, as of the last day of the end of the most recent plan year ending prior to the date hereof; the fair market value of the assets of each Ottawa Pension Plan exceeds the present value of the "benefit liabilities" (as defined in Section 4001(a)(16) of ERISA) under such Ottawa Pension Plan as of the end of the most recent plan year with respect to the respective Ottawa Pension Plan ending prior to the date hereof, calculated on the basis of the actuarial assumptions used in the most recent actuarial valuation for such Ottawa Pension Plan as of the date hereof; and no notice of a "reportable event" (as defined in Section 4043 of ERISA) for which the 30-day reporting requirement has not been waived has been required to be filed for any Ottawa Pension Plan within the 12-month period ending on the date hereof. Ottawa has not provided, or been required to provide, security to any Ottawa Pension Plan or to any single-employer plan of an ERISA Affiliate pursuant to Section 401(a)(29) of the IRC. Neither Ottawa, nor any ERISA Affiliate, has contributed to any "multiemployer plan," as defined in Section 3(37) of ERISA.

(iv) Each Ottawa Employee Plan that is an "employee pension benefit plan" (as defined in Section 3(2) of ERISA) and which is intended to be qualified under Section 401(a) of the IRC (a "**Ottawa Qualified Plan**") has received a favorable determination letter from the IRS, and, to the knowledge of Ottawa, there are not any circumstances likely to result in revocation of any such favorable determination letter. Each Ottawa Qualified Plan that is an "employee stock ownership plan" (as defined in Section 4975(e)(7) of the IRC) has satisfied all of the applicable requirements of Sections 409 and 4975(e)(7) of the IRC and the regulations thereunder in all material respects and any assets of any such Ottawa Qualified Plan that, as of the end of the plan year, are not allocated to participants' individual accounts are pledged as security for, and may be applied to satisfy, any securities acquisition indebtedness.

(v) Except as set forth in the Ottawa Disclosure Letter, Ottawa does not have any obligations for post-retirement or post-employment benefits under any Ottawa Employee Plan that cannot be amended or terminated upon 60 days' notice or less without incurring any liability thereunder, except for coverage required by Part 6 of Title I of ERISA or Section 4980B of the IRC, or similar state laws, the cost of which is borne by the insured individuals. The execution and delivery of this Agreement and the consummation of the transactions contemplated hereby will not result in any payment or series of payments by Ottawa to any person which is an "excess parachute payment" (as defined in Section 280G of the IRC) or is a nondeductible payment under Section 162(m) of the IRC, increase or secure (by way of a trust or other vehicle) any benefits payable under any Ottawa Employee Plan or accelerate the time of payment or vesting of any such benefit.

(p) *Title to Assets.* Ottawa has good and marketable title to its properties and assets (including any property acquired in a judicial foreclosure proceeding or by way of a deed in lieu of foreclosure or similar transfer) whether real or personal, tangible or intangible, in each case free and clear of any Liens except (i) liens for Taxes not yet due and payable, (ii) pledges to secure deposits and other Liens incurred in the ordinary course of business, and (iii) such easements, restrictions and encumbrances, if any, as are not material in character, amount or extent, and do not materially detract from the value, or materially interfere with the present use of the properties subject thereto or affected thereby. Each lease pursuant to which Ottawa is lessee or lessor is valid and in full force and effect and neither Ottawa, nor, to the knowledge of Ottawa, any other party to any such lease, is in default or in violation of any material provisions of any such lease. All real property owned or leased by Ottawa is in a good state of maintenance and repair (normal wear and tear excepted), conform in all material respects with all applicable ordinances, regulations and zoning laws and are considered by Ottawa to be adequate for the current business of Ottawa. To the knowledge of Ottawa, none of the buildings, structures or other improvements located on its real property encroaches upon or over any adjoining parcel or real estate or any easement or right-of-way.

(q) *Compliance with Laws.* Each of Ottawa Savings Bancorp MHC, Ottawa Savings Bancorp and Ottawa Savings Bank conducts its business in compliance with all statutes, laws, regulations, ordinances, rules, judgments, orders or decrees applicable to it or the employees conducting such business, except where noncompliance would not, individually or in the aggregate, reasonably be expected to have a Material Adverse Effect on Ottawa. Ottawa has all material permits, licenses, certificates of authority, orders and approvals of, and has made all filings, applications and registrations with, all Governmental Entities that are required in order to permit it to carry on its business as it is presently conducted; all such permits, licenses, certificates of authority, orders and approvals are in full force and effect, and no suspension or cancellation of any of them is, to the knowledge of Ottawa, threatened. Ottawa is not in violation of or has not been given notice or been charged with any violation of, any law, ordinance, regulation, order, writ, rule, decree or condition to approval of any Governmental Entity which, individually or in the aggregate, would reasonably be expected to have a Material Adverse Effect on Ottawa, considered as a whole.

(r) *Environmental Matters.*

(i) Each of Ottawa's properties, the Participation Facilities, and, to the knowledge of Ottawa, the Loan Properties, are, and have been, during the period of Ottawa's ownership or operation thereof, in material compliance with all Environmental Laws.

(ii) There is no suit, claim, action, demand, executive or administrative order, directive, investigation or proceeding pending or, to the knowledge of Ottawa, threatened, before any court or Governmental Entity against Ottawa or any Participation Facility (A) for alleged noncompliance (including by any predecessor) with, or liability under, any Environmental Law or (B) relating to the presence of or release into the environment of any Hazardous Material, whether or not occurring at or on a site owned, leased or operated by Ottawa or any Participation Facility.

(iii) To the knowledge of Ottawa, there is no suit, claim, action, demand, executive or administrative order, directive, investigation or proceeding pending or threatened before any court or Governmental Entity relating to or against any Loan Property (or Ottawa in respect of such Loan Property) (A) relating to alleged noncompliance (including by any predecessor) with, or liability under, any Environmental Law or (B) relating to the presence of or release into the environment of any Hazardous Material, whether or not occurring at a Loan Property.

(iv) Ottawa has not received any notice, demand letter, executive or administrative order, directive or request for information from any Governmental Entity or any third party indicating that it may be in violation of, or liable under, any Environmental Law.

(v) To the knowledge of Ottawa, there are no underground storage tanks at any properties owned or operated by Ottawa or any Participation Facility and no underground storage tanks have been closed or removed from any properties owned or operated by Ottawa or any Participation Facility.

(vi) During the period of (A) the ownership or operation by Ottawa of any of its current properties or (B) the participation of Ottawa in the management of any Participation Facility, there has been no release of Hazardous Materials in, on, under or affecting such properties. To the knowledge of Ottawa, prior to the period of (A) the ownership or operation by Ottawa of any of its current properties or (B) the participation of Ottawa in the management of any Participation Facility, there was no contamination by or release of Hazardous Material in, on, under or affecting such properties.

(s) *Loan Portfolio; Allowance for Loan Losses.*

(i) All Loans held by Ottawa Savings Bank were made in all material respects for good, valuable and adequate consideration in the ordinary course of the business, and, to the knowledge of Ottawa, the Loans are not subject to any defenses, setoffs or counterclaims, including without limitation any such as are afforded by usury or truth in lending laws, except as may be provided by bankruptcy, insolvency or similar laws or by general principles of equity.

(ii) Neither the terms of any Loan, any of the documentation for any Loan, the manner in which any Loans have been administered and serviced, nor the practices of approving or rejecting Loan applications, violate in any material respect any federal, state, or local law, rule or regulation applicable thereto, including, without limitation, the Truth In Lending Act, Regulations O and Z of the Federal Reserve Board, the CRA, the Equal Credit Opportunity Act, and any state laws, rules and regulations relating to consumer protection, installment sales and usury.

(iii) The allowance for loan losses reflected in Ottawa audited balance sheet at December 31, 2013 was, and the allowance for loan losses shown on the balance sheets in Ottawa Savings Bancorp Financial Statements for periods ending after December 31, 2013, in the opinion of management, was or will be adequate, as of the dates thereof, under GAAP.

(iv) Ottawa's Disclosure Letter sets forth a true and complete listing, as of March 31, 2014, of:

(A) all Loans that have been classified (whether regulatory or internal) as "Special Mention," "Substandard," "Doubtful," "Loss" or words of similar import listed by category, including the amounts thereof; and

(B) Loans (1) that are contractually past due 90 days or more in the payment of principal and/or interest, (2) that are on a non-accrual status, (3) where the interest rate terms have been reduced and/or the maturity dates have been extended by Ottawa due to concerns regarding the borrower's ability to pay in accordance with such initial terms, or (4) where a specific reserve allocation exists in connection therewith, listed by category, including the amounts thereof.

(v) Neither Ottawa Savings Bank nor any of its Subsidiaries is a party to any Loan that is in violation, in any material respect, of any law, regulation or rule of any Governmental Entity. Any asset of Ottawa Savings Bank or any of its Subsidiaries that is classified as "Real Estate Owned" or words of similar import that is included in any non-performing assets of Ottawa Savings Bank or any of its Subsidiaries is carried net of reserves at the lower of cost

or fair value, less estimated selling costs, based on current independent appraisals or evaluations or current management appraisals or evaluations; *provided, however*, that “current” shall mean within the past 12 months.

A-33

(vi) (A) There are no Loans to any Ottawa employee, officer, director or affiliate thereof on which the borrower is paying a rate other than that reflected in the note or other relevant credit or security agreement or on which the borrower is paying a rate which was not in compliance with Regulation O and (B) all such Loans are and were originated in compliance in all material respects with all applicable laws.

(t) *Deposits.* The deposit accounts of Ottawa Savings Bank are insured by the FDIC to the maximum extent permitted by law.

(u) *Insurance.* In the opinion of management, Ottawa is presently insured for amounts deemed reasonable by management against such risks as companies engaged in a similar business would, in accordance with good business practice, customarily be insured. All of the insurance policies and bonds maintained by Ottawa are in full force and effect, Ottawa is not in default thereunder, and all material claims thereunder have been filed in due and timely fashion.

(v) *Investment Securities.*

(i) Except for restrictions that exist for securities that are classified as “held to maturity,” none of the investment securities held by Ottawa is subject to any restriction (contractual or statutory) that would materially impair the ability of the entity holding such investment freely to dispose of such investment at any time.

(ii) Neither Ottawa nor any of its Subsidiaries is a party to or has agreed to enter into an exchange-traded or over-the-counter equity, interest rate, foreign exchange or other swap, forward, future, option, cap, floor or collar or any other contract that is a derivative contract (including various combinations thereof) or owns securities that (A) are referred to generically as “structured notes,” “high risk mortgage derivatives,” “capped floating rate notes” or “capped floating rate mortgage derivatives” or (B) are likely to have changes in value as a result of interest or exchange rate changes that significantly exceed normal changes in value attributable to interest or exchange rate changes.

(w) *Books and Records.* The books and records of Ottawa and its Subsidiaries have been, and are being, maintained in accordance with applicable legal and accounting requirements and reflect in all material respects the substance of events and transactions that should be included therein.

(x) *Corporate Documents.* Ottawa has previously furnished or made available to Twin Oaks a complete and correct copy of its charter and bylaws and the similar organizational documents of each of its Subsidiaries, as in effect as of

the date of this Agreement. Neither Ottawa nor any of their Subsidiaries is in violation of its charter, bylaws or similar organizational documents. The minute books of Ottawa and each of its Subsidiaries constitute a complete and correct record of all actions taken by its boards of directors (and each committee thereof) and their stockholders or members, as the case may be.

A-34

(y) *CRA, Anti-Money Laundering, OFAC and Customer Information Security.* Ottawa Savings Bank has received a rating of “Satisfactory” or better in its most recent examination or interim review with respect to the CRA. Ottawa does not have knowledge of any facts or circumstances that would cause Ottawa Savings Bank: (i) to be deemed not to be in satisfactory compliance in any material respect with the CRA, and the regulations promulgated thereunder, or to be assigned a rating for CRA purposes by federal bank regulators of lower than “Satisfactory”; or (ii) to be deemed to be operating in violation in any material respect of the Bank Secrecy Act, the USA PATRIOT Act, any order issued with respect to anti-money laundering by the U.S. Department of the Treasury’s Office of Foreign Assets Control, or any other applicable anti-money laundering statute, rule or regulation; or (iii) to be deemed not to be in satisfactory compliance in any material respect with the applicable privacy of customer information requirements contained in any federal and state privacy laws and regulations, including without limitation, in Title V of the Gramm-Leach-Bliley Act of 1999 and the regulations promulgated thereunder. To the knowledge of Ottawa, no non-public customer information has been disclosed to or accessed by an unauthorized third party in a manner which would cause either Ottawa or any of its Subsidiaries to undertake any remedial action. The Board of Directors of Ottawa Savings Bank has adopted and implemented, an anti-money laundering program that contains adequate and appropriate customer identification verification procedures that comply with Section 326 of the USA PATRIOT Act and such anti-money laundering program meets the requirements in all material respects of Section 352 of the USA PATRIOT Act and the regulations thereunder, and has complied in all material respects with any requirements to file reports and other necessary documents as required by the USA PATRIOT Act and the regulations thereunder.

(z) *Undisclosed Liabilities.* To its knowledge, Ottawa has not incurred any debt, liability or obligation of any nature whatsoever (whether accrued, contingent, absolute or otherwise and whether due or to become due) other than liabilities reflected on or reserved against in the consolidated balance sheet of Ottawa as of December 31, 2013, except for (i) liabilities incurred since December 31, 2013 in the ordinary course of business consistent with past practice that, either alone or when combined with all similar liabilities, have not had, and would not reasonably be expected to have, a Material Adverse Effect on Ottawa’s ability to perform its obligations under this Agreement, and (ii) liabilities incurred for legal, accounting, financial advising fees and out-of-pocket expenses in connection with the transactions contemplated by this Agreement. Further, to Ottawa’s knowledge, there are no liabilities for environmental hazards which would adversely impact its ability to perform under this Agreement.

(aa) *Securities Filings.* Ottawa has filed with the SEC all reports, schedules, registration statements, definitive proxy statements and exhibits thereto that it has been required to file under the Securities Act or the Exchange Act since January 1, 2011 (collectively, "**Ottawa Reports**"). None of the Ottawa Reports contained any untrue statement of a material fact or omitted to state a material fact required to be stated therein, in light of the circumstances under which they were made, not misleading. As of their respective dates of filing with the SEC, all of the Ottawa Reports complied in all material respects with the applicable requirements of the Securities Act or the Exchange Act; as the case may be, and the rules and regulations of the SEC promulgated thereunder. Each of the financial statements (including, in each case, any notes thereto) of Ottawa included in the Ottawa Reports complied as to form, as of their respective dates of filing with the SEC, in all material respects with applicable accounting requirements and with the published rules and regulations of the SEC with respect thereto.

(bb) *Internal Controls.* Ottawa has devised and maintains a system of internal control over financial reporting as defined in Rule 13a-15(f) of the Exchange Act sufficient to provide reasonable assurances regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP and to provide reasonable assurances that (i) transactions are executed in accordance with management's general or specific authorizations, (ii) transactions are recorded as necessary to permit preparation of financial statements in conformity with GAAP and to maintain accountability for assets, and (iii) access to assets is permitted only in accordance with management's general or specific authorization. Except as disclosed in the Ottawa Reports, there are no significant deficiencies or material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect in any material respect Ottawa's ability to record, process, summarize and report financial information. There has occurred no fraud, whether or not material, that involves management or other employees who have a significant role in Ottawa's internal controls over financial reporting.

ARTICLE IV

Conduct Pending the Merger

4.1 Forbearances by Twin Oaks. Except as expressly contemplated or permitted by this Agreement or disclosed in Twin Oaks' Disclosure Letter, during the period from the date of this Agreement to the Effective Time of the Merger, Twin Oaks shall not without the prior written consent of Ottawa Savings Bank, which consent shall not be unreasonably withheld, conditioned or delayed:

(a) conduct its business other than in the regular, ordinary and usual course consistent with past practice; fail to use its reasonable efforts maintain and preserve intact its business organization, properties, leases, employees and advantageous business relationships and retain the services of its officers and key employees; or take any action that would adversely affect or delay its ability to perform its obligations under this Agreement or to consummate the transactions contemplated hereby;

- (b) (i) incur, modify, extend or renegotiate any indebtedness for borrowed money, or assume, guarantee, endorse or otherwise as an accommodation become responsible for the obligations of any other individual, corporation or other entity, other than (A) the creation of deposit liabilities consistent with past practice or (B) borrowings from the Federal Home Loan Bank or (C) borrowing pursuant to Twin Oaks' current line of credit with the Bankers Bank, Madison, Wisconsin;
- (ii) prepay any indebtedness or other similar arrangements so as to incur any prepayment penalty thereunder; or
- (iii) purchase any brokered certificates of deposit.
- (c) make, declare or pay any dividend or make any other distribution to its members other than the payment of interest on its savings accounts in the ordinary course of business;
- (d) other than in the ordinary course of business consistent with past practice, (i) sell, transfer, mortgage, encumber or otherwise dispose of any of its real property or other assets, or (ii) cancel, release or assign any indebtedness to any such person or any claims held by any such person;
- (e) make any equity investment, other than required purchases of FHLB stock, either by purchase of stock or securities, contributions to capital, property transfers, or purchase of any property or assets of any other individual, corporation or other entity or form any new subsidiary;
- (f) enter into, renew, amend or terminate any contract or agreement, or make any change in any of its leases or contracts, other than with respect to those involving aggregate payments of less than, or the provision of goods or services with a market value of less than, \$25,000 per annum;
- (g) make, renegotiate, renew, increase the amount of, extend the term of, modify or purchase any Loan, or make any commitment in respect of any of the foregoing, except (i) in conformity with existing lending practices in amounts not to exceed an aggregate of \$400,000 with respect to any individual borrower, or (ii) loans or advances as to which it has a binding obligation to make such loans or advances as of the date hereof; provided, however, in the event Twin Oaks requests in the manner contemplated by Section 8.7 that Ottawa approve a loan requiring Ottawa's approval hereunder and Ottawa fails to respond thereto in writing within three (3) business days, such approval shall be deemed to have been given;

A-37

(h) except as described in Twin Oaks' Disclosure Letter and except for Loans made in accordance with Regulation O of the Federal Reserve Board (12 C.F.R. Part 215) make or increase any Loan, or commit to make or increase any such Loan, to any director or executive officer of Twin Oaks, or any entity controlled, directly or indirectly, by any of the foregoing;

(i) (i) increase in any manner the compensation or fringe benefits of any of its employees or directors or pay any bonus, pension, retirement allowance or contribution not required by any existing plan or agreement to any such employees or directors;

(ii) become a party to, amend, renew, extend or commit itself to any pension, retirement, profit-sharing or welfare benefit plan or agreement or employment, severance or change in control agreement with or for the benefit of any employee or director; or

(iii) appoint to any senior executive office any person who is not a member of its senior executive officer team as of the date of this Agreement or elect to its Board of Directors any person who is not a member of its Board of Directors as of the date of this Agreement, or hire any employee at an annual salary in excess of \$25,000 per annum;

(j) commence any action or proceeding, other than to enforce any obligation owed to Twin Oaks and in accordance with past practice or settle any claim, action or proceeding (i) involving payment by it of money damages in excess of \$25,000 or (ii) that would impose any material restriction of the operations of Ottawa;

(k) amend its charter or bylaws;

(l) increase the interest paid on certificates of deposit;

(m) restructure or materially change its investment securities portfolio or its interest rate risk position, through purchases, sales or otherwise, or the manner in which the portfolio is classified or reported;

(n) make any investment in any debt security, including mortgage-backed and mortgage-related securities, other than U.S. government and U.S. government agency securities with final maturities not greater than one year;

(o) make any capital expenditures in excess of \$25,000 other than pursuant to binding commitments existing on the date hereof and other than expenditures necessary to maintain existing assets in good repair or as required by Government Regulators;

(p) establish or commit to the establishment of any new branch or other office facilities or file any application to relocate or terminate the operation of any banking office;

A-38

- (q) enter into any futures contract, option, swap agreement, interest rate cap, interest rate floor, interest rate exchange agreement, or take any other action for purposes of hedging the exposure of its interest-earning assets or interest-bearing liabilities to changes in market rates of interest;
- (r) make any changes in policies in any material respect in existence on the date hereof with regard to: the extension of credit, or the establishment of reserves with respect to possible loss thereon or the charge off of losses incurred thereon; investments; asset/liability management; or other material banking policies, except as may be required by changes in applicable law or regulations, GAAP, or the direction of a Governmental Entity;
- (s) except as required by law or for communications in the ordinary course of business consistent with past practice that do not relate to the Merger or other transactions contemplated hereby;
- (i) issue any communication of a general nature to employees (including general communications relating to benefits and compensation) without prior consultation with Ottawa and, to the extent relating to post-Closing employment, benefit or compensation information, without the prior consent of Ottawa (which shall not be unreasonably withheld, conditioned or delayed); or
- (ii) issue any communication of a general nature to customers without the prior approval of Ottawa (which shall not be unreasonably withheld, conditioned or delayed);
- (t) make, change or rescind any material election concerning Taxes or Tax Returns, file any amended Tax Return, enter into any closing agreement with respect to Taxes, settle or compromise any material Tax claim or assessment, or surrender any right to claim a refund of Taxes or obtain any Tax ruling;
- (u) take any action that is intended or expected to result in any of its representations and warranties set forth in this Agreement being or becoming untrue in any material respect at any time prior to the Closing Date, or in any of the conditions set forth in Article VI not being satisfied or in a violation of any provision of this Agreement;
- (v) implement or adopt any change in its accounting principles, practices or methods, other than as may be required by GAAP or regulatory guidelines; or

(w) agree to take, make any commitment to take, or adopt any resolutions of its Board of Directors in support of, any of the actions prohibited by this *Section 4.1*.

A-39

Any request by Twin Oaks or response thereto by Ottawa shall be made in accordance with the notice provisions of *Section 8.7* and shall note that it is a request pursuant to this *Section 4.1*.

4.2 Forbearances by Ottawa. Except as expressly contemplated or permitted by this Agreement, and except to the extent required by law or regulation or any Governmental Entity, during the period from the date of this Agreement to the Effective Time, Ottawa shall not, nor shall they permit any Subsidiary to, without the prior written consent of Twin Oaks, which shall not unreasonably be withheld, conditioned or delayed:

- (a) conduct its business other than in the regular, ordinary and usual course consistent with past practice; fail to use reasonable efforts to maintain and preserve intact its business organization, properties, leases, employees and advantageous business relationships and retain the services of its officers and key employees;
- (b) take any action that would adversely affect or delay its ability to timely perform its obligations under this Agreement or to consummate the transactions contemplated hereby;
- (c) take any action that is intended to or expected to result in any of its representations and warranties set forth in this Agreement being or becoming untrue in any material respect at any time prior to the Effective Time, or in any of the conditions to the Merger set forth in Article VI not being satisfied or in violation of any provision of this Agreement; or
- (d) agree to take, make any commitment to take, or adopt any resolutions of its Board of Directors in support of, any of the actions prohibited by this *Section 4.2*.

ARTICLE V

Covenants

5.1 Acquisition Proposals.

- (a) From the date of this Agreement until the earlier to occur of the Closing or the termination of this Agreement in accordance with its terms, except as permitted by this Agreement, Twin Oaks shall not, and shall not authorize or

permit any of its officers, directors or employees or any investment banker, financial advisor, attorney, accountant or other representative retained by it directly or indirectly, (i) solicit, initiate or encourage, or take any other action to facilitate, any inquiries, discussions or the making of any proposal that constitutes or could reasonably be expected to lead to an Acquisition Proposal, (ii) furnish any information or data regarding Twin Oaks to any person in connection with or in response to an Acquisition Proposal or an inquiry or indication of interest that would reasonably be expected to lead to an Acquisition Proposal, (iii) participate in any discussions or negotiations, or otherwise communicate in any way with any person (other than Ottawa), regarding an Acquisition Proposal; or (iv) approve, endorse or recommend any Acquisition Proposal or (v) enter into or consummate any agreement, arrangement or understanding requiring it to abandon, terminate or fail to consummate the transactions contemplated hereby. Without limiting the foregoing, it is understood that any violation of the restrictions set forth in the preceding sentence by any officer, director or employee of Twin Oaks or any investment banker, financial advisor, attorney, accountant or other representative retained by Twin Oaks shall be deemed to be a breach of this *Section 5.1* by Twin Oaks.

Notwithstanding the foregoing, prior to the adoption and approval of this Agreement by Twin Oaks' members at a meeting of the members of Twin Oaks, this *Section 5.1(a)* shall not prohibit Twin Oaks from furnishing nonpublic information regarding Twin Oaks to, or entering into discussions with, any person in response to an Acquisition Proposal that is submitted to Twin Oaks by such person (and not withdrawn) if (1) the Acquisition Proposal constitutes or is reasonably expected to result in a Superior Proposal, (2) Twin Oaks has not breached any of the covenants set forth in this *Section 5.1*, (3) Twin Oaks' Board of Directors determines in good faith, after consultation with and based upon the advice of its outside legal counsel, that such action is required in order for the Board of Directors to comply with its fiduciary obligations under applicable law, and (4) at least three (3) Business Days prior to furnishing any non-public information to, or entering into discussions with, such person, Twin Oaks gives Ottawa written notice of the identity of such person and of Twin Oaks' intention to furnish non-public information to, or enter into discussions with, such person and Twin Oaks receives from such person an executed confidentiality agreement on terms no more favorable to such person than the confidentiality agreement between Ottawa and Twin Oaks.

(b) Twin Oaks will notify Ottawa Savings Bancorp immediately orally (within three (3) Business Days) and in writing (within five (5) Business Days) of receipt of any Acquisition Proposal, any request for non-public information that could reasonably be expected to lead to an Acquisition Proposal, or any inquiry with respect to or that could reasonably be expected to lead to an Acquisition Proposal, including, in each case, the identity of the person making such Acquisition Proposal, request or inquiry and the terms and conditions thereof, and shall provide to Ottawa Savings Bancorp any written materials received by Twin Oaks in connection therewith. Twin Oaks will keep Ottawa Savings Bancorp informed of any developments with respect to any such Acquisition Proposal, request or inquiry immediately upon the occurrence thereof.

(c) Twin Oaks will immediately cease and cause to be terminated any existing activities, discussions or negotiations with any parties conducted prior to the date of this Agreement with respect to any of the foregoing. Twin Oaks shall not release any third party from, or waive any provisions of, any confidentiality agreements or standstill agreement to which it is a party.

5.2 Advice of Changes. Prior to the Closing, each party shall promptly advise the other party orally and in writing to the extent that it has knowledge of (i) any representation or warranty made by it contained in this Agreement becoming untrue or inaccurate in any material respect or (ii) the failure by it to comply in any material respect with or satisfy in any material respect any covenant, condition or agreement to be complied with or satisfied by it under this Agreement; *provided, however*, that no such notification shall affect the representations, warranties, covenants or agreements of the parties or the conditions to the obligations of the parties under this Agreement.

5.3 Access and Information.

(a) Upon reasonable notice, Twin Oaks shall afford Ottawa and Ottawa shall afford Twin Oaks, and their representatives (including, without limitation, directors, officers and employees of each of Ottawa and Twin Oaks and its affiliates and counsel, accountants and other professionals retained by Ottawa or Twin Oaks, as applicable) such reasonable access during normal business hours throughout the period prior to the Effective Time to the books, records (including, without limitation, tax returns and, subject to the requirements of the independent auditors of such party, work papers of independent auditors), contracts, properties, personnel and to such other information relating to Twin Oaks and Ottawa, as the case may be, as Ottawa or Twin Oaks may reasonably request; *provided, however*, that no investigation pursuant to this *Section 5.3* shall affect or be deemed to modify any representation or warranty made by Twin Oaks or Ottawa in this Agreement.

(b) From the date hereof until the Effective Time of the Merger, Twin Oaks and Ottawa shall each promptly provide the other with (i) a copy of each report, schedule and other document filed with or, unless prohibited by law or regulation, received by it from a Governmental Entity, (ii) a copy of any materials furnished to its senior management and all materials furnished to its Board of Directors, (iii) a copy of each press release made available to the public and (iv) any other information concerning its business, properties and personnel as Ottawa or Twin Oaks may reasonably request. Notwithstanding the foregoing, neither, Twin Oaks nor Ottawa shall be required to provide access to or to disclose information where such access or disclosure would violate the rights of such entity's customers, jeopardize the attorney-client privilege of the entity in possession or control of such information, or contravene any law, rule, regulation, order, judgment, decree or binding agreement entered into prior to the date of this Agreement. The parties hereto will make appropriate substitute disclosure arrangements under circumstances in which the restrictions of the previous sentence apply.

(c) Neither Ottawa nor Twin Oaks will, and will each cause its representatives not to, use any information and documents obtained in the course of the consideration of the consummation of the transactions contemplated by this Agreement, including any information and documents obtained pursuant to this *Section 5.3*, for any purpose unrelated to the consummation of the transactions contemplated by this Agreement. All information and documents obtained pursuant to this *Section 5.3* shall be held in confidence to the extent required by, and in accordance with, the provisions of confidentiality set forth in a letter agreement, dated September 21, 2013, between Ottawa and Twin Oaks.

(d) From and after the date hereof, representatives of Ottawa Savings Bank and Twin Oaks shall meet on a regular basis to discuss and plan for the conversion of Twin Oaks' data processing and related electronic informational systems to those used by Ottawa Savings Bank with the goal of conducting such conversion simultaneously with the consummation of the Merger.

(e) Within ten Business Days following the end of each calendar month, Twin Oaks will provide Ottawa with an updated list of Loans described in *Section 3.2(s)(v)*.

(f) As soon as reasonably practicable after the date hereof, Twin Oaks will have Crowe Horwath LLP prepare, and Twin Oaks will provide to Ottawa, audited balance sheets as of March 31, 2014 and related statements of income, changes in retained earnings and cash flows for the period ended March 31, 2014, together with notes (the "**Audited Financial Statements**"). Through the Closing Date, each of Twin Oaks and Ottawa shall continue to prepare and provide to the other unaudited statements of income, and, in the case of Ottawa, all Ottawa Reports, for each interim period following the period ended March 31, 2014 (the "**Interim Financial Statements**"). As of their respective dates, the foregoing financial statements shall be prepared in accordance with GAAP. The books and records of each of Twin Oaks and Ottawa shall be maintained in all material respects, in accordance with GAAP and any other applicable legal and accounting requirements and reflect only actual transactions. Crowe Horwath LLP shall not have resigned (or informed Twin Oaks that it intends to resign) or been dismissed as Twin Oaks' independent accountants as a result of or in connection with any disagreements with Twin Oaks on a matter of accounting principles or practices, financial statement disclosure or auditing scope or procedure.

5.4 Applications; Consents.

(a) Ottawa and Twin Oaks shall cooperate with each other and shall use their reasonable best efforts to prepare and file as soon as practicable after the date hereof all necessary applications, notices and filings to obtain all permits, consents, approvals and authorizations of all Governmental Entities that are necessary or advisable to consummate the transactions contemplated by this Agreement. Ottawa and Twin Oaks shall furnish each other with all information concerning themselves, and any of their directors, officers and stockholders and such other matters as may be reasonably necessary or advisable in connection with any application, notice or filing made by or on behalf of Twin Oaks or Ottawa to any Governmental Entity in connection with the transactions contemplated by this Agreement. Ottawa and Twin Oaks shall have the right to review in advance, and to the extent practicable each will consult with the other on, all information relating to it that appears in any filing made with, or written materials submitted to, any Governmental Entity pursuant to this *Section 5.4(a)*.

(b) As soon as practicable after the date hereof, each of the parties hereto shall use its best efforts to obtain any consent, authorization or approval of any third party that is required to be obtained in connection with the transactions contemplated by this Agreement.

5.5 Antitakeover Provisions. Twin Oaks shall take all steps required by any relevant federal or state law or regulation or under any relevant agreement or other document to exempt or continue to exempt Ottawa, the Agreement and the transactions contemplated hereby from any provisions of an antitakeover nature in the charter and bylaws of Twin Oaks, and the provisions of any applicable federal or state antitakeover laws.

5.6 Additional Agreements. Subject to the terms and conditions herein provided, each of the parties hereto agree to use all reasonable efforts to take promptly, or cause to be taken promptly, all actions and to do promptly, or cause to be done promptly, all things necessary, proper or advisable under applicable laws and regulations to consummate and make effective the transactions contemplated by this Agreement as expeditiously as possible, including using efforts to obtain all necessary actions or non-actions, extensions, waivers, consents and approvals from all applicable Governmental Entities, effecting all necessary registrations, applications and filings (including, without limitation, filings under any applicable state securities laws) and obtaining any required contractual consents and regulatory approvals.

5.7 Publicity. The initial press release announcing this Agreement shall be a joint press release. Thereafter the parties hereto shall consult with each other prior to issuing any press releases or otherwise making public statements with respect to the transactions contemplated by this Agreement and in making any filings with any Governmental Entity or with any national securities exchange or market with respect thereto; *provided, however*, that nothing in this Section 5.7 shall be deemed to prohibit any party from making any disclosure which its counsel deems necessary in order to satisfy such party's disclosure obligations imposed by law.

5.8 Stockholders Meeting; Members Meeting.

(a) Ottawa Savings Bancorp will submit to its stockholders this Agreement and any other matters required to be approved or adopted by stockholders in order to carry out the intentions of this Agreement. In furtherance of that obligation, Ottawa Savings Bancorp will take, in accordance with applicable law and its charter and bylaws, all action necessary to call, give notice of, and use its best efforts to convene and hold a meeting of its stockholders (the "**Ottawa Stockholders Meeting**") as promptly as practicable for the purpose of considering and voting on approval and adoption of this Agreement and the transactions provided for in this Agreement. Ottawa Savings Bancorp's Board of Directors will use all reasonable best efforts to obtain from Ottawa Savings Bancorp's stockholders a vote approving and adopting this Agreement. Except as provided in this Agreement, (i) Ottawa Savings Bancorp's Board of Directors shall recommend to Ottawa Savings Bancorp's stockholders approval and adoption of this Agreement, (ii) the proxy statement Ottawa Savings Bancorp distributes to its stockholders shall include a statement to the effect that Ottawa

Savings Bancorp's Board of Directors has recommended that Ottawa Savings Bancorp's stockholders vote in favor of the approval and adoption of this Agreement, and (iii) Ottawa Savings Bancorp MHC shall vote all shares of Ottawa Savings Bancorp Common Stock owned by it in favor of the approval and adoption of this Agreement.

A-44

(b) Twin Oaks will submit to its members this Agreement and any other matters required to be approved or adopted by members in order to carry out the intentions of this Agreement. In furtherance of that obligation, Twin Oaks will take, in accordance with applicable law and its charter and bylaws, all action necessary to call, give notice of, and use its best efforts to convene and hold a meeting of Twin Oaks' members, (the "**Twin Oaks Members Meeting**") as promptly as practicable for the purpose of considering and voting on approval and adoption of this Agreement and the transactions provided for in this Agreement. Twin Oaks' Board will use all reasonable best efforts to obtain from Twin Oaks' members a vote approving and adopting this Agreement. Except as provided in this Agreement, (i) Twin Oaks' Board will recommend to its members that they vote in favor of the approval and adoption of this Agreement, (ii) the proxy statement Twin Oaks distributes to its members shall include a statement to the effect that Twin Oaks' Board of Directors has recommended that its members vote in favor of the approval and adoption of this Agreement, and (iii) neither Twin Oaks' Board of Directors nor any committee thereof shall withdraw, amend, modify or propose or resolve to withdraw, amend or modify, in a manner adverse to Ottawa, the recommendation of Twin Oaks' Board of Directors that its members vote in favor of approval and adoption of this Agreement or make any statement in connection with the Twin Oaks Members Meeting inconsistent with such recommendation. Notwithstanding the foregoing, if Twin Oaks' Board of Directors, after consultation with and based on the advice of counsel, determines in good faith that it would result in a violation of its fiduciary duties under applicable law to recommend this Agreement, then in submitting the Agreement to members at the Twin Oaks Members Meeting it may submit the Agreement without recommendation, in which case the Board of Directors may communicate the basis for its lack of a recommendation to the members in the proxy statement distributed to its members or an appropriate amendment or supplement thereto to the extent required by law; provided that prior to submitting the Agreement without recommendation, Twin Oaks shall have complied in all material respects with *Section 5.1*, including providing Ottawa Savings Bancorp with prompt written notice (and in any event within twenty-four (24) hours) advising it of the decision of Twin Oaks' Board of Directors to take such action.

(c) If required, Ottawa Savings Bancorp MHC will submit to its members this Agreement or any other matters required to be approved or adopted by members in order to carry out the intentions of this Agreement. In furtherance of that obligation, if required, Ottawa Savings Bancorp MHC will take, in accordance with applicable law and its charter and bylaws, all action necessary to call, give notice of, and use its best efforts to convene and hold a meeting of its members (the "**Ottawa Members Meeting**") as promptly as practicable for the purpose of considering and voting on approval and adoption of this Agreement or any other matters required to be approved or adopted by members in order to carry out the intentions of this Agreement. If Ottawa Savings Bancorp MHC is required to hold such Ottawa Members Meeting, Ottawa Savings Bancorp MHC's Board of Directors will use all reasonable best efforts to obtain from Ottawa Savings Bancorp MHC's members a vote approving and adopting this Agreement or any other matters required to be approved or adopted by members in order to carry out the intentions of this Agreement. If Ottawa Savings Bancorp MHC is required to hold such Ottawa Members Meeting, (i) Ottawa Savings Bancorp MHC's Board of Directors shall recommend to Ottawa Savings Bancorp MHC's members approval and adoption of this Agreement or any other matters required to be approved or adopted by members in order to carry out the intentions of this Agreement, and (ii) any proxy statement Ottawa Savings Bancorp MHC is required to distribute to its members shall include a statement to the effect that Ottawa Savings Bancorp MHC's Board of Directors has recommended that Ottawa Savings Bancorp MHC's members vote in favor of the approval and adoption of this Agreement or any other matters required to be approved or adopted by members in order to carry out the intentions of this Agreement.

5.9 Proxy Statements.

(a) As promptly as reasonably practicable following the date hereof, Ottawa Savings Bancorp and, if required, Ottawa Savings Bancorp MHC, shall prepare and file with the Federal Reserve Board, a proxy statement and related materials relating to the matters to be submitted to the stockholders of Ottawa Savings Bancorp and/or the members of Ottawa Savings Bancorp MHC at their respective Ottawa Members Meeting or Ottawa Stockholders Meeting, (such proxy statement(s) and related materials and any amendments or supplements thereto being individually and collectively referred to as the **“Ottawa Proxy Statement”**). Twin Oaks will furnish to Ottawa the information required to be included in the Ottawa Proxy Statement with respect to the financial statements, business and affairs of Twin Oaks and shall have the right to review and consult with Ottawa on the form of, and any characterizations of such information included in, the Ottawa Proxy Statement prior to its being filed with the Federal Reserve Board and the SEC. Ottawa Savings Bancorp shall use reasonable best efforts to have the Ottawa Proxy Statement cleared for use by the Federal Reserve Board and the SEC and to have the Ottawa Proxy Statement mailed to Ottawa Savings Bancorp’s stockholders and/or to the Ottawa Savings Bancorp MHC’s members, required. As applicable, Ottawa Savings Bancorp and/or Ottawa Savings Bancorp MHC will advise Twin Oaks, promptly after it receives notice thereof, of the time when the Ottawa Proxy Statement has been cleared for use by the Federal Reserve Board and the SEC or any request by the Federal Reserve Board or the SEC for amendment of the Ottawa Proxy Statement. If at any time prior to the Effective Time any information relating to Twin Oaks or Ottawa, or any of their respective affiliates, officers or directors, should be discovered by Twin Oaks or Ottawa which should be set forth in an amendment or supplement to the Ottawa Proxy Statement so that such document would not include any misstatement of a material fact or omit to state any material fact necessary to make the statements therein, in light of the circumstances under which they were made, not misleading, the party that discovers such information shall promptly notify the other party hereto and, to the extent required by law, rules or regulations, an appropriate amendment or supplement describing such information shall be promptly filed with the Federal Reserve Board and the SEC and disseminated to the stockholders of Ottawa Savings Bancorp.

(b) As promptly as reasonably practicable following the date hereof, Twin Oaks shall prepare and file with the Federal Reserve Board and the OCC, a proxy statement and related materials relating to the matters to be submitted to the members of Twin Oaks at its Members Meeting (such proxy statement and related materials and any amendments or supplements thereto being individually and collectively referred to as the (“**Twin Oaks Proxy Statement**”). Upon request, Ottawa will furnish to Twin Oaks the information required to be included in the Twin Oaks Proxy Statement with respect to its business and affairs and shall have the right to review and consult with Twin Oaks on the form of, and any characterizations of such information included in, the Twin Oaks Proxy Statement prior to its being filed with the Federal Reserve Board or the OCC, as applicable. Twin Oaks shall use reasonable best efforts to have the Twin Oaks Proxy Statement cleared for use by the Federal Reserve Board or the OCC, as applicable, and to have the Twin Oaks Proxy Statement mailed to Twin Oaks’ members as promptly as practicable thereafter. Twin Oaks will advise Ottawa, promptly after it receives notice thereof, of the time when the Twin Oaks Proxy Statement has been cleared for use by the Federal Reserve Board or the OCC, as applicable, or any request by the Federal Reserve Board or the OCC, as applicable, for amendment of the Twin Oaks Proxy Statement. If at any time prior to the Effective Time any information relating to Twin Oaks or Ottawa or any of their respective affiliates, officers or directors, should be discovered by Twin Oaks or Ottawa which should be set forth in an amendment or supplement to the Twin Oaks Proxy Statement so that such document would not include any misstatement of a material fact or omit to state any material fact necessary to make the statements therein, in light of the circumstances under which they were made, not misleading, the party that discovers such information shall promptly notify the other party hereto and, to the extent required by law, rules or regulations, an appropriate amendment or supplement describing such information shall be promptly filed with the Federal Reserve Board or the OCC, as applicable, and disseminated to Twin Oaks’ members.

5.10 Notification of Certain Matters. Each party shall give prompt notice to the other of: (i) any event or notice of, or other communication relating to, a default or event that, with notice or lapse of time or both, would become a default, received by it or any of its Subsidiaries subsequent to the date of this Agreement and prior to the Effective Time, under any contract material to the financial condition, properties, businesses or results of operations of each party and any Subsidiary taken as a whole to which each party or any Subsidiary is a party or is subject; and (ii) any event, condition, change or occurrence which individually or in the aggregate has, or which, so far as reasonably can be foreseen at the time of its occurrence, is reasonably likely to result in, a Material Adverse Effect. Each of the parties hereto shall give prompt notice to the other party of any notice or other communication from any third party alleging that the consent of such third party is or may be required in connection with any of the transactions contemplated by this Agreement.

5.11 Employee Benefits Matters.

(a) It is Ottawa's intention to retain as many of Twin Oaks' officers and employees as is reasonably practical. All persons who are employees of Twin Oaks immediately prior to the Effective Time and whose employment is not specifically terminated at or prior to the Effective Time (a "**Twin Oaks Continuing Employee**") shall, at the Effective Time, become employees of Ottawa Savings Bank; *provided, however*, that in no event shall any of Twin Oaks' employees be officers of Ottawa Savings Bancorp MHC, Ottawa Savings Bancorp or Ottawa Savings Bank, or have or exercise any power or duty conferred upon such an officer, unless and until duly elected or appointed to such position in accordance with the bylaws of Ottawa Savings Bancorp MHC, Ottawa Savings Bancorp and Ottawa Savings Bank. At the Effective Time, Ottawa will appoint Craig M. Hepner as Chief Operating Officer in accordance with the bylaws. All other Twin Oaks Continuing Employees shall be employed at the will of Ottawa Savings Bank and no contractual right to employment shall inure to such employees because of this Agreement.

(b) To the extent that Ottawa terminates the employment of any of Twin Oaks' employees, other than for cause, at or within twelve months following the Effective Time, Ottawa shall provide to such former Twin Oaks employee a severance payment equal to two weeks' salary for each year of service that such employee was employed by Twin Oaks, up to a maximum of 26 weeks' salary; *provided, however*, that Ottawa shall not have any obligation to provide any severance payment to any of Twin Oaks' employees or Twin Oaks Continuing Employees whose termination of employment occurs due to death, disability, resignation or discharge for cause, or who are entitled to severance benefits or the equivalent thereof under the terms of an individual contract with Twin Oaks or Ottawa. For purposes of calculating the number of years of service, fractional years of service shall be rounded up or down to the nearest full year, except no employee shall receive less than two weeks of base pay. For purposes of calculating base pay, Twin Oaks employees who are paid on an hourly basis shall be deemed to have a base pay equal to the employee's average weekly compensation over the two months prior to the termination date. For these purposes, "**Cause**" shall mean termination due to the employee's personal dishonesty, willful misconduct, any breach of fiduciary duty involving personal profit, intentional failure to perform stated duties, willful violation of any law, rule or regulation (other than minor traffic violations or similar offenses) or final removal and prohibition order.

(c) As of the Effective Time, Ottawa Savings Bank shall make available employer-provided health and other employee welfare benefit plans to each Twin Oaks Continuing Employee on the same basis as it provides such coverage to Ottawa Savings Bank employees. Twin Oaks Continuing Employees shall receive credit for service with Twin Oaks under any existing or new Ottawa Savings Bank health plan in which such employees or their dependents would be eligible to enroll. Such service shall also apply for purposes of satisfying any waiting periods, actively-at-work requirements, and evidence of insurability requirements. Twin Oaks Continuing Employees who become covered under a Ottawa Savings Bank health plan shall be required to satisfy the deductible limitations of the Ottawa Savings Bank health plan and shall be subject to the out of pocket maximums of that plan for the plan year in which coverage commences, with offset for deductibles satisfied and out- of- pocket expenses incurred under the Twin Oaks health plan and Twin Oaks Continuing Employees shall not be subject to any preexisting condition under such plans. Unless a Twin Oaks Continuing Employee affirmatively terminates coverage under an Twin Oaks health plan prior to the time that such Twin Oaks Continuing Employee becomes eligible to participate in an Ottawa Savings Bank health plan, no coverage of any of the Twin Oaks Continuing Employees or their dependents shall terminate

under any other Twin Oaks health plans prior to the time such Twin Oaks Continuing Employees and their dependents become eligible to participate in the health plans, programs and benefits common to all employees of Ottawa Savings Bank and their dependents.

A-48

(d) Each Twin Oaks Continuing Employee shall be eligible to participate in the Ottawa Employee Stock Ownership Plan and 401(k) Plan with credit for prior service with Twin Oaks for purposes of eligibility and vesting but not for purposes of benefit accrual.

(e) Prior to the Effective Date, Twin Oaks will freeze the Twin Oaks Savings Bank Director Retirement Plan as to benefit accruals and years of service immediately prior to the Effective Date. Prior to the Effective Date Twin Oaks will amend the Twin Oaks Savings Bank Director Retirement Plan to clarify that benefits to which Twin Oaks directors are entitled pursuant to such plan are based solely on the level of fees paid to such directors by Twin Oaks. Ottawa shall honor all obligations under the Twin Oaks Savings Bank Director Retirement Plan. Non-continuing directors will be treated as retirees under the Plan and begin receiving distributions following the Closing Date. Continuing directors will receive benefits following their retirement from the Ottawa Board of Directors at such time as they become eligible to receive such benefits. The director and officer deferred compensation arrangements under the Twin Oaks Savings Bank 2008 Deferred Income Plan and the Twin Oaks Savings Bank Deferred Directors' Plan will be paid out by Twin Oaks immediately prior to the Effective Time in accordance with their terms or, alternatively, if consented to by Ottawa Savings Bank, which consent will not be unreasonably withheld, Twin Oaks may pay out such deferred compensation through the transfer of life insurance policies owned by Twin Oaks for which the applicable director is the named insured.

(f) Until and through December 31, 2014, Twin Oaks' Continuing Employees will remain eligible for the benefits provided under Twin Oaks' vacation, sick leave and personal day policies existing as of the date of this Agreement. Beginning on January 1, 2015, Twin Oaks Continuing Employees shall be eligible for the benefits provided under any existing or new Ottawa Savings Bank vacation, sick leave or personal day policies on the same basis as Ottawa Savings Bank provides such benefits to Ottawa Savings Bank employees, with Twin Oaks Continuing Employees receiving credit for prior service with Twin Oaks for purposes of eligibility and vacation accrual.

5.12 Indemnification.

(a) From and after the Effective Time, through the sixth anniversary of the Effective Time, Ottawa Savings Bank agrees to indemnify and hold harmless each of the current and former directors, officers and employees of Twin Oaks (each, an “**Indemnified Party**”), and any person who becomes an Indemnified Party between the date hereof and the Effective Time against any costs or expenses (including reasonable attorneys’ fees and expenses), judgments, fines, losses, claims, damages or liabilities and amounts paid in settlement incurred in connection with any actual or threatened claim, action, suit, proceeding or investigation, whether civil, criminal, administrative or investigative, arising out of matters existing or occurring at or prior to the Effective Time, whether asserted or claimed prior to, at or after the Effective Time, based in whole or in part on, or arising in whole or in part out of, or pertaining to (i) the fact that he or she is or was a director or officer of Twin Oaks or was prior to the Effective Time serving at the request of any such party as a director, officer, employee, trustee or partner of another corporation, partnership, trust, joint venture, employee benefit plan or other entity or (ii) any matters arising in connection with the transactions contemplated by this Agreement, to the fullest extent such person would have been indemnified or have the right to advancement of expenses pursuant to Twin Oaks’ charter and bylaws or applicable regulations as in effect on the date of this Agreement and as permitted by applicable law, and Ottawa Savings Bank shall also advance expenses as incurred to the fullest extent permitted under applicable law, provided that the person to whom expenses are advanced provides an undertaking to repay such advances if it is ultimately determined by a court of competent jurisdiction that such person is not entitled to indemnification.

(b) Any Indemnified Party wishing to claim indemnification under *Section 5.12(a)*, upon learning of any such action, suit, proceeding or investigation described above, shall promptly notify Ottawa Savings Bank thereof. Any failure to so notify shall not affect the obligations of Ottawa under *Section 5.12(a)* unless and to the extent that Ottawa Savings Bank is actually prejudiced as a result of such failure.

(c) For a period of three years from the Effective Time, Ottawa Savings Bank shall maintain Twin Oaks’ current directors’ and officers’ liability insurance covering each person currently covered by Twin Oaks’ directors’ and officers’ liability insurance policy with respect to claims against such persons arising from facts or events occurring at or prior to the Effective Time; *provided*, however, that in no event shall Ottawa Savings Bank be required to expend, in the aggregate, pursuant to this *Section 5.12(c)*, more than 150% of the annual premiums currently paid by Twin Oaks for such insurance (“**Maximum Insurance Amount**”); *provided further*, that if the amount of the annual premiums necessary to maintain or procure such insurance coverage exceeds the Maximum Insurance Amount, Ottawa Savings Bank shall obtain the most advantageous coverage obtainable for an annual premium equal to the Maximum Insurance Amount and *provided further* that Ottawa may (i) request Twin Oaks to, and Twin Oaks shall, purchase at Ottawa’s expense prior to the Effective Time, an extended reporting period endorsement under Twin Oaks’ existing directors’ and officers’ liability insurance policy or (ii) request Twin Oaks to, and Twin Oaks shall, purchase prior to the Effective Time, a prepaid “tail” policy the material terms of which, including coverage and amount are no less favorable in any material respect to such persons than Twin Oaks’ existing insurance policy as of the date hereof, at an aggregate cost not to exceed 200% of the current annual premium for such insurance. If such tail policy has been obtained by Twin Oaks prior to the Effective Time, Ottawa Savings Bank shall cause such policy to be maintained in full force and effect for its full term, and shall cause all obligations thereunder to be honored by Ottawa Savings Bank and no

other party shall have any further obligation to purchase or pay for insurance hereunder. The officers and directors of Twin Oaks may be required to make application and provide customary representations and warranties to Ottawa's insurance carrier for the purpose of obtaining such insurance.

A-50

(d) In the event Ottawa Savings Bank or any of its successors or assigns (i) consolidates with or merges into any other person or entity and shall not be the continuing or surviving corporation or entity of such consolidation or merger, or (ii) liquidates, dissolves, transfers or conveys all or substantially all of its properties and assets to any person or entity, then, and in required each such case, to the extent necessary, proper provision shall be made so that the successors and assigns of Ottawa Savings Bank assume the obligations set forth in this *Section 5.12*.

(d) The provisions of this *Section 5.12* are intended to be for the benefit of, and shall be enforceable by, each Indemnified Party and his or her representatives.

5.13 Board of Directors and Executive Officers.

(a) Ottawa shall take all action necessary to appoint three members of Twin Oaks' Board of Directors, who shall be Craig M. Hepner, Thomas Adler and William Kuiper, to the Board of Directors of Ottawa Savings Bancorp MHC, Ottawa Savings Bancorp and Ottawa Savings Bank, effective upon the Effective Time. Messrs. Hepner, Adler and Kuiper shall each be appointed to a different one of the three classes of directors for each of Ottawa Savings Bancorp MHC, Ottawa Savings Bancorp and Ottawa Savings Bank.

(b) Ottawa shall take all action necessary to appoint Craig M. Hepner as Chief Operating Officer of Ottawa Savings Bancorp and Ottawa Savings Bank.

5.14 Registration of Ottawa Savings Bancorp Common Stock. Ottawa Savings Bancorp shall take any action required to be taken under any applicable state securities laws in connection with the Merger and Twin Oaks shall furnish all information concerning it as may be reasonably requested in connection with such action.

5.15 Branches. It is expected that there will be no Ottawa Savings Bank or Twin Oaks branch closings or relocations or consolidations of exiting branches as part of the Merger. The branch offices of Twin Oaks will continue to operate under the name “Twin Oaks Savings Bank, a division of Ottawa Savings Bank,” subject to applicable laws, rules and regulations governing names of divisions of federal savings banks.

ARTICLE VI

Conditions to Consummation

6.1 Conditions to Each Party’s Obligations. The respective obligations of each party to effect the Merger shall be subject to the satisfaction of the following conditions:

(a) *Stockholder/Member Approval.* This Agreement shall have been approved by the requisite vote of Ottawa Savings Bancorp’s Stockholders, Twin Oaks’ members and, if required, by Ottawa Savings Bancorp MHC’s members, in accordance with applicable laws and regulations.

(b) *Regulatory Approvals.* All approvals, consents or waivers of any Governmental Entity required to permit consummation of the transactions contemplated by this Agreement shall have been obtained and shall remain in full force and effect, and all statutory waiting periods shall have expired.

(c) *No Injunctions or Restraints; Illegality.* No party hereto shall be subject to any order, decree or injunction of a court or agency of competent jurisdiction that enjoins or prohibits the consummation of the Merger and no Governmental Entity shall have instituted any proceeding for the purpose of enjoining or prohibiting the consummation of the Merger or any transactions contemplated by this Agreement. No statute, rule or regulation shall have been enacted, entered, promulgated or enforced by any Governmental Entity which prohibits or makes illegal consummation of the Merger.

(d) *Third Party Consents.* The parties hereto shall have obtained the consent or approval of each person (other than the governmental approvals or consents referred to in *Section 6.1(b)*) whose consent or approval shall be required to consummate the transactions contemplated by this Agreement, except those for which failure to obtain such consents and approvals would not, individually or in the aggregate, have a Material Adverse Effect on Ottawa (after giving effect to the consummation of the transactions contemplated hereby).

6.2 Conditions to the Obligations of Ottawa. The obligations of Ottawa to effect the Merger or other transactions contemplated by this Agreement shall be further subject to the satisfaction of the following additional conditions, any one or more of which may be waived by Ottawa:

A-52

(a) *Twin Oaks' Representations and Warranties.* Each of the representations and warranties of Twin Oaks set forth in this Agreement that is qualified as to Material Adverse Effect or materiality shall be true and correct, and each of the representations and warranties of Twin Oaks set forth in this Agreement that is not so qualified shall be true and correct, except where the failure to be so true and correct, individually or in the aggregate, has, or is reasonably likely to have, a Material Adverse Effect on Twin Oaks, considered as a whole, in each case, as of the date of this Agreement and as of the Closing Date as though made at and as of the Closing Date.

(b) *Performance of Twin Oaks' Obligations.* Twin Oaks shall have performed in all material respects all obligations required to be performed by it under this Agreement at or prior to the Effective Time.

(c) *Officers' Certificate.* Ottawa shall have received a certificate signed by the chief executive officer and the chief financial or principal accounting officer of Twin Oaks to the effect that the conditions set forth in *Sections 6.2(a)* and *(b)* have been satisfied.

(d) *No Material Adverse Effect.* Since the date of this Agreement, there shall not have occurred any event or occurrence that has had, or is reasonably expected to have, a Material Adverse Effect on Twin Oaks.

(e) *Good Standing and Other Certificates.* Ottawa shall have received certificates (such certificates to be dated as of a day as close as practicable to the Closing Date) from appropriate authorities as to the corporate existence of Twin Oaks and such other documents and certificates to evidence fulfillment of the conditions set forth in *Sections 6.1 and 6.2* as Ottawa may reasonably require.

(f) *Burdensome Condition.* None of the approvals, consents or waivers of any Governmental Entity required to permit consummation of the transactions contemplated by this Agreement shall contain any condition or requirement that would so materially and adversely impact the economic or business benefits to Ottawa of the transactions contemplated hereby that, had such condition or requirement been known, Ottawa would not, in its reasonable judgment, have entered into this Agreement.

6.3 Conditions to the Obligations of Twin Oaks. The obligations of Twin Oaks to effect the Merger shall be further subject to the satisfaction of the following additional conditions, any one or more of which may be waived by Twin Oaks:

(a) *Ottawa Representations and Warranties.* Each of the representations and warranties of Ottawa Savings Bancorp MHC, Ottawa Savings Bancorp and Ottawa Savings Bank set forth in this Agreement that is qualified as to Material Adverse Effect or materiality shall be true and correct, and each of the representations and warranties of Ottawa Savings Bancorp MHC, Ottawa Savings Bancorp and Ottawa Savings Bank set forth in this Agreement that is not so qualified shall be true and correct, except where the failure to be so true and correct, individually or in the aggregate, has, or is reasonably likely to have, a Material Adverse Effect on Ottawa considered as a whole, in each case, as of the date of this Agreement and as of the Closing Date as though made at and as of the Closing Date.

A-53

(b) *Performance of Ottawa Savings Bancorp MHC, Ottawa Savings Bancorp and Ottawa Savings Bank's Obligations.* Ottawa Savings Bancorp MHC, Ottawa Savings Bancorp and Ottawa Savings Bank shall have performed in all material respects all obligations required to be performed by each of them under this Agreement at or prior to the Effective Time of the Merger.

(c) *Officers' Certificate.* Twin Oaks shall have received a certificate signed by the chief executive officer and the chief financial or principal accounting officer of Ottawa Savings Bancorp MHC, Ottawa Savings Bancorp and Ottawa Savings Bank to the effect that the conditions set forth in *Sections 6.3(a) and (b)* have been satisfied.

(d) *No Material Adverse Effect.* Since the date of this Agreement, there shall not have occurred any event or occurrence that has had, or is reasonably expected to have, a Material Adverse Effect on Ottawa.

(e) *Good Standing and Other Certificates.* Twin Oaks shall have received certificates (such certificates to be dated as of a day as close as practicable to the Closing Date) from appropriate authorities as to the corporate existence of Ottawa and its Subsidiaries and such other documents and certificates to evidence fulfillment of the conditions set forth in *Sections 6.1 and 6.2* as Twin Oaks may reasonably require.

(f) *Burdensome Condition.* None of the approvals, consents or waivers of any Governmental Entity required to permit consummation of the transactions contemplated by this Agreement shall contain any condition or requirement that would so materially and adversely impact the economic or business benefits to Twin Oaks of the transactions contemplated hereby that, had such condition or requirement been known, Twin Oaks would not, in its reasonable judgment, have entered into this Agreement.

ARTICLE VII

Termination

7.1 Termination. This Agreement may be terminated, and the Merger abandoned, at any time prior to the Effective Time, by action taken or authorized by the Board of Directors of the terminating party, either before or after any required member or stockholder approval:

- (a) *Mutual Consent.* By the mutual written consent of Ottawa Savings Bancorp MHC, Ottawa Savings Bancorp, Ottawa Savings Bank and Twin Oaks; or

- (b) *No Stockholder or Member Approval.* By Ottawa or Twin Oaks, in the event of the failure of Ottawa Savings Bancorp's stockholders or Twin Oaks' members, or, if required, Ottawa Savings Bancorp MHC's members, to approve the Agreement at their respective meetings, *provided, however,* that;
 - (i) Ottawa shall only be entitled to terminate the Agreement pursuant to this clause if Ottawa Savings Bancorp MHC and Ottawa Savings Bancorp have complied in all material respects with their obligations under *Section 5.8*; and
 - (ii) Twin Oaks shall only be entitled to terminate the Agreement pursuant to this clause if Twin Oaks has complied in all material respects with its obligations under *Section 5.8*; or

- (c) *No Regulatory Approval.* By either Ottawa or Twin Oaks, if either (i) any approval, consent or waiver of a Governmental Entity required to permit consummation of the transactions contemplated by this Agreement shall have been denied and such denial has become final and non-applicable or (ii) any court or other Governmental Entity of competent jurisdiction shall have issued a final, unappealable order enjoining or otherwise prohibiting consummation of the transactions contemplated by this Agreement; or

(d) *Delay.* By either Ottawa or Twin Oaks, in the event the Merger shall not have occurred by April 30, 2015, unless the failure to so consummate by such date is due to the breach of any representation, warranty or covenant contained in this Agreement by the party seeking to terminate; or

A-55

(e) *Material Breach of Representation, Warranty or Failure to Perform Covenant.* By either Ottawa or Twin Oaks (provided that the party seeking termination is not then in material breach of any representation, warranty, covenant or other agreement contained herein), in the event of a breach of any covenant or agreement on the part of the other party set forth in this Agreement, or if any representation or warranty of the other party shall have become untrue, in either case such that the conditions set forth in *Sections 6.2(a) and (b)* or *Sections 6.3(a) and (b)*, as the case may be, would not be satisfied and such breach or untrue representation or warranty has not been or cannot be cured within thirty (30) days following written notice to the party committing such breach or making such untrue representation or warranty; or

(f) *Failure of Twin Oaks to Recommend Approval.* By Ottawa if: (i) the Board of Directors of Twin Oaks does not publicly recommend in any proxy statement utilized in connection with the transactions contemplated by this Agreement, the approval and adoption of this Agreement or (ii) if, after making such recommendation in any such proxy statement, the Board of Directors of Twin Oaks withdraws, qualifies or revises such recommendation or takes any action in any respect materially adverse to Ottawa; or

(g) *Failure of Ottawa to Recommend Approval.* By Twin Oaks if: (i) the Board of Directors of Ottawa Savings Bancorp MHC or Ottawa Savings Bancorp, as applicable, does not publicly recommend in any proxy statement utilized in connection with the transactions contemplated by this Agreement, that the members of Ottawa Savings Bancorp MHC or the stockholders of Ottawa Savings Bancorp, as applicable, approve and adopt this Agreement or (ii) after making such recommendation in such proxy statement, the Board of Directors of Ottawa Savings Bancorp MHC or Ottawa Savings Bancorp, as applicable, withdraws, qualifies or revises such recommendation or takes any action in any respect materially adverse to Twin Oaks; or

(h) *Superior Proposal.* By Twin Oaks, (i) if the Board of Directors of Twin Oaks authorizes Twin Oaks to enter into an agreement with respect to an Acquisition Transaction that the Board of Directors of Twin Oaks has determined is a Superior Proposal and (2) Twin Oaks has not materially breached its obligations under *Section 5.1*; provided, that Twin Oaks shall not terminate this Agreement pursuant to this *Section 7.1(h)* and enter into an agreement for an Acquisition Transaction until the expiration of three business days following Twin Oaks' written notice advising Ottawa Savings Bancorp that Twin Oaks has received a Superior Proposal specifying the material terms and conditions of such Superior Proposal (and including a copy thereof), identifying the person making such Superior Proposal and stating whether Twin Oaks intends to enter into a definitive agreement for an Acquisition Transaction. After providing such notice, Twin Oaks shall provide a reasonable opportunity to Ottawa Savings Bancorp during such three-day period to make such adjustments to the terms and conditions of this Agreement as would enable Twin Oaks to proceed with the transactions contemplated herein on such adjusted terms.

7.2 Termination Fees.

(a) If this Agreement is terminated by Twin Oaks pursuant to *Section 7.1(e)* hereof as a result of Ottawa's willful or intentional breach, in any material respect, of its representations or warranties or as a result of Ottawa's willful or intentional failure to perform, in any material respect, any of its covenants or other agreements contained in this Agreement, then Ottawa shall pay Twin Oaks a termination fee of \$122,500.

(b) If this Agreement is terminated by (i) Ottawa pursuant to *Section 7.1(e)* hereof as a result of Twin Oaks' willful or intentional breach, or willful or intentional failure to perform, in any material respect, its covenants contained in *Section 5.1* hereof, or (ii) Twin Oaks pursuant to *Section 7.1(h)* hereof, then Twin Oaks shall pay Ottawa a termination fee of \$250,000.

(c) If after the date of this Agreement and prior to the termination of this Agreement a bona fide Acquisition Proposal shall have been made known to senior management of Twin Oaks or has been made directly to its members generally or any person shall have publicly announced (and not withdrawn) an Acquisition Proposal with respect to Twin Oaks and (i) thereafter this Agreement is terminated by either Twin Oaks or Ottawa pursuant to *Section 7.1(d)* and Twin Oaks shall have failed to obtain the approval of this Agreement by Twin Oaks' members at the duly convened meeting of Twin Oaks' members or any adjournment or postponement thereof at which a vote on the approval of this Agreement was taken or (ii) thereafter this Agreement is terminated by Ottawa pursuant to *Section 7.1(f)*, and (iii) prior to the date this is twelve (12) months after the date of such termination, Twin Oaks enters into a definitive agreement or consummates a transaction with respect to an Acquisition Proposal (whether or not the same Acquisition Proposal as that referred to above), then Twin Oaks shall pay Ottawa a termination fee of \$250,000.

(d) Except to the extent this Agreement is terminated pursuant to *Section 7.2(b)*, *Section 7.2(c)*, or *Section 7.2(e)* hereof, if this Agreement is terminated by Ottawa pursuant to *Section 7.1(e)* hereof as a result of Twin Oaks' willful or intentional breach, in any material respect, of its representations or warranties or as a result of Twin Oaks' willful or intentional failure to perform, in any material respect, any of its covenants or other agreements contained in this Agreement, then Twin Oaks shall pay Ottawa a termination fee of \$122,500.

(e) If this Agreement is terminated by Ottawa pursuant to *Section 7.1(e)* hereof because Twin Oaks has experienced a Material Adverse Effect as identified by the preparation of the Audited Financial Statements, then Twin Oaks shall pay Ottawa a termination fee equal to the reasonable expenses Ottawa has incurred in connection with the preparation of this Agreement and any actions relating thereto or as a result thereof, up to a maximum of \$122,500.

7.3 Effect of Termination. In the event of termination of this Agreement by either Ottawa or Twin Oaks as provided in *Section 7.1*, this Agreement shall forthwith become void and, subject to *Section 7.2*, have no effect, and there shall be no liability on the part of any party hereto or their respective officers and directors, except that (i) *Sections 5.3(c), 7.2 and 8.6*, shall survive any termination of this Agreement and (ii) notwithstanding anything to the contrary contained in this Agreement, no party shall be relieved or released from any liabilities or damages arising out of the willful breach of any provision of this Agreement.

ARTICLE VIII

Certain Other Matters

8.1 Interpretation. When a reference is made in this Agreement to Sections or Exhibits such reference shall be to a Section of, or Exhibit to, this Agreement unless otherwise indicated. The table of contents and headings contained in this Agreement are for ease of reference only and shall not affect the meaning or interpretation of this Agreement. Whenever the words “include,” “includes” or “including” are used in this Agreement, they shall be deemed followed by the words “without limitation.” Any singular term in this Agreement shall be deemed to include the plural, and any plural term the singular. Any reference to gender in this Agreement shall be deemed to include any other gender.

8.2 Survival. Only those agreements and covenants of the parties that are by their terms applicable in whole or in part after the Effective Time, including *Section 5.12* and *Section 5.13* of this Agreement, shall survive the Effective Time. All other representations, warranties, agreements and covenants shall be deemed to be conditions of the Agreement and shall not survive the Effective Time.

8.3 Waiver; Amendment. Prior to the Effective Time, any provision of this Agreement may be: (i) waived in writing by the party benefitted by the provision or (ii) amended or modified at any time (including the structure of the transaction) by an agreement in writing between the parties hereto.

8.4 Counterparts. This Agreement may be executed in counterparts each of which shall be deemed to constitute an original, but all of which together shall constitute one and the same instrument. A facsimile or other electronic copy of a signature page shall be deemed to be an original signature page.

8.5 Governing Law. This Agreement shall be governed by, and interpreted in accordance with, the laws of the State of Illinois, without regard to conflicts of laws principles.

8.6 Expenses. Except as provided in *Section 7.2*, or as is otherwise expressly set forth in this Agreement, each party hereto will bear all expenses incurred by it in connection with this Agreement and the transactions contemplated hereby.

A-58

8.7 Notices. All notices and other communications in connection with this Agreement shall be in writing and shall be deemed given if delivered personally, sent via facsimile (with confirmation), by email, by registered or certified mail (return receipt requested) or by commercial overnight delivery service, or delivered by an express courier (with confirmation) to the parties at the following addresses (or at such other address for a party as shall be specified by like notice):

If to Ottawa Savings Bancorp MHC, Ottawa Savings Bancorp and Ottawa Savings Bank, to:

Ottawa Savings Bank FSB

925 LaSalle Street

Ottawa, Illinois 61350

Facsimile: (815) 433-2573

Attention: Jon Kranov

With copies to:

Kilpatrick Townsend & Stockton LLP

607 14th Street, NW, Suite 900

Washington, DC 20005

Facsimile: (202) 204-5614

Attention: Edward G. Oliner, Esq.

If to Twin Oaks, to:

Twin Oaks Savings Bank

125 West Bluff Street

Marseilles, Illinois 61341

Facsimile: (815) 795-6381

Attention: Craig M. Hepner

With copies to:

Howard & Howard Attorneys PLLC

200 South Michigan Avenue

Suite 1100

Chicago, Illinois 60604

Facsimile: (312) 939-5617

Attention: Joseph B. Hemker, Esq.

8.8 Entire Agreement; etc. This Agreement, together with the Disclosure Letters, represents the entire understanding of the parties hereto with reference to the transactions contemplated hereby and supersedes any and all other oral or written agreements heretofore made. All terms and provisions of this Agreement shall be binding upon and shall inure to the benefit of the parties hereto and their respective successors and assigns. Except for *Section 5.12 and Section 5.13*, which confer rights on the parties described therein, nothing in this Agreement is intended to confer upon any other person any rights or remedies of any nature whatsoever under or by reason of this Agreement.

8.9 Successors and Assigns; Assignment. This Agreement shall be binding upon and inure to the benefit of the parties hereto and their respective successors and assigns; provided, however, that this Agreement may not be assigned by any party hereto without the written consent of the other parties.

[Signature Page To Follow]

A-60

In Witness Whereof, the parties hereto have caused this Agreement to be executed by their duly authorized officers as of the date first above written.

Ottawa Savings Bancorp MHC

By: /s/ Jon Kranov
Jon Kranov
President and Chief Executive Officer

Ottawa Savings Bancorp, Inc.

By: /s/ Jon Kranov
Jon Kranov
President and Chief Executive Officer

Ottawa Savings Bank FSB

By: /s/ Jon Kranov
Jon Kranov
President and Chief Executive Officer

Twin Oaks Savings Bank

By: /s/ Craig M. Hepner
Craig M. Hepner
President

Exhibit A

Voting Agreement

June __, 2014

Ottawa Savings Bank FSB

Ottawa Savings Bancorp, Inc.

Ottawa Savings MHC

925 LaSalle Street

Ottawa, Illinois 61350

To the Board of Directors:

The undersigned is a director and/or an executive officer of Twin Oaks Savings Bank (“Twin Oaks”). Simultaneously with the execution hereof, Ottawa Savings Bank FSB (“Ottawa Savings”) and Twin Oaks are executing an Agreement and Plan of Merger (the “Agreement”) contemplating the acquisition of Twin Oaks through the merger of Twin Oaks with and into Ottawa Savings (the “Merger”). The execution of the Agreement by Ottawa Savings is subject to the execution and delivery of this letter agreement.

In consideration of the expenses that Ottawa Savings will incur in connection with the transactions contemplated by the Agreement and to induce Ottawa Savings to execute the Agreement and to proceed to incur such expenses, the undersigned agrees and undertakes, in his capacity as a member of Twin Oaks, and not in his capacity as a director or officer of Twin Oaks, as follows:

Edgar Filing: NATIONAL HOLDINGS CORP - Form 10-Q

1. While this letter agreement is in effect the undersigned shall vote or cause to be voted all of the votes that the undersigned shall be entitled to so vote: (a) for the approval of the Agreement and the Merger at the meeting of the members of Twin Oaks; and (b) against any Acquisition Proposal (as defined in the Agreement) (other than the Merger).

2. The undersigned acknowledges and agrees that any remedy at law for breach of the foregoing provisions shall be inadequate and that, in addition to any other relief that may be available, Ottawa Savings shall be entitled to temporary and permanent injunctive relief without having to prove actual damages.

3. This letter agreement shall automatically terminate upon the earlier of (i) the favorable vote of Twin Oaks' members with respect to the approval of the Agreement and the Merger, (ii) the termination of the Agreement in accordance with its terms or (iii) the Effective Time (as that term is defined in the Agreement) of the Merger.

4. The parties hereto acknowledge that the undersigned is entering into this letter agreement solely in his or her capacity as a member of Twin Oaks and, notwithstanding anything to the contrary in this letter agreement, nothing in this letter agreement is intended or shall be construed to require the undersigned, in his or her capacity as a director and/or an executive officer of Twin Oaks, to act or fail to act other than in accordance with his or her fiduciary duties.

IN WITNESS WHEREOF, the undersigned has executed this agreement as of the date first above written.

Very truly yours,

Print Name

Accepted and agreed to as of

the date first above written:

Ottawa Savings Bank

By: Jon Kranov

Its: President and Chief Executive Officer

A-62

Exhibit B

Directors of the Resulting Savings Institution

Thomas Adler

John M. Armstrong

James Ferrero

Craig M. Hepner

Keith Johnson

Jon Kranov

William Kuiper

Arthur C. Mueller

Daniel J. Reynolds

A-63

Exhibit C

Senior Executive Officers of the Resulting Savings Institution

Jon Kranov, President and Chief Executive Officer

Craig M. Hepner, Executive Vice President and Chief Operating Officer

Marc N. Kingry, Chief Financial Officer

Philip B. Devermann, Vice President

A-64
