CITIZENS FIRST FINANCIAL CORP
Form 10-Q
November 15, 2004

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10 - Q

QUARTERLY REPORT UNDER SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2004 Commission File No.: 0-27740

CITIZENS FIRST FINANCIAL CORP.

(Exact name of registrant as specified in its charter)

DELAWARE	**37-1351861**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer I.D. No.)

2101 North Veterans Parkway, Bloomington, Illinois 61704
(Address of principal executive offices)

Registrant s telephone number: **(309) 661-8700**

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 past 90 days.

Yes X No___

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).
Yes___ No X

The Registrant had 1,498,570 shares of Common Stock outstanding as of November 1, 2004.

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Statement re: Computation of Per Share Earnings
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Certification of Dallas G. Smiley Required by Rule 13a-14(a)
Certification of C. William Landefeld Required by Section 906
Certification of Dallas G. Smiley Required by Section 906

Statements contained in this Form 10-Q which are not historical facts are forward-looking statements, as that term is described in the Private Securities Litigation Reform Act of 1995. The forward-looking statements are generally identifiable by the use of such words as believes , expects , anticipates , estimates , projects , intends or similar expressions. Such forward-looking statements are subject to risk and uncertainties which could cause actual results to differ materially from those projected. Such risks and uncertainties include potential changes in interest rates, competitive factors in the financial services industry, general and local economic conditions, the effect of new legislation and other risks detailed in documents filed by the Company with the Securities and Exchange Commission from time to time.

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PART I. FINANCIAL INFORMATION

Citizens First Financial Corp. and Subsidiary

Condensed Consolidated Balance Sheets
As of September 30, 2004 and December 31, 2003
(in thousands except share data)

	September 30, 2004	December 31, 2003
	(Unaudited)	
ASSETS		
Cash and due from banks	$ 6,070	$ 6,692
Interest-bearing deposits and federal funds sold	26,405	10,139
Cash and cash equivalents	32,475	16,831
Available for sale securities	26,998	20,746
Mortgage loans held for sale	963	376
Loans	240,081	282,477
Allowance for loan losses	(3,215)	(3,072)
Net loans	236,866	279,405
Land in real estate joint venture		683
Premises and equipment	5,843	6,183
Federal Home Loan Bank stock	15,914	15,206
Foreclosed assets	631	2,135
Mortgage servicing rights	385	469
Cash surrender value of bank owned life insurance	4,252	4,115
Other assets	2,776	3,366
Total assets	$327,103	$349,515
LIABILITIES AND STOCKHOLDERS EQUITY		
Liabilities		
Deposits	$231,416	$250,013
Long-term debt	58,750	63,975
Other liabilities	2,724	2,153
Total liabilities	292,890	316,141
Minority interest in real estate joint venture		382

Commitments and Contingent Liabilities		
Stockholders Equity		
Preferred stock, $.01 par value		
Authorized and unissued 1,000,000 shares		
Common stock, $.01 par value; authorized 8,000,000 shares;		
2,817,500 shares issued and outstanding	28	28
Additional paid-in-capital	26,666	27,910
Retained earnings	29,566	26,870
Accumulated other comprehensive income (loss)	3	(20)
Less:		
Treasury shares, 1,318,930 and 1,318,025, respectively	(22,050)	(21,796)
Total stockholders equity	34,213	32,992
Total liabilities and stockholders equity	$327,103	$349,515

See notes to condensed consolidated financial statements

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Citizens First Financial Corp. and Subsidiary

Condensed Consolidated Statements of Income

	For the nine months ended September 30, 2004	For the nine months ended September 30, 2003
	(Unaudited and in thousands except share data)	
Interest income		
Interest on loans	$ 11,643	$ 13,460
Interest on investments, deposits with banks, federal funds sold and other	1,544	1,244
Total interest income	13,187	14,704
Interest expense		
Interest on deposits	3,682	4,385
Interest on borrowings	1,432	2,339
Total interest expense	5,114	6,724
Net interest income	8,073	7,980
Provision (credit) for loan losses	(109)	867
Net interest income after provision for loan losses	8,182	7,113
Noninterest income		
Service charges on deposit accounts	829	741
Net gains on loan sales	95	1,091
Gains on sales of land in joint venture	230	400
Other	251	241
Total noninterest income	1,405	2,596
Noninterest expense		
Salaries and employee benefits	3,178	2,879

Net occupancy and equipment expenses	927	929
Net loss on sale or write-down of foreclosed assets	417	770
Deposit insurance expense	46	30
Data processing expense	278	270
Minority interest in net income of real estate joint venture	97	198
Other	1,434	1,472
Total noninterest expense	6,377	6,548
Income before income tax	3,210	3,161
Income tax expense	1,193	1,201
Net income	2,017	1,960
Other comprehensive loss, net of tax:		
Unrealized appreciation (depreciation) on available for sale securities	23	(179)
Comprehensive income	$ 2,040	$ 1,781
Basic earnings per share	$ 1.34	$ 1.33
Weighted average shares outstanding	1,506,717	1,472,457
Diluted earnings per share	$ 1.26	$ 1.22
Weighted average shares outstanding	1,601,567	1,610,261

See notes to condensed consolidated financial statements

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Citizens First Financial Corp. and Subsidiary

Condensed Consolidated Statements of Income

	For the three months ended September 30, 2004	For the three months ended September 30, 2003
	(Unaudited and in thousands except share data)	
Interest income		
Interest on loans	$ 3,580	$ 4,428
Interest on investments, deposits with banks, federal funds sold and other	577	454
Total interest income	4,157	4,882
Interest expense		
Interest on deposits	1,154	1,369
Interest on borrowings	421	768
Total interest expense	1,575	2,137
Net interest income	2,582	2,745
Provision for loan losses	141	476
Net interest income after provision for loan losses	2,441	2,269
Noninterest income		
Service charges on deposit accounts	271	290
Net gains on loan sales	63	272
Recovery of mortgage servicing rights		123
Gains on sale of land in joint venture		206
Other	95	122
Total noninterest income	429	1,013
Noninterest expense		

Salaries and employee benefits	1,153	835
Net occupancy and equipment expenses	237	300
Net loss (gain) on sale or write-down of foreclosed assets	(55)	771
Deposit insurance expense	27	10
Data processing expense	94	95
Minority interest in net income of real estate joint venture		101
Other	460	390
Total noninterest expense	1,916	2,502
Income before income tax	954	780
Income tax expense	355	283
Net income	599	497
Other comprehensive income, net of tax:		
Unrealized appreciation (depreciation) on available for sale securities	112	(150)
Comprehensive income	$ 711	$ 347
Basic earnings per share	$ 0.40	$ 0.33
Weighted average shares outstanding	1,498,599	1,494,322
Diluted earnings per share	$ 0.38	$ 0.31
Weighted average shares outstanding	1,590,098	1,624,766

See notes to condensed consolidated financial statements

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Citizens First Financial Corp. and Subsidiary
CITIZENS FIRST FINANCIAL CORP. AND SUBSIDIARY

Condensed Consolidated Statements of Cash Flows

	For the nine months ended September 30, 2004	For the nine months ended September 30, 2003
	(Unaudited and in thousands)	
Operating activities		
Net income	$ 2,017	$ 1,960
Adjustments to reconcile net income to net cash Provided (used) by operating activities:		
Provision (credit) for loan losses	(109)	867
Increase in cash surrender value of life insurance policies	(137)	
Investment securities amortization, net	69	157
Minority interest in net income of real estate joint venture	97	198
Net gain on sale of land in real estate joint venture	(230)	(400)
Net loss on sale or write-down of foreclosed assets	535	770
Net gains on sale of mortgage loans	(95)	(1,091)
Recovery of mortgage servicing rights		(123)
Amortization of mortgage servicing rights	115	211
Depreciation	531	537
Mortgage loans originated for sale	(5,560)	(63,190)
Proceeds from sale of mortgage loans	5,037	65,859
Federal Home Loan Bank dividends	(708)	(286)
Change in:		
Other assets	602	87
Other liabilities	1,060	115
Net cash provided by operating activities	3,224	5,671
Investing Activities		
Purchase of available for sale securities	(9,824)	(11,661)
Proceeds from maturities and principal paydowns on available for sale securities	3,514	9,621
Purchase of Federal Home Loan bank stock		10,000
Net change in loans	41,916	(789)
investment in land in real estate joint venture		(28)
Proceeds from sales of land real estate joint venture	913	633
Net distribution of minority interest portion of real estate joint venture	(479)	(295)
Purchases of premises and equipment	(191)	(50)
Proceeds from sales of foreclosed assets	1,701	2,177

Investment in bank-owned life insurance		(4,000)
Net cash provided by (used in) investing activities	37,550	(14,392)

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	For the nine months ended September 30, 2004	For the nine months ended September 30, 2003
	(Unaudited and in thousands)	
Financing Activities		
Net change in deposits	$(18,597)	$ (2,542)
Proceeds from borrowings	25,000	3,000
Repayment of borrowings	(30,225)	(7,025)
Purchase of treasury stock shares	(602)	(1,155)
Cash dividends paid on common stock	(459)	(452)
Exercise of stock options	242	1,092
Net change in advances by borrowers for taxes and insurance	(489)	(196)
Net cash used in financing activities	(25,130)	(7,278)
Net change in cash and cash equivalents	15,644	(15,999)
Cash and cash equivalents, beginning of period	16,831	33,583
Cash and cash equivalents, end of period	$ 32,475	$ 17,584
Additional cash flows information:		
Interest paid	$ 5,175	$ 6,677
Income tax paid	$ 931	$ 1,115
Loans transferred to foreclosed assets	$ 732	$ 4,614

See notes to condensed consolidated financial statements

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Citizens First Financial Corp.

Notes to Condensed Consolidated Financial Statements

1. Background Information

Citizens First Financial Corp. (the Company) was incorporated in January 1996 and on May 1, 1996 acquired all of the outstanding shares of common stock of Citizens Savings Bank (the Bank) upon the Bank s conversion from a federally chartered mutual savings bank to a federally chartered stock savings bank. The Company purchased 100% of the outstanding capital stock of the Bank using 50% of the net proceeds from the Company s initial stock offering which was completed on May 1, 1996. In April 1999, the Bank was converted from a federally chartered savings bank to an Illinois state savings bank.

The Company sold 2,817,500 shares of common stock in the initial offering at $10.00 per share, including 225,400 shares purchased by the Bank s Employee Stock Ownership Plan (the ESOP). The ESOP shares were acquired by the Bank with proceeds from a Company loan totaling $2,254,000. The net proceeds of the offering totaled $27,012,000; $28,175,000 less $1,163,000 in underwriting commissions and other expenses. The Company s stock is traded on the NASDAQ National Market under the symbol CFSB .

2. Statement of Information Furnished

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with Form 10-Q instructions and Rule 10-01 of Regulation S-X, and in the opinion of management reflect all adjustments necessary to present a fair statement of the consolidated financial position as of September 30, 2004 and December 31, 2003, and the consolidated statements of income for the nine and three months ended September 30, 2004 and 2003 and statement of cash flows for the nine months ended June 30, 2004 and 2003. All adjustments to the financial statements were of a normal recurring nature. These results have been determined on the basis of accounting principles generally accepted in the United States of America. The results of operations for the nine and three months ended September 30, 2004 are not necessarily indicative of the results to be expected for the entire fiscal year.

The condensed consolidated financial statements are those of the Company and the Bank. These condensed consolidated financial statements should be read in conjunction with the audited financial statements and notes thereto included in the Company s 2003 Annual Report to Stockholders.

3. Earnings Per Share

Basic earnings per share have been computed based upon the weighted average common shares outstanding for the nine and three months ended September 30, 2004 and 2003. Diluted earnings per share for the nine and three months ended September 30, 2004 reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the Company.

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4. Stock Options

The Company has a stock-based employee compensation plan, which is described more fully in Notes to Financial Statements included in the December 31, 2003 Annual Report to Shareholders. The Company accounts for this plan under the recognition and measurement principles of APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations. No stock-based employee compensation cost is reflected in net income, as all options granted under the plan had an exercise price equal to the market value of the underlying common stock on the grant date. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value provisions of Statement of Financial Accounting Standards (SFAS) No. 123, *Accounting for Stock-Based Compensation*, to stock-based employee compensation.

	Three Months Ended September 30,	**Three Months Ended September 30,**	**Nine Months Ended September 30,**	**Nine Months Ended September 30,**
	2004	**2003**	**2004**	**2003**
Net income, as reported	$ 599	$ 497	$ 2,017	$ 1,960
Less: Total stock-based employee compensation cost determined under the fair value based method, net of income taxes	(21)	(24)	(63)	(72)
Pro forma net income	$ 578	$ 473	$ 1,954	$ 1,888
Earnings per share:				
Basic as reported	$ 0.40	$ 0.33	$ 1.34	$ 1.33
Basic pro forma	$ 0.39	$ 0.32	$ 1.30	$ 1.28
Diluted as reported	$ 0.38	$ 0.31	$ 1.26	$ 1.22
Diluted pro forma	$ 0.36	$ 0.29	$ 1.22	$ 1.17

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5. Recent Accounting Pronouncements

SEC Staff Accounting Bulletin (SAB) No. 105, Application of Accounting Principles to Loan Commitments. SAB 105 summarizes the views of the staff of the SEC regarding the application of generally accepted accounting principles to loan commitments accounted for as derivative instruments. SAB 105 provides that the fair value of recorded loan commitments that are accounted for as derivatives under SFAS 133, Accounting for Derivative Instruments and Hedging Activities, should not incorporate the expected future cash flows related to the associated servicing of the future loan. In addition, SAB 105 requires registrants to disclose their accounting policy for loan commitments. The provisions of SAB 105 must be applied to loan commitments accounted for as derivatives that are entered into after March 31, 2004. The adoption of this accounting standard did not have a material impact on the Company s financial statements.

Emerging Issues Task Force (EITF) Issue 03-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments. EITF 03-1 provides guidance for determining when an investment is considered impaired, whether impairment is other-than-temporary, and measurement of an impairment loss. An investment is considered impaired if the fair value of the investment is less than its cost. Generally, an impairment is considered other-than-temporary unless: (i) the investor has the ability and intent to hold an investment for a reasonable period of time sufficient for an anticipated recovery of fair value up to (or beyond) the cost of the investment; and (ii) evidence indicating that the cost of the investment is recoverable within a reasonable period of time outweighs evidence to the contrary. If impairment is determined to be other-than-temporary, then an impairment loss should be recognized equal to the difference between the investment s cost and its fair value. Certain disclosure requirements of EITF 03-1 were adopted in 2003 and the Company began presenting the new disclosure requirements in its consolidated financial statements for the year ended December 31, 2003. The recognition and measurement provisions were initially effective for other-than-temporary impairment evaluations in reporting periods beginning after June 15, 2004. However, in September 2004, the effective date of these provisions was delayed until the finalization of a FASB Staff Position (FSP) to provide additional implementation guidance. Currently, the FASB expects to issue the FSP no later than December 2004.

American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) No. 03-3, Accounting for Certain Loans or Debt Securities Acquired in a Transfer. SOP 03-3 addresses accounting for differences between the contractual cash flows of certain loans and debt securities and the cash flows expected to be collected when loans or debt securities are acquired in a transfer and those cash flow differences are attributable, at least in part, to credit quality. As such, SOP 03-3 applies to loans and debt securities acquired individually, in pools or as part of a business combination and does not apply to originated loans. The application of SOP 03-3 limits the interest income, including accretion of purchase price discounts, that may be recognized for certain loans and debt securities. Additionally, SOP 03-3 does not allow the excess of contractual cash flows over cash flows expected to be collected to be recognized as an adjustment of yield, loss accrual or valuation allowance, such as the allowance for possible loan losses. SOP 03-3 requires that increases in expected cash flows subsequent to the initial investment be recognized prospectively through adjustment of the yield on the loan or debt security over its remaining life. Decreases in expected cash flows should be recognized as impairment. In the case of loans acquired in a business combination where the loans show signs of credit deterioration, SOP 03-3 represents a significant change from current purchase accounting practice whereby the acquiree s allowance for loan losses is typically added to the acquirer s allowance for loan losses. SOP 03-3 is effective for loans and debt securities acquired by the Company beginning January 1, 2005. The adoption of this new standard is not expected to have a material impact on the Company s financial statements.

6. Subsequent Event

On November 7, 2004, the Company entered into an Agreement and Plan of Merger with Main Street Trust, Inc. (Main Street), an Illinois corporation. Main Street Trust, Inc. will acquire all of the Company s issued and outstanding shares of common stock. Each of the Company s shareholders will have the option of receiving either 1.1051 shares of Main Street s stock for each share of the Company s stock or $35.00 of cash for each share of the Company s common stock or a combination of both. The transaction is subject to approval by state and federal regulators and by the Company s shareholders and is expected to close in the second quarter of 2005.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

GENERAL

Citizens First Financial Corp. (the Company) is the holding company for Citizens Savings Bank (the Bank). The Bank was originally chartered in 1888 by the State of Illinois and in 1989 became a federally chartered savings bank. In April 1999, the Bank was converted from a federally chartered savings bank to an Illinois state savings bank. The Bank s principal business consists of the acceptance of retail deposits from the general public in the areas surrounding its main and branch offices and the investment of these deposits, together with funds generated from operations and borrowings into loans and investment securities. The Bank originates one-to-four family residential mortgages, commercial, multi-family, construction and land, commercial real estate, agricultural, consumer and other loans. The Bank has a wholly-owned service corporation, CSL Service Corporation (CSL), which is an Illinois-chartered corporation that had invested in Williamsburg LLC (Williamsburg), a real estate development joint venture. CSL, who was a 50% owner of Williamsburg, sold its interest in May 2004. The results of Williamsburg until May 2004 are consolidated into the Company s financial statements.

COMPARISON OF FINANCIAL CONDITION AT SEPTEMBER 30, 2004 and DECEMBER 31, 2003

Total assets decreased from $349.5 million at December 31, 2003 to $327.1 million at September 30, 2004. The $22.4 million or 6.4% decrease was primarily due to the decrease in loans, offset by an increase in interest-bearing deposits and federal funds sold and available for sale securities.

Cash and cash equivalents increased from $16.8 million at December 31, 2003 to $32.5 million at September 30, 2004, an increase of $15.7 million or 93.5%. The increase occurred primarily because of the decrease of loans of $42.4 million, offset by the decreases of $18.6 million in deposits and $5.2 million in long-term debt.

Available for sale securities increased from $20.7 million at December 31, 2003 to $27.0 million at September 30, 2004, an increase of $6.3 million or 30.4%. The increase was primarily due to the purchase of $9.8 million of investment securities which was offset by $3.5 million in maturities and principal paydowns.

Loans, net of allowance for loan losses and including mortgage loans held for sale, decreased from $279.8 million at December 31, 2003 to $237.8 million at September 30, 2004, a decrease of $42.0 million or 15.0%. The decrease was primarily due to a decrease of $16.8 million in construction and land development loans, $12.7 million in loans secured by 1-4 family residential properties, $5.4 million in non-farm/non-residential real estate loans, $5.2 million of commercial & industrial loans and $1.5 million of farmland real estate loans. The decreases were due to loan repayments. The Company sells primarily fixed rate residential loans in the secondary market (primarily to the Federal Home Loan Mortgage Corporation) as a source of income from gains on sale and servicing fees and as a means of controlling interest rate risk. The Company sold $5.1 million in loans during the first nine months of 2004. The

Company serviced $84.5 million and $96.1 million at September 30, 2004 and December 31, 2003, respectively.

The Company has a significant concentration in construction and commercial real estate loans related to the real estate market in Bloomington-Normal, Illinois. Management believes that due to the continued strength of this market, this concentration does not pose a significant risk to the Company.

The allowance for loan losses is established through a provision for loan losses based on management s evaluation of the risks inherent in the loan portfolio and the general economy. The allowance for loan losses is maintained at an amount management considers adequate to cover estimated losses in loans receivable which are deemed probable and can be estimated based on information available to management at such time. While management believes the allowance for loan losses is sufficient to cover future loan losses inherent in its loan portfolio at this time, no assurances can be given that the level of the allowance for loan losses will be sufficient to cover future loan losses incurred or that future adjustments to the allowance for loan losses will not be necessary if economic and other conditions differ substantially from the economic and other conditions used by management to determine the current level of the allowance for loan losses. The allowance is based upon a number of factors, including asset classification, economic trends, industry experience and trends, industry and geographic concentrations, estimated collateral value, management s assessments of the credit risk inherent in the portfolio, historical loan loss experience, and the Company s underwriting policies. Management will continue to monitor and modify the allowance for loan losses as conditions dictate. Various regulatory agencies, as an integral part of their examination process, periodically review the allowance for loan losses. These agencies may require additional valuation allowances, based on their judgments of the information available at the time of the examination.

The Company s policy is to charge off loans when it is determined that they are no longer collectible. The policy for loans secured by real estate, which comprises the majority of the loan portfolio, is to establish loss reserves in accordance with the loan classification process, based on accounting principles generally accepted in the United States of America. The Company s policy is to obtain an appraisal or evaluation on all real estate acquired through foreclosure at the time of foreclosure.

The allowance for loan losses increased from $3,072,000 at December 31, 2003 to $3,215,000 at September 30, 2004, an increase of $143,000 or 4.7%. The increase was primarily due to recoveries in the first nine months of 2004 of charged-off loans in prior years of $410,000. Included in these recoveries was a $389,000 payment from the bankruptcy trustee for a commercial developer. Due to the large amount of recoveries, decrease in the loan portfolio and the Company s review of the adequacy of its allowance for loan losses, the Company recorded a credit to the provision for loan losses of $109,000 during the first nine months of 2004. During the first nine months of 2004, $57,000 of loans were charged-off to the allowance for loan losses.

The Company s non-performing and potential problem loans increased from $8,428,000 at December 31, 2003 to $21,910,000 at September 30, 2004, an increase of $13,482,000. The increase was primarily attributable to the classification as a potential problem a loan of $10,956,000 for a commercial real estate development because of the concentration of loans to this borrower and the slow sales in this development. This loan is contractually current on all required payments. In addition to the collateralized property, the borrower has personally guaranteed a portion of the outstanding balance. Management believes that there is adequate collateral for this loan and anticipates that there will be no loss on this loan. The non-performing and potential problem loans were considered impaired as of September 30, 2004 and December 31, 2003. The Company has established a loss reserve of $2,012,000 for non-performing and potential problem loans and believes that it has adequately reserved for any potential loss.

Non-performing loans, which are loans past due 90 days or more and non-accruing loans, decreased from $2,459,000 at December 31, 2003 to $1,822,000 at September 30, 2004. The ratio of the Company s allowance for loan losses to total non-performing loans was 176.4% and 124.9% at September 30, 2004 and December 31, 2003, respectively. Management believes that the problems with these borrowers are identified and not indicative of the loan portfolio in total.

Non-accruing loans decreased from $2,452,000 at December 31, 2003 to $1,822,000 at September 30, 2004, a decrease of $630,000 or 25.7%. At September 30, 2004, non-accrual loans consist of five construction and land development loans with a balance of $930,000, six 1-4 family residential loans with a balance of $530,000, three commercial & industrial loans with a balance of $357,000 and two consumer loans with a balance of $5,000. The Company has established a loss reserve of $457,000 for non-accrual loans.

Loans delinquent greater than 90 days decreased from $7,000 at December 31, 2003 to $-0- at September 30, 2004.

Potential problem loans are loans that are not classified as non-accrual or 90 days or more delinquent, but due to factors regarding the borrower, the loan or the economy may represent a possible loss to the Company. Potential problem loans increased from $5,969,000 at December 31, 2003 to $20,088,000 at September 30, 2004, an increase of $14,119,000. The reason for the increase was primarily due to the classification as potential problem of a loan of $10,956,000 for a commercial real estate development. This loan, which had previously been classified as an OAEM asset, had been classified as a potential problem loan because of the concentration of loans to this borrower. This loan is contractually current on all required payments and no reserve for loss has been established for this loan. The Company has established loan loss reserves of $1,555,000 at September 30, 2004 for all potential problem loans. As of September 30, 2004, $5,406,000 of the other potential problem loans relates to five borrowers. The first borrower with potential problem loans of $1,609,000 is a manufacturing and sales company, which has experienced recent losses. The second borrower with potential problem loans of $821,000 is a land development venture, which is a concern to the Company because of delays in the sale of properties. The third borrower with potential problem loans of $1,771,000 is a developer with recent financial difficulties. The fourth borrower is a retail facility that has been experiencing financial difficulties. The loans to this borrower of $621,000 are contractually current. The fifth borrower, with $584,000 in loans, operates a service facility, which is a concern to the Company because of inadequate capitalization. All loans to this borrower are contractually current. The remaining potential problem loans have a balance of $3,726,000 and consist of thirty-four residential loans with a balance of $3,147,000, four commercial & industrial loans with a balance of $307,000, two non-farm/non-residential loan with a balance of $171,000, and fourteen consumer loans with a balance of $101,000. For all of the potential problem loans, the Company believes that it has adequately reserved for any potential loss.

Other assets especially mentioned (OAEM) loans decreased from $15,638,000 at December 31, 2003 to $2,725,000 at September 30, 2004, a decrease of $12,913,000. The primary reason for the decrease was the previously discussed $10,956,000 commercial development loan which had been classified as an OAEM asset at December 31, 2003. This loan had a balance of $11,437,000 at December 31, 2003. OAEM loans are loans that are not classified as non-accrual, delinquent or potential problem, but still require monitoring by the Company due to factors regarding the borrower, the loan or the economy. At September 30, 2004, OAEM loans consists of twenty-nine residential loans with a balance of $2,337,000, one non-farm/non-residential loan with a balance of $269,000, three commercial & industrial loans with a balance of $63,000, three consumer loans with a balance of $6,000, a secured agricultural loan for $21,000 and a construction and land development loan for $29,000.

Foreclosed assets decreased from $2,135,000 at December 31, 2003 to $631,000 at September 30, 2004, a decrease of $1,504,000 or 70.4%. The decrease was primarily due to the sale of foreclosed assets and the increase in the loss reserves for foreclosed assets of $484,000. The additional reserves consisted of $246,000 additional reserves for a retail development property based on a lower revised offer price, $225,000 for land near the retail development property based on a lack of buyer interest at the previous carrying value and $13,000 for two 1-4 family residential properties. The retail development property was sold in the second quarter of 2004. During the first nine months of 2004, $732,000 in loans were transferred to foreclosed assets and $1,701,000 of foreclosed assets were sold with a net gain of $67,000. In addition, $118,000 was depreciated for certain foreclosed assets held greater than one year. Foreclosed assets at September 30, 2004 consist of $539,000 of undeveloped commercial properties and $92,000 in residential properties. Properties being transferred to foreclosed assets are appraised or evaluated and, if required, loss

reserves are established by management.

Other assets decreased from $3.4 million at December 31, 2003 to $2.8 million at September 30, 2004, a decrease of $600,000 or 17.6%. The decrease was primarily due to a $392,000 decrease in accrued interest receivable on loans and investments.

Deposits decreased from $250.0 million at December 31, 2003 to $231.4 million at September 30, 2004, a decrease of $18.6 million or 7.4%. The decrease was primarily due to a decrease of $16.0 million in certificate of deposit accounts. With the increased balances of cash and cash equivalents, the Company did not aggressively compete for certificate of deposit accounts during the first nine months of 2004.

Long-term debt decreased from $64.0 million at December 31, 2003 to $58.8 million at September 30, 2004, a decrease of $5.2 million or 8.1%, due to repayments during the first nine months of 2004. During the first quarter of 2004, the Bank repaid $30.0 million of maturing Federal Home Loan Bank (FHLB) advances with an average interest rate of 4.9% and obtained $25.0 million of new FHLB advances at an average rate of 1.6%.

Minority interest in real estate joint venture decreased from $382,000 at December 31, 2003 to $-0- at September 30, 2004 due to the sale in May 2004 of the Company s interest in the real estate joint venture.

Other liabilities increased from $2.2 million at December 31, 2004 to $2.7 million at September 30, 2004, an increase of $500,000. The primary reason for the increase was a $278,000 increase in accrued income taxes payable and a $126,000 increase in accruals for employee benefit programs.

Total stockholders equity increased by $1,221,000, from $32,992,000 at December 31, 2003 to $34,213,000 at September 30, 2004. The increase resulted from the earnings of the Company of $2,017,000 for the nine months ended September 30, 2004, an increase in unrealized appreciation on available-for-sale securities of $23,000 and exercised stock options of $242,000, offset by the purchase of treasury shares of $602,000 and payment of $459,000 in dividends to stockholders.

COMPARISON OF OPERATING RESULTS FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2004 and SEPTEMBER 30, 2003

GENERAL

Net income increased by $57,000 from $1,960,000 for the nine months ended September 30, 2003 to $2,017,000 for the nine months ended September 30, 2004. The increase was due primarily to a negative provision for loan losses and a decrease in net loss on sale or write-down of foreclosed assets, offset by a decrease in net gains on loan sales and gains on sale of land in a real estate joint venture.

INTEREST INCOME

Interest on loans decreased by $1,817,000 or 13.5%, from $13,460,000 for the nine months ended September 30, 2003 to $11,643,000 for the nine months ended September 30, 2004. Interest on loans decreased due to a decrease of 45 basis points in the average yield on loans outstanding and a $19.3 million decrease in the average balance of outstanding loans.

Interest on investments, deposits with banks, federal funds sold and other increased from $1,244,000 for the nine months ended September 30, 2003 to $1,544,000 for the nine months ended September 30, 2004, an increase of $300,000 or 24.1%. The increase was primarily due to a $12.4 million increase in the average balance of investment securities, FHLB stock and interest-bearing deposits.

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INTEREST EXPENSE

Interest on deposits decreased by $703,000 or 16.0%, from $4,385,000 for the nine months ended September 30, 2003 to $3,682,000 for the nine months ended September 30, 2004. The decrease was primarily due to a 44 basis point decrease in the average cost of deposits, offset by a $1.4 million increase in the average balance of deposits.

The interest on borrowings decreased by $907,000 or 38.8%, from $2,339,000 for the nine months ended September 30, 2003 to $1,432,000 for the nine months ended September 30, 2004 as a result of a 125 basis point decrease in the average cost of borrowings and a $10.3 million decrease in the average balance of borrowings.

PROVISION FOR LOAN LOSSES

There was a negative provision for loan losses of $109,000 for the nine months ended September 30, 2004, compared to a provision for loan losses of $867,000 for the nine months ended September 30, 2003, a change of $976,000. The change was primarily due to recoveries of prior charged-off loans of $410,000 during the first nine months of 2004 and the decrease in the size of the loan portfolio.

NONINTEREST INCOME

Total noninterest income decreased by $1,191,000 or 45.9%, from $2,596,000 for the nine months ended September 30, 2003 to $1,405,000 for the nine months ended September 30, 2004. The decrease was due primarily to a decrease in gains on loan sales of $996,000 and a decrease in the gains on sales of land in a real estate joint venture of $170,000, offset by increases in cash surrender value of life insurance of $82,000 and service charges on deposit accounts of $88,000. The net gains on loan sales decreased due to decreased loan sales resulting from the level interest rate environment during 2004. The increase in service charges was due to a $121,000 increase in overdraft fees on demand deposits.

NONINTEREST EXPENSE

Total noninterest expense decreased from $6,548,000 for the nine months ended September 30, 2003 to $6,377,000 for the nine months ended September 30, 2004, a decrease of $171,000 or 2.6%. Other noninterest expense decreased primarily because of a decrease of $353,000 in net loss on sale and write-down of foreclosed assets.

INCOME TAX EXPENSE

Total income tax expense was $1,193,000 for the nine months ended September 30, 2004, compared to $1,201,000 for the nine months ended September 30, 2003, a decrease of $8,000. The decrease was attributable to the decrease in non-taxable assets. The effective tax rates were 37.2% and 38.0% for the nine months ended September 30, 2004 and 2003, respectively.

COMPARISON OF OPERATING RESULTS FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2004 and SEPTEMBER 30, 2003

GENERAL

Net income increased by $102,000 from $497,000 for the three months ended September 30, 2003 to $599,000 for the three months ended September 30, 2004. The increase was due primarily to the write-down of foreclosed assets that was recorded in 2003 and a decrease in the provision for loan losses, offset by decreases in net gains on loan sales, gain on sale of land in a real estate joint venture, and recovery of mortgage servicing rights.

INTEREST INCOME

Interest on loans decreased by $848,000 or 19.2%, from $4,428,000 for the three months ended September 30, 2003 to $3,580,000 for the three months ended September 30, 2004. Interest on loans decreased due to a decrease of 53 basis points in the average yield on loans outstanding of and a $31.3 million decrease in the average balance of outstanding loans.

Interest on investments, deposits with banks, federal funds sold and other increased from $454,000 for the three months ended September 30, 2003 to $577,000 for the three months ended September 30, 2004, an increase of $123,000 or 27.1%. The increase was primarily due to a $21.8 million increase in the average balance of investment securities, FHLB stock and interest-bearing deposits, offset by a 43 basis point decrease in the average yield of these assets in 2004.

INTEREST EXPENSE

Interest on deposits decreased by $215,000 or 15.7%, from $1,369,000 for the three months ended September 30, 2003 to $1,154,000 for the three months ended September 30, 2004. The decrease was primarily due to a 36 basis point decrease in the average cost of deposits, partially offset by a $3.2 million increase in the average balance of deposits.

The interest on borrowings decreased by $347,000 or 45.2%, from $768,000 for the three months ended September 30, 2003 to $421,000 for the three months ended September 30, 2004 as a result of a 160 basis point decrease in the average cost of borrowings and a $10.2 million decrease in the average balance of borrowings.

PROVISION FOR LOAN LOSSES

The provision for loan losses decreased to $141,000 for the three months ended September 30, 2004 from $476,000 for the three months ended September 30, 2003, a decrease of $335,000 or 70.4%. The decrease was attributable to additional loan loss reserves recorded in the third quarter of 2003.

NONINTEREST INCOME

Total noninterest income decreased by $584,000 or 57.7%, from $1,013,000 for the three months ended September 30, 2003 to $429,000 for the three months ended September 30, 2004. The decrease was due primarily to a decrease in gains on loan sales of $209,000, a recovery in 2003 for $123,000 of mortgage servicing rights and a gain on sale of land in a real estate joint venture of $206,000.

NONINTEREST EXPENSE

Total noninterest expense decreased from $2,502,000 for the three months ended September 30, 2003 to $1,916,000 for the three months ended September 30, 2004, a decrease of $586,000 or 23.4%. The decrease was primarily attributable to an $826,000 decrease in the net loss (gain) on sale or write-down of foreclosed assets and the recording in 2003 of $101,000 minority interest in a real estate joint venture, offset by a $318,000 increase in salaries and benefits expense attributable to a decreased amortization of deferred loan costs and an increase in the expense of certain employee benefits programs.

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INCOME TAX EXPENSE

Total income tax expense was $355,000 for the three months ended September 30, 2004, compared to $283,000 for the three months ended September 30, 2003, an increase of $72,000 or 25.4%. The increase was primarily attributable to the increase in 2004 of taxable income. The effective tax rates were 37.2% and 36.3% for the three months ended September 30, 2004 and 2003, respectively.

SUBSEQUENT EVENTS

On November 7, 2004, the Company entered into an Agreement and Plan of Merger with Main Street Trust, Inc. (Main Street), an Illinois corporation. Main Street Trust, Inc. will acquire all of the Company s issued and outstanding shares of common stock. Each of the Company s shareholders will have the option of receiving either 1.1051 shares of Main Street s stock for each share of the Company s stock or $35.00 of cash for each share of the Company s common stock or a combination of both. The transaction is subject to approval by state and federal regulators and by the Company s shareholders and is expected to close in the second quarter of 2005.

CRITICAL ACCOUNTING POLICIES

The preparation of financial statements in conformity with accounting standards generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and the related disclosure of contingent assets and liabilities. Actual results could differ from those estimates under different assumptions and conditions. Management believes that its critical accounting policies and significant estimates include determining the allowance for loan losses, the valuation of loan servicing rights and the valuation of foreclosed assets.

Allowance for Loan Losses

The allowance for loan losses is a significant estimate that can and does change based on management s assumptions about specific borrowers and current general and economic and business conditions, among other factors. Management reviews the adequacy of the allowance for loan losses on at least a quarterly basis. The evaluation by management includes consideration of past loss experience, changes in the composition of the loan portfolio, the current economic condition and amount of loans outstanding, identified problem loans and the probability of collecting all amounts due.

The determination of the adequacy of the allowance for loan losses is based on estimates that are particularly susceptible to significant changes in the economic environment and market conditions. A worsening or protracted economic decline would increase the likelihood of additional losses due to credit and market risk and could create the need for additional loss reserves.

Mortgage Servicing Rights

The Company recognizes the rights to service loans as a separate asset on its consolidated balance sheet. The total cost of loans when sold is allocated between loans and loan servicing rights based on the relative fair value of each. Mortgage servicing rights are subsequently carried at the lower of the initial carrying value, adjusted for amortization or fair value. Mortgage servicing rights are evaluated for impairment based on the fair value of those rights. Factors included in the calculation of fair value of the loan servicing rights include estimating the present value of future net cash flows, market loan prepayment speeds for similar loans, discount rates, servicing costs, and other economic factors. Servicing rights are amortized over the estimated period of net servicing revenue. It is likely that these economic factors will change over the life of the mortgage servicing rights, resulting in different valuations of the

mortgage servicing rights. The differing valuations will affect the carrying value of the mortgage servicing rights on the consolidated balance sheet as well as the income recorded from mortgage servicing on the income statement. As of September 30, 2004 and December 31, 2003, mortgage servicing rights had carrying values of $385,000 and $469,000, respectively.

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Foreclosed Assets

Foreclosed assets are carried at the lower of cost or fair value less estimated selling costs. Management estimates the fair value of the properties based on current appraisal information. Fair value estimates are particularly susceptible to significant changes in the economic environment, market conditions, and the real estate market. A worsening or protracted economic decline would increase the likelihood of a decline in property values and could create the need to write down the properties through current operations.

OFF BALANCE SHEET ARRANGEMENTS

The only material off balance sheet obligations incurred routinely by the Company are its commitments to extend credit and its standby letters of credit. At September 30, 2004, the Company had unused loan commitments of $21.9 million and financial standby letters of credit of $520,000.

LIQUIDITY AND CAPITAL RESOURCES

The Company s primary sources of funds are deposits, principal and interest payments on loans and securities, sales of loans and securities and FHLB advances. While maturing and scheduled amortization of loans are predictable sources of funds, deposit outflows and mortgage prepayments are greatly influenced by general interest rates, economic conditions and competition. The Company s liquidity requirement, which may be varied at the direction of the Company s regulators depending on economic conditions and deposit flows, is based upon a percentage of the Company s deposits and short-term borrowings.

At September 30, 2004, the Bank exceeded all of its regulatory capital requirements with Tier 1 capital of $31.3 million, or 9.6% of average total assets, which is above the required level of $13.1 million or 4.0%; and risk-based capital of $33.9 million or 16.1% of risk-weighted assets, which is above the required level of $16.8 million or 8.0%.

The Company s most liquid assets are cash and interest-bearing demand accounts. The level of these accounts is dependent on the operating, financing, lending and investing activities during any given period. At September 30, 2004, cash and interest-bearing deposits totaled $32.5 million.

The Company has other sources of liquidity if a need for additional funds arises, including FHLB advances, loan sales, brokered deposits and Fed funds. At September 30, 2004, the Company had outstanding advances with the FHLB of $56.8 million. The FHLB maintains two limitations on borrowing availability based on (1) FHLB stock ownership and (2) total assets. The Company currently meets the stock limitation; however, this limit may be raised by the purchase of additional FHLB stock. Based on the total assets limitations, the Company may increase its borrowings with the FHLB by approximately $56.2 million. The ability to borrow this amount would require meeting regulatory mandated loan and collateral limits. Depending upon market conditions and the pricing of deposit products and FHLB borrowings, the Bank may utilize FHLB advances to fund loan originations.

At September 30, 2004, the Company had commitments to originate loans and unused letters of credit totaling $22.4 million. Certificate accounts which are scheduled to mature in one year or less from September 30, 2004 totaled $81.7 million. The Company anticipates that it will have sufficient funds to meet its current commitments and maturing deposits.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Sources of market risk include interest rate risk, foreign currency exchange rate risk, commodity price risk and equity price risk. The Company is only subject to interest rate risk. The Company purchased no financial instruments for trading purposes during the nine months ended September 30, 2004 and 2003.

The principal objective of the Company s interest rate risk management function is to evaluate the interest rate risk included in balance sheet accounts, determine the level of risk appropriate given the Company s business strategy, operating environment, capital and liquidity requirements and performance objectives, and manage the risk consistent with Board of Director approved guidelines. Through such management, the Company seeks to reduce the vulnerability of its operations to changes in interest rates. The Company monitors its interest rate risk as such risk relates to its operating strategies. The Company s Board of Directors reviews the Company s interest rate risk position on a quarterly basis. The Company s Asset/Liability Committee is comprised of the Company s senior management under the direction of the Board of Directors, with the Committee responsible for reviewing with the Board of Directors its activities and strategies, the effect of those strategies on the Company s net interest margin, the market value of the portfolio and the effect that changes in the interest rates will have on the Company s portfolio and its exposure limits. The extent of the movement of interest rates is an uncertainty that could have a negative impact on the earnings of the Company.

In recent years, the Company has utilized the following strategies to manage interest rate risk: (1) originating for investment adjustable-rate residential mortgage and fixed-rate one-to-four family loans with maturities of 10 years or less; (2) generally selling fixed-rate one-to-four family loans with maturities exceeding 10 years in the secondary market without recourse and on a servicing retained basis; (3) increasing its origination of shorter term and/or adjustable rate commercial loans; and (4) investing in shorter term investment securities which may generally bear lower yields as compared to longer term investments, but which may better position the Company for increases in market interest rates.

The Company s interest rate and market risk profile has not materially changed from the year ended December 31, 2003. Please refer to the Company s 2003 Form 10-K for further discussion of the Company s market and interest rate risk.

ITEM 4. CONTROLS AND PROCEDURES

(a) Disclosure controls and procedures. We evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of September 30, 2004. Our disclosure controls and procedures are the controls and other procedures that we designed to ensure that we record, process, summarize and report in a timely manner the information we must disclose in reports that we file with or submit to the SEC. C. William Landefeld, our President and Chief Executive Officer, and Dallas G. Smiley, our Executive Vice President and Chief Financial Officer, reviewed and participated in this evaluation. Based on this evaluation, Messrs. Landefeld and Smiley concluded that, as of the date of their evaluation, our disclosure controls were effective.

(b) Internal controls. There have not been any significant changes in our internal accounting controls or in other factors that could significantly affect those controls during the quarter ended September 30, 2004.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

The Company is not involved in any legal proceedings of a material nature at this time other than those occurring in the ordinary course of business, which in the aggregate involve amounts which are believed by management to be immaterial to the financial condition of the Company.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

(c) The following table information about purchases of the Company s stock by the Company during the quarter ended September 30, 2004.

ISSUER PURCHASES OF EQUITY SECURITIES

Period	**(a) Total Number of Shares Purchased**	**(b) Average Price Paid Per Share**	**(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs**	**(d) Maximum Number of shares that May Yet Be Purchased Under the Plans Or Programs**
07/01/04 07/31/04	-0-	n/a	-0-	59,555
08/01/04 - 08/31/04	-0-	n/a	-0-	59,555
09/01/04 09/30/04	-0-	n/a	-0-	59,555
Total	-0-	n/a	-0-	59,555

(1) The Company adopted a repurchase plan on July 28, 2003 (the 2003 Program) pursuant to which it authorized the repurchase of 76,189 shares of the Company s common stock. Unless terminated earlier by resolution of the board of directors, the 2003 Program will expire when the Company has repurchased all of the shares authorized for repurchase under the 2003 Program.

Item 3. Defaults Upon Senior Securities

Not applicable.

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

Not applicable.

Item 5. Other Information

Not applicable.

Item 6. Exhibits and Reports on Form 8-K

a. Exhibits

See Exhibit Index.

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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.

	Citizens First Financial Corp.
Date: November 15, 2004	/s/ C. William Landefeld
	C. William Landefeld President
Date: November 15, 2004	/s/ Dallas G. Smiley
	Dallas G. Smiley Chief Financial Officer

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