

Magyar Bancorp, Inc.
Form 10-Q
August 14, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT UNDER SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2009

Commission File Number 000-51726

Magyar Bancorp, Inc.
(Exact Name of Registrant as Specified in Its Charter)

Delaware
(State or Other Jurisdiction of
Incorporation or Organization)

20-4154978
(I.R.S. Employer Identification Number)

400 Somerset Street, New Brunswick,
New Jersey
(Address of Principal Executive Office)

08901
(Zip Code)

(732)
342-7600
(Issuer's
Telephone
Number
including area
code)

Indicate by check mark whether the registrant (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 12 months (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 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 the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

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Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company
(Do not check if a 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

State the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

| Class | Outstanding at August 1, 2009 |
|--------------------------------|-------------------------------|
| Common Stock, \$0.01 Par Value | 5,767,434 |

MAGYAR BANCORP, INC.

Form 10-Q Quarterly Report

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

MAGYAR BANCORP, INC. AND SUBSIDIARY
Consolidated Balance Sheets
(In Thousands, Except Share and Per Share Data)

| | June 30, 2009 | September 30, 2008 |
|--|------------------|--------------------------|
| | (Unaudited) | |
| Assets | | |
| Cash | \$4,548 | \$4,756 |
| Interest earning deposits with banks | 330 | 257 |
| Total cash and cash equivalents | 4,878 | 5,013 |
| Investment securities - available for sale, at fair value | 27,805 | 49,326 |
| Investment securities - held to maturity, at amortized cost (fair value of \$42,706 and \$9,629 at June 30, 2009 and September 30, 2008, respectively) | 42,783 | 9,618 |
| Federal Home Loan Bank of New York stock, at cost | 3,090 | 3,867 |
| Loans receivable, net of allowance for loan losses of \$7,620 and \$4,502 at June 30, 2009 and September 30, 2008, respectively | 438,616 | 406,149 |
| Bank owned life insurance | 10,871 | 10,547 |
| Accrued interest receivable | 2,131 | 2,177 |
| Premises and equipment, net | 20,895 | 21,613 |
| Other real estate owned | 5,128 | 4,666 |
| Other assets | 1,432 | 1,296 |
| Total assets | \$557,629 | \$514,272 |
| Liabilities and Stockholders' Equity | | |
| Liabilities | | |
| Deposits | \$443,017 | \$375,560 |
| Escrowed funds | 1,276 | 1,285 |
| Federal Home Loan Bank of New York advances | 53,172 | 72,934 |
| Securities sold under agreements to repurchase | 15,000 | 15,000 |
| Accrued interest payable | 660 | 660 |
| Accounts payable and other liabilities | 4,316 | 3,007 |
| Total liabilities | 517,441 | 468,446 |
| Stockholders' equity | | |
| Preferred stock: \$.01 Par Value, 1,000,000 shares authorized; none issued | - | - |
| Common stock: \$.01 Par Value, 8,000,000 shares authorized; 5,923,742 issued; 5,767,434 and 5,756,141 outstanding at June 30, 2009 and September 30, 2008, respectively, at cost | 59 | 59 |
| Additional paid-in capital | 26,224 | 26,209 |
| Treasury stock: 156,308 and 167,601 shares at June 30, 2009 and September 30, 2008, respectively, at cost | (1,897) | (2,093) |
| Unearned Employee Stock Ownership Plan shares | (1,476) | (1,551) |

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| | | |
|--|-----------|-----------|
| Retained earnings | 17,222 | 23,398 |
| Accumulated other comprehensive income (loss), net | 56 | (196) |
| Total stockholders' equity | 40,188 | 45,826 |
| Total liabilities and stockholders' equity | \$557,629 | \$514,272 |

The accompanying notes are an integral part of these statements.

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MAGYAR BANCORP, INC. AND SUBSIDIARY
 Consolidated Statements of Income
 (In Thousands, Except Per Share Data)

| | For the Three Months Ended June 30, | | For the Nine Months Ended June 30, | |
|---|--|--------------|---------------------------------------|---------------|
| | 2009 | 2008 | 2009 | 2008 |
| | (Unaudited) | | | |
| Interest and dividend income | | | | |
| Loans, including fees | \$5,800 | \$6,251 | \$17,337 | \$19,713 |
| Investment securities | | | | |
| Taxable | 710 | 660 | 2,346 | 1,805 |
| Tax-exempt | 2 | 33 | 46 | 98 |
| Federal Home Loan Bank of New York stock | 55 | 77 | 61 | 192 |
| Total interest and dividend income | 6,567 | 7,021 | 19,790 | 21,808 |
| Interest expense | | | | |
| Deposits | 2,327 | 2,428 | 7,125 | 8,765 |
| Borrowings | 729 | 843 | 2,323 | 2,260 |
| Total interest expense | 3,056 | 3,271 | 9,448 | 11,025 |
| Net interest and dividend income | 3,511 | 3,750 | 10,342 | 10,783 |
| Provision for loan losses | 3,178 | 310 | 7,591 | 924 |
| Net interest and dividend income after provision for loan losses | 333 | 3,440 | 2,751 | 9,859 |
| Other income | | | | |
| Service charges | 272 | 219 | 674 | 734 |
| Other operating income | 113 | 141 | 344 | 394 |
| Gains on sales of loans | 75 | 27 | 90 | 27 |
| Gains (losses) on sales of available-for-sale securities | 432 | - | 1,204 | (19) |
| Losses on the sales of other real estate owned | - | - | - | (88) |
| Total other income | 892 | 387 | 2,312 | 1,048 |
| Other expenses | | | | |
| Compensation and employee benefits | 1,975 | 2,109 | 6,083 | 6,421 |
| Occupancy expenses | 614 | 668 | 1,893 | 1,984 |
| Advertising | 42 | 69 | 174 | 196 |
| Professional fees | 179 | 216 | 532 | 533 |
| Service fees | 145 | 143 | 431 | 426 |
| FDIC deposit insurance premiums | 573 | 76 | 817 | 152 |
| Other expenses | 457 | 465 | 1,301 | 1,298 |
| Total other expenses | 3,985 | 3,746 | 11,231 | 11,010 |

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| | | | | |
|---|------------|--------|------------|--------|
| Income (loss) before income tax expense | (2,760) | 81 | (6,168) | (103) |
| Income tax expense (benefit) | 10 | (171) | 54 | (199) |
| Net income (loss) | \$(2,770) | \$252 | \$(6,222) | \$96 |
| Net income (loss) per share-basic and diluted | \$(0.48) | \$0.04 | \$(1.08) | \$0.02 |

The accompanying notes are an integral part of these statements.

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MAGYAR BANCORP, INC. AND SUBSIDIARY
Consolidated Statement of Changes in Stockholders' Equity
Nine Months Ended June 30, 2009
(In Thousands)
(Unaudited)

| | Common Stock Shares Outstanding | Par Value | Additional Paid-In Capital | Treasury Stock | Unearned ESOP Shares | Retained Earnings | Accumulated Other Comprehensive Income/(Loss) | Total |
|---|---------------------------------------|--------------|----------------------------------|-------------------|----------------------------|----------------------|--|----------|
| Balance, September 30, 2008 | 5,756,141 | \$59 | \$ 26,209 | \$(2,093) | \$ (1,551) | \$23,398 | \$ (196) | \$45,826 |
| Comprehensive loss | | | | | | | | |
| Net loss | - | - | - | - | - | (6,222) | - | (6,222) |
| Unrealized loss on securities available-for-sale, net of tax benefit of \$339 | - | - | - | - | - | - | (428) | (428) |
| Reclassification adjustment for gains included in net loss, net of tax expense of \$481 | - | - | - | - | - | - | 723 | 723 |
| Unrealized loss on derivatives, net of tax benefit of \$28 | - | - | - | - | - | - | (43) | (43) |
| Total comprehensive loss | | | | | | | | (5,970) |
| Purchase of treasury stock | (9,600) | - | - | (61) | - | - | - | (61) |
| Treasury stock used for restricted stock plan | 20,893 | - | (303) | 257 | - | 46 | - | - |
| ESOP shares earned | - | - | (30) | - | 75 | - | - | 45 |
| Stock-based compensation expense | - | - | 348 | - | - | - | - | 348 |
| Balance, June 30, 2009 | 5,767,434 | \$59 | \$ 26,224 | \$(1,897) | \$ (1,476) | \$17,222 | \$ 56 | \$40,188 |

The accompanying notes are an integral part of this statement.

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MAGYAR BANCORP, INC. AND SUBSIDIARY
Consolidated Statements of Cash Flows
(In Thousands)

| | For the Nine Months Ended June 30, 2009 2008 (Unaudited) | |
|--|--|-----------|
| Operating activities | | |
| Net (loss) income | \$(6,222) | \$96 |
| Adjustment to reconcile net (loss) income to net cash provided by operating activities | | |
| Depreciation expense | 825 | 769 |
| Premium amortization on investment securities, net | 56 | 46 |
| Proceeds from the sales of loans | 4,092 | 4,352 |
| Provision for loan losses | 7,591 | 924 |
| Gains on sale of loans | (90) | (27) |
| (Gains) losses on sales of available for sale securities | (1,204) | 19 |
| Losses on the sales of other real estate owned | - | 125 |
| ESOP compensation expense | 45 | 199 |
| Stock-based compensation expense | 348 | 348 |
| Deferred income tax provision | - | (604) |
| Decrease in accrued interest receivable | 46 | 318 |
| Increase in bank owned life insurance | (324) | (315) |
| (Increase) decrease in other assets | (322) | 508 |
| Decrease in accrued interest payable | - | (817) |
| Increase in accounts payable and other liabilities | 1,309 | 561 |
| Net cash provided by operating activities | 6,150 | 6,502 |
| Investing activities | | |
| Net increase in loans receivable | (45,960) | (26,768) |
| Purchases of investment securities held to maturity | (35,327) | - |
| Purchases of investment securities available for sale | (19,101) | (33,624) |
| Sales of investment securities held to maturity | - | 2,320 |
| Sales of investment securities available for sale | 36,701 | 2,825 |
| Proceeds from calls of investment securities held to maturity | 10 | 2,005 |
| Principal repayments on investment securities held to maturity | 2,134 | 3,587 |
| Principal repayments on investment securities available for sale | 5,524 | 7,294 |
| Purchases of premises and equipment | (107) | (322) |
| Investment in other real estate owned | (293) | (614) |
| Proceeds from the sale of other real estate owned | 1,732 | 1,120 |
| Redemption (purchase) of Federal Home Loan Bank stock | 777 | (1,742) |
| Net cash used in investing activities | (53,910) | (43,919) |
| Financing activities | | |
| Net increase (decrease) in deposits | 67,457 | (6,191) |
| Stock compensation tax benefit | - | 90 |
| Net (decrease) increase in escrowed funds | (9) | 167 |
| Proceeds from long-term advances | 4,000 | 30,622 |
| Repayments of long-term advances | (7,487) | (3,763) |

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| | | |
|---|-----------|----------|
| Net change in short-term advances | (16,275) | 10,550 |
| Proceeds from securities sold under agreements to repurchase | - | 5,000 |
| Purchase of treasury stock | (61) | (489) |
| Net cash provided by financing activities | 47,625 | 35,986 |
| Net decrease in cash and cash equivalents | (135) | (1,431) |
| Cash and cash equivalents, beginning of period | 5,013 | 5,233 |
| Cash and cash equivalents, end of period | \$4,878 | \$3,802 |
| Supplemental disclosures of cash flow information | | |
| Cash paid for | | |
| Interest | \$9,448 | \$11,842 |
| Income taxes | \$39 | \$134 |
| Non-cash investing activities | | |
| Real estate acquired in full satisfaction of loans in foreclosure | \$1,900 | \$4,000 |

The accompanying notes are an integral part of these statements.

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MAGYAR BANCORP, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements
(Unaudited)

NOTE A – BASIS OF PRESENTATION

The consolidated financial statements include the accounts of the Magyar Bancorp, Inc. (the “Company”), its wholly owned subsidiary Magyar Bank, and the Bank’s wholly owned subsidiaries Magyar Service Corporation, Hungaria Urban Renewal, LLC, and MagBank Investment Company. All material intercompany transactions and balances have been eliminated. The Company prepares its financial statements on the accrual basis and in conformity with accounting principles generally accepted in the United States of America (“US GAAP”). The unaudited information furnished herein reflects all adjustments (consisting of normal recurring accruals) that are, in the opinion of management, necessary to a fair statement of the results for the interim periods presented.

Operating results for the three and nine months ended June 30, 2009 are not necessarily indicative of the results that may be expected for the year ending September 30, 2009. The September 30, 2008 information has been derived from the audited consolidated financial statements at that date but does not include all of the information and footnotes required by US GAAP for complete financial statements.

The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses.

The Company has evaluated subsequent events and transactions occurring subsequent to the balance sheet date of June 30, 2009, for items that should potentially be recognized or disclosed in these financial statements. The evaluation was conducted through August 13, 2009, the date these financial statements were issued.

NOTE B- RECENT ACCOUNTING PRONOUNCEMENTS

In December 2007, the Financial Accounting Standards Board “FASB” issued Statement of Financial Accounting Standards “SFAS” No.141(R), “Business Combinations.” SFAS No. 141(R) requires most identifiable assets, liabilities, noncontrolling interests, and goodwill acquired in a business combination to be recorded at “full fair value.” SFAS No. 141(R) applies to all business combinations, including combinations among mutual entities and combinations by contract alone. Under SFAS No. 141(R), all business combinations will be accounted for by applying the acquisition method. SFAS No. 141(R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008 and may not be applied before that date. The Company does not expect that the adoption of SFAS No. 141(R) will have a material impact on its consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160, “Noncontrolling Interests in Consolidated Financial Statements.” SFAS No. 160 will require noncontrolling interests (previously referred to as minority interests) to be treated as a separate component of equity, not as a liability or other item outside of permanent equity. SFAS No. 160 applies to the accounting for noncontrolling interests and transactions with noncontrolling interest holders in consolidated financial statements. SFAS No. 160 is effective for periods beginning on or after December 15, 2008. Earlier application is prohibited. The Company does not

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expect that the adoption of SFAS No. 160 will have a material impact on its consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities". SFAS No. 161 is intended to improve financial reporting about derivative instruments and hedging activities by requiring enhanced disclosures to enable investors to better understand their effects on an entity's financial position, financial performance, and cash flows. SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. The adoption of this pronouncement, effective March 31, 2009, did not have a material impact on the Company's consolidated financial statements.

In June 2008, EITF 03-6-1 was issued which addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting and, therefore, need to be included in the earnings allocation in computing earnings per share. The Statement is effective for financial statements issued for fiscal years beginning after December 15, 2008. The Company does not expect that the adoption of EITF 03-6-1 will have a material impact on its consolidated financial statements.

In April 2009, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) No. FAS 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly (FSP FAS 157-4). FASB Statement 157, Fair Value Measurements, defines fair value as the price that would be received to sell the asset or transfer the liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. FSP FAS 157-4 provides additional guidance on determining when the volume and level of activity for the asset or liability has significantly decreased. The FSP also includes guidance on identifying circumstances when a transaction may not be considered orderly. FSP FAS 157-4 provides a list of factors that a reporting entity should evaluate to determine whether there has been a significant decrease in the volume and level of activity for the asset or liability in relation to normal market activity for the asset or liability. When the reporting entity concludes there has been a significant decrease in the volume and level of activity for the asset or liability, further analysis of the information from that market is needed and significant adjustments to the related prices may be necessary to estimate fair value in accordance with Statement 157. This FSP clarifies that when there has been a significant decrease in the volume and level of activity for the asset or liability, some transactions may not be orderly. In those situations, the entity must evaluate the weight of the evidence to determine whether the transaction is orderly. The FSP provides a list of circumstances that may indicate that a transaction is not orderly. A transaction price that is not associated with an orderly transaction is given little, if any, weight when estimating fair value. This FSP is effective for interim and annual reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. An entity early adopting FSP FAS 157-4 must also early adopt FSP FAS 115-2 and FAS 124-2, Recognition and Presentation of Other-Than-Temporary Impairments. The adoption of this pronouncement, effective June 30, 2009, did not have a material impact on the Company's consolidated financial statements.

In April 2009, the FASB issued FSP No. FAS 115-2 and FAS 124-2, Recognition and Presentation of Other-Than-Temporary Impairments (FSP FAS 115-2 and FAS 124-2). FSP FAS 115-2 and FAS 124-2 clarifies the interaction of the factors that should be considered when determining whether a debt security is other-than-temporarily impaired. For debt securities, management must assess whether (a) it has the intent to sell the security and (b) it is more likely than not that it will be required to sell the security prior to its anticipated recovery. These steps are done before assessing whether the entity will recover the cost basis of the investment. Previously, this assessment required management to assert it has both the intent and the ability to hold a security for a period of time sufficient to allow for an anticipated recovery in fair value to avoid recognizing an other-than-temporary impairment. This change does not affect the need to forecast recovery of the value of the security through either cash flows or market price. In instances when a determination is made that an other-than-temporary impairment exists but the

investor does not intend to

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sell the debt security and it is not more likely than not that it will be required to sell the debt security prior to its anticipated recovery, FSP FAS 115-2 and FAS 124-2 changes the presentation and amount of the other-than-temporary impairment recognized in the income statement. The other-than-temporary impairment is separated into (a) the amount of the total other-than-temporary impairment related to a decrease in cash flows expected to be collected from the debt security (the credit loss) and (b) the amount of the total other-than-temporary impairment related to all other factors. The amount of the total other-than-temporary impairment related to the credit loss is recognized in earnings. The amount of the total other-than-temporary impairment related to all other factors is recognized in other comprehensive income. This FSP is effective for interim and annual reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. An entity early adopting FSP FAS 115-2 and FAS 124-2 must also early adopt FSP FAS 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly. The adoption of this pronouncement, effective June 30, 2009, did not have a material effect on the Company's consolidated financial statements.

In April 2009, the FASB issued FSP No. FAS 107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments (FSP FAS 107-1 and APB 28-1). FSP FAS 107-1 and APB 28-1 amends FASB Statement No. 107, Disclosures about Fair Value of Financial Instruments, to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. This FSP also amends APB Opinion No. 28, Interim Financial Reporting, to require those disclosures in summarized financial information at interim reporting periods. This FSP is effective for interim and annual reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. An entity early adopting FSP FAS 107-1 and APB 28-1 must also early adopt FSP FAS 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly and FSP FAS 115-2 and FAS 124-2, Recognition and Presentation of Other-Than-Temporary Impairments. The adoption of this pronouncement, effective June 30, 2009, did not have a material impact on the Company's consolidated financial statements.

NOTE C - CONTINGENCIES

The Company, from time to time, is a party to routine litigation that arises in the normal course of business. In the opinion of management, the resolution of this litigation, if any, would not have a material adverse effect on the Company's consolidated financial position or results of operations.

NOTE D – NET INCOME (LOSS) PER SHARE

Basic and diluted net income (loss) per share for the three and nine months ended June 30, 2009 and 2008 were calculated by dividing net income (loss) by the weighted-average number of shares outstanding for the period. Stock options and restricted stock awards were anti-dilutive for the three and nine months ended June 30, 2009 and the three and nine months ended June 30, 2008. The following table shows the Company's net income (loss) per share for the periods presented:

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| | For the Three Months Ended June 30, | | For the Nine Months Ended June 30, | |
|---|--|---------|---------------------------------------|---------|
| | 2009 | 2008 | 2009 | 2008 |
| | (In thousands except for per share data) | | | |
| Net income (loss) | \$ (2,770) | \$ 252 | \$ (6,222) | \$ 96 |
| Weighted average number of common shares outstanding - basic | 5,771 | 5,785 | 5,768 | 5,798 |
| Stock options and restricted stock | - | - | - | - |
| Weighted average number of common shares and common share equivalents - diluted | 5,771 | 5,785 | 5,768 | 5,798 |
| Basic net income (loss) per share | \$ (0.48) | \$ 0.04 | \$ (1.08) | \$ 0.02 |
| Diluted net income (loss) per share | \$ (0.48) | \$ 0.04 | \$ (1.08) | \$ 0.02 |

Options to purchase 217,826 shares of common stock at a weighted average price of \$14.61 and 62,890 shares of restricted shares at a weighted average price of \$14.51 were outstanding and not included in the computation of diluted earnings per share for the three and nine months ended June 30, 2009 because of the net losses recorded during the these periods. Options to purchase 217,826 shares of common stock at an average price of \$14.61 and 83,783 restricted shares at a weighted average price of \$14.51 were outstanding and not included in the computation of diluted earnings per share for the three and nine months ended June 30, 2008 because the grant (or option strike) price was greater than the average market price of the common shares during the periods.

NOTE E – STOCK-BASED COMPENSATION

The Company accounts for its share-based compensation in accordance with SFAS No. 123(R), “Share-Based Payments.” SFAS 123(R) requires that compensation cost relating to share-based payment transactions be recognized in financial statements. The cost is measured based on the fair value of the equity or liability instruments issued. SFAS No. 123(R) also requires the Company to realize as a financing cash flow rather than an operating cash flow, as previously required, the benefits of realized tax deductions in excess of previously recognized tax benefits on compensation expense. In accordance with SEC Staff Accounting Bulletin (“SAB”) No. 107, the Company classified share-based compensation for employees and outside directors within “compensation and employee benefits” in the consolidated statement of operations to correspond with the same line item as the cash compensation paid.

Stock options generally vest over a five-year service period. The strike price for all options was determined by the market price of the common stock on the date the options were granted. Management recognizes compensation expense for all option grants over the awards’ respective requisite service periods. The fair values of all option grants were estimated using the Black-Scholes option-pricing model. Since there was limited historical information on the volatility of the Company’s stock, management also considered the average volatilities of similar entities for an appropriate period in determining the assumed volatility rate used in the estimation of fair value. Management estimated the expected life of the options using the simplified method allowed under SAB 107 and 110. The 7-year Treasury yield in effect at the time of the grant provides the risk-free rate for periods within the contractual life of the option. Management recognizes compensation expense for the fair values of these awards on a straight-line basis over the requisite service period of the awards.

Restricted shares generally vest over a five-year service period on the anniversary of the grant date. Once vested, these awards are irrevocable. The product of the number of shares granted and the grant date market

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price of the Company's common stock determine the fair value of restricted shares under the Company's restricted stock plans. Management recognizes compensation expense for the fair value of restricted shares on a straight-line basis over the requisite service period.

The following is a summary of the status of the Company's stock option activity and related information for its option plan for the nine months ended June 30, 2009:

| | Number of Stock Options | Weighted Average Exercise Price | Weighted Average Remaining Contractual Life | Aggregate Intrinsic Value |
|-------------------------------|----------------------------|---------------------------------------|---|---------------------------------|
| Balance at September 30, 2008 | 217,826 | \$ 14.61 | | |
| Granted | - | - | | |
| Exercised | - | - | | |
| Forfeited | - | - | | |
| Balance at June 30, 2009 | 217,826 | \$ 14.61 | 7.7 years | \$ - |
| Exercisable at June 30, 2009 | 87,130 | \$ 14.61 | 7.7 years | \$ - |

On March 1, 2009, recipients of stock options under the 2006 Equity Incentive Plan were entitled to 40% of the options awarded, or 87,130 shares.

The following is a summary of the status of the Company's non-vested options as of June 30, 2009:

| | Number of Stock Options | Weighted Average Grant Date Fair Value |
|-------------------------------|-------------------------------|---|
| Balance at September 30, 2008 | 174,261 | \$ 3.91 |
| Granted | - | - |
| Exercised | - | - |
| Forfeited | - | - |
| Vested | (43,565) | 3.91 |
| Balance at June 30, 2009 | 130,696 | 3.91 |

The following is a summary of the status of the Company's restricted shares as of September 30, 2008 and changes during the nine months ended June 30, 2009:

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| | Number of Stock Awards | Weighted Average Grant Date Fair Value |
|-------------------------------|------------------------------|---|
| Balance at September 30, 2008 | 83,783 | \$ 14.51 |
| Granted | - | - |
| Forfeited | - | - |
| Vested | (20,893) | 14.51 |
| Balance at June 30, 2009 | 62,890 | 14.51 |

Stock option and stock award expenses included with compensation expense were \$121,000 and \$227,000, respectively, for the nine months ended June 30, 2009.

The Company completed its first stock repurchase program of 130,927 shares in November 2007 and announced a second repurchase program in November 2007 of up to 5% of its publicly-held outstanding shares of common stock, or 129,924 shares. At June 30, 2009, the Company had repurchased a total of 197,897 shares of its common stock at an average cost of \$12.30 per share under both programs. Under the stock repurchase program, 62,954 shares of the 129,924 shares authorized remained available for repurchase as of June 30, 2009. The Company's intended use of the repurchased shares is for general corporate purposes, including the funding of awards granted under the 2006 Equity Incentive Plan. On March 1, 2009, recipients of stock awards under the 2006 Equity Incentive Plan were entitled to their second 20% of the shares awarded, or 20,893 shares. Accordingly, these shares were distributed from the Company's treasury stock in March 2009.

The Company has an Employee Stock Ownership Plan ("ESOP") for the benefit of employees of the Company and the Bank who meets the eligibility requirements as defined in the plan. The ESOP trust purchased 217,863 shares of common stock in the open market using proceeds of a loan from the Company. The total cost of shares purchased by the ESOP trust was \$2.3 million, reflecting an average cost per share of \$10.58. The Bank makes cash contributions to the ESOP on an annual basis sufficient to enable the ESOP to make the required loan payments to the Company. The loan bears a variable interest rate that adjusts annually every January 1st to the then published Prime Rate (3.25% at January 1, 2009) with principal and interest payable annually in equal installments over thirty years. The loan is secured by shares of the Company's common stock.

As the debt is repaid, shares are released as collateral and allocated to qualified employees. Accordingly, the shares pledged as collateral are reported as unearned ESOP shares in the Consolidated Balance Sheets. The Company accounts for its ESOP in accordance with Statement of Position ("SOP") 93-6, "Employer's Accounting for Employee Stock Ownership Plans", issued by the Accounting Standards Division of the American Institute of Certified Public Accountants ("AICPA"). As shares are released from collateral, the Company reports compensation expense equal to the then current market price of the shares, and the shares become outstanding for earnings per share computations.

At June 30, 2009, shares allocated to ESOP participants totaled 64,644. Unallocated ESOP shares held in suspense totaled 153,219 at June 30, 2009 and had a fair market value of \$794,000. The Company's contribution expense for the ESOP was \$45,000 and \$199,000 for the nine months ended June 30, 2009 and 2008, respectively.

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NOTE F - COMPREHENSIVE INCOME (LOSS)

The components of comprehensive income and the related income tax effects are as follows (in thousands):

| | Three Months Ended June 30, | | | | | |
|--|-----------------------------|-------------------------------------|-------------------------|----------------------|-------------------------------------|-------------------------|
| | Before Tax Amount | 2009 Tax Benefit (Expense) | Net of Tax Amount | Before Tax Amount | 2008 Tax Benefit (Expense) | Net of Tax Amount |
| Unrealized holding gains (losses) arising during period on: | | | | | | |
| Available-for-sale investments | \$(543) | \$231 | \$(312) | \$(371) | \$144 | \$(227) |
| Less reclassification adjustment for gains realized in net income | 432 | (173) | 259 | - | - | - |
| Interest rate derivatives | (98) | 39 | (59) | (367) | 147 | (220) |
| Other comprehensive income (loss), net | \$(209) | \$97 | \$(112) | \$(738) | \$291 | \$(447) |

| | Nine Months Ended June 30, | | | | | |
|--|----------------------------|-------------------------------------|-------------------------|----------------------|-------------------------------------|-------------------------|
| | Before Tax Amount | 2009 Tax Benefit (Expense) | Net of Tax Amount | Before Tax Amount | 2008 Tax Benefit (Expense) | Net of Tax Amount |
| Unrealized holding gains (losses) arising during period on: | | | | | | |
| Available-for-sale investments | \$(767) | \$339 | \$(428) | \$(239) | \$103 | \$(136) |
| Less reclassification adjustment for gains realized in net income | 1,204 | (481) | 723 | 8 | (3) | 5 |
| Interest rate derivatives | (71) | 28 | (43) | 517 | (206) | 311 |
| Other comprehensive income, net | \$366 | \$(114) | \$252 | \$286 | \$(106) | \$180 |

NOTE G – FAIR VALUE MEASUREMENTS

Effective October 1, 2008, we adopted SFAS No. 157 “Fair Value Measurements” and related interpretations, which defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value

measurements. SFAS No. 157 applies only to fair value measurements already required or permitted by other accounting standards and does not impose requirements for additional fair value measures. SFAS No. 157 was issued to increase consistency and comparability in reporting fair values. Our adoption of SFAS No. 157 did not have a material impact on our financial condition or results of operations.

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The following disclosures, which include certain disclosures which are generally not required in interim period financial statements, are included herein as a result of our adoption of SFAS No. 157.

We use fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Our securities available-for-sale are recorded at fair value on a recurring basis. Additionally, from time to time, we may be required to record at fair value other assets or liabilities on a non-recurring basis, such as held-to-maturity securities, mortgage servicing rights, loans receivable and other real estate owned, or OREO. These non-recurring fair value adjustments involve the application of lower-of-cost-or-market accounting or write-downs of individual assets.

In accordance with SFAS No. 157, we group our assets and liabilities at fair value in three levels, based on the markets in which the assets are traded and the reliability of the assumptions used to determine fair value. These levels are:

Level 1 - Valuation is based upon quoted prices for identical instruments traded in active markets.

Level 2 - Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-based valuation techniques for which all significant assumptions are observable in the market.

Level 3 - Valuation is generated from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect our own estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include the use of option pricing models, discounted cash flow models and similar techniques. The results cannot be determined with precision and may not be realized in an actual sale or immediate settlement of the asset or liability.

We base our fair values on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. SFAS No. 157 requires us to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

The following is a description of valuation methodologies used for assets measured at fair value on a recurring basis.

Securities available-for-sale

Our available-for-sale portfolio is carried at estimated fair value on a recurring basis, with any unrealized gains and losses, net of taxes, reported as accumulated other comprehensive income/loss in stockholders' equity. Our securities available-for-sale portfolio consists of U.S government and government-sponsored enterprise obligations, municipal bonds, and mortgage-backed securities. The fair values of these securities are obtained from an independent nationally recognized pricing service. Our independent pricing service provides us with prices which are categorized as Level 2, as quoted prices in active markets for identical assets are generally not available for the securities in our portfolio.

Derivative financial instruments

The Company uses interest rate floors to manage its interest rate risk. The valuation of these instruments is based on a third party value of interest rate derivative contracts which are based on the fair market value using market prices provided from brokers trading in such instruments, less their carrying value. The carrying value is the price paid for the derivative contracts less prior amortization of the price paid.

The following table provides the level of valuation assumptions used to determine the carrying value of our assets measured at fair value on a recurring basis at June 30, 2009 (in thousands).

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| | Total | Fair Value at June 30, 2009 | | |
|-----------------------|-----------|-----------------------------|-----------|---------|
| | | Level 1 | Level 2 | Level 3 |
| Investment securities | | | | |
| available-for-sale | \$ 27,805 | \$ - | \$ 27,805 | \$ - |
| Derivatives | 262 | - | 262 | - |
| | \$ 28,067 | \$ - | \$ 28,067 | \$ - |

The following is a description of valuation methodologies used for assets measured at fair value on a non-recurring basis.

Mortgage Servicing Rights, net

Mortgage Servicing Rights (MSR's) are carried at the lower of cost or estimated fair value. The estimated fair value of MSR is determined through a calculation of future cash flows, incorporating estimates of assumptions market participants would use in determining fair value including market discount rates, prepayment speeds, servicing income, servicing costs, default rates and other market driven data, including the market's perception of future interest rate movements and, as such, are classified as Level 3.

Impaired Loans

Loans which meet certain criteria are evaluated individually for impairment. A loan is impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. As used in SFAS No. 114, Accounting by Creditors for Impairment of a Loan (FAS114), and in SFAS No. 5, Accounting for Contingencies (FAS 5), as amended, all amounts due according to the contractual terms means that both the contractual interest payments and the contractual principal payments of a loan will be collected as scheduled in the loan agreement. FAS 114 established three impairment measurement methods, depending upon the collateral securing the asset: 1) the present value of expected future cash flows discounted at the loan's effective interest rate (the rate of return implicit in the loan); 2) the asset's observable market price; or 3) the fair value of the collateral if the asset is collateral dependent. The regulatory agencies require this method for loans from which repayment is expected to be provided solely by the underlying collateral. Our impaired loans are generally collateral dependent and, as such, are carried at the estimated fair value of the collateral less estimated selling costs. Fair value is estimated through current appraisals, and adjusted as necessary, by management, to reflect current market conditions and, as such, are generally classified as Level 3.

Appraisals of collateral securing impaired loans are conducted by approved, qualified, and independent third-party appraisers. Such appraisals are ordered via the Bank's credit administration department, independent from the lender who originated the loan, once the loan is deemed impaired, as described in the previous paragraph. Impaired loans are generally re-evaluated with an updated appraisal within one year of the last appraisal. However, the Company also obtains updated appraisals on performing construction loans that are approaching their maturity date to determine whether or not the fair value of the collateral securing the loan remains sufficient to cover the loan amount prior to considering an extension. The Company discounts the appraised "as is" value of the collateral for estimated selling and disposition costs and compares the resulting fair value of collateral to the outstanding loan amount. If the outstanding loan amount is greater than the discounted fair value, the Company requires a reduction in the outstanding loan balance or additional collateral before considering an extension to the loan. If the borrower is unwilling or unable to reduce the loan balance or increase the collateral securing the loan, it is deemed impaired and the difference between the loan amount and the fair value of collateral, net of estimated selling and disposition costs, is charged off through a reduction of the allowance for loan loss.

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Other Real Estate Owned

Other real estate owned is carried at lower of cost or estimated fair value. The estimated fair value of the real estate is determined through current appraisals, and adjusted as necessary, by management, to reflect current market conditions. As such, other real estate owned is generally classified as Level 3.

The following table provides the level of valuation assumptions used to determine the carrying value of our assets measured at fair value on a non-recurring basis at June 30, 2009 (in thousands):

| | Total | Fair Value at June 30, 2009 | | |
|---------------------------|-----------|-----------------------------|---------|-----------|
| | | Level 1 | Level 2 | Level 3 |
| Mortgage servicing rights | \$ 78 | \$ - | \$ - | \$ 78 |
| Impaired loans | 21,872 | - | - | 21,872 |
| Other real estate owned | 5,128 | - | - | 5,128 |
| | \$ 27,078 | \$ - | \$ - | \$ 27,078 |

Impaired loans reported in the above table consist of twenty-two loans with aggregate loan balances of \$30.7 million reduced by \$6.2 million in cumulative charge-offs and \$2.6 million in specific loss reserves. These loans are all collateralized by real estate.

Other real estate owned reported in the above table consists of one commercial property carried at \$2.2 million and five residential building lots carried at \$2.9 million.

Additional information related to impaired loans and other real estate owned is included in Management's Discussion and Analysis of Financial Condition and Results of Operations.

NOTE H - INVESTMENT SECURITIES

The following table is an analysis of the amortized cost and fair values of securities available for sale at June 30, 2009 (in thousands):

| | Amortized Cost | At June 30, 2009 | | Fair Value |
|---|-------------------|------------------------------|-------------------------------|---------------|
| | | Gross Unrealized Gains | Gross Unrealized Losses | |
| Securities available for sale: | | | | |
| Obligations of U.S. government-sponsored enterprises: | | | | |
| Mortgage-backed securities - residential | \$ 20,024 | \$ 509 | \$ (9) | \$ 20,524 |
| Debt securities | 2,237 | - | (15) | 2,222 |
| Private label mortgage-backed securities - residential | 5,794 | - | (735) | 5,059 |
| Total securities available for sale | \$ 28,055 | \$ 509 | \$ (759) | \$ 27,805 |

The maturities of the debt securities and mortgage backed securities available-for-sale at June 30, 2009 are summarized in the following table (in thousands):

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| | At June 30, 2009 | |
|---------------------------------|-------------------|---------------|
| | Amortized Cost | Fair Value |
| Due within 1 year | \$ - | \$ - |
| Due after 1 but within 5 years | - | - |
| Due after 5 but within 10 years | - | - |
| Due after 10 years | 2,237 | 2,222 |
| Total debt securities | 2,237 | 2,222 |
| Mortgage-backed securities: | | |
| Residential(1) | 25,818 | 25,583 |
| Total | \$ 28,055 | \$ 27,805 |

(1) Mortgage-backed securities – residential include an amortized cost of \$20.0 million and a fair value of \$20.5 million for Obligation of U.S. government-sponsored enterprises issued by Federal National Mortgage Association and Federal Home Loan Mortgage Corporation. Also included are mortgage backed securities issued by non-U.S. government-sponsored enterprises with an amortized cost of \$5.8 million and fair value of \$5.1 million.

The following table is an analysis of the amortized cost and fair values of securities held to maturity at June 30, 2009 (in thousands):

| | At June 30, 2009 | | | |
|--|-------------------|------------------------------|-------------------------------|---------------|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| Securities held to maturity: | | | | |
| Obligations of U.S. government agencies: | | | | |
| Mortgage-backed securities - residential | \$ 8,438 | \$ 8 | \$ (114) | \$ 8,332 |
| Mortgage-backed securities - commercial | 2,003 | - | (7) | 1,996 |
| Obligations of U.S. government-sponsored enterprises: | | | | |
| Mortgage backed securities - residential | 19,165 | 139 | (25) | 19,279 |
| Debt securities | 6,044 | 16 | (6) | 6,054 |
| Private label mortgage-backed securities - residential | 3,011 | 63 | (95) | 2,979 |
| Obligations of state and political subdivisions | 122 | 9 | - | 131 |
| Corporate securities | 4,000 | - | (65) | 3,935 |
| Total securities held to maturity | \$ 42,783 | \$ 235 | \$ (312) | \$ 42,706 |

The maturities of the debt securities and the mortgage backed securities held to maturity at June 30, 2009 are summarized in the following table (in thousands):

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| | At June 30, 2009 | |
|---------------------------------|-------------------|---------------|
| | Amortized Cost | Fair Value |
| Due within 1 year | \$ - | \$ - |
| Due after 1 but within 5 years | 4,122 | 4,066 |
| Due after 5 but within 10 years | - | - |
| Due after 10 years | 6,044 | 6,054 |
| Total debt securities | 10,166 | 10,120 |
| Mortgage backed securities: | | |
| Residential(1) | 30,614 | 30,590 |
| Commercial(2) | 2,003 | 1,996 |
| Total | \$ 42,783 | \$ 42,706 |

(1) Mortgage-backed securities – residential include an amortized cost of \$8.4 million and a fair value of \$8.3 million for obligations of U.S. government agencies issued by the Government National Mortgage Association. Obligations of U.S. government-sponsored enterprises includes obligations issued by Federal National Mortgage Association and Federal Home Loan Mortgage Corporation which had an amortized cost of \$19.2 million and a fair value of \$19.3 million. Also included are mortgage backed securities issued by non-U.S. government-sponsored enterprises with an amortized cost of \$3.0 million and a fair value of \$3.0 million.

(2) Mortgage-backed securities – commercial include an amortized cost of \$2.0 million and a fair value of \$2.0 million for obligations of U.S. government agencies issued by the Small Business Administration.

NOTE I – IMPAIRMENT OF INVESTMENT SECURITIES

The Company has adopted FSP FAS 115-2 and FAS 124-2, “Recognition and Presentation of Other-Than-Temporary Impairment” which requires that credit related other-than-temporary impairment on debt securities be recognized in earnings while noncredit related other-than-temporary impairment on debt securities not expected to be sold be recognized in other comprehensive income (“OCI”).

We review our investment portfolio on a quarterly basis for indications of impairment. This review includes analyzing the length of time and the extent to which the fair value has been lower than the cost, the financial condition and near-term prospects of the issuer, including any specific events which may influence the operations of the issuer and the intent and ability to hold the investment for a period of time sufficient to allow for any anticipated recovery in the market. We evaluate our intent and ability to hold debt securities based upon our investment strategy for the particular type of security and our cash flow needs, liquidity position, capital adequacy and interest rate risk position. In addition, the risk of future other-than-temporary impairment may be influenced by prolonged recession in the U.S. economy, changes in real estate values and interest deferrals.

The following table presents the gross unrealized losses and fair value at June 30, 2009 for both available for sale and held to maturity securities by investment category and time frame for which the loss has been outstanding (dollars in thousands):

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| | Number of Securities | Less Than 12 Months | | June 30, 2009 12 Months Or Greater | | Total | |
|--|----------------------------|---------------------|----------------------|---------------------------------------|----------------------|---------------|----------------------|
| | | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| Obligations of U.S. government agencies: | | | | | | | |
| Mortgage-backed securities - residential | 4 | \$7,329 | \$(114) | \$- | \$- | \$7,329 | \$(114) |
| Mortgage-backed securities - commercial | 3 | 1,904 | (6) | 92 | (1) | 1,996 | (7) |
| Obligations of U.S. government-sponsored enterprises: | | | | | | | |
| Mortgage backed securities - residential | 7 | 14,345 | (34) | - | - | 14,345 | (34) |
| Debt securities | 2 | 5,259 | (21) | - | - | 5,259 | (21) |
| Private label mortgage-backed securities - residential | | | | | | | |
| Corporate securities | 4 | 3,706 | (141) | 2,699 | (689) | 6,405 | (830) |
| | 1 | 3,935 | (65) | - | - | 3,935 | (65) |
| Total | 21 | \$36,478 | \$(381) | \$2,791 | \$(690) | \$39,269 | \$(1,071) |

The following table provides additional information related to our corporate securities (dollars in thousands):

| Security and Name of Issuer | Name of Issuer's Parent Company | Book Value | Fair Value | Unrealized Loss | S & P Rating |
|---------------------------------|------------------------------------|---------------|---------------|--------------------|-----------------|
| Bank of America Covered Bond | Bank of America, N.A. | \$ 4,000 | \$ 3,935 | \$ (65) | Aa2/AAA |

NOTE J – LOANS RECEIVABLE, NET

Loans receivable, net were comprised of the following (in thousands):

| | June 30, 2009 | September 30, 2008 |
|--------------------------------|------------------|--------------------------|
| One-to four-family residential | \$ 169,931 | \$ 157,867 |
| Commercial real estate | 104,265 | 92,823 |
| Construction | 98,256 | 92,856 |
| Home equity lines of credit | 21,315 | 15,893 |
| Commercial business | 39,136 | 35,995 |
| Other | 13,280 | 15,294 |
| Total loans receivable | 446,183 | 410,728 |
| Net deferred loan costs (fees) | 53 | (77) |

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| | | |
|-----------------------------|------------|------------|
| Allowance for loan losses | (7,620) | (4,502) |
| Total loans receivable, net | \$ 438,616 | \$ 406,149 |

At June 30, 2009 and September 30, 2008, non-performing loans had a total principal balance of \$33,223,000 and \$20,068,000, respectively. The amount of interest income not recognized on non-performing loans was \$756,000 and \$459,000 for the nine month periods ended June 30, 2009 and 2008, respectively.

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NOTE K - OTHER REAL ESTATE OWNED

The Company held \$5.1 million of other real estate owned properties at June 30, 2009 and \$4.7 million of other real estate owned properties at September 30, 2008.

The Company did not incur any write downs on properties foreclosed upon during the nine months ended June 30, 2009. Additionally, there were no further charges to expense for properties held during the nine months ended June 30, 2009. Further declines in real estate values may result in a charge to expense in the future. Routine holding costs are charged to expense as incurred and improvements to real estate owned that enhance the value of the real estate are capitalized.

NOTE L - DEPOSITS

A summary of deposits by type of account are summarized as follows (in thousands):

| | June 30, 2009 | September 30, 2008 |
|-------------------------|------------------|--------------------------|
| Demand accounts | \$ 33,673 | \$ 24,699 |
| Savings accounts | 57,256 | 34,081 |
| NOW accounts | 49,784 | 36,163 |
| Money market accounts | 78,277 | 73,775 |
| Certificates of deposit | 191,485 | 177,279 |
| Retirement certificates | 32,542 | 29,563 |
| | \$ 443,017 | \$ 375,560 |

NOTE M – INCOME TAXES

The Company records income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes," as amended, using the asset and liability method. Accordingly, deferred tax assets and liabilities: (i) are recognized for the expected future tax consequences of events that have been recognized in the financial statements or tax returns; (ii) are attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases; and (iii) are measured using enacted tax rates expected to apply in the years when those temporary differences are expected to be recovered or settled.

Where applicable, deferred tax assets are reduced by a valuation allowance for any portions determined not likely to be realized. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income tax expense in the period of enactment. The valuation allowance is adjusted, by a charge or credit to income tax expense, as changes in facts and circumstances warrant. In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which temporary differences are deductible and carry forwards are available. Due to the uncertainty of the Company's ability to realize the benefit of the deferred tax assets, the net deferred tax assets were fully offset by a valuation allowance at June 30, 2009 and September 30, 2008.

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NOTE N - FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK

The Company uses derivative financial instruments, such as interest rate floors and collars, as part of its interest rate risk management. Interest rate caps and floors are agreements whereby one party agrees to pay or receive a floating rate of interest on a notional principal amount for a predetermined period of time if certain market interest rate thresholds are met. The Company considers the credit risk inherent in these contracts to be negligible.

As of June 30, 2009, the Company held one Prime-based interest rate floor. The counterparty in the transaction is Wachovia Bank, N.A. In accordance with SFAS No. 133 cash flow hedge accounting, the amortization of the costs of the derivatives flowed through the Company's income statement as a reduction to loan interest income. In addition, all changes in fair value of the derivative contracts are recorded through other comprehensive income.

The table below shows the notional amount, strike and maturity date of each interest rate derivative contract as of June 30, 2009 and September 30, 2008 (dollars in thousands):

| | Notional Amount | Strike | Maturity Date | Fair Value June 30, 2009 | Fair Value September 30, 2008 |
|---------------------|--------------------|--------|------------------|--------------------------------|--|
| Interest rate floor | \$ 5,000 | 7.25 | % 12/27/10 | \$ 262 | \$ 205 |

In April 2008, the Company unwound a \$10 million interest rate collar with Lehman Brothers Special Financing Inc. and received an \$817,000 termination fee. The termination fee was netted against the book value of \$112,000, resulting in an unrealized gain of \$705,000. In accordance with SFAS No. 133, the unrealized gain remained in other comprehensive income, net of deferred tax expense at September 30, 2008. The gain will be accreted to income over the previously contracted life of the interest rate collar, which was scheduled to mature June 24, 2013. At September 30, 2008, the book value of the unwound derivative was \$595,000, recorded as \$357,000 in other comprehensive income, net of deferred tax expense of \$238,000.

The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments are commitments to extend credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the balance sheets.

| | June 30, 2009 | September 30, 2008 |
|---|------------------|--------------------------|
| Financial instruments whose contract amounts represent credit risk (in thousands) | | |
| Letters of credit | \$ 1,818 | \$ 1,620 |
| Unused line of credits | 33,583 | 38,427 |
| Fixed rate loan commitments | 15,823 | 10,202 |
| Variable rate loan commitments | - | 36,371 |
| | \$ 51,224 | \$ 86,620 |

NOTE O - FAIR VALUE OF FINANCIAL INSTRUMENTS

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The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate fair value:

Cash and interest earning deposits with banks: The carrying amounts are a reasonable estimate of fair value.

Investment securities: For investment securities, fair values are calculated individually based on quoted market prices.

Loans: Fair value for the loan portfolio is estimated based on discounted cash flow analysis using interest rates currently offered for loans with similar terms to borrowers of similar credit quality.

For nonperforming loans, fair value is calculated by first reducing the carrying value by a reserve amount based on internal and regulatory loan classifications. Values are further adjusted according to recent appraised values on the individual properties. If recent appraisals are not available, a discount is applied depending on the date of the last appraisal performed on the property. The carrying value, which is net of reserves and valuation allowances, is therefore considered a reasonable estimate of fair value.

Bank-owned life insurance: The carrying amounts are based on the cash surrender values of the individual policies, which is a reasonable estimate of fair value.

The fair value of commitments to extend credit is estimated based on the amount of unamortized deferred loan commitment fees. The fair value of letters of credit is based on the amount of unearned fees plus the estimated costs to terminate the letters of credit. Fair values of unrecognized financial instruments including commitments to extend credit and the fair value of letter of credit are considered immaterial.

Savings deposits: The fair value of savings deposits with no stated maturity, such as money market deposit accounts, interest-bearing checking accounts and savings accounts, is equal to the amount payable on demand. The fair value of certificates of deposit is based on the discounted value of contractual cash flows. The discount rate is equivalent to the rate currently offered by the Bank for deposits of similar size, type and maturity.

Accrued interest receivable and payable: For these short-term instruments, the carrying amount is a reasonable estimate of fair value.

Federal Home Loan Bank of New York advances and securities sold under reverse repurchase agreements: The fair value of borrowings is based on the discounted value of contractual cash flows. The discount rate is equivalent to the rate currently offered by the Federal Home Loan Bank of New York for borrowings of similar maturity and terms.

Interest rate derivatives: The third party value of interest rate derivative contracts are based on the fair market value using market prices provided from brokers trading in such instruments, less their carrying value. The carrying value is the price paid for the derivative contracts less prior amortization of the price paid.

The carrying amounts and estimated fair values of the Company's financial instruments at June 30, 2009 and September 30, 2008 were as follows:

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| | June 30, 2009 | | September 30, 2008 | |
|--|-------------------|------------------|-----------------------|------------------|
| | Carrying Value | Fair Value | Carrying Value | Fair Value |
| | (In thousands) | | | |
| Financial assets | | | | |
| Investment securities | \$70,588 | \$70,511 | \$58,944 | \$58,955 |
| Loan, net of allowance for loan losses | \$438,616 | \$445,584 | \$406,149 | \$404,078 |
| Bank owned insurance policies | \$10,871 | \$10,871 | \$10,547 | \$10,547 |
| Financial liabilities | | | | |
| Deposits | | | | |
| Demand, NOW and money market savings | \$218,990 | \$218,990 | \$168,718 | \$168,718 |
| Certificates of deposit | 224,027 | 223,508 | 206,842 | 207,581 |
| Total deposits | \$443,017 | \$442,498 | \$375,560 | \$376,299 |
| Borrowings | \$68,172 | \$71,611 | \$87,934 | \$89,202 |
| Interest rate derivatives | \$262 | \$262 | \$205 | \$205 |

The fair value of commitments to extend credit is estimated based on the amount of unamortized deferred loan commitment fees. The fair value of letters of credit is based on the amount of unearned fees plus the estimated cost to terminate the letters of credit. Fair values of unrecognized financial instruments including commitments to extend credit and the fair value of letters of credit are considered immaterial.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Statements

When used in this filing and in future filings by the Company with the Securities and Exchange Commission, in the Company's press releases or other public or shareholder communications, or in oral statements made with the approval of an authorized executive officer, the words or phrases, "anticipate," "would be," "will allow," "intends to," "will likely result," "are expected to," "will continue," "is anticipated," "estimated," "projected," or similar expressions are intended to identify "forward looking statements." Forward-looking statements are subject to numerous risks and uncertainties, including, but not limited to, those risks previously disclosed in the Company's filings with the SEC, general economic conditions, changes in interest rates, regulatory considerations, competition, technological developments, retention and recruitment of qualified personnel, and market acceptance of the Company's pricing, products and services, and with respect to the loans extended by the Bank and real estate owned, the following: risks related to the economic environment in the market areas in which the Bank operates, particularly with respect to the real estate market in New Jersey; the risk that the value of the real estate securing these loans may decline in value; and the risk that significant expense may be incurred by the Company in connection with the resolution of these loans.

The Company wishes to caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made, and advises readers that various factors, including regional and national economic conditions, substantial changes in levels of market interest rates, credit and other risks of lending and investing activities, and competitive and regulatory factors, could affect the Company's financial performance and could cause the Company's actual results for future periods to differ materially from those anticipated or projected.

The Company does not undertake, and specifically disclaims any obligation, to update any forward-looking statements to reflect occurrences or unanticipated events or circumstances after the date of such statements.

Critical Accounting Policies

Critical accounting policies are defined as those that are reflective of significant judgments and uncertainties, and could potentially result in materially different results under different assumptions and conditions. Critical accounting policies may involve complex subjective decisions or assessments. We consider the following to be our critical accounting policies.

Allowance for Loan Loss. The allowance for loan losses is the amount estimated by management as necessary to cover credit losses in the loan portfolio both probable and reasonably estimable at the balance sheet date. The allowance is established through the provision for loan losses which is charged against income. In determining the allowance for loan losses, management makes significant estimates and has identified this policy as one of our most critical. Due to the high degree of judgment involved, the subjectivity of the assumptions utilized and the potential for changes in the economic environment that could result in changes to the amount of the recorded allowance for loan losses, the methodology for determining the allowance for loan losses is considered a critical accounting policy by management.

As a substantial amount of our loan portfolio is collateralized by real estate, appraisals of the underlying value of property securing loans and discounted cash flow valuations of properties are critical in determining the amount of the allowance required for specific loans. Assumptions for appraisals and discounted cash flow valuations are instrumental in determining the value of properties. Overly optimistic assumptions or negative changes to assumptions could significantly affect the valuation of a property securing a loan and the related allowance determined. The assumptions supporting such appraisals and discounted cash flow valuations are carefully reviewed by management to determine that the resulting values reasonably reflect amounts realizable on the related loans.

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Management performs a quarterly evaluation of the adequacy of the allowance for loan losses. We consider a variety of factors in establishing this estimate including, but not limited to, current economic conditions, delinquency statistics, geographic and industry concentrations, the adequacy of the underlying collateral, the financial strength of the borrower, results of internal loan reviews and other relevant factors. This evaluation is inherently subjective as it requires material estimates by management that may be susceptible to significant change based on changes in economic and real estate market conditions.

The evaluation has a specific and general component. The specific component relates to loans that are delinquent or otherwise identified as impaired through the application of our loan review process and our loan grading system. All such loans are evaluated individually, with principal consideration given to the value of the collateral securing the loan and discounted cash flows. Specific impairment allowances are established as required by this analysis. The general component is determined by segregating the remaining loans by type of loan, risk weighting (if applicable) and payment history. We also analyze historical loss experience, delinquency trends, general economic conditions and geographic and industry concentrations. This analysis establishes factors that are applied to the loan groups to determine the amount of the general component of the allowance for loan losses.

Actual loan losses may be significantly greater than the allowances we have established, which could have a material negative effect on our financial results.

Deferred Income Taxes. The Company records income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes," as amended, using the asset and liability method. Accordingly, deferred tax assets and liabilities: (i) are recognized for the expected future tax consequences of events that have been recognized in the financial statements or tax returns; (ii) are attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases; and (iii) are measured using enacted tax rates expected to apply in the years when those temporary differences are expected to be recovered or settled.

Where applicable, deferred tax assets are reduced by a valuation allowance for any portions determined not likely to be realized. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income tax expense in the period of enactment. The valuation allowance is adjusted, by a charge or credit to income tax expense, as changes in facts and circumstances warrant.

Comparison of Financial Condition at June 30, 2009 and September 30, 2008

Total assets increased \$43.4 million, or 8.4%, to \$557.6 million at June 30, 2009 from \$514.3 million at September 30, 2008, represented by significant growth in net loans receivable, investment securities, and interest earning deposits with banks.

Net loans receivable increased \$32.5 million, or 8.0%, to \$438.6 million at June 30, 2009 from \$406.1 million at September 30, 2008. During the nine months ended June 30, 2009, one-to-four family residential mortgage loans increased \$12.1 million, or 7.6%, to \$169.9 million. In addition, commercial real estate loans and commercial business loans increased \$11.4 million, or 12.3%, and \$3.1 million, or 8.7%, to \$104.3 million and \$39.1 million, respectively. Home equity lines of credit increased \$5.4 million, or 34.1% to \$21.3 million. Construction loans increased \$5.4 million, or 5.8%, to \$98.3 million at June 30, 2009.

At June 30, 2009, the significant loan categories in terms of the percent of total loans were 38.1% in one-to-four family residential mortgage loans, 23.4% in commercial real estate loans, and 22.0% in construction loans. At September 30, 2008 these categories in terms of the percent of total loans were 38.4% in one-to-four family residential mortgage loans, 22.6% in commercial real estate loans, and 22.6% in construction loans. The remaining total loans at June 30, 2009 were comprised of 8.8% commercial business, 4.8% home equity lines of credit and 2.9% of other

loans, which consisted primarily of stock-secured

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consumer loans. Throughout 2009 we expect to continue with our strategy of diversifying the Company's balance sheet with higher concentrations in commercial business and commercial real estate loans.

Total non-performing loans increased by \$13.2 million to \$33.2 million at June 30, 2009 from \$20.1 million at September 30, 2008. Non-performing loans consisted of fourteen (14) construction loans totaling \$22.4 million, six (6) commercial real estate loans totaling \$7.5 million, seven (7) loans secured by one-to-four family residential properties totaling \$2.5 million and five (5) commercial business loans totaling \$813,000.

Adverse economic conditions have led to an increase in non-performing loans, particularly in the Company's construction loan portfolio. The repayment of construction loans is typically dependent upon the sale of the collateral securing the loan, which has been negatively impacted by rapid deterioration in the housing market and decreased buyer demand. As a result, construction projects have slowed and reached their maturity dates. In order for the Company to extend the loans beyond the original maturity date, the value of the collateral securing the loan must be assessed, which is typically done by obtaining an updated third-party appraisal. Given the deterioration in the economy and, specifically, the housing market, updated valuations of the collateral reflect depreciation from earlier assessments. To the extent that an updated valuation of the collateral is insufficient to cover a collateral-dependent loan, the Company reduces the balance of the loan via a charge to the allowance for loan loss.

Non-performing construction loans increased \$7.5 million to \$22.4 million at June 30, 2009 from \$14.9 million at September 30, 2008. At June 30, 2009, three non-performing construction loans totaling \$7.4 million were secured by real estate in Newark, New Jersey. The real estate securing these loans ranges from vacant and partially completed residential lots to a substantially completed 24 unit townhome project. In addition to these projects, there were eleven non-performing loans totaling \$15.0 million used for land acquisition and construction in various locations in the State of New Jersey. Magyar Bank is determining the proper course of action to collect the principal outstanding on these loans. Year-to-date, Magyar Bank had charged off \$2.4 million in non-performing construction loan balances through a reduction of its allowance for loan loss.

Construction loans may contain interest reserves on which the interest is capitalized to the loan. At June 30, 2009, there were 12 performing construction loans with interest reserves representing outstanding balances of \$24.1 million, original interest reserves of \$2.4 million, advanced interest reserves of \$621,000, and remaining interest reserve balances of \$1.8 million. At March 31, 2009, there were 15 performing construction loans with interest reserves representing outstanding balances of \$25.1 million, original interest reserves of \$3.4 million, advanced interest reserves of \$1.3 million, and remaining interest reserve balances of \$2.1 million. At December 31, 2008, there were 15 performing construction loans with interest reserves representing outstanding balances of \$18.8 million, original interest reserves of \$2.7 million, advanced interest reserves of \$1.5 million, and remaining interest reserve balances of \$1.2 million. At September 30, 2008, there were 14 performing construction loans with interest reserves representing outstanding balances of \$20.1 million, original interest reserves of \$2.9 million, advanced interest reserves of \$1.6 million, and remaining interest reserve balances of \$1.3 million.

Underwriting for construction loans with and without interest reserves has followed a uniform process. Construction loan progress is monitored by loan on a monthly basis by management of the Bank as well as by the Board of Directors. Each time an advance is requested, an inspection is made of the project by an outside engineer or appraiser, depending on the size and complexity of the project, to determine the amount of work completed and if the costs to date are supported adequately. The Bank's construction loan operations personnel compare the advance request with the original budget and remaining loan funds available to ensure the project is in balance and that at all times the amount remaining on the loan is sufficient to complete the project.

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A number of the Bank's construction loans have been extended due to slower sales as a result of worsening economic conditions. In cases where updated appraisals reflect collateral values insufficient to cover the loan, additional collateral and/or a principal reduction is required to extend the loan. Some of the Bank's loans that originally had interest reserves are non-performing. The Bank does not have any currently non-performing loans with active interest reserves. Once a loan is deemed impaired, any interest reserve is frozen and the loan is placed on non-accrual so that no future interest income is recorded on these loans. The Bank ceased originating new non-owner occupied construction loans in October 2008.

Non-performing commercial real estate loans increased \$4.1 million to \$7.5 million at June 30, 2009 from \$3.4 million at September 30, 2008. However, during the nine month period ended June 30, 2009, Magyar Bank completed the foreclosure of a \$1.9 million catering facility, which would have reduced the balance of non-performing commercial real estate loans at June 30, 2009 were it not for five new non-performing loans totaling \$6.0 million. Magyar Bank had begun foreclosure proceedings on the properties as of June 30, 2009. Year-to-date, Magyar Bank had charged off \$704,000 in non-performing commercial real estate loan balances through a reduction of its allowance for loan loss.

Non-performing loans secured by one-to four-family residential properties increased \$0.9 million to \$2.5 million at June 30, 2009 from \$1.6 million at September 30, 2008. Of these non-performing loans, one loan totaling \$1.0 million was made to a developer that had been negatively impacted by the downturn in the real estate market. In addition to this loan, there were six non-performing owner-occupied mortgage loans totaling \$1.5 million. Magyar Bank had begun foreclosure proceedings on the majority of the properties as of June 30, 2009. The Bank anticipates receiving a deed-in-lieu of foreclosure on one of the loans totaling \$426,000 in the next quarter. Year-to-date, Magyar Bank had charged off \$771,000 in non-performing loans secured by one-to four-family residential properties through a reduction of its allowance for loan loss.

Non-performing commercial business loans increased \$637,000 to \$813,000 at June 30, 2009 from \$176,000 at September 30, 2008. Of the five non-performing loans, two loans totaling \$761,000 were secured by real estate collateral as an abundance of caution while three loans totaling \$52,000 were unsecured. Magyar Bank is determining the proper course of action to collect the principal outstanding on these loans which will include foreclosure proceedings for those loans secured by real estate. Year-to-date, Magyar Bank had charged off \$631,000 in non-performing commercial business loans through a reduction of its allowance for loan loss.

The ratio of non-performing loans to total loans receivable was 7.4% at June 30, 2009 compared with 4.9% at September 30, 2008. Accordingly, the allowance for loan losses increased \$3.1 million to \$7.6 million or 22.9% of non-performing loans at June 30, 2009 compared with \$4.5 million or 22.4% of non-performing loans at September 30, 2008. Provisions for loan loss during the nine months ended June 30, 2009 were \$7.6 million while net charge-offs were \$4.5 million. The allowance for loan losses was 1.7% of gross loans outstanding at June 30, 2009 and 1.1% of gross loans outstanding at September 30, 2008. In connection with its most recent regular examination of the Bank, the FDIC requested, and the Bank's board of directors agreed in December 2008, to certain corrective actions, which related to the implementation of an enhanced loan review program, an enhanced credit administration program, and the reduction of adversely classified, special mention and delinquent assets.

Securities available-for-sale decreased \$21.5 million, or 43.6%, to \$27.8 million at June 30, 2009 from \$49.3 million at September 30, 2008. The decrease was the result of \$36.7 million in securities sold and \$5.5 million in principal payments partially offset by \$19.1 million in new security purchases and an increase in the market value of securities available-for-sale of \$437,000. Securities held-to-maturity increased \$33.2 million, or 344.8%, to \$42.8 million at June 30, 2009 from \$9.6 million at September 30, 2008. The increase was the result of \$35.3 million in new security purchases partially offset by \$2.1 million in principal payments.

Other real estate owned (OREO) increased \$462,000 during the nine months to \$5.1 million at June 30, 2009. The foreclosure of a banquet facility located in Lodi, New Jersey during the Company's first fiscal quarter resulted in a \$2.2 million increase in the balance of OREO. The Bank was in the process of evaluating

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offers to purchase the property at June 30, 2009. The increase in OREO was partially offset by \$1.7 million in deposits to purchase three of six residential lots owned in Rumson, New Jersey. The carrying value of other real estate owned represents the lower of cost or the Bank's net realizable value at June 30, 2009.

Total deposits increased \$67.5 million, or 18.0%, to \$443.0 million at June 30, 2009. The increase was primarily due to higher balances in saving accounts, which increased \$23.2 million, or 68.0%, to \$57.3 million at June 30, 2009 from \$34.1 million at September 30, 2008. Certificates of deposit (including retirement accounts) increased \$17.2 million, or 12.5%, to \$224.0 million at June 30, 2009 from \$206.8 million at September 30, 2008. The \$17.2 million increase included a \$6.2 increase in CDARS time deposits, a CD instrument that provides FDIC insurance up to \$50 million. Other significant changes in total deposits over the nine month period included increases in interest-bearing NOW accounts of \$13.6 million, or 37.7%, to \$49.8 million, increases in demand accounts of \$9.0 million, or 36.3% to \$33.7 million, and increases in money market accounts of \$4.5 million, or 6.1%, to \$78.3 million.

Borrowings from the Federal Home Loan Bank of New York decreased \$19.8 million, or 27.1% to \$53.2 million at June 30, 2009 from \$72.9 million at September 30, 2008. To the extent that the growth in deposit accounts was not used to fund loan growth and purchase investment securities, borrowings were repaid.

Stockholders' equity decreased \$5.6 million, or 12.3%, to \$40.2 million at June 30, 2009 from \$45.8 million at September 30, 2008. The decrease was attributable to a net loss of \$6.2 million recorded during the nine month period, partially offset by accumulated other comprehensive gains of \$252,000. For the nine months ended June 30, 2009, 9,600 shares of Company stock were repurchased at an aggregate cost of \$61,000.

Average Balance Sheets for the Three and Nine Months Ended June 30, 2009 and 2008

The tables on the following pages present certain information regarding the Company's financial condition and net interest income for the three and nine months ended June 30, 2009 and 2008. The tables present the annualized average yield on interest-earning assets and the annualized average cost of interest-bearing liabilities. We derived the yields and costs by dividing annualized income or expense by the average balance of interest-earning assets and interest-bearing liabilities, respectively, for the periods shown. We derived average balances from daily balances over the periods indicated. Interest income includes fees that we consider adjustments to yields.

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MAGYAR BANCORP, INC. AND SUBSIDIARY
Comparative Average Balance Sheets
(Dollars In Thousands)

| | For the Three Months Ended June 30, | | | | | | | |
|---|-------------------------------------|--|------------|---|--------------------|--|------------|---|
| | Average Balance | 2009 Interest Income/ Expense | Yield/Cost | % | Average Balance | 2008 Interest Income/ Expense | Yield/Cost | % |
| (Unaudited) | | | | | | | | |
| Interest-earning assets: | | | | | | | | |
| Interest-earning deposits | \$7,606 | \$1 | 0.08 | % | \$306 | \$1 | 1.56 | % |
| Loans receivable, net | 435,617 | 5,800 | 5.34 | % | 400,703 | 6,251 | 6.26 | % |
| Securities | | | | | | | | |
| Taxable | 65,129 | 709 | 4.37 | % | 54,372 | 659 | 4.86 | % |
| Tax-exempt (1) | 122 | 3 | 9.12 | % | 3,398 | 50 | 5.83 | % |
| FHLB of NY stock | 3,191 | 55 | 6.92 | % | 4,102 | 77 | 7.51 | % |
| Total interest-earning assets | 511,665 | 6,568 | 5.15 | % | 462,881 | 7,038 | 6.10 | % |
| Noninterest-earning assets | 45,075 | | | | 45,953 | | | |
| Total assets | \$556,740 | | | | \$508,834 | | | |
| Interest-bearing liabilities: | | | | | | | | |
| Savings accounts (2) | \$55,521 | 185 | 1.34 | % | \$34,773 | 60 | 0.69 | % |
| NOW accounts (3) | 121,720 | 414 | 1.36 | % | 113,105 | 538 | 1.91 | % |
| Time deposits (4) | 230,500 | 1,728 | 3.01 | % | 188,869 | 1,830 | 3.89 | % |
| Total interest-bearing deposits | 407,741 | 2,327 | 2.29 | % | 336,747 | 2,428 | 2.89 | % |
| Borrowings | 70,486 | 729 | 4.15 | % | 93,194 | 843 | 3.63 | % |
| Total interest-bearing liabilities | 478,227 | 3,056 | 2.56 | % | 429,941 | 3,271 | 3.05 | % |
| Noninterest-bearing liabilities | 34,901 | | | | 29,167 | | | |
| Total liabilities | 513,128 | | | | 459,108 | | | |
| Retained earnings | 43,612 | | | | 49,726 | | | |
| Total liabilities and retained earnings | \$556,740 | | | | \$508,834 | | | |
| Tax-equivalent basis adjustment | | | | | | | | |
| | | (1) | | | | (17) | | |
| Net interest income | | \$3,511 | | | | \$3,750 | | |
| Interest rate spread | | | 2.59 | % | | | 3.05 | % |
| Net interest-earning assets | \$33,438 | | | | \$32,940 | | | |
| Net interest margin (5) | | | 2.75 | % | | | 3.25 | % |
| Average interest-earning assets to average interest-bearing liabilities | 106.99 | % | | | 107.66 | % | | |

(1) Calculated using 34% tax rate for all periods.

(2) Includes passbook savings, money market passbook and club accounts.

(3) Includes interest-bearing checking and money market accounts.

(4) Includes certificates of deposits and individual retirement accounts.

(5) Calculated as net interest income divided by average total interest-earning assets.

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MAGYAR BANCORP, INC. AND SUBSIDIARY
Comparative Average Balance Sheets
(Dollars In Thousands)

| | For the Nine Months Ended June 30, | | | | | | | |
|---|------------------------------------|--|------------|---|--------------------|--|------------|---|
| | Average Balance | 2009 Interest Income/ Expense | Yield/Cost | % | Average Balance | 2008 Interest Income/ Expense | Yield/Cost | % |
| (Unaudited) | | | | | | | | |
| Interest-earning assets: | | | | | | | | |
| Interest-earning deposits | \$3,550 | \$3 | 0.10 | % | \$286 | \$6 | 2.87 | % |
| Loans receivable, net | 425,056 | 17,337 | 5.43 | % | 393,075 | 19,713 | 6.68 | % |
| Securities | | | | | | | | |
| Taxable | 65,555 | 2,343 | 4.76 | % | 48,175 | 1,799 | 4.98 | % |
| Tax-exempt (1) | 1,529 | 70 | 6.09 | % | 3,370 | 148 | 5.87 | % |
| FHLB of NY stock | 3,889 | 61 | 2.08 | % | 3,251 | 192 | 7.85 | % |
| Total interest-earning assets | 499,579 | 19,814 | 5.28 | % | 448,157 | 21,858 | 6.50 | % |
| Noninterest-earning assets | 44,821 | | | | 44,936 | | | |
| Total assets | \$544,400 | | | | \$493,093 | | | |
| Interest-bearing liabilities: | | | | | | | | |
| Savings accounts (2) | \$44,173 | \$365 | 1.10 | % | \$34,527 | \$212 | 0.82 | % |
| NOW accounts (3) | 110,881 | 1,235 | 1.48 | % | 112,966 | 2,203 | 2.60 | % |
| Time deposits (4) | 225,080 | 5,525 | 3.27 | % | 193,104 | 6,350 | 4.38 | % |
| Total interest-bearing deposits | 380,134 | 7,125 | 2.50 | % | 340,597 | 8,765 | 3.43 | % |
| Borrowings | 87,587 | 2,323 | 3.53 | % | 73,872 | 2,260 | 4.07 | % |
| Total interest-bearing liabilities | 467,721 | 9,448 | 2.69 | % | 414,469 | 11,025 | 3.54 | % |
| Noninterest-bearing liabilities | 36,745 | | | | 29,383 | | | |
| Total liabilities | 504,466 | | | | 443,852 | | | |
| Retained earnings | 39,934 | | | | 49,241 | | | |
| Total liabilities and retained earnings | \$544,400 | | | | \$493,093 | | | |
| Tax-equivalent basis adjustment | | | | | | | | |
| | | (24) | | | | (50) | | |
| Net interest income | | \$10,342 | | | | \$10,783 | | |
| Interest rate spread | | | 2.59 | % | | | 2.96 | % |
| Net interest-earning assets | \$31,858 | | | | \$33,688 | | | |
| Net interest margin (5) | | | 2.76 | % | | | 3.21 | % |
| Average interest-earning assets to average interest-bearing liabilities | 106.81 | % | | | 108.13 | % | | |

(1) Calculated using 34% tax rate for all periods.

(2) Includes passbook savings, money market passbook and club accounts.

(3) Includes interest-bearing checking and money market accounts.

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- (4) Includes certificates of deposits and individual retirement accounts.
- (5) Calculated as net interest income divided by average total interest-earning assets.

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Comparison of Operating Results for the Three Months Ended June 30, 2009 and 2008

Net Income (Loss). Net income decreased \$3.0 million to a net loss of \$2.8 million for the three months ended June 30, 2009 compared with the net income of \$252,000 for the three months ended June 30, 2008.

Net Interest and Dividend Income. Net interest and dividend income decreased \$239,000, or 6.4%, to \$3.5 million for the three months ended June 30, 2009 from \$3.8 million for the three months ended June 30, 2008. Total interest and dividend income decreased \$454,000, or 6.5%, to \$6.6 million for the three month period ended June 30, 2009 while total interest expense decreased \$215,000, or 6.6%, to \$3.1 million from the same three month period one year earlier. For the comparison period our interest rate spread decreased 46 basis points to 2.59% from 3.05%.

Interest Income. The decrease in interest income of \$454,000, or 6.5%, to \$6.6 million for the three months ended June 30, 2009 was primarily due to a 95 basis point decrease in the overall yield of interest-bearing assets to 5.15% from 6.10%, partially offset by an increase in the average balance of interest-earning assets of \$48.8 million to \$511.7 million from \$462.9 million. Interest earned on loans decreased \$451,000 to \$5.8 million for the three months ended June 30, 2009 from \$6.3 million for the prior year period. The decrease reflected a 92 basis point decrease in the average yield on such loans to 5.34% from 6.26%, partially offset by a \$34.9 million, or 8.7%, increase in the average balance of such loans. The decrease in yield between the two periods was due primarily to the increased level of nonaccrual loans and to adjustable-rate loans that are indexed to the Prime Rate, which fell 175 basis points to 3.25% at June 30, 2009 from 5.00% at June 30, 2008.

Interest earned on our investment securities, excluding Federal Home Loan Bank of New York stock, increased \$19,000, or 2.7%, to \$712,000. The increase was due to a \$7.5 million, or 12.9%, increase in the average balance of such securities to \$65.3 million for the current period from \$57.8 for the same period of last year, while the average yield on such securities decreased 54 basis points to 4.38% for the three months ended June 30, 2009 from 4.92% for the three months ended June 30, 2008. The increased average balance of our investment securities reflected additional investment of proceeds from growth in deposit accounts.

Interest Expense. Interest expense decreased \$215,000, or 6.6%, to \$3.1 million for the three months ended June 30, 2009 from \$3.3 million for the three months ended June 30, 2008. The decrease in interest expense was primarily due to a 49 basis point decrease in the average cost of such liabilities to 2.56% from 3.05%, partially offset by an increase in the average balance of interest-bearing liabilities of \$48.3 million, or 11.2%, to \$478.2 million from \$429.9 million.

The average balance of interest bearing deposits increased to \$407.7 million from \$336.7 million while the average cost of such deposits decreased 60 basis points to 2.29% from 2.89% in the lower market interest rate environment. As a result, interest paid on deposits decreased to \$2.3 million for the three months ended June 30, 2009 from \$2.4 million for the three months ended June 30, 2008. Interest paid on advances and securities sold under agreements to repurchase decreased to \$729,000 for the three months ended June 30, 2009 from \$843,000 for the prior year period. A decrease in the average balance of such borrowings to \$70.5 million from \$93.2 million was largely offset by a 52 basis point increase in the average cost of advances and securities sold under agreements to repurchase to 4.15% for the three months ended June 30, 2009 from 3.63% for the prior year period.

Provision for Loan Losses. We establish provisions for loan losses, which are charged to earnings, at a level necessary to absorb known and inherent losses that are both probable and reasonably estimable at the date of the financial statements. In evaluating the level of the allowance for loan losses, management considers historical loss experience, the types of loans and the amount of loans in the loan portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, peer group information and prevailing economic conditions. This evaluation is inherently subjective as it requires

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estimates that are susceptible to significant revision as more information becomes available or as future events occur. After an evaluation of these factors, management recorded a provision of \$3.2 million for the three months ended June 30, 2009 compared to a provision of \$310,000 for the prior year period.

The increase in loan loss reserves was due to higher levels of non-performing loans, adverse economic conditions resulting in the depreciation of collateral values securing construction and commercial loans, and higher levels of loan charge-offs during the current quarter. During the three months ended June 30, 2009, non-performing loans increased \$9.3 million to \$33.2 million from \$23.9 million at March 31, 2009.

Net charge-offs were \$1.7 million for the three months ended June 30, 2009 compared to \$2,000 for the three months ended June 30, 2008. Using updated appraised values on real estate securing non-performing loans, net of anticipated disposal costs, the Bank increased its allowance for loan loss by reducing the carrying value of five loans totaling \$5.9 million by \$1.7 million during the three months ended June 30, 2009.

Determining the amount of the allowance for loan losses necessarily involves a high degree of judgment. Management reviews the level of the allowance on a quarterly basis, and establishes the provision for loan losses based on the factors set forth in the preceding paragraph. As management evaluates the allowance for loan losses, the increased risk associated with larger non-homogenous construction, commercial real estate and commercial business loans may result in larger additions to the allowance for loan losses in future periods.

Other Income. Non-interest income increased \$505,000, or 130.5%, to \$892,000 for the three months ended June 30, 2009 from \$387,000 for the three months ended June 30, 2008. The increase in non-interest income was primarily due to \$432,000 in gains on the sales of available-for-sale investment securities. The gains resulted from sales of mortgage-backed securities in the current lower interest rate environment.

Other Expenses. Non-interest expenses increased \$239,000, or 6.4%, to \$4.0 million for the three months ended June 30, 2009 from \$3.7 million for the three months ended June 30, 2008. The increase in other expenses was due to a \$497,000, or 653.9%, increase in FDIC premium to \$573,000 from \$76,000 for the three months ended June 30, 2008. The increase in FDIC premium was partially offset by a decrease of \$134,000 in compensation and employee benefits, \$54,000 in occupancy expenses, \$37,000 in professional fees, \$27,000 in advertising expense, and \$8,000 in other expenses between the comparable three month periods.

Compensation and employee benefits decreased \$134,000, or 6.4%, to \$2.0 million for the three months ended June 30, 2009 compared with \$2.1 million for the three months ended June 30, 2008. The decrease was the result of reductions in the number of Bank staff, benefits, such as 401(k) matches and Employee Stock Ownership Plan contributions, incentive expenses, and conference and convention expenses.

The FDIC substantially increased its assessment rate for all insured banks in an effort to increase its reserve ratio, resulting in an increased expense of \$238,000 or 213.2%, to \$314,000 in the current quarter compared from \$76,000 for the quarter ended June 30, 2008. In addition to significantly higher annual assessment rates, the FDIC announced a one-time fee on all insured institutions equal to the lesser of 10% of deposits or 5% of assets minus tier 1 equity. The Bank recorded a \$259,000 accrual for the one-time fee during the three months ended June 30, 2009. In the continued wake of bank failures, it is likely that the FDIC assessment will be increased further and that there will be a second one-time assessment in the Company's next fiscal year.

Income Tax (Benefit) Expense. The Company recognized income tax expenses of \$10,000 for the three months ended June 30, 2009 compared with \$171,000 of income tax benefit for the three months ended June 30, 2008. The effective tax rate was (0.4%) and (211.1%) for the three month periods ended June 30, 2009 and 2008, respectively.

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Where applicable, deferred tax assets are reduced by a valuation allowance for any portions determined not likely to be realized. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income tax expense in the period of enactment. The valuation allowance is adjusted, by a charge or credit to income tax expense, as changes in facts and circumstances warrant. In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which temporary differences are deductible and carry forwards are available. Due to the uncertainty of the Company's ability to realize the benefit of the deferred tax assets, the net deferred tax assets are fully offset by a valuation allowance at June 30, 2009.

Comparison of Operating Results for the Nine Months Ended June 30, 2009 and 2008

Net Income (Loss). The Company recorded a net loss of \$6.2 million for the nine months ended June 30, 2009. Net income decreased \$6.3 million from net income of \$96,000 for the nine months ended June 30, 2008.

Net Interest and Dividend Income. Net interest and dividend income decreased \$441,000, or 4.1%, to \$10.3 million for the nine months ended June 30, 2009 from \$10.8 million for the nine months ended June 30, 2008. Total interest and dividend income decreased \$2.0 million to \$19.8 million for the nine-month period ended June 30, 2009 while total interest expense decreased \$1.6 million to \$9.4 million for the same nine-month period. For the comparison period our interest rate spread decreased 37 basis points to 2.59% from 2.96%.

Interest Income. Interest income decreased \$2.0 million, or 9.2%, to \$19.8 million for the nine months ended June 30, 2009 from \$21.8 million for the same period last year. The decrease in interest income was primarily due to a 122 basis point decrease in the overall yield of interest-bearing assets to 5.28% from 6.50%, partially offset by an increase in the average balance of interest-earning assets of \$51.4 million to \$499.6 million from \$448.2 million. Interest earned on loans decreased to \$17.3 million for the nine months ended June 30, 2009 from \$19.7 million for the prior year period. The decrease reflected a 125 basis point decrease in the average yield on such loans to 5.43% from 6.68%, partially offset by a \$32.0 million, or 8.1%, increase in the average balance of loans. The decline in yield on loans reflected increased nonaccrual loans and an overall lower interest rate environment for loans as well as an increase in the amount of non-performing loans.

Interest earned on investment securities, excluding Federal Home Loan Bank of New York stock, increased 25.7% to \$2.4 million for the nine month period ended June 30, 2009 from \$1.9 million a year earlier. An increase in the average balance of such securities of \$15.5 million, or 30.1% to \$67.1 million from \$51.5 million was partially offset by a 25 basis point decrease in the average yield on investment securities to 4.79% from 5.04%. The increased average balance of our investment securities reflected the more favorable spreads available on such investments as compared with the prior year period when the interest yield curve was either flat or inverted.

Interest Expense. Interest expense decreased \$1.6 million, or 14.3%, to \$9.4 million for the nine months ended June 30, 2009 from \$11.0 million for the nine months ended June 30, 2008. The decrease in interest expense was primarily due to an 85 basis point decrease in the average cost of such liabilities to 2.69% from 3.54%, partially offset by an increase in the average balance of interest-bearing liabilities of \$53.3 million, or 12.8%, to \$467.7 million.

The average balance of interest bearing deposits increased \$39.5 million to \$380.1 million for the nine months ended June 30, 2009 from \$340.6 million for the same period last year while the average cost of such deposits decreased 93 basis points to 2.50% from 3.43%. This resulted in an 18.7% decrease in interest paid on deposits to \$7.1 million for the nine months ended June 30, 2009 from \$8.8 million for the nine months

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ended June 30, 2008. Interest paid on advances and securities sold under agreements to repurchase increased \$63,000 to \$2.3 million for the nine months ended June 30, 2009 compared to the prior year period. The increase in advance interest expense was due to an increase in the average balance of such advances to \$87.6 million from \$73.9 million partially offset by a 54 basis point decrease in the average cost of advances and securities sold under agreements to repurchase to 3.53% for the nine months ended June 30, 2009 from 4.07% for the prior year period. The proceeds from the increase in the balance of deposits and advances were used to fund the increase in loans and investment securities during the period.

Provision for Loan Losses. Management made a provision of \$7.6 million for the nine months ended June 30, 2009 compared to a \$924,000 provision for the prior year period. The increase in the provision for loan loss was due primarily to higher level of non-performing loans, adverse economic conditions resulting in the depreciation of collateral values securing construction and commercial loans, and higher level of loan charge-offs during the nine months period. Non-performing loans increased \$13.2 million to \$33.2 million at June 30, 2009 from \$20.1 million at September 30, 2008.

Net charge-offs were \$4.5 million for the nine months ended June 30, 2009 compared to \$301,000 for the nine months ended June 30, 2008. Using updated appraised values on real estate securing non-performing loans, net of anticipated disposal costs, the Bank decreased its allowance for loan loss by reducing the carrying value of eleven loans totaling \$10.5 million by \$4.5 million during the nine months ended June 30, 2009. In addition to these charge-offs, the Bank accepted short-sales on a two construction loans totaling \$2.3 million that resulted in a \$37,000 reduction in the allowance for loan loss.

Other Income. Non-interest income increased \$1.3 million to \$2.3 million for the nine months ended June 30, 2009 from \$1.0 million for the nine months ended June 30, 2008. The increase in non-interest income was primarily due to \$1.2 million in gains on the sales of available-for-sale investment securities. The gains resulted from sales of mortgage-backed securities and municipal bonds in the current lower interest rate environment.

Other Expenses. Non-interest expenses increased \$221,000, or 2.0%, to \$11.2 million for the nine months ended June 30, 2009 from \$11.0 million for the nine months ended June 30, 2008. The increase in other expenses was due to a \$665,000, or 437.5%, increase in FDIC premium to \$817,000 for the nine months ended June 30, 2009 from \$152,000 for the nine months ended June 30, 2008. The increase in FDIC premium was partially offset by decreases of \$338,000 in compensation and employee benefits and \$91,000 in occupancy expenses between the comparable nine month periods.

Compensation and employee benefits decreased \$338,000, or 5.3%, to \$6.1 million for the nine months ended June 30, 2009 compared with \$6.4 million for the nine months ended June 30, 2008. The decrease was the result of reductions in the number of Bank staff, benefits, such as 401(k) matches and Employee Stock Ownership Plan contributions, incentive expenses, and conference and convention expenses.

The FDIC substantially increased its assessment rate for all insured banks in an effort to increase its reserve ratio, resulting in an increased expense of \$406,000 or 267.1%, to \$558,000 for the nine months ended June 30, 2009 compared with \$152,000 for the nine months ended June 30, 2008. In addition to significantly higher annual assessment rates, the FDIC announced a one-time fee on all insured institutions equal to the lesser of 10% of deposits or 5% of assets minus tier 1 equity. The Bank recorded a \$259,000 accrual for the one-time fee during the quarter ended June 30, 2009. In the continued wake of bank failures, it is likely that the FDIC assessment will be increased further and that there will be a second one-time assessment in the Company's next fiscal year.

Income Tax Expense (Benefit). The Company recognized an income tax expense of \$54,000 for the nine months ended June 30, 2009 compared with \$199,000 of income tax benefit for the nine months ended June 30, 2008.

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LIQUIDITY AND CAPITAL RESOURCES

Liquidity

The Company's liquidity is a measure of its ability to fund loans, pay withdrawals of deposits, and other cash outflows in an efficient, cost-effective manner. The Company's short-term sources of liquidity include maturity, repayment and sales of assets, excess cash and cash equivalents, new deposits, brokered deposits, other borrowings, and new advances from the Federal Home Loan Bank. There has been no material adverse change during the nine month period ended June 30, 2009 in the ability of the Company and its subsidiaries to fund their operations.

At June 30, 2009, the Company had commitments outstanding under letters of credit of \$1.8 million, commitments to originate loans of \$15.8 million, and commitments to fund undisbursed balances of closed loans and unused lines of credit of \$33.6 million. There has been no material change during the nine months ended June 30, 2009 in any of the Company's other contractual obligations or commitments to make future payments.

Capital Requirements

The Bank was in compliance with all of its regulatory capital requirements as of June 30, 2009.

Item 3- Quantitative and Qualitative Disclosures about Market Risk

Not applicable to smaller reporting companies.

Item 4T – Controls and Procedures

Under the supervision and with the participation of our management, including our Principal Executive Officer and Principal Financial Officer, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report. Based upon that evaluation, the Principal Executive Officer and Principal Financial Officer concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective to ensure that information required to be disclosed in the reports that Magyar Bancorp, Inc. files or submits under the Securities Exchange Act of 1934, is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms.

There has been no change in Magyar Bancorp, Inc.'s internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934) during Magyar Bancorp, Inc.'s first nine months of fiscal year 2009 that has materially affected, or is reasonably likely to materially affect, Magyar Bancorp, Inc.'s internal control over financial reporting.

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PART II - OTHER INFORMATION

Item 1. Legal proceedings

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

Item 1A. Risk Factors

Not applicable to smaller reporting companies.

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

a.) Not applicable.

b.) Not applicable.

c.) There were no Company shares repurchased during the quarter ended June 30, 2009.

The Company completed its first stock repurchase program of 130,927 shares in November 2007. The Company announced a second repurchase program of 129,924 shares in November 2007, under which 66,970 shares had been repurchased as of June 30, 2009 at an average price of \$9.39.

Item 3. Defaults Upon Senior Securities

None

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

None

Item 5. Other Information

a.) Not applicable.

b.) There were no material changes to the procedures by which security holders may recommend nominees to the Company's Board of Directors during the period covered by the Form 10-Q.

Item 6. Exhibits

Exhibits

31.1 Certification of Chief Executive Officer Pursuant to Rule 13a-14(a)

31.2 Certification of Chief Financial Officer Pursuant to Rule 13a-14(a)

32.1 Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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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.

MAGYAR BANCORP, INC.
(Registrant)

Date: August 14, 2009

/s/ Elizabeth E. Hance
Elizabeth E. Hance
President and Chief Executive Officer
(Principal Executive Officer)

Date: August 14, 2009

/s/ Jon R. Ansari
Jon R. Ansari
Senior Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)