

United Community Bancorp  
Form 10-K  
September 26, 2008  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

**FORM 10-K**

(Mark One)

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the fiscal year ended June 30, 2008**

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

Commission file number: 0-51800

**UNITED COMMUNITY BANCORP**

(Exact name of registrant as specified in its charter)

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**United States**  
(State or other jurisdiction of  
incorporation or organization)

**36-4587081**  
(I.R.S. Employer  
Identification No.)

**92 Walnut Street, Lawrenceburg, Indiana**  
(Address of principal executive offices)

**47025**  
(Zip Code)

**Registrant's telephone number, including area code: (812) 537-4822**

**Securities registered pursuant to Section 12(b) of the Act:**

**Common Stock, par value \$0.01 per share**  
Title of Class

**Nasdaq Global Market**  
Name of each exchange on which registered

**Securities registered pursuant to Section 12(g) of the Act: None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES  NO

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. YES  NO

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large Accelerated Filer  Accelerated Filer  Non-accelerated Filer  Smaller Reporting Company

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates as of December 31, 2007 was \$38,175,409. The number of shares outstanding of the registrant's common stock as of September 12, 2008 was 8,464,000, of which 4,655,200 shares were held by United Community MHC.

**DOCUMENTS INCORPORATED BY REFERENCE**

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Portions of the Proxy Statement for the 2008 Annual Meeting of Stockholders are incorporated by reference in Part III of this Form 10-K.

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*Note on Forward-Looking Statements*

*This report contains certain forward-looking statements within the meaning of the federal securities laws. These statements are not historical facts, rather statements based on United Community Bancorp's current expectations regarding its business strategies, intended results and future performance. Forward-looking statements are preceded by terms such as expects, believes, anticipates, intends and similar expressions. Such statements are subject to certain risks and uncertainties including changes in economic conditions in the Company's market area, changes in policies by regulatory agencies, the outcome of litigation, fluctuations in interest rates, demand for loans in the Company's market area, and competition that could cause actual results to differ materially from historical earnings and those presently anticipated or projected. Additional factors that may affect our results are discussed in this annual report on Form 10-K under Item 1A. Risk Factors. 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. The Company wishes to advise readers that the factors listed above could affect the Company's financial performance and could cause the Company's actual results for future periods to differ materially from any opinions or statements expressed with respect to future periods in any current statements.*

*The Company does not undertake, and specifically disclaims any obligation, to publicly release the result of any revisions, which may be made to any forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.*

**PART I**

**Item 1. Business**

**United Community Bancorp.** United Community Bancorp was organized as a federal corporation upon completion of United Community Bank's reorganization into the mutual holding company form of organization (the Reorganization) on March 30, 2006. As a result of the Reorganization, United Community Bank became a wholly owned subsidiary of United Community Bancorp and United Community Bancorp became a majority-owned subsidiary of United Community MHC, a federally chartered mutual holding company. United Community Bancorp's business activities are the ownership of the outstanding capital stock of United Community Bank and management of the investment of offering proceeds retained from the Reorganization. United Community Bancorp neither owns nor leases any property, but instead, uses the premises, equipment and other property of United Community Bank with the payment of appropriate rental fees, as required by applicable law and regulations. In the future, United Community Bancorp may acquire or organize other operating subsidiaries; however, there are no current plans, arrangements, agreements or understandings, written or oral, to do so.

**United Community MHC.** United Community MHC is our federally chartered mutual holding company parent. As a mutual holding company, United Community MHC is a non-stock company that has as its members depositors of United Community Bank. United Community MHC does not engage in any business activity other than owning a majority of the common stock of United Community Bancorp. So long as we remain in the mutual holding company form of organization, United Community MHC will own a majority of the outstanding shares of United Community Bancorp.

**United Community Bank.** United Community Bank is a federally chartered savings bank and was created on April 12, 1999 through the merger of Perpetual Federal Savings and Loan Association and Progressive Federal Savings Bank, both located in Lawrenceburg, Indiana. At June 30, 2008, we had approximately \$382.7 million in assets and \$320.8 million in deposits. We operate as a community-oriented financial institution offering a full menu of banking services and products to consumers and businesses in our market areas. Recent years have seen the expansion of services we offer from a traditional savings and loan product mix to one of a full-service financial institution servicing the needs of consumer and commercial customers.

We attract deposits from the general public and local municipalities and use those funds to originate one- to four-family real estate, multi-family and nonresidential real estate and land, construction, commercial and consumer loans, which, with the exception of long-term fixed-rate one-to four-family real estate loans, we primarily hold for investment. We also maintain an investment portfolio. We offer non-deposit investment products through a third-party network arrangement with a registered broker-dealer.

**UCB Real Estate Management Holding, LLC.** UCB Real Estate Management Holding, LLC is a wholly-owned subsidiary of United Community Bank. The entity was formed for the purpose of holding real estate assets that are acquired by the Bank through, or in lieu of, foreclosure.



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### **Market Areas**

We are headquartered in Lawrenceburg, Indiana, which is in the eastern part of Dearborn County, Indiana, along the Ohio River. The economy of the region in which our current offices are located, and planned future offices will be located, has historically been a mixture of light industrial enterprises and services. The economy in Lawrenceburg has been strong in recent years as a result of the opening of a riverboat casino in Lawrenceburg whose presence has led to new retail centers, job growth and an increase in housing development. Located 20 miles from Cincinnati, Ohio, Dearborn County has also benefited from the growth in and around Cincinnati and Northern Kentucky, as many residents commute to these areas for employment.

Dearborn County's road system includes eight state highways and two U.S. highways. Interstate 275 enters Indiana near Lawrenceburg and offers easy connection to Interstate 71 and Interstate 75. At the northern end of the county, Interstate 74 connects us with Indianapolis to the northwest and Cincinnati to the east. Dearborn County is 20 minutes from the Greater Cincinnati/Northern Kentucky International Airport by way of Interstate 275. The county has four rail lines and port facilities due to the proximity of the Ohio River.

### **Competition**

We face significant competition for the attraction of deposits and origination of loans. Our most direct competition for deposits has historically come from the several financial institutions operating in our market areas and, to a lesser extent, from other financial service companies such as brokerage firms, credit unions and insurance companies. We also face competition for investors' funds from money market funds, mutual funds and other corporate and government securities. At June 30, 2007, which is the most recent date for which data is available from the Federal Deposit Insurance Corporation, we held approximately 36.26% of the deposits in Dearborn County, which was the largest market share out of the eight financial institutions with offices in Dearborn County. In addition, banks owned by large out-of-state bank holding companies such as Fifth Third Bancorp and U.S. Bancorp also operate in our market areas. These institutions are significantly larger than us and, therefore, have significantly greater resources.

Our competition for loans comes primarily from financial institutions in our market areas, and, to a lesser extent, from other financial service providers such as mortgage companies and mortgage brokers. Competition for loans also comes from the increasing number of non-depository financial service companies entering the mortgage market such as insurance companies, securities companies and specialty finance companies.

We expect competition to increase in the future as a result of legislative, regulatory and technological changes and the continuing trend of consolidation in the financial services industry. Technological advances, for example, have lowered the barriers to market entry, allowed banks and other lenders to expand their geographic reach by providing services over the Internet and made it possible for non-depository institutions to offer products and services that traditionally have been provided by banks. Changes in federal law permit affiliation among banks, securities firms and insurance companies, which promotes a competitive environment in the financial services industry. Competition for deposits and the origination of loans could limit our future growth.

### **Lending Activities**

**General.** We originate loans primarily for investment purposes. The largest segment of our loan portfolio is one- to four-family residential real estate loans. The other significant segments of our loan portfolio are nonresidential real estate and land loans, multifamily residential real estate loans, residential loans and consumer loans.

**One- to Four-Family Residential Real Estate Loans.** The largest segment of our loan portfolio is comprised of mortgage loans to enable borrowers to purchase or refinance existing homes most of which serve as the primary residence of the owner. We offer fixed-rate and adjustable-rate loans with terms up to 30 years. Borrower demand for adjustable-rate loans versus fixed-rate loans is a function of the level of interest rates, the

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expectations of changes in the level of interest rates, and the difference between the interest rates and loan fees offered for fixed-rate mortgage loans and the initial period interest rates and loan fees for adjustable-rate loans. The relative amount of fixed-rate mortgage loans and adjustable-rate mortgage loans that can be originated at any time is largely determined by the demand for each in a competitive environment. The loan fees, interest rates and other provisions of mortgage loans are determined by us on the basis of our own pricing criteria and competitive market conditions. Most of our loan originations result from relationships with existing or past customers, members of our local community and referrals from realtors, attorneys and builders.

While one- to four-family residential real estate loans are normally originated with up to 30-year terms, such loans typically remain outstanding for substantially shorter periods because borrowers often prepay their loans in full upon sale of the property pledged as security or upon refinancing the original loan. Therefore, average loan maturity is a function of, among other factors, the level of purchase and sale activity in the real estate market, prevailing interest rates and the interest rates payable on outstanding loans. Additionally, our current practice is generally to (i) sell in the secondary market newly originated conforming fixed-rate 15-, 20- and 30-year one- to four-family residential real estate loans, and (ii) to hold in our portfolio fixed-rate loans with 10-year terms or less and adjustable-rate loans. Occasionally, we have purchased loans and purchased participation interests in loans originated by other institutions to supplement our origination efforts.

Interest rates and payments on our adjustable-rate mortgage loans generally adjust annually after an initial fixed period that ranges from one to 10 years. Interest rates and payments on these adjustable-rate loans generally are based on the one-year constant maturity Treasury index (three-year constant maturity Treasury index in the case of three-year adjustable-rate loans) as published by the Federal Reserve in Statistical Release H.15. The maximum amount by which the interest rate may be increased is generally two percentage points per adjustment period and the lifetime interest rate cap ranges from five to six percentage points over the initial interest rate of the loan. Our adjustable-rate residential mortgage loans generally do not provide for a decrease in the rate paid below the initial contract rate. The inability of our residential real estate loans to adjust downward below the initial contract rate can contribute to increased income in periods of declining interest rates, and also assists us in our efforts to limit the risks to earnings and equity value resulting from changes in interest rates, subject to the risk that borrowers may refinance these loans during periods of declining interest rates.

We generally do not make conventional loans with loan-to-value ratios exceeding 95% at the time the loan is originated. Private mortgage insurance is generally required for all fixed-rate loans with loan-to-value ratios in excess of 80%, and all adjustable-rate loans with loan-to-value ratios exceeding 85%. We require all properties securing mortgage loans to be appraised by a board-approved independent appraiser. We generally require title insurance on all first mortgage loans. Borrowers must obtain hazard insurance, and flood insurance for loans on properties located in a flood zone, before closing the loan.

In an effort to provide financing for low- and moderate-income and first-time buyers, we offer a special home buyers program. We offer residential mortgage loans through this program to qualified individuals and originate the loans using reduced interest rates, fees and loan conditions.

***Multi-Family Real Estate Loans.*** We offer adjustable-rate mortgage loans secured by multi-family real estate. Our multi-family real estate loans are generally secured by apartment buildings. We also make multi-family real estate loans secured by apartment buildings outside of our primary market area to existing customers. We intend to continue to grow this segment of our loan portfolio.

These loans are typically repaid or the term extended before maturity, in which case a new rate is negotiated to meet market conditions and an extension of the loan is executed for a new term with a new amortization schedule. We originate adjustable-rate multi-family real estate loans with terms up to 30 years. Interest rates and payments on most of these loans typically adjust annually after an initial fixed term of five or seven years. Interest rates and payments on our adjustable-rate loans generally are based on the prime interest rate. The maximum amount by which the interest rate may be increased is generally two percentage points per adjustment period and the lifetime interest rate cap is six percentage points over the initial interest rate of the loan (five percentage points for loans with three-year terms). Loans are secured by first mortgages that generally do not exceed 80% of the property's appraised value. When the borrower is a corporation, partnership or other entity, we generally require that significant equity holders serve as co-borrowers on the loan, or, to a lesser extent, serve as a personal guarantor of the loan.



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Loans secured by multi-family real estate generally have larger balances and involve a greater degree of risk than one- to four-family residential mortgage loans. Of primary concern in multi-family real estate lending is the borrower's creditworthiness and the feasibility and cash flow potential of the project. Payments on loans secured by income properties often depend on successful operation and management of the properties. As a result, repayment of such loans may be subject to a greater extent than one- to four-family residential real estate loans to adverse conditions in the real estate market or the economy. To monitor cash flows on income properties, we require borrowers and loan guarantors of loan relationships totaling more than \$1.0 million, in the aggregate, to provide annual financial statements and/or tax returns. In reaching a decision on whether to make a multi-family real estate loan, we consider the net operating income of the property, the borrower's character and expertise, credit history and profitability and the value of the underlying property. In addition, with respect to rental properties, we will also consider the term of the lease and the credit quality of the tenants. We have generally required that the properties securing these real estate loans have debt service coverage ratios (the ratio of earnings before debt service to debt service) of at least 1.20x.

At June 30, 2008, the largest outstanding multi-family real estate loan had an outstanding balance of \$4.6 million and is secured by apartment buildings in Cincinnati, Ohio. This loan was performing according to its original terms at June 30, 2008.

***Nonresidential Real Estate and Land Loans.*** We offer adjustable-rate mortgage loans secured by nonresidential real estate. Our nonresidential real estate loans are generally secured by commercial buildings. We intend to continue to grow this segment of our loan portfolio. These loans are typically repaid or the term extended before maturity, in which case a new rate is negotiated to meet market conditions and an extension of the loan is executed for a new term with a new amortization schedule. We originate adjustable-rate nonresidential real estate loans with terms up to 30 years. Interest rates and payments on most of these loans typically adjust annually after an initial fixed term of five or seven years. Interest rates and payments on these loans generally are based on the prime interest rate. The maximum amount by which the interest rate may be increased is generally two percentage points per adjustment period and the lifetime interest rate cap is six percentage points over the initial interest rate of the loan (six percentage points for loans with three-year terms). Loans are secured by first mortgages that generally do not exceed 80% of the property's appraised value (75% for land only loans). When the borrower is a corporation, partnership or other entity, we generally require that significant equity holders serve as co-borrowers or as personal guarantors of the loan.

Loans secured by nonresidential real estate generally have larger balances and involve a greater degree of risk than one- to four-family residential mortgage loans. Of primary concern in nonresidential real estate lending is the borrower's creditworthiness and the feasibility and cash flow potential of the project. Payments on loans secured by income properties often depend on successful operation and management of the properties. As a result, repayment of such loans may be subject to a greater extent than one- to four-family residential real estate loans to adverse conditions in the real estate market or the economy. To monitor cash flows on income properties, we require borrowers and loan guarantors of loan relationships totaling more than \$1.0 million, in the aggregate, to provide annual financial statements and/or tax returns. In reaching a decision on whether to make a nonresidential real estate loan, we consider the net operating income of the property, the borrower's expertise and character, credit history and profitability and the value of the underlying property. In addition, with respect to rental properties, we will also consider the term of the lease and the credit quality of the tenants. We have generally required that the properties securing these real estate loans have debt service coverage ratios (the ratio of earnings before debt service to debt service) of at least 1.20x. Environmental surveys and inspections are generally required for loans over \$500,000.

We also originate loans secured by unimproved property, including lots for single family homes and for mobile homes, raw land, commercial property and agricultural property. The terms and rates of our land loans are the same as our nonresidential and multifamily real estate loans. Loans secured by undeveloped land or improved lots generally involve greater risks than residential mortgage lending because land loans are more difficult to evaluate. If the estimate of value proves to be inaccurate, in the event of default and foreclosure, we may be confronted with a property the value of which is insufficient to assure full repayment. Loan amounts generally do not exceed 80% of the lesser of the appraised value or the purchase price.

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At June 30, 2008, we had \$66.9 million in nonresidential real estate loans outstanding, or 23.5% of total loans, and \$6.3 million in land loans outstanding, or 2.2% of total loans.

At June 30, 2008, the largest outstanding nonresidential real estate loan had an outstanding balance of \$3.5 million. This loan is secured by a hotel and was performing according to its original terms at June 30, 2008. At June 30, 2008, our largest land loan, which was performing according to its original terms at that date, was for \$1.2 million and was secured by land held for commercial real estate development.

**Construction Loans.** We originate fixed-rate and adjustable-rate loans to individuals and, to a lesser extent, builders to finance the construction of residential dwellings. We also make construction loans for commercial development projects, including apartment buildings, restaurants, shopping centers and owner-occupied properties used for businesses. Our construction loans generally provide for the payment of interest only during the construction phase, which is usually nine months for residential properties and 12 months for commercial properties. At the end of the construction phase, the loan generally converts to a permanent mortgage loan. Loans generally can be made with a maximum loan to value ratio of 95% on residential construction and 80% on commercial construction at the time the loan is originated. Before making a commitment to fund a construction loan, we require an appraisal of the property by an independent licensed appraiser. We also will require an inspection of the property before disbursement of funds during the term of the construction loan.

At June 30, 2008, our largest outstanding residential construction loan was for \$381,000, of which \$144,000 was outstanding. At June 30, 2008, our largest outstanding commercial construction loan was for \$2.3 million, of which \$235,000 was outstanding, and is secured by a commercial office building. These loans were performing in accordance with their original terms at June 30, 2008.

**Commercial Loans.** We occasionally make commercial business loans to professionals, sole proprietorships and small businesses in our market area. We extend commercial business loans on an unsecured basis and secured basis, the maximum amount of which is limited by our in house loans to one borrower limit.

We originate secured and unsecured commercial lines of credit to finance the working capital needs of businesses to be repaid by seasonal cash flows or to provide a period of time during which the business can borrow funds for planned equipment purchases. Secured commercial lines of credit secured by nonresidential real estate are adjustable-rate loans whose rates are based on the prime interest rate and adjust monthly. Commercial lines of credit secured by nonresidential real estate have a maximum term of five years and a maximum loan-to-value ratio of 80% of the pledged collateral when the collateral is commercial real estate. We also originate commercial lines of credit secured by marketable securities and unsecured lines of credit. These lines of credit, as well as certain commercial lines of credit secured by nonresidential real estate, require that only interest be paid on a monthly or quarterly basis and have a maximum term of five years.

We also originate secured and unsecured commercial loans. Secured commercial loans are generally collateralized by nonresidential real estate, marketable securities, accounts receivable, inventory, industrial/commercial machinery and equipment and furniture and fixtures. We originate both fixed-rate and adjustable-rate commercial loans with terms up to 20 years for secured loans and up to five years for unsecured loans. Adjustable-rate loans are based on prime and adjust either monthly or annually. Where the borrower is a corporation, partnership or other entity, we generally require significant equity holders to be co-borrowers and in cases where they are not co-borrowers we generally require personal guarantees from significant equity holders.

When making commercial business loans, we consider the financial statements and/or tax returns of the borrower, the borrower's payment history of both corporate and personal debt, the debt service capabilities of the borrower, the projected cash flows of the business, the viability of the industry in which the customer operates and the value of the collateral.

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At June 30, 2008, our largest commercial loan was a \$1.2 million loan secured by assets of a life jacket manufacturer. This loan was performing in accordance with its original terms at June 30, 2008.

**Consumer Loans.** We offer a variety of consumer loans, primarily home equity loans and lines of credit, and, to a much lesser extent, loans secured by savings accounts or certificates of deposit (share loans), new farm and garden equipment, automobile and recreational vehicle loans and secured and unsecured personal loans.

The procedures for underwriting consumer loans include an assessment of the applicant's payment history on other debts and ability to meet existing obligations and payments on the proposed loan. Although the applicant's creditworthiness is a primary consideration, the underwriting process also includes a comparison of the value of the collateral, if any, to the proposed loan amount.

We generally offer home equity loans and lines of credit with a maximum combined loan to value ratio of 100%. Our lowest interest rates are generally offered to customers with a maximum combined loan to value ratio of 80%. Home equity lines of credit have adjustable-rates of interest that are based on the prime interest rate. Home equity lines of credit generally require that only interest be paid on a monthly basis and have terms up to 20 years. Interest rates on these loans typically adjust monthly. We offer fixed-rate and adjustable-rate home equity loans. Home equity loans with fixed-rates have terms that range from one to 15 years. Home equity loans with adjustable-rates have terms that range from 16 to 30 years. Interest rates on these loans are based on the prime interest rate. We hold a first mortgage position on most of the homes that secure our home equity loans and home equity lines of credit.

We offer loans secured by new and used vehicles. These loans have fixed interest rates and generally have terms up to five years.

We offer loans secured by new and used boats, motor homes, campers and motorcycles. We offer fixed and adjustable-rate loans for new motor homes and boats with terms up to 20 years for adjustable-rate loans and up to 10 years for fixed-rate loans. We offer fixed-rate loans for all other new and used recreational vehicles with terms up to 10 years for campers and five years for motorcycles.

We offer secured consumer loans with fixed interest rates and terms up to 10 years and secured lines of credit with adjustable-rates based on the prime rate with terms up to five years. We also offer fixed-rate unsecured consumer loans and lines of credit with terms up to five years. For more information on our loan commitments, see *Management's Discussion and Analysis of Financial Condition and Results of Operations* *Risk Management* *Liquidity Management*.

## **Loan Underwriting Risks**

**Adjustable-Rate Loans.** While we anticipate that adjustable-rate loans will better offset the adverse effects of an increase in interest rates as compared to fixed-rate mortgages, the increased mortgage payments required of adjustable-rate loan borrowers in a rising interest rate environment could cause an increase in delinquencies and defaults. The marketability of the underlying property also may be adversely affected in a high interest rate environment. In addition, although adjustable-rate mortgage loans help make our loan portfolio more responsive to changes in interest rates, the extent of this interest sensitivity is limited by the annual and lifetime interest rate adjustment limits.

**Multi-Family and Nonresidential Real Estate and Land Loans.** Loans secured by multi-family and nonresidential real estate generally have larger balances and involve a greater degree of risk than one- to four-family residential mortgage loans. Of primary concern in multi-family and nonresidential real estate lending is the borrower's creditworthiness and the feasibility and cash flow potential of the project. Payments on loans secured by income properties often depend on successful operation and management of the properties. As a result, repayment of such loans may be subject to a greater extent than residential real estate loans to adverse conditions in the real estate market or the economy. To monitor cash flows on income properties, we require borrowers and loan guarantors of

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loan relationships totaling more than \$1.0 million, in the aggregate, to provide annual financial statements and/or tax returns. In reaching a decision on whether to make a multi-family and nonresidential real estate loan, we consider the net operating income of the property, the borrower's expertise, credit history and profitability and the value of the underlying property. We have generally required that the properties securing these real estate loans have debt service coverage ratios (the ratio of earnings before debt service to debt service) of at least 1.20x. Environmental surveys and inspections are obtained when circumstances suggest the possibility of the presence of hazardous materials.

We underwrite all loan participations to our own underwriting standards and will not participate in a loan unless each participant has at least a 10% interest in the loan. In addition, we also consider the financial strength and reputation of the lead lender. To monitor cash flows on loan participations, we require the lead lender to provide annual financial statements for the borrower. Generally, we also conduct an annual internal loan review for loan participations.

**Construction Loans.** Construction financing is generally considered to involve a higher degree of risk of loss than long-term financing on improved, occupied real estate. Risk of loss on a construction loan depends largely upon the accuracy of the initial estimate of the property's value at completion of construction and the estimated cost (including interest) of construction. During the construction phase, a number of factors could result in delays and cost overruns. If the estimate of construction costs proves to be inaccurate, we may be required to advance funds beyond the amount originally committed to permit completion of the building. If the estimate of value proves to be inaccurate, we may be confronted, at or before the maturity of the loan, with a building having a value which is insufficient to assure full repayment. If we are forced to foreclose on a building before or at completion due to a default, there can be no assurance that we will be able to recover all of the unpaid balance of, and accrued interest on, the loan as well as related foreclosure and holding costs.

**Commercial Loans.** Unlike residential mortgage loans, which generally are made on the basis of the borrower's ability to make repayment from his or her employment or other income, and which are secured by real property the value of which tends to be more easily ascertainable, commercial loans are of higher risk and typically are made on the basis of the borrower's ability to make repayment from the cash flow of the borrower's business. As a result, the availability of funds for the repayment of commercial loans may depend substantially on the success of the business itself. Further, any collateral securing such loans may depreciate over time, may be difficult to appraise and may fluctuate in value.

**Consumer Loans.** Consumer loans may entail greater risk than do residential mortgage loans, particularly in the case of consumer loans that are unsecured or secured by assets that depreciate rapidly. In such cases, repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment for the outstanding loan and the remaining deficiency often does not warrant further substantial collection efforts against the borrower. In addition, consumer loan collections depend on the borrower's continuing financial stability, and therefore are more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy. Furthermore, the application of various federal and state laws, including bankruptcy and insolvency laws, may limit the amount that can be recovered on such loans.

**Loan Originations, Purchases and Sales.** Loan originations come from a number of sources. The primary source of loan originations are existing customers, walk-in traffic, advertising and referrals from customers. We advertise on television and on radio and in newspapers that are widely circulated in Dearborn County, Indiana. Accordingly, when our rates are competitive, we attract loans from throughout Dearborn County. We occasionally purchase loans and participation interests in loans to supplement our origination efforts.

We generally originate loans for our portfolio but our current practice is to sell to the secondary market almost all newly originated conforming fixed-rate, 15-, 20- and 30-year one- to four-family residential real estate loans and to hold in our portfolio fixed-rate loans with 10-year terms or less and adjustable-rate loans. Our decision to sell loans is based on prevailing market interest rate conditions and interest rate risk management. Generally, loans are sold to Freddie Mac with servicing retained.

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***Loan Approval Procedures and Authority.*** Our lending activities follow written, non-discriminatory underwriting standards and loan origination procedures established by our board of directors and management. The board has granted the Management Mortgage Loan Committee (comprised of the President, Executive Vice President and the Senior Vice President, Lending) with loan approval authority for mortgage loans up to \$200,000 and to the Board Loan Committee up to \$1.0 million.

The board has granted authority to approve consumer loans to certain employees up to prescribed limits, depending on the officer's experience and tenure. The board also granted loan approval authority to the Management Consumer Loan Committee, consisting of the President and the Executive Vice President, the Senior Vice President, Lending and two other experienced lenders. Any two members of the Committee may approve consumer loans secured by real estate up to \$250,000, and consumer loans secured by assets other than real estate up to \$100,000. The board of directors has also granted loan approval authority to the Management Commercial Loan Committee, consisting of the President, the Executive Vice President, the Senior Vice President, Lending. Any two members of the Committee may approve commercial loans secured by real estate up to \$250,000, commercial loans secured by assets other than real estate up to \$50,000 and unsecured commercial loans up to \$25,000. The Management Commercial Loan Committee may approve commercial loans secured by real estate up to \$500,000, commercial loans secured by assets other than real estate up to \$100,000 and unsecured commercial loans up to \$50,000 with unanimous approval by the Committee.

The Board Loan Committee, consisting of the President, the Executive Vice President and five to six other members of the board, may approve consumer and commercial loans secured by real estate up to \$1,000,000, consumer and commercial loans secured by assets other than real estate up to \$300,000 and unsecured consumer commercial loans up to \$100,000.

All loans in excess of these limits must be approved by the full Board of Directors.

***Loans to One Borrower.*** The maximum amount that we may lend to one borrower and the borrower's related entities generally is limited, by regulation, to 15% of our unimpaired capital and surplus. At June 30, 2008, our general regulatory limit on loans to one borrower was \$7.7 million. On June 30, 2008, our largest lending relationship was a \$6.0 million commercial real estate loan relationship. The loans that comprise this relationship were performing according to their original terms at June 30, 2008. In 2007, to reduce the risk of loss to any one borrower, the Board established a loans to one borrower limit of 7.5% of unimpaired capital and surplus. Any relationship in excess of 7.5% at the time of implementation would have been grandfathered in and allowed to continue without participating lenders.

***Loan Commitments.*** We issue commitments for fixed- and adjustable-rate mortgage loans conditioned upon the occurrence of certain events. Commitments to originate mortgage loans are legally binding agreements to lend to our customers. Generally, our mortgage loan commitments expire after 30 days.

## **Investment Activities**

We have legal authority to invest in various types of liquid assets, including U.S. Treasury obligations, securities of various federal agencies and municipal governments, deposits at the Federal Home Loan Bank of Indianapolis and certificates of deposit of federally insured institutions. Within certain regulatory limits, we also may invest a portion of our assets in mutual funds. We also are required to maintain an investment in Federal Home Loan Bank of Indianapolis stock. While we have the authority under applicable law to invest in derivative securities, our investment policy does not permit this investment. We had no investments in derivative securities at June 30, 2008.

At June 30, 2008, our investment portfolio totaled \$38.2 million and consisted primarily of U.S. Government sponsored entity securities and mortgage-backed securities issued primarily by Fannie Mae, Freddie Mac and Ginnie Mae, securities of municipal governments and mutual funds that invest in adjustable-rate mortgages and U.S. Treasury obligations.

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At June 30, 2008, \$8.9 million of our investment portfolio consisted of callable securities. These securities contain either a one-time call option or may be called anytime during the life of the security. We face reinvestment risk with callable securities, particularly during periods of falling market interest rates when issuers of callable securities tend to call or redeem their securities. Reinvestment risk is the risk that we may have to reinvest the proceeds from called securities at lower rates of return than the rates paid on the called securities.

Our investment objectives are to provide and maintain liquidity, to establish an acceptable level of interest rate and credit risk, to provide an alternate source of low-risk investments when demand for loans is weak and to generate a favorable return. The Investment Committee is responsible for the implementation of the investment policy. The Management Investment Committee, consisting of the Chief Executive Officer, the Chief Operating Officer, and the Chief Financial Officer, is responsible for monitoring our investment performance. Individual investment transactions, portfolio composition and performance are reviewed by our board of directors monthly.

### **Deposit Activities and Other Sources of Funds**

**General.** Deposits, borrowings and loan repayments are the major sources of our funds for lending and other investment purposes. Loan repayments are a relatively stable source of funds, while deposit inflows and outflows and loan prepayments are significantly influenced by general interest rates and money market conditions.

**Deposit Accounts.** Substantially all of our depositors are residents of the State of Indiana. We attract deposits in our market area through advertising and through our website. We offer a broad selection of deposit instruments, including noninterest-bearing demand accounts (such as checking accounts), interest-bearing accounts (such as NOW and money market accounts), regular savings accounts and certificates of deposit. Municipal deposits comprise a substantial portion of our total deposits. At June 30, 2008, \$127.5 million, or 39.7% of our total deposits, were municipal deposits. At June 30, 2008, we did not utilize brokered deposits. Deposit account terms vary according to the minimum balance required, the time periods the funds must remain on deposit and the interest rate, among other factors. In determining the terms of our deposit accounts, we consider the rates offered by our competition, our liquidity needs, profitability to us, matching deposit and loan products and customer preferences and concerns. We generally review our deposit mix and pricing weekly. Our current strategy is to offer competitive rates and to be in the middle of the market for rates on all types of deposit products.

**Borrowings.** We may utilize advances from the Federal Home Loan Bank of Indianapolis to supplement our supply of investable funds. The Federal Home Loan Bank functions as a central reserve bank providing credit for its member financial institutions. As a member, we are required to own capital stock in the Federal Home Loan Bank of Indianapolis and are authorized to apply for advances on the security of such stock and certain of our whole first mortgage loans and other assets (principally securities which are obligations of, or guaranteed by, the United States), provided certain standards related to creditworthiness have been met. Advances are made under several different programs, each having its own interest rate and range of maturities. Depending on the program, limitations on the amount of advances are based either on a fixed percentage of an institution's net worth or on the Federal Home Loan Bank's assessment of the institution's creditworthiness. At June 30, 2008, \$4.8 million was advanced from the Federal Home Loan Bank at an interest rate of 3.2%.

### **Personnel**

As of June 30, 2008, we had 78 full-time employees and 14 part-time employees, none of which are represented by a collective bargaining unit. We believe our relationship with our employees is good.

### **Subsidiaries**

United Community Bank has two subsidiaries: United Community Bank Financial Services, Inc. and Real Estate Management Holdings, LLC. United Community Bank Financial Services, Inc. receives commissions from the sale of non-deposit investment and insurance products. Real Estate Management Holdings, LLC owns and operates real estate that has been acquired through, or in lieu of, foreclosure.

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**Regulation and Supervision**

**General**

As a federal mutual holding company, United Community MHC is required by federal law to report to, and otherwise comply with the rules and regulations of, the Office of Thrift Supervision ( OTS ). United Community Bancorp as a federally chartered corporation, is also subject to reporting to and regulation by the OTS. United Community Bank is subject to extensive regulation, examination and supervision by the OTS, as its primary federal regulator, and the Federal Deposit Insurance Corporation ( FDIC ), as the deposit insurer. United Community Bank is a member of the Federal Home Loan Bank System and, with respect to deposit insurance, of the Deposit Insurance Fund managed by the FDIC. United Community Bank must file reports with the OTS and the FDIC concerning its activities and financial condition in addition to obtaining regulatory approvals prior to entering into certain transactions such as mergers with, or acquisitions of, other savings institutions. The OTS and/or the FDIC conduct periodic examinations to test United Community Bank's safety and soundness and compliance with various regulatory requirements.

This regulation and supervision establishes a comprehensive framework of activities in which an institution can engage and is intended primarily for the protection of the insurance fund and depositors. The regulatory structure also gives the regulatory authorities extensive discretion in connection with their supervisory and enforcement activities and examination policies, including policies with respect to the classification of assets and the establishment of adequate loan loss reserves for regulatory purposes. Any change in such regulatory requirements and policies, whether by the OTS, the FDIC or Congress, could have a material adverse impact on United Community MHC, United Community Bancorp, United Community Bank and their operations. Certain regulatory requirements applicable to United Community Bank and to United Community MHC are referred to below or elsewhere herein. The description of statutory provisions and regulations applicable to savings institutions and their holding companies set forth below and elsewhere in this document does not purport to be a complete description of such statutes and regulations and their effects on United Community Bank and United Community MHC and is qualified in its entirety by reference to the actual statutes and regulations.

**Holding Company Regulation**

**General.** United Community MHC is a savings and loan holding company within the meaning of federal law. As such, United Community MHC is registered with the OTS and is subject to OTS regulations, examinations, supervision and reporting requirements. In addition, the OTS has enforcement authority over United Community MHC and its non-savings institution subsidiaries. Among other things, this authority permits the OTS to restrict or prohibit activities that are determined to be a serious risk to the subsidiary savings institution.

**Activities Restrictions Applicable to Mutual Holding Companies.** Pursuant to federal law and OTS regulations, a mutual holding company, such as United Community MHC, may engage in the following activities: (i) investing in the stock of a savings association; (ii) acquiring a mutual association through the merger of such association into a savings association subsidiary of such holding company or an interim savings association subsidiary of such holding company; (iii) merging with or acquiring another holding company, one of whose subsidiaries is a savings association; (iv) investing in a corporation, the capital stock of which is available for purchase by a savings association under federal law or under the law of any state where the subsidiary savings association or associations share their home offices; (v) furnishing or performing management services for a savings association subsidiary of such company; (vi) holding, managing or liquidating assets owned or acquired from a savings subsidiary of such company; (vii) holding or managing properties used or occupied by a savings association subsidiary of such company; (viii) acting as trustee under deeds of trust; (ix) any other activity (A) that the Federal Reserve Board, by regulation, has determined to be permissible for bank holding companies under Section 4(c) of the Association Holding Company Act, unless the OTS, by regulation, prohibits or limits any such activity for savings and loan holding companies; or (B) in which multiple savings and loan holding companies were authorized (by regulation) to directly engage on March 5, 1987; and (x) purchasing, holding, or disposing of stock acquired in connection with a qualified stock issuance if the purchase of such stock by such savings and loan holding company is approved by the OTS.

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The Gramm-Leach Bliley Act of 1999 was designed to modernize the regulation of the financial services industry by expanding the ability of bank holding companies to affiliate with other types of financial services companies such as insurance companies and investment banking companies. The legislation also expanded the activities permitted for mutual savings and loan holding companies to also include any activity permitted a financial holding company under the legislation, including a broad array of insurance and securities activities.

Federal law prohibits a savings and loan holding company, including a federal mutual holding company, from, directly or indirectly or through one or more subsidiaries, acquiring more than 5% of the voting stock of another savings institution, or holding company thereof, without prior written approval of the OTS or from acquiring or retaining, with certain exceptions, more than 5% of a non-subsidiary holding company or savings association. A savings and loan holding company is also prohibited from acquiring more than 5% of a company engaged in activities other than those authorized by federal law; or acquiring or retaining control of a depository institution that is not insured by the FDIC. In evaluating applications by holding companies to acquire savings institutions, the OTS must consider the financial and managerial resources and future prospects of United Community MHC and institution involved, the effect of the acquisition on the risk to the insurance funds, the convenience and needs of the community and competitive factors.

The OTS is prohibited from approving any acquisition that would result in a multiple savings and loan holding company controlling savings institutions in more than one state, except: (i) the approval of interstate supervisory acquisitions by savings and loan holding companies; and (ii) the acquisition of a savings institution in another state if the laws of the state of the target savings institution specifically permit such acquisitions. The states vary in the extent to which they permit interstate savings and loan holding company acquisitions.

If the savings institution subsidiary of a savings and loan holding company fails to meet the qualified thrift lender test set forth in federal law, the holding company must register with the Federal Reserve Board as a bank holding company within one year of the savings institution's failure to so qualify.

Although savings and loan holding companies are not currently subject to regulatory capital requirements or specific restrictions on the payment of dividends or other capital distributions, federal regulations do prescribe such restrictions on subsidiary savings institutions as described below. United Community Bank must notify the OTS 30 days before declaring any dividend. In addition, the financial impact of a holding company on its subsidiary institution is a matter that is evaluated by the OTS and the agency has authority to order cessation of activities or divestiture of subsidiaries deemed to pose a threat to the safety and soundness of the institution.

***Stock Holding Company Subsidiary Regulation.*** The OTS has adopted regulations governing the two-tier mutual holding company form of organization and mid-tier stock holding companies that are controlled by mutual holding companies. Under these rules, the stock holding company subsidiary holds all the shares of the mutual holding company's savings association subsidiary and issues the majority of its own shares to the mutual holding company parent. In addition, the stock holding company subsidiary is permitted to engage in activities that are permitted for its mutual holding company parent subject to the same terms and conditions. Finally, OTS regulations maintain that the stock holding company subsidiary must be federally chartered for supervisory reasons.

***Acquisition of United Community MHC.*** Under the Federal Change in Control Act, a notice must be submitted to the OTS if any person (including a company), or group acting in concert, seeks to acquire control of a savings and loan holding company or savings institution. Under certain circumstances, a change of control may occur, and prior notice is required, upon the acquisition of 10% or more of the outstanding voting stock of United Community MHC or institution, unless the OTS has found that the acquisition will not result in a change of control of United Community MHC. Under the Change in Control Act, the OTS generally has 60 days from the filing of a complete notice to act, taking into consideration certain factors, including the financial and managerial resources of the acquirer and the anti-trust effects of the acquisition. Any company that acquires control would then be subject to regulation as a savings and loan holding company.



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**Federal Savings Institution Regulation**

**Business Activities.** The activities of federal savings associations are governed by federal law and regulations. These laws and regulations delineate the nature and extent of the activities in which federal savings banks may engage. In particular, certain lending authority for federal savings institutions, e.g., commercial, non-residential real property loans and consumer loans, is limited to a specified percentage of the institution's capital or assets.

**Capital Requirements.** The OTS capital regulations require savings institutions to meet three minimum capital standards: a 1.5% tangible capital to total assets ratio; a 4% Tier 1 capital to total assets leverage ratio (3% for institutions receiving the highest rating on the CAMELS examination rating system); and an 8% risk-based capital ratio. In addition, the prompt corrective action standards discussed below also establish, in effect, a minimum 2% tangible capital standard, a 4% leverage ratio (3% for institutions receiving the highest rating on the CAMELS system) and, together with the risk-based capital standard itself, a 4% Tier 1 risk-based capital standard. The OTS regulations also require that, in meeting the tangible, leverage and risk-based capital standards, institutions must generally deduct investments in and loans to subsidiaries engaged in activities as principal that are not permissible for a national bank.

The risk-based capital standard for savings institutions requires the maintenance of Tier 1 (core) and total capital (which is defined as core capital and supplementary capital) to risk-weighted assets of at least 4% and 8%, respectively. In determining the amount of risk-weighted assets, all assets, including certain off-balance sheet activities, recourse obligations, residual interests and direct credit substitutes, are multiplied by a risk-weight factor of 0% to 100%, assigned by the OTS capital regulation based on the risks believed inherent in the type of asset. Core (Tier 1) capital is generally defined as common stockholders' equity (including retained earnings), certain noncumulative perpetual preferred stock and related surplus, and minority interests in equity accounts of consolidated subsidiaries less intangibles other than certain mortgage servicing rights and credit card relationships. The components of supplementary capital (Tier 2 capital) currently include cumulative preferred stock, long-term perpetual preferred stock, mandatory convertible securities, subordinated debt and intermediate preferred stock, the allowance for loan and lease losses, limited to a maximum of 1.25% of risk-weighted assets, and up to 45% of unrealized gains on available-for-sale equity securities with readily determinable fair market values. Overall, the amount of supplementary capital included as part of total capital cannot exceed 100% of core capital.

The OTS also has authority to establish individual minimum capital requirements in appropriate cases upon a determination that an institution's capital level is or may become inadequate in light of the particular circumstances. At June 30, 2008, United Community Bank met each of its capital requirements.

**Prompt Corrective Regulatory Action.** The OTS is required to take certain supervisory actions against undercapitalized institutions, the severity of which depends upon the institution's degree of undercapitalization. Generally, a savings institution that has a ratio of total capital to risk-weighted assets of less than 8%, a ratio of Tier 1 (core) capital to risk-weighted assets of less than 4% or a ratio of core capital to total assets of less than 4% (3% or less for institutions with the highest examination rating) is considered to be undercapitalized. A savings institution that has a total risk-based capital ratio less than 6%, a Tier 1 capital ratio of less than 3% or a leverage ratio that is less than 3% is considered to be significantly undercapitalized and a savings institution that has a tangible capital to assets ratio equal to or less than 2% is deemed to be critically undercapitalized. Subject to a narrow exception, the OTS is required to appoint a receiver or conservator within specified time frames for an institution that is critically undercapitalized. The regulation also provides that a capital restoration plan must be filed with the OTS within 45 days of the date a savings institution is deemed to have received notice that it is undercapitalized, significantly undercapitalized or critically undercapitalized. Compliance with the plan must be guaranteed by any parent holding company in an amount of up to the lesser of 5% of the savings association's total assets when it was deemed to be undercapitalized or the amount necessary to achieve compliance with applicable capital regulations. In addition, numerous mandatory supervisory actions become immediately applicable to an undercapitalized institution, including, but not limited to, increased monitoring by regulators and restrictions on growth, capital distributions and expansion. The OTS could also take any one of a number of discretionary supervisory actions, including the issuance of a capital directive and the replacement of senior executive officers and directors. Significantly and undercapitalized institutions are subject to additional mandatory and discretionary restrictions.

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**Insurance of Deposit Accounts.** The Bank's deposits are insured up to applicable limits by the Deposit Insurance Fund of the FDIC. The Deposit Insurance Fund is the successor to the Bank Insurance Fund and the Savings Association Insurance Fund, which were merged in 2006. The FDIC recently amended its risk-based assessment system for 2007 to implement authority granted by the Federal Deposit Insurance Reform Act of 2005 ( Reform Act ). Under the revised system, insured institutions are assigned to one of four risk categories based on supervisory evaluations, regulatory capital levels and certain other factors. An institution's assessment rate depends upon the category to which it is assigned. Risk category I, which contains the least risky depository institutions, is expected to include more than 90% of all institutions. Unlike the other categories, Risk Category I contains further risk differentiation based on the FDIC's analysis of financial ratios, examination component ratings and other information. Assessment rates are determined by the FDIC and currently range from five to seven basis points for the healthiest institutions (Risk Category I) to 43 basis points of assessable deposits for the riskiest (Risk Category IV). The FDIC may adjust rates uniformly from one quarter to the next, except that no single adjustment can exceed three basis points. No institution may pay a dividend if in default of the FDIC assessment.

The Reform Act also provided for a one-time credit for eligible institutions based on their assessment base as of December 31, 1996. Subject to certain limitations with respect to institutions that are exhibiting weaknesses, credits can be used to offset assessments until exhausted. The Bank's one-time credit is expected to approximate \$145,000. The Reform Act also provided for the possibility that the FDIC may pay dividends to insured institutions once the Deposit Insurance Fund reserve ratio equals or exceeds 1.35% of estimated insured deposits.

In addition to the assessment for deposit insurance, institutions are required to make payments on bonds issued in the late 1980s by the Financing Corporation to recapitalize a predecessor deposit insurance fund.

The Reform Act provided the FDIC with authority to adjust the Deposit Insurance Fund ratio to insured deposits within a range of 1.15% and 1.50%, in contrast to the prior statutorily fixed ratio of 1.25%. The ratio, which is viewed by the FDIC as the level that the fund should achieve, was established by the agency at 1.28%, subject to future adjustments.

The FDIC has authority to increase insurance assessments. A significant increase in insurance premiums would likely have an adverse effect on the operating expenses and results of operations of the Bank. Management cannot predict what insurance assessment rates will be in the future.

Insurance of deposits may be terminated by the FDIC upon a finding that the institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC. The management of the Bank does not know of any practice, condition or violation that might lead to termination of deposit insurance.

**Loans to One Borrower.** Federal law provides that savings institutions are generally subject to the limits on loans to one borrower applicable to national banks. Generally, subject to certain exceptions, a savings institution may not make a loan or extend credit to a single or related group of borrowers in excess of 15% of its unimpaired capital and surplus. An additional amount may be lent, equal to 10% of unimpaired capital and surplus, if secured by specified readily-marketable collateral.

**QTL Test.** Federal law requires savings institutions to meet a qualified thrift lender test. Under the test, a savings association is required to either qualify as a domestic building and loan association under the Internal Revenue Code or maintain at least 65% of its portfolio assets (total assets less: (i) specified liquid assets up to 20% of total assets; (ii) intangibles, including goodwill; and (iii) the value of property used to conduct business) in certain qualified thrift investments (primarily residential mortgages and related investments, including certain mortgage-backed securities) in at least 9 months out of each 12 month period. Recent legislation has expanded the extent to which education loans, credit card loans and small business loans may be considered qualified thrift investments.

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A savings institution that fails the qualified thrift lender test is subject to certain operating restrictions and may be required to convert to a bank charter. As of June 30, 2008, United Community Bank maintained 93.0% of its portfolio assets in qualified thrift investments and, therefore, met the qualified thrift lender test.

***Limitation on Capital Distributions.*** OTS regulations impose limitations upon all capital distributions by a savings institution, including cash dividends, payments to repurchase its shares and payments to shareholders of another institution in a cash-out merger. Under the regulations, an application to and prior approval of the OTS is required prior to any capital distribution if the institution does not meet the criteria for expedited treatment of applications under OTS regulations (i.e., generally, examination and Community Reinvestment Act ratings in the two top categories), the total capital distributions for the calendar year exceed net income for that year plus the amount of retained net income for the preceding two years, the institution would be undercapitalized following the distribution or the distribution would otherwise be contrary to a statute, regulation or agreement with the OTS. If an application is not required, the institution must still provide prior notice to the OTS of the capital distribution if, like United Community Bank, it is a subsidiary of a holding company. In the event United Community Bank's capital fell below its regulatory requirements or the OTS notified it that it was in need of increased supervision, United Community Bank's ability to make capital distributions could be restricted. In addition, the OTS could prohibit a proposed capital distribution by any institution, which would otherwise be permitted by the regulation, if the OTS determines that such distribution would constitute an unsafe or unsound practice. Federal law further provides that no insured depository institution may pay a dividend that causes it to fall below any applicable regulatory capital requirement or if it is in default of its FDIC deposit insurance assessment.

***Standards for Safety and Soundness.*** The federal banking agencies have adopted Interagency Guidelines prescribing Standards for Safety and Soundness. The guidelines set forth the safety and soundness standards that the federal banking agencies use to identify and address problems at insured depository institutions before capital becomes impaired. If the OTS determines that a savings institution fails to meet any standard prescribed by the guidelines, the OTS may require the institution to submit an acceptable plan to achieve compliance with the standard.

***Transactions with Related Parties.*** United Community Bank's authority to engage in transactions with affiliates (e.g., any entity that controls or is under common control with an institution, including United Community MHC and its non-savings institution subsidiaries) is limited by federal law. The aggregate amount of covered transactions with any individual affiliate is limited to 10% of the capital and surplus of the savings institution. The aggregate amount of covered transactions with all affiliates is limited to 20% of the savings institution's capital and surplus. Certain transactions with affiliates are required to be secured by collateral in an amount and of a type specified by federal law. The purchase of low quality assets from affiliates is generally prohibited. The transactions with affiliates must be on terms and under circumstances that are at least as favorable to the institution as those prevailing at the time for comparable transactions with non-affiliated companies. In addition, savings institutions are prohibited from lending to any affiliate that is engaged in activities that are not permissible for bank holding companies and no savings institution may purchase the securities of any affiliate other than a subsidiary.

The Sarbanes-Oxley Act of 2002 generally prohibits loans by United Community MHC to its executive officers and directors. However, the law contains a specific exception for loans by United Community Bank to its executive officers and directors in compliance with federal banking laws. Under such laws, United Community Bank's authority to extend credit to executive officers, directors and 10% shareholders (insiders), as well as entities such persons control, is limited. The law limits both the individual and aggregate amount of loans United Community Bank may make to insiders based, in part, on United Community Bank's capital position and requires certain board approval procedures to be followed. Such loans are required to be made on terms substantially the same as those offered to unaffiliated individuals and not involve more than the normal risk of repayment. There is an exception for loans made pursuant to a benefit or compensation program that is widely available to all employees of the institution and does not give preference to insiders over other employees. Additional restrictions apply to loans by United Community Bank to its executive officers.

***Enforcement.*** The OTS has primary enforcement responsibility over savings institutions and has the authority to bring actions against the institution and all institution-affiliated parties, including stockholders, and any

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attorneys, appraisers and accountants who knowingly or recklessly participate in wrongful action likely to have an adverse effect on an insured institution. Formal enforcement action may range from the issuance of a capital directive or cease and desist order to removal of officers and/or directors to institution of receivership, conservatorship or termination of deposit insurance. Civil penalties cover a wide range of violations and can amount to \$25,000 per day, or even \$1 million per day in especially egregious cases. The FDIC has the authority to recommend to the Director of the OTS that enforcement action to be taken with respect to a particular savings institution. If action is not taken by the Director, the FDIC has authority to take such action under certain circumstances. Federal law also establishes criminal penalties for certain violations.

**Assessments.** Savings institutions are required to pay assessments to the OTS to fund the agency's operations. The general assessments, paid on a semi-annual basis, are computed based upon the savings institution's (including consolidated subsidiaries) total assets, condition and complexity of portfolio. The OTS assessments paid by United Community Bank for the fiscal year ended June 30, 2008 totaled \$105,000.

### **Federal Home Loan Bank System**

United Community Bank is a member of the Federal Home Loan Bank System, which consists of 12 regional Federal Home Loan Banks. The Federal Home Loan Bank provides a central credit facility primarily for member institutions. United Community Bank, as a member of the Federal Home Loan Bank, is required to acquire and hold shares of capital stock in that Federal Home Loan Bank. United Community Bank was in compliance with this requirement with an investment in Federal Home Loan Bank stock at June 30, 2008 of \$1.9 million.

The Federal Home Loan Banks are required to provide funds for the resolution of insolvent thrifts in the late 1980s and to contribute funds for affordable housing programs. These requirements could reduce the amount of dividends that the Federal Home Loan Banks pay to their members and could also result in the Federal Home Loan Banks imposing a higher rate of interest on advances to their members. If dividends were reduced, or interest on future Federal Home Loan Bank advances increased, United Community Bank's net interest income would likely also be reduced.

### **Federal Reserve System**

The Federal Reserve Board regulations require savings institutions to maintain non-interest earning reserves against their transaction accounts (primarily Negotiable Order of Withdrawal (NOW) and regular checking accounts). The regulations generally provide that reserves be maintained against aggregate transaction accounts as follows: a 3% reserve ratio is assessed on net transaction accounts up to and including \$45.8 million; a 10% reserve ratio is applied above \$45.8 million. The first \$8.5 million of otherwise reservable balances (subject to adjustments by the Federal Reserve Board) are exempted from the reserve requirements. The amounts are adjusted annually. United Community Bank complies with the foregoing requirements.

## **Federal and State Taxation**

### **Federal Income Taxation**

**General.** United Community Bank reports its income on a fiscal year basis using the accrual method of accounting. The federal income tax laws apply to United Community Bank in the same manner as to other corporations with some exceptions, including the reserve for bad debts discussed below. The following discussion of tax matters is intended only as a summary and does not purport to be a comprehensive description of the tax rules applicable to United Community Bank. United Community Bank's federal income tax returns have been either audited or closed under the statute of limitations through June 30, 2004. For its 2008 tax year, United Community Bank's maximum federal income tax rate was 34%.

**Bad Debt Reserves.** For fiscal years beginning before June 30, 1996, thrift institutions that qualified under certain definitional tests and other conditions of the Internal Revenue Code were permitted to use certain favorable

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provisions to calculate their deductions from taxable income for annual additions to their bad debt reserve. A reserve could be established for bad debts on qualifying real property loans, generally secured by interests in real property improved or to be improved, under the percentage of taxable income method or the experience method. The reserve for nonqualifying loans was computed using the experience method. Federal legislation enacted in 1996 repealed the reserve method of accounting for bad debts and the percentage of taxable income method for tax years beginning after 1995 and require savings institutions to recapture or take into income certain portions of their accumulated bad debt reserves. Approximately \$748,000 of United Community Bank's accumulated bad debt reserves would not be recaptured into taxable income unless United Community Bank makes a non-dividend distribution to United Community Bancorp as described below.

**Distributions.** If United Community Bank makes non-dividend distributions to United Community Bancorp, the distributions will be considered to have been made from United Community Bank's unrecaptured tax bad debt reserves, including the balance of its reserves as of December 31, 1987, to the extent of the non-dividend distributions, and then from United Community Bank's supplemental reserve for losses on loans, to the extent of those reserves, and an amount based on the amount distributed, but not more than the amount of those reserves, will be included in United Community Bank's taxable income. Non-dividend distributions include distributions in excess of United Community Bank's current and accumulated earnings and profits, as calculated for federal income tax purposes, distributions in redemption of stock and distributions in partial or complete liquidation. Dividends paid out of United Community Bank's current or accumulated earnings and profits will not be so included in United Community Bank's taxable income.

The amount of additional taxable income triggered by a non-dividend is an amount that, when reduced by the tax attributable to the income, is equal to the amount of the distribution. Therefore, if United Community Bank makes a non-dividend distribution to United Community Bancorp, approximately one and one-half times the amount of the distribution not in excess of the amount of the reserves would be includable in income for federal income tax purposes, assuming a 34.0% federal corporate income tax rate. United Community Bank does not intend to pay dividends that would result in a recapture of any portion of its bad debt reserves.

**State Taxation**

**Indiana Taxation.** Indiana imposes an 8.5% franchise tax based on a financial institution's adjusted gross income as defined by statute. In computing adjusted gross income, deductions for municipal interest, U.S. Government interest, the bad debt deduction computed using the reserve method and pre-1990 net operating losses are disallowed. United Community Bank's state franchise tax returns have not been audited for the past five tax years.

**Executive Officers of United Community Bancorp and United Community Bank**

| <b>Name</b>           | <b>Age at<br/>June 30, 2008</b> | <b>Principal Position</b>   |
|-----------------------|---------------------------------|---|
| William F. Ritzmann   | 60                              | President and Chief Executive Officer                                     |
| Elmer G. McLaughlin   | 56                              | Executive Vice President, Chief Operating Officer and Corporate Secretary |
| James W. Kittle       | 50                              | Senior Vice President, Lending  |
| Vicki A. March, CPA   | 52                              | Senior Vice President, Chief Financial Officer and Treasurer              |
| W. Michael McLaughlin | 49                              | Senior Vice President, Operations   |

Unless otherwise noted, all officers have held the position described below for at least the past five years.

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**William F. Ritzmann** has served as President and Chief Executive Officer of United Community Bank since the merger of Perpetual Federal Savings and Loan Association and Progressive Federal Savings Bank to form United Community Bank on April 12, 1999, and for United Community Bancorp since its inception in March 2006. Before the merger, Mr. Ritzmann served for 23 years as director, President and Managing Officer of Progressive Federal Savings Bank. Mr. Ritzmann also serves on United Community Bancorp's Board of Directors and has served as a Director of the Bank since 1975, which includes his term as a director of Progressive Federal Savings Bank.

**Elmer G. McLaughlin** has served as Executive Vice President and Chief Operating Officer of United Community Bank since the merger of Perpetual Federal Savings and Loan Association and Progressive Federal Savings Bank to form United Community Bank in April 1999, and in the same positions with United Community Bancorp since its inception in March 2006. Before the merger, Mr. McLaughlin served for nine years as President, and 19 years as director of Perpetual Federal Savings and Loan Association, and was Executive Vice President and head of operations and senior loan officer of Perpetual Federal from 1978 until 1990. Mr. McLaughlin is the brother of W. Michael McLaughlin, a Senior Vice President of United Community Bank. Mr. McLaughlin is a Director of United Company Bancorp and has served as a Director of United Community Bank since 1980, which includes his term as a director of Perpetual Federal.

**James W. Kittle** has served as Senior Vice President, Lending of the Bank since 1980.

**Vicki A. March** has served as Chief Financial Officer, Treasurer and Senior Vice President, Finance of the Bank, since 1999 and for United Community Bancorp since its inception in March 2006. Ms. March previously served as Treasurer of the Bank from 1980 to 1999.

**W. Michael McLaughlin** has served as Senior Vice President, Operations of the Bank since 1983.

### **Item 1A. Risk Factors**

*An investment in shares of our common stock involves various risks. Before deciding to invest in our common stock, you should carefully consider the risks described below in conjunction with the other information in this Annual Report on Form 10-K, including the items included as exhibits. Our business, financial condition and results of operations could be harmed by any of the following risks or by other risks that have not been identified or that we may believe are immaterial or unlikely. The value or market price of our common stock could decline due to any of these risks. The risks discussed below also include forward-looking statements, and our actual results may differ substantially from those discussed in these forward-looking statements.*

#### **Our primary market area depends substantially on the gaming industry, and a downturn in that industry could hurt our business and our prospects.**

Our business is concentrated in the Lawrenceburg, Indiana, area. Lawrenceburg is the site of a riverboat casino that opened in 1996. The economy of the Lawrenceburg metropolitan area significantly depends on services and industries related to gaming and tourism. Any event that negatively and materially impacts the gaming and tourism industry will adversely impact the Lawrenceburg economy.

Gaming revenue is vulnerable to fluctuations in the national economy. A prolonged downturn in the national economy could have a significant adverse effect on the economy of the Lawrenceburg area. Virtually any development or event that could dissuade travel or spending related to gaming and tourism, whether inside or outside of Lawrenceburg, could adversely affect the Lawrenceburg economy. Consequently, the Lawrenceburg economy is more susceptible than the economies of other cities to issues such as higher gasoline and other fuel prices, unemployment levels, recession, rising interest rates, and other economic conditions, whether domestic or foreign.

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A deterioration in economic conditions generally, and a slowdown in gaming and tourism activities in particular, could result in the following consequences, any of which could adversely affect our business, financial condition, results of operations and prospects and expose us to a greater risk of loss:

Loan delinquencies may increase;

Problem assets and foreclosures may increase;

Demand for our products and services may decline; and

Collateral for loans made by us may decline in value, reducing the amount of money that our customers may borrow against the collateral, and reducing the value of assets and collateral associated with our loans.

**An expansion of permissible gaming activities in other states, particularly in Kentucky and/or Ohio, may lead to a decline in gaming revenue in Lawrenceburg, Indiana, which could hurt our business and our prospects.**

Lawrenceburg, Indiana competes with other areas of the country for gaming revenue, and it is possible that the expansion of gaming operations in other states, as a result of changes in laws or otherwise, could significantly reduce gaming revenue in the Lawrenceburg area. This is particularly true if gaming operations were to be authorized in Kentucky and/or Ohio, states from which the Lawrenceburg casino generally draws substantial year-round clientele. Kentucky and/or Ohio legislative proposals could permit gaming activities. The establishment of casino gaming in Kentucky and/or Ohio, or other states, could have a substantial adverse effect on gaming revenue in Lawrenceburg which would adversely affect the Lawrenceburg economy and our business.

**We rely heavily on municipal deposits as a source of funds and a reduced level of those deposits may hurt our profits.**

Historically, municipal deposits, consisting primarily of tax revenues from the local river boat casino operations, have been a significant source of funds for our lending and investment activities. At June 30, 2008, \$127.5 million, or 39.7% of our total deposits, consisted of municipal deposits. Municipal deposits are generally short-term deposits and are generally considered rate-sensitive instruments. Consequently, if our municipal deposits decrease to a level where we would need to resort to other sources of funds for our lending and investment activities, such as borrowings from the Federal Home Loan Bank of Indianapolis, the interest expense associated with these other funding sources may be higher than the rates we pay on the municipal deposits, which would hurt our profits.

**Our income is subject to inherent risk.**

Our primary source of income is net interest income, which is the difference between the interest income generated by our interest-earning assets (consisting primarily of loans and, to a lesser extent, securities) and the interest expense generated by our interest-bearing liabilities (consisting primarily of deposits and, to a lesser extent, wholesale borrowings).

The level of net interest income is a function of the average balance of our interest-earning assets, the average balance of our interest-bearing liabilities, and the spread between the yield on such assets and the cost of such liabilities. These factors are influenced by both the pricing and mix of our interest-earning assets and our interest-bearing liabilities which, in turn, are affected by such external factors as the local economy, competition for loans and deposits, the monetary policy of the Federal Open Market Committee of the Federal Reserve Board of Governors (the FOMC ) and market interest rates.

The cost of our deposits and short-term wholesale borrowings is largely based on short-term interest rates, the level of which is driven by the FOMC. However, the yields on our loans and securities are typically based on intermediate-term or long-term interest rates, which are set by the market and generally vary daily. The level of net

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interest income is therefore influenced by movements in such interest rates, and the pace at which such movements occur. If the interest rates on our interest-bearing liabilities increase at a faster pace than the interest rates on our interest-earning assets, the result could be a reduction in net interest income and with it, a reduction in our earnings. Our net interest income and earnings would be similarly impacted were the interest rates on its interest-earning assets to decline more quickly than the interest rates on our interest-bearing liabilities.

In addition, such changes in interest rates could affect our ability to originate loans and attract and retain deposits, the fair value of our financial assets and liabilities, and the average life of our loan and securities portfolios.

Changes in interest rates could also have an effect on the slope of the yield curve. A flat to inverted yield curve could cause our net interest income and net interest margin to contract, which could have a material adverse effect on our net income and cash flows and the value of our assets.

Changes in interest rates particularly affect the value of our securities portfolio. Generally, the value of fixed-rate securities fluctuates inversely with changes in interest rates. Unrealized gains and losses on securities available for sale are reported as a separate component of equity, net of tax. Decreases in the fair value of securities available for sale resulting from increases in interest rates could have an adverse effect on stockholders' equity. In addition, we invest in callable securities that expose us to reinvestment risk, particularly during periods of falling market interest rates when issuers of callable securities tend to call or redeem their securities. Reinvestment risk is the risk that we may have to reinvest the proceeds from called securities at lower rates of return than the rates earned on the called securities.

**Our increased emphasis on multi-family residential and nonresidential real estate and land lending may expose us to increased lending risks.**

At June 30, 2008, \$116.9 million, or 40.3%, of our loan portfolio consisted of multi-family residential and nonresidential real estate and land loans. We have grown our loan portfolio in recent years, particularly with respect to multi-family residential and nonresidential real estate and land loans and intend to continue to emphasize these types of lending. These types of loans generally expose a lender to greater risk of non-payment and loss than one- to four-family residential mortgage loans because repayment of the loans often depends on the successful operation of the property and the income stream of the borrowers. Such loans typically involve larger loan balances to single borrowers or groups of related borrowers compared to one- to four-family residential mortgage loans. In addition, since such loans generally entail greater credit risk than one- to four-family residential mortgage loans, we may need to increase our allowance for loan losses in the future to account for the likely increase in probable incurred credit losses associated with the growth of such loans. Also, many of our multi-family residential and nonresidential real estate and land borrowers have more than one loan outstanding with us. Consequently, an adverse development with respect to one loan or one credit relationship can expose us to a significantly greater risk of loss compared to an adverse development with respect to a one- to four-family residential mortgage loan. At June 30, 2008, our largest multi-family residential, nonresidential real estate, or land lending relationship was a \$6.0 million commercial real estate loan relationship. This loan relationship was within our maximum lending limit to one borrower at June 30, 2008.

**If we do not achieve profitability on new branches, the new branches may hurt our earnings.**

We cannot assure you that our branch expansion strategy and our branch upgrading will increase our earnings in the short term or within a reasonable period of time, if at all. Numerous factors will affect our branch expansion strategy, such as our ability to select suitable branch locations, real estate acquisition costs, competition, interest rates, managerial resources, our ability to hire and retain qualified personnel, the effectiveness of our marketing strategy and our ability to attract deposits. It takes time for a new branch to generate significant deposits and loan volume to offset expenses, some of which, like salaries and occupancy expense, are relatively fixed costs. We can provide no assurance that we will be successful in increasing the volume of our loans and deposits by expanding our branch network. Building and staffing new branch offices will increase our operating expenses. We can provide no assurance that we will be able to manage the costs and implementation risks associated with this strategy so that expansion of our branch network will be profitable.



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**Strong competition within our market areas could hurt our profits and slow growth.**

We face intense competition both in making loans and attracting deposits. In particular, several financial institutions have recently opened new offices or branches in Dearborn County, Indiana. This competition has made it more difficult for us to make new loans and at times has forced us to offer higher deposit rates. Price competition for loans and deposits might result in us earning less on our loans and paying more on our deposits, which would reduce net interest income. Competition also makes it more difficult to grow loans and deposits. As of June 30, 2007, the most recent date for which information is available, we held 36.26% of the deposits in Dearborn County. Competition also makes it more difficult to hire and retain experienced employees. Some of the institutions with which we compete have substantially greater resources and lending limits than we have and may offer services that we do not provide. We expect competition to increase in the future as a result of legislative, regulatory and technological changes and the continuing trend of consolidation in the financial services industry. Our profitability depends upon our continued ability to compete successfully in our market areas.

**We operate in a highly regulated environment and we may be adversely affected by changes in laws and regulations.**

We are subject to extensive regulation, supervision and examination by the OTS, our primary federal regulator, and by the FDIC, as insurer of our deposits. Such regulation and supervision governs the activities in which an institution and its holding company may engage, and is intended primarily for the protection of the insurance fund and the depositors and borrowers of United Community Bank rather than for holders of United Community Bancorp common stock. Regulatory authorities have extensive discretion in their supervisory and enforcement activities, including the imposition of restrictions on our operations, the classification of our assets and determination of the level of our allowance for loan losses. Any change in such regulation and oversight, whether in the form of regulatory policy, regulations, legislation or supervisory action, may have a material impact on our operations.

**A decline in our return on equity as a result of the capital we raised in our March 2006 stock offering may negatively impact the value of our common stock.**

Return on equity, which equals net income divided by average equity, is a ratio used by many investors to compare the performance of a particular company with other companies. For the year ended June 30, 2008, our return on equity was (2.67)%. Over time, we intend to use the net proceeds from our March 2006 stock offering to increase earnings per share and book value per share, without assuming undue risk, with the goal of achieving a return on equity that is competitive with other publicly held subsidiaries of mutual holding companies. This goal could take a number of years to achieve, and we cannot assure you that it will be attained. Consequently, you should not expect a competitive return on equity in the near future. Failure to achieve a competitive return on equity might make an investment in our common stock unattractive to some investors and might cause our common stock to trade at lower prices than comparable companies with higher returns on equity.

**United Community MHC's majority control of United Community Bancorp's common stock enables it to exercise voting control over most matters put to a vote of stockholders including preventing sale or merger transactions or a second-step conversion transaction you may find advantageous.**

United Community MHC owns a majority of United Community Bancorp's common stock and, through its board of directors, exercises voting control over most matters put to a vote of stockholders. The same directors and officers who will manage United Community Bancorp and United Community Bank also manage United Community MHC. As a federally chartered mutual holding company, the board of directors of United Community MHC must ensure that the interests of depositors of United Community Bank are represented and considered in matters put to a vote of stockholders of United Community Bancorp. Therefore, the votes cast by United Community MHC may not be in your personal best interests as a stockholder. For example, United Community MHC may exercise its voting control to defeat a stockholder nominee for election to the board of directors of United Community Bancorp. In addition, stockholders are not able to force a merger or second-step conversion transaction

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without the consent of United Community MHC. Some stockholders may desire a sale or merger transaction, since stockholders typically receive a premium for their shares, or a second-step conversion transaction, since fully converted institutions tend to trade at higher multiples than mutual holding companies.

**OTS policy on remutualization transactions could prohibit acquisition of United Community Bancorp, which may adversely affect our stock price.**

Current OTS regulations permit a mutual holding company to be acquired by a mutual institution in a remutualization transaction. The possibility of a remutualization transaction has recently resulted in a degree of takeover speculation for mutual holding companies that is reflected in the per share price of mutual holding companies' common stock. However, the OTS has issued a policy statement indicating that it views remutualization transactions as raising significant issues concerning disparate treatment of minority stockholders and mutual members of the target entity and raising issues concerning the effect on the mutual members of the acquiring entity. Under certain circumstances, the OTS intends to give these issues special scrutiny and reject applications providing for the remutualization of a mutual holding company unless the applicant can clearly demonstrate that the OTS's concerns are not warranted in the particular case. Should the OTS prohibit or otherwise restrict these transactions in the future, our per share stock price may be adversely affected.

**OTS regulations and anti-takeover provisions in our charter restrict the accumulation of United Community Bancorp's common stock, which may adversely affect our stock price.**

OTS regulations provide that for a period of three years following the date of the completion of the Reorganization, no person, acting alone or together with associates or in a group of persons acting in concert, may directly or indirectly offer to acquire or acquire the beneficial ownership of more than 10.0% of our common stock without the prior written approval of the OTS. In addition, United Community Bancorp's charter provides that, for a period of five years from the date of the reorganization, no person, other than United Community MHC, may acquire directly or indirectly the beneficial ownership of more than 10.0% of any class of any equity security of United Community Bancorp. In the event a person acquires shares in violation of this charter provision, all shares beneficially owned by such person in excess of 10.0% will be considered excess shares and will not be counted as shares entitled to vote or counted as voting shares in connection with any matters submitted to the stockholders for a vote. These factors make it more difficult and less attractive for stockholders to acquire a significant amount of our common stock, which may adversely affect our stock price.

**Item 1B. Unresolved Staff Comments**

Not applicable.

**Table of Contents****Item 2. Properties**

The following table sets forth the location of the Company's office facilities at June 30, 2008, and certain other information relating to these properties at that date.

| Location  | Year<br>Opened   | Owned/<br>Leased     | Date of Lease<br>Expiration | Net Book<br>Value<br>as of<br>June 30, 2008 |
|---|------------------|----------------------|-----------------------------|---|
| <b>Main Office:</b>   |                  |                      |                             |   |
| 92 Walnut Street<br>Lawrenceburg, Indiana 47025   | 2004             | Owned                |                             | \$ 1,407,000                                |
| <b>Full-Service Branches:</b>   |                  |                      |                             |   |
| 215 W. Eads Parkway<br>Lawrenceburg, Indiana 47025  | 1914             | Owned                |                             | 605,000                                     |
| 19710 Stateline Road<br>Lawrenceburg, Indiana 47025   | 2000             | Owned                |                             | 716,000                                     |
| 447 Bielby Road<br>Lawrenceburg, Indiana 47025  | 1999             | Leased               | 2/2011                      |   |
| 500 Green Blvd<br>Aurora, Indiana 47001   | 2006             | Owned                |                             | 1,142,000                                   |
| 7600 Frey Road<br>St. Leon, Indiana 47012   | 2006             | Owned                |                             | 1,280,000                                   |
| <b>Other Properties:</b>  |                  |                      |                             |   |
| (Future Site of Milan Branch Office)<br>Corner of State Route 350 & State Route 101<br>Milan, Indiana 47031 | Expected<br>2009 | Owned <sup>(1)</sup> |                             | 135,000                                     |

(1) Land only.

In the beginning of 2004, our Board of Directors made the strategic decision to expand into our select markets in Dearborn County, Indiana, and adjacent Ripley County, Indiana. In April 2004, we purchased land in Aurora and St. Leon, Indiana, and in May 2004 purchased land in Milan, Indiana (Ripley County), each for the purpose of opening a full-service branch office. We opened a limited-service branch office in a temporary facility across the street from the Aurora property in August 2005 and built a permanent full-service facility for the Aurora branch on the Aurora property which opened on September 25, 2006. In addition, we built a full-service branch office on the St. Leon, Indiana property, which opened in May 2007. We also expect to open a full-service branch office on the Milan, Indiana property in 2009.

**Item 3. Legal Proceedings**

Periodically, there have been various claims and lawsuits against us, such as claims to enforce liens and contracts, condemnation proceedings on properties in which we hold security interests, claims involving the making and servicing of real property loans and other issues incident to our

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business. We are not party to any pending legal proceedings that we believe would have a material adverse effect on our financial condition, results of operations or cash flows.

**Table of Contents****Item 4. Submission of Matters to a Vote of Security Holders**

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

**PART II****Item 5. Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

The Company's common stock, par value \$0.01 per share, is traded on the Nasdaq Global Market under the symbol UCBA. On September 10, 2008, there were 717 holders of record of the Company's common stock. The Company began paying quarterly dividends during the fourth quarter of fiscal year 2006. The Company's ability to pay dividends is dependent on dividends received from the Bank. See *Business Regulation and Supervision - Limitation on Capital Distributions* and Note 16 to the consolidated financial statements, included in Item 8 of this Annual Report on Form 10-K, for a discussion of the restrictions on the payment of cash dividends by the Company.

The following table sets forth the high and low sales prices for the common stock as reported on the Nasdaq Global Market and the cash dividends declared on the common stock.

| <b>Fiscal year 2008:</b> | <b>High</b> | <b>Low</b> | <b>Dividends Declared</b> |
|--------------------------|-------------|------------|---------------------------|
| First Quarter            | \$ 12.05    | \$ 11.33   | \$ 0.08                   |
| Second Quarter           | \$ 12.20    | \$ 10.92   | \$ 0.08                   |
| Third Quarter            | \$ 11.64    | \$ 9.39    | \$ 0.08                   |
| Fourth Quarter           | \$ 9.62     | \$ 6.62    | \$ 0.09                   |

  

| <b>Fiscal Year 2007:</b> | <b>High</b> | <b>Low</b> | <b>Dividends Declared</b> |
|--------------------------|-------------|------------|---------------------------|
| First Quarter            | \$ 10.78    | \$ 10.40   | \$ 0.07                   |
| Second Quarter           | \$ 11.98    | \$ 10.63   | \$ 0.07                   |
| Third Quarter            | \$ 13.70    | \$ 11.70   | \$ 0.07                   |
| Fourth Quarter           | \$ 12.64    | \$ 11.13   | \$ 0.08                   |

**Purchases of Equity Securities**

The following table presents information regarding the Company's stock repurchases during the three months ended June 30, 2008.

| <b>Period</b>                          | <b>(a)<br/>Total<br/>Number of<br/>Shares<br/>Purchased</b> | <b>(b)<br/>Average<br/>Price Paid<br/>per<br/>Share</b> | <b>(c)<br/>Total Number of<br/>Shares Purchased<br/>as Part of Publicly<br/>Announced Plans<br/>or Programs</b> | <b>(d)<br/>Maximum Number<br/>of Shares that May<br/>Yet Be Purchased<br/>Under the Plans or<br/>Programs</b> |
|--|---|---|---|---|
| Month #1: April<br>April 1 to April 30 | 6,228   | \$ 9.89   | 6,228   |   |
| Month #2: May<br>May 1 to May 31       |   |   |   |   |
| Month #3: June<br>June 1 to June 30    |   |   |   |   |
| <b>Total</b>                           | <b>6,228</b>  | <b>\$ 9.89</b>  | <b>6,228</b>  |   |

On February 14, 2008, the Board of Directors of the Company approved the repurchase of up to 171,728 shares of its outstanding common stock, or 5% of outstanding shares not held by United Community MHC. The program was completed on April 3, 2008.



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During December 2006, the Board of Directors of the Company authorized the funding of a trust that purchased 165,894 shares of the Company's outstanding common stock during the three months ended March 31, 2007 to be used to fund restricted stock awards granted under the 2006 Equity Incentive Plan. The repurchased stock has been recorded in shares purchased for stock plans at a cost of \$2,118,000 as of June 30, 2008.

**Item 6. Selected Financial Data**

|   | 2008                   | 2007       | At June 30,<br>2006 | 2005       | 2004       |
|---|------------------------|------------|---------------------|------------|------------|
|   | (Dollars in thousands) |            |                     |            |            |
| <b>Financial Condition Data:</b>              |                        |            |                     |            |            |
| Total assets                                  | \$ 382,726             | \$ 381,061 | \$ 354,707          | \$ 331,505 | \$ 257,145 |
| Cash and cash equivalents                     | 35,710                 | 43,025     | 15,010              | 76,263     | 6,681      |
| Securities held-to-maturity                   | 200                    | 223        | 245                 | 265        | 669        |
| Securities available-for-sale                 | 13,816                 | 17,231     | 42,083              | 9,937      | 16,025     |
| Mortgage-backed securities available-for-sale | 24,211                 | 26,701     | 34,263              | 28,199     | 40,082     |
| Loans receivable, net                         | 284,504                | 273,605    | 244,537             | 200,878    | 179,257    |
| Deposits                                      | 320,774                | 316,051    | 289,807             | 299,379    | 227,939    |
| Advances from Federal Home Loan Bank          | 4,833                  |            |                     |            |            |
| Stockholders' equity                          | 54,489                 | 62,461     | 62,485              | 29,736     | 27,584     |

|   | 2008   | 2007      | 2006      | 2005      | 2004      |
|---|--|-----------|-----------|-----------|-----------|
|   | For the Years Ended June 30,<br>(Dollars in thousands) |           |           |           |           |
| <b>Operating Data:</b>                              |  |           |           |           |           |
| Interest income                                     | \$ 21,615  | \$ 21,687 | \$ 17,878 | \$ 13,471 | \$ 12,488 |
| Interest expense                                    | 11,353   | 10,576    | 7,762     | 4,656     | 4,133     |
| Net interest income                                 | 10,262   | 11,111    | 10,116    | 8,815     | 8,355     |
| Provision for loan losses                           | 4,718  | 730       | 120       | 857       | 120       |
| Net interest income after provision for loan losses | 5,544  | 10,381    | 9,996     | 7,958     | 8,235     |
| Other income  | 2,197  | 2,848     | 1,189     | 1,708     | 1,372     |
| Other expense                                       | 9,850  | 9,250     | 9,572     | 6,979     | 6,252     |
| Income (loss) before income taxes                   | (2,109)  | 3,979     | 1,613     | 2,687     | 3,355     |
| Provision (benefit) for income taxes                | (653)  | 1,485     | 575       | 642       | 1,199     |
| Net income (loss)                                   | \$ (1,456)   | \$ 2,494  | \$ 1,038  | \$ 2,045  | \$ 2,156  |

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|   | At or for the Years Ended June 30, |        |        |        |        |
|---|------------------------------------|--------|--------|--------|--------|
|   | 2008                               | 2007   | 2006   | 2005   | 2004   |
| <b>Performance Ratios:</b>  |                                    |        |        |        |        |
| Return on average assets  | (0.38)%                            | 0.67%  | 0.31%  | 0.75%  | 0.82%  |
| Return on average equity  | (2.48)                             | 3.96   | 2.53   | 7.02   | 7.99   |
| Interest rate spread (1)  | 2.43                               | 2.68   | 2.94   | 3.33   | 3.23   |
| Net interest margin (2)   | 2.85                               | 3.15   | 3.15   | 3.44   | 3.35   |
| Noninterest expense to average assets                                   | 2.58                               | 2.48   | 2.82   | 2.55   | 2.39   |
| Efficiency ratio (3)  | 79.06                              | 66.27  | 84.67  | 68.06  | 64.27  |
| Average interest-earning assets to average interest-bearing liabilities | 112.97                             | 115.40 | 108.42 | 105.64 | 107.46 |
| Average equity to average assets  | 15.41                              | 16.92  | 12.07  | 10.64  | 10.31  |
| Dividend payout ratio (4)   | N/A                                | 41.46  | 38.09  | N/A    | N/A    |
| <b>Capital Ratios:</b>  |                                    |        |        |        |        |
| Tangible capital  | 13.00                              | 13.42  | 13.23  | 8.76   | 10.46  |
| Core capital  | 13.00                              | 13.42  | 13.23  | 8.76   | 10.46  |
| Total risk-based capital  | 20.51                              | 21.24  | 19.66  | 15.59  | 17.26  |
| <b>Asset Quality Ratios:</b>  |                                    |        |        |        |        |
| Nonperforming loans as a percent of total loans                         | 2.62                               | 1.14   | 0.33   | 0.72   | 0.61   |
| Allowance for loan losses as a percent of total loans                   | 1.59                               | 0.97   | 0.85   | 1.10   | 0.85   |
| Allowance for loan losses as a percent of nonperforming loans           | 61.98                              | 84.55  | 256.39 | 153.21 | 138.15 |
| Net charge-offs to average outstanding loans during the period          | 1.06                               | 0.06   | 0.12   | 0.07   | 0.03   |
| <b>Other Data:</b>  |                                    |        |        |        |        |
| Number of:  |                                    |        |        |        |        |
| Real estate loans outstanding   | 1,396                              | 1,456  | 2,146  | 2,288  | 2,198  |
| Deposit accounts  | 22,175                             | 21,655 | 19,380 | 18,362 | 18,205 |
| Offices   | 6                                  | 6      | 5      | 4      | 4      |

- (1) Represents the difference between the weighted average yield on average interest-earning assets and the weighted average cost on average interest-bearing liabilities.
- (2) Represents net interest income as a percent of average interest-earning assets.
- (3) Represents other expense divided by the sum of net interest income and other income.
- (4) Due to the timing of the Bank's reorganization into the mutual holding company structure and the completion of the Company's minority stock offering on March 30, 2006, the 2006 calculation is based solely on earnings subsequent to that date.



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**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

**Overview**

**Income.** Our primary source of pre-tax income is net interest income. Net interest income is the difference between interest income, which is the income that we earn on our loans and securities, and interest expense, which is the interest that we pay on our deposits and Federal Home Loan Bank borrowings. Other significant sources of pre-tax income are service charges on deposit accounts and other loan fees. In addition, in February 2003, we entered into a contract with a non-affiliated registered broker dealer, Lincoln Financial Advisors, that allows us to provide non-deposit investment products and services to our community. We also recognize income or losses from the sale of investments in years that we have such sales.

**Allowance for Loan Losses.** The allowance for loan losses is a valuation allowance for probable credit losses inherent in the loan portfolio. The allowance is established through the provision for loan losses, which is charged to income. Charge-offs, if any, are charged to the allowance. Subsequent recoveries, if any, are credited to the allowance. Management estimates the allowance balance required using past loan loss experience, the nature and value of the portfolio, information about specific borrower situations, and estimated collateral values, economic conditions, and other factors. Allocation of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged-off.

**Expenses.** The noninterest expenses we incur in operating our business consist of salaries and employee benefits expenses, occupancy and equipment expenses, advertising and public relations expenses and various other miscellaneous expenses.

Salaries and employee benefits consist primarily of salaries and wages paid to our employees, payroll taxes and expenses for health insurance and other employee benefits, and stock-based compensation.

Occupancy and equipment expenses, which are the fixed and variable costs of buildings and equipment, consist primarily of depreciation charges, furniture and equipment expenses, maintenance, real estate taxes and costs of utilities. Depreciation of premises and equipment is computed using the straight-line method based on the useful lives of the related assets, which range from three to 40 years.

Advertising and public relations expenses include expenses for print, radio and television advertisements, promotions, third-party marketing services and premium items.

Regulatory fees and deposit insurance premiums are primarily payments we make to the FDIC for insurance of our deposit accounts.

Other expenses include expenses for supplies, telephone and postage, data processing, contributions and donations, director and committee fees, professional fees, insurance and surety bond premiums and other fees and expenses.

As a result of our March 2006 public stock offering, our noninterest expenses have increased as a result of operating as a public company. These additional expenses are primarily legal and accounting fees. We expect expenses to increase in the future due to fees for auditor attestation and compliance with the internal control over financial reporting provisions of the Sarbanes-Oxley Act.

Noninterest expenses have also increased as a result of our strategy to expand our branch network. These additional expenses consist of salaries and employee benefits and occupancy and equipment expenses. Over time, we anticipate that we will generate sufficient income to offset the expenses related to our new facilities and new employees, but we cannot assure you that our branch expansion will increase our earnings or that it will increase our earnings within a reasonable period of time.

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### **Critical Accounting Policies**

We consider accounting policies involving significant judgments and assumptions by management that have, or could have, a material impact on the carrying value of certain assets or on income to be critical accounting policies. We consider the following to be our critical accounting policies: allowance for loan losses and deferred income taxes.

**Allowance for Loan Losses.** The allowance for loan losses is the amount estimated by management as necessary to cover probable credit losses in the loan portfolio at the statement of financial condition date. The allowance is established through the provision for loan losses, which is charged to income. Determining the amount of the allowance for loan losses necessarily involves a high degree of judgment. Among the material estimates required to establish the allowance are: loss exposure at default; the amount and timing of future cash flows on impacted loans; value of collateral; and determination of loss factors to be applied to the various elements of the portfolio. All of these estimates are susceptible to significant change. Management reviews the level of the allowance on a quarterly basis and establishes the provision for loan losses based upon an evaluation of the portfolio, past loss experience, current economic conditions and other factors related to the collectibility of the loan portfolio. Although we believe that we use the best information available to establish the allowance for loan losses, future adjustments to the allowance may be necessary if economic conditions differ substantially from the assumptions used in making the evaluation. In addition, the OTS, as an integral part of its examination process, periodically reviews our allowance for loan losses. Such agency may require us to recognize adjustments to the allowance based on its judgments about information available to it at the time of its examination. A large loss could deplete the allowance and require increased provisions to replenish the allowance, which would negatively affect earnings. For additional discussion, see notes 1 and 5 of the notes to the consolidated financial statements included in Item 8 of this Annual Report on Form 10-K.

**Deferred Income Taxes.** We use the asset and liability method of accounting for income taxes as prescribed in Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. If current available information raises doubt as to the realization of the deferred tax assets, a valuation allowance is established. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. We exercise significant judgment in evaluating the amount and timing of recognition of the resulting tax liabilities and assets. These judgments require us to make projections of future taxable income. The judgments and estimates we make in determining our deferred tax assets, which are inherently subjective, are reviewed on a continual basis as regulatory and business factors change. Any reduction in estimated future taxable income may require us to record a valuation allowance against our deferred tax assets. A valuation allowance would result in additional income tax expense in the period, which would negatively affect earnings.

### **Operating Strategy**

Our mission is to operate and grow a profitable, independent community-oriented financial institution serving primarily retail customers and small businesses in our market areas. We plan to continue our strategy of:

expanding our branch network and upgrading our existing branches;

pursuing opportunities to increase and diversify our loan portfolio in our expanding market areas;

increasing core deposits through the expansion of our branch network and new deposit products;

continuing to increase our sale of non-deposit investment products and services; and

applying disciplined underwriting practices to maintain the high quality of our loan portfolio.

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### ***Expanding our branch network and upgrading our existing branches***

Since our merger in 1999, we have opened four new branches, including our Aurora branch office which opened in September 2006 and our St. Leon branch office which opened in May 2007. In addition to these branches, we have acquired a branch site in Milan, Indiana for a cost of \$135,000. The total expected cost, including improvements, for the new Milan branch is approximately \$750,000 and the branch is expected to open in 2009.

The new branches have been and are expected to continue to be funded by cash generated by our business. Consequently, we do not expect to borrow funds for these expansion projects. We may continue to upgrade our current branch facilities and may pursue further expansion in Southeastern Indiana, Northern Kentucky or Southwest Ohio in future years through de novo branching, branch acquisitions and acquisitions of other financial institutions.

### ***Pursuing opportunities to increase and diversify our lending portfolio in our expanding market areas***

In recent years we have sought to diversify our loan portfolio beyond residential mortgage loans. In particular, since June 30, 2006, our multi-family and nonresidential real estate, land, consumer, commercial business and construction loan portfolio has increased \$26.0 million, or 19.9%, and at June 30, 2008 was 53.8% of our total loan portfolio. During this period, we have taken advantage of the significant growth in both residential and nonresidential real estate development in our market and have originated loans in other market areas. We expect to continue to expand all of our lending activities and, in particular, intend to continue to pursue the larger lending relationships associated with multi-family and nonresidential real estate. We expect that our loan portfolio, including our multi-family and nonresidential real estate, commercial business and construction loan portfolio, will continue to increase.

### ***Increasing core deposits through the expansion of our branch network and new deposit products***

Historically, retail deposits are our primary source of funds for investing and lending. However, in recent years, we have increased our reliance on municipal deposits significantly. These municipal deposits represent tax and other revenues from the local gaming industry. Currently, our core deposits, which include all deposit account types except certificates of deposit and municipal deposits. Core deposits are generally lower cost to us than certificate of deposit accounts, and they are generally less sensitive to withdrawal when interest rates fluctuate. At June 30, 2008, core deposits represented 26.2% of our total deposits. We believe that our expanding branch network and offering new deposit and savings products will contribute to increasing core deposits.

### ***Continuing to increase noninterest income***

Our profits rely heavily on the spread between the interest earned on loans and securities and interest paid on deposits and Federal Home Loan Bank borrowings. In order to decrease our reliance on interest rate spread income, we have pursued initiatives to increase noninterest income. Our primary recurring source of noninterest income has been services charges on deposit products and other services. In addition, we offer non-deposit investment products through a third party registered broker-dealer, Lincoln Financial Advisors. In connection with our expanding branch network, we intend to continue to increase our sale of non-deposit investment products and expect to increase service charge income.

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### ***Applying disciplined underwriting practices to maintain the high quality of our loan portfolio***

We believe that high asset quality is a key to long-term financial success. We have sought to grow and diversify the loan portfolio, while maintaining a high level of asset quality and moderate credit risk, using underwriting standards that we believe are conservative, and diligent monitoring and collection efforts. The downturn in the local and national economy during the year ended June 30, 2008 has had a negative impact on the ability of some of our borrowers to repay their loans. As a result of this, our nonperforming loans were \$7.5 million or 2.62% of our total loans at June 30, 2008, compared to \$3.2 million or 1.14% at June 30, 2007, and \$821,000 or 0.33% at June 30, 2006. Management does not believe that the recent increase in nonperforming loans is indicative of our current lending policies. Management is continuing to work with these borrowers to minimize the risk of loss to the Bank, and has continued to tighten lending standards in an effort to reduce nonperforming loans in the future.

### **Balance Sheet Analysis**

**Loans.** Our primary lending activity is the origination of loans secured by real estate. We originate one- to four-family residential loans, multi-family and nonresidential real estate loans and construction loans. To a lesser extent, we originate commercial and consumer loans. We do not offer subprime, Alt-A, low-doc, no-doc loans or loans with negative amortization and generally do not offer interest-only loans.

The largest segment of our loan portfolio is one- to four-family residential loans. At June 30, 2008, these loans totaled \$135.0 million, or 46.5% of total gross loans, compared to \$126.4 million, or 45.4% of total loans, at June 30, 2007 and \$117.1 million, or 47.2% of total loans, at June 30, 2006. As a percentage of the total loan portfolio, one- to four-family residential loans have increased at the same pace as our entire loan portfolio over the last two years.

Multi-family and nonresidential real estate and land loans totaled \$116.9 million and represented 40.4% of total loans at June 30, 2008, compared to \$113.8 million, or 41.0% of total loans, at June 30, 2007 and \$93.7 million, or 37.8% of total loans, at June 30, 2006. Our multi-family and nonresidential real estate loan portfolio growth has slowed in the current year with the overall slow down in the economy.

Construction loans totaled \$2.5 million, or 0.9% of total loans, at June 30, 2008, compared to \$9.5 million, or 3.4% of total loans, at June 30, 2007 and \$11.2 million, or 4.5% of total loans, at June 30, 2006. Between June 30, 2007 and June 30, 2008, the portfolio decreased by \$7.0 million primarily as a result of construction loans converting to permanent mortgage loans. Between June 30, 2006 and June 30, 2007, the portfolio decreased by \$1.7 million as a result of construction loans converting to permanent mortgage loans.

Commercial business loans totaled \$6.1 million, or 2.1% of total loans, at June 30, 2008, compared to \$5.9 million, or 2.1% of total loans, at June 30, 2007 and \$5.0 million, or 2.0% of total loans, at June 30, 2006.

Consumer loans totaled \$29.5 million, or 10.1% of total loans, at June 30, 2008, compared to \$22.6 million, or 8.1% of total loans, at June 30, 2007 and \$20.8 million, or 8.5% of total loans, at June 30, 2006. The growth in the consumer loan portfolio for the year ended June 30, 2008 is primarily attributable to an advertising campaign to promote such loans.

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The following table sets forth the composition of our loan portfolio at the dates indicated.

|  | 2008       |         | 2007       |         | At June 30,<br>2006 |         | 2005       |         | 2004       |         |
|--|------------|---------|------------|---------|---------------------|---------|------------|---------|------------|---------|
|  | Amount     | Percent | Amount     | Percent | Amount              | Percent | Amount     | Percent | Amount     | Percent |
| (Dollars in thousands)                     |            |         |            |         |                     |         |            |         |            |         |
| <b>Residential real estate:</b>            |            |         |            |         |                     |         |            |         |            |         |
| One- to four-family                        | \$ 134,965 | 46.5%   | \$ 126,398 | 45.4%   | \$ 117,060          | 47.2%   | \$ 109,325 | 53.2%   | \$ 107,589 | 58.9%   |
| Multi-family                               | 43,671     | 15.1    | 37,500     | 13.5    | 20,250              | 8.2     | 13,194     | 6.4     | 10,932     | 6.0     |
| Total residential real estate loans        | 178,636    | 61.6    | 163,898    | 58.9    | 137,310             | 55.4    | 122,519    | 59.6    | 118,521    | 64.9    |
| Construction                               | 2,493      | 0.9     | 9,507      | 3.4     | 11,228              | 4.5     | 5,899      | 2.9     | 1,186      | 0.6     |
| <b>Nonresidential real estate and land</b> |            |         |            |         |                     |         |            |         |            |         |
| Commercial business                        | 73,238     | 25.3    | 76,333     | 27.5    | 73,419              | 29.6    | 59,263     | 28.8    | 48,237     | 26.4    |
| Consumer:                                  | 6,062      | 2.1     | 5,937      | 2.1     | 5,005               | 2.0     | 4,996      | 2.4     | 2,074      | 1.1     |
| Home equity                                | 19,608     | 6.7     | 16,580     | 6.0     | 15,872              | 6.4     | 9,205      | 4.5     | 5,256      | 2.9     |
| Auto                                       | 1,960      | 0.7     | 2,049      | 0.7     | 2,587               | 1.1     | 2,161      | 1.1     | 2,837      | 1.6     |
| Share loans                                | 1,382      | 0.5     | 1,250      | 0.4     | 1,258               | 0.5     | 861        | 0.4     | 2,495      | 1.4     |
| Other                                      | 6,547      | 2.2     | 2,716      | 1.0     | 1,127               | 0.5     | 610        | 0.3     | 1,975      | 1.1     |
| Total consumer loans                       | 29,497     | 10.1    | 22,595     | 8.1     | 20,844              | 8.5     | 12,837     | 6.3     | 12,563     | 7.0     |
| Total loans                                | \$ 289,926 | 100.0%  | \$ 278,270 | 100.0%  | \$ 247,806          | 100.0%  | \$ 205,514 | 100.0%  | \$ 182,581 | 100.0%  |
| <b>Less (Plus):</b>                        |            |         |            |         |                     |         |            |         |            |         |
| Deferred loan fees (costs)                 | (381)      |         | (300)      |         | (279)               |         | (173)      |         | (113)      |         |
| Undisbursed portion of loans in process    | 1,184      |         | 2,294      |         | 1,443               |         | 2,543      |         | 1,887      |         |
| Allowance for loan losses                  | 4,619      |         | 2,671      |         | 2,105               |         | 2,266      |         | 1,550      |         |
| Loans, net                                 | \$ 284,504 |         | \$ 273,605 |         | \$ 244,537          |         | \$ 200,878 |         | \$ 179,257 |         |

**Table of Contents****Loan Maturity**

The following table sets forth certain information at June 30, 2008 regarding the dollar amount of loan principal repayments becoming due during the periods indicated. The table does not include any estimate of prepayments which significantly shorten the average life of all loans and may cause our actual repayment experience to differ from that shown below. Demand loans having no stated schedule of repayments and no stated maturity are reported as due in one year or less.

|                             | One- to<br>Four-<br>Family<br>Real Estate<br>Loans | Multi-<br>family<br>Real Estate<br>Loans | Construction<br>Loans | Non-<br>residential<br>Real Estate<br>and<br>Land<br>Loans | Consumer<br>and<br>Commercial<br>Business<br>Loans | Total<br>Loans |
|-----------------------------|--|--|-----------------------|--|--|----------------|
| (In thousands)              |  |  |                       |  |  |                |
| <b>At June 30, 2008</b>     |  |  |                       |  |  |                |
| Amounts due in:             |  |  |                       |  |  |                |
| One year or less            | \$ 40,560  | \$ 1,743                                 | \$ 2,493              | \$ 17,573  | \$ 18,774  | \$ 81,143      |
| More than one to five years | 39,742   | 32,121                                   |                       | 41,274   | 13,083   | 126,220        |
| More than five years        | 54,663   | 9,807                                    |                       | 14,391   | 3,702  | 82,563         |
| Total                       | \$ 134,965   | \$ 43,671                                | \$ 2,493              | \$ 73,238  | \$ 35,559  | \$ 289,926     |

The following table sets forth the dollar amount of all loans at June 30, 2008 that have either fixed interest rates or adjustable interest rates. The amounts shown below exclude unearned interest on consumer loans and deferred loan fees.

|                                     | Fixed Rates | Floating or<br>Adjustable Rates | Total      |
|-------------------------------------|-------------|---------------------------------|------------|
| (In thousands)                      |             |                                 |            |
| <b>At June 30, 2008</b>             |             |                                 |            |
| Residential real estate:            |             |                                 |            |
| One- to four-family                 | \$ 30,543   | \$ 104,422                      | \$ 134,965 |
| Multifamily                         | 5,415       | 38,256                          | 43,671     |
| Construction                        |             | 2,493                           | 2,493      |
| Nonresidential real estate and land | 9,931       | 63,307                          | 73,238     |
| Consumer and commercial business    | 6,210       | 29,349                          | 35,559     |
| Total                               | \$ 52,099   | \$ 237,827                      | \$ 289,926 |

**Table of Contents****Loans Originated**

The following table shows loan origination, participation, purchase and sale activity during the periods indicated.

|                                    | Year Ended June 30, |            |            |
|------------------------------------|---------------------|------------|------------|
|                                    | 2008                | 2007       | 2006       |
|                                    | (In thousands)      |            |            |
| Total loans at beginning of period | \$ 278,270          | \$ 247,806 | \$ 205,514 |
| Loans originated:                  |                     |            |            |
| Real estate mortgages              | 49,993              | 63,233     | 64,989     |
| Land                               | 2,377               | 3,123      | 5,289      |
| Construction                       | 15,706              | 885        | 10,310     |
| Commercial business                | 2,487               | 2,936      | 1,936      |
| Consumer                           | 4,701               | 9,672      | 7,873      |
| Total loans originated             | 75,264              | 79,849     | 90,397     |
| Loans purchased                    |                     | 4,000      | 400        |
| Deduct:                            |                     |            |            |
| Loan principal repayments          | 61,818              | 51,118     | 46,119     |
| Loan sales                         | 1,790               | 2,267      | 2,386      |
| Other repayments                   |                     |            |            |
| Net loan activity                  | 11,656              | 30,464     | 42,292     |
| Total loans at end of period       | \$ 289,926          | \$ 278,270 | \$ 247,806 |

**Securities.** Our securities portfolio consists primarily of callable U.S. government agency bonds, U.S. government agency mortgage-backed securities, and municipal bonds. In the year ended June 30, 2008, our securities totaled \$38.2 million, a decrease of \$6.0 million from \$44.2 at June 30, 2007, and a decrease of \$38.4 million from \$76.6 million at June 30, 2006. The decreases in 2008 and 2007 were primarily as a result of the redeployment of these funds into higher yielding loans. Our callable securities consist of U.S. government agency bonds which contain either a one-time call option or may be callable anytime during the life of the security.

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The following table sets forth the amortized cost and fair values of our securities portfolio at the dates indicated.

|   | 2008              |                  | At June 30,<br>2007 |                  | 2006              |                  |
|---|-------------------|------------------|---------------------|------------------|-------------------|------------------|
|   | Amortized<br>Cost | Fair<br>Value    | Amortized<br>Cost   | Fair<br>Value    | Amortized<br>Cost | Fair<br>Value    |
| (In thousands)                          |                   |                  |                     |                  |                   |                  |
| <b>Securities available-for-sale:</b>   |                   |                  |                     |                  |                   |                  |
| U.S. League intermediate term portfolio | \$ 1,785          | \$ 1,718         | \$ 2,069            | \$ 2,013         | \$ 1,970          | \$ 1,918         |
| Callable agency bonds                   | 8,943             | 8,864            | 13,843              | 13,610           | 38,127            | 37,640           |
| Freddie Mac common stock                | 9                 | 155              | 9                   | 574              | 27                | 1,587            |
| Municipal bonds                         | 3,040             | 2,929            | 960                 | 953              | 960               | 938              |
| Other equity securities                 | 211               | 150              | 78                  | 81               |                   |                  |
| Mortgage-backed securities              | 24,683            | 24,211           | 27,642              | 26,701           | 35,736            | 34,263           |
| <b>Total</b>                            | <b>\$ 38,671</b>  | <b>\$ 38,027</b> | <b>\$ 44,601</b>    | <b>\$ 43,932</b> | <b>\$ 76,820</b>  | <b>\$ 76,346</b> |
| <b>Securities held-to-maturity:</b>     |                   |                  |                     |                  |                   |                  |
| Municipal bonds                         | \$ 200            | \$ 200           | \$ 223              | \$ 223           | \$ 245            | \$ 245           |

At June 30, 2008, we had no investments in a single company or entity (other than U.S. Government-sponsored entity securities) that had an aggregate book value in excess of 10% of our stockholders' equity at June 30, 2008. At June 30, 2008, we did not hold any stock in Fannie Mae. In July, 2008, we sold all remaining stock in Freddie Mac for a gain of \$91,000.



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The following table sets forth the stated maturities and weighted average yields of investment securities at June 30, 2008. Weighted average yields on tax-exempt securities are not presented on a tax equivalent basis as the amount would be immaterial. Certain mortgage-backed securities have adjustable interest rates and will reprice annually within the various maturity ranges. These repricing schedules are not reflected in the table below.

|   | One Year<br>or Less<br>Weighted |                  | More than<br>One Year to<br>Five Years<br>Weighted |                  | More than<br>Five Years to<br>Ten Years<br>Weighted |                  | More than<br>Ten Years<br>Weighted |                  | Total<br>Weighted |                  |
|---|---------------------------------|------------------|--|------------------|---|------------------|------------------------------------|------------------|-------------------|------------------|
|   | Carrying<br>Value               | Average<br>Yield | Carrying<br>Value                                  | Average<br>Yield | Carrying<br>Value                                   | Average<br>Yield | Carrying<br>Value                  | Average<br>Yield | Carrying<br>Value | Average<br>Yield |
|   | (Dollars in thousands)          |                  |  |                  |   |                  |                                    |                  |                   |                  |
| Securities available-for-sale:          |                                 |                  |  |                  |   |                  |                                    |                  |                   |                  |
| U.S. League intermediate term portfolio | \$ 1,718                        | 4.21%            | \$   | %                | %   | \$               |                                    | %                | \$ 1,718          | 0.04 %           |
| Callable agency bonds                   |                                 |                  | 7,557  | 3.52             | 1,307   | 4.50             |                                    |                  | 8,864             | 3.66             |
| Freddie Mac common stock                | 155                             | 6.71             |  |                  |   |                  |                                    |                  | 155               | 6.71             |
| Municipal bonds                         | 394                             | 4.44             |  |                  | 262   | 3.20             | 2,273                              | 3.54             | 2,929             | 3.63             |
| Other equity securities                 | 150                             | 5.80             |  |                  |   |                  |                                    |                  | 150               | 5.80             |
| Mortgage-backed securities              |                                 |                  | 465  | 5.02             | 11,725  | 4.62             | 12,021                             | 4.34             | 24,211            | 4.49             |
| Total                                   | \$ 2,417                        |                  | \$ 8,022   |                  | \$ 13,294   |                  | \$ 14,294                          |                  | \$ 38,027         |                  |
| Securities held-to-maturity:            |                                 |                  |  |                  |   |                  |                                    |                  |                   |                  |
| Municipal bonds                         | \$                              |                  | %  | \$               | %   | \$ 200           | 5.62%                              | \$               | %                 | \$ 200 5.62 %    |

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**Deposits.** Our primary source of funds is our deposit accounts, which are comprised of noninterest-bearing accounts, interest-bearing NOW accounts, money market accounts, passbook accounts and certificates of deposit. These deposits are provided primarily by individuals within our market areas. During the year ended June 30, 2008, our deposits increased \$4.7 million or 1.5%, primarily as a result of increases in certificates of deposit. During fiscal 2008, our municipal deposits decreased primarily as a result of a decrease in the revenue earned by local casinos during that time. During the year ended June 30, 2007, our deposits increased by \$26.2 million, or 9.1%, primarily as a result of increases in certificates of deposit. During fiscal 2007, our municipal deposits decreased as a result of withdrawals to fund various municipal needs.

The following table sets forth the balances of our deposit products at the dates indicated.

|                               | 2008                               | At June 30,<br>2007<br>(In thousands) | 2006                               |
|-------------------------------|------------------------------------|---------------------------------------|------------------------------------|
| NOW accounts                  | \$ 64,206                          | \$ 63,540                             | \$ 74,749                          |
| Passbook accounts             | 41,787                             | 42,166                                | 49,549                             |
| Money market deposit accounts | 68,621                             | 67,856                                | 59,846                             |
| Certificates of deposit       | 146,160                            | 142,489                               | 105,663                            |
| <b>Total</b>                  | <b>\$ 320,774<sup>(1)(4)</sup></b> | <b>\$ 316,051<sup>(2)(4)</sup></b>    | <b>\$ 289,807<sup>(3)(4)</sup></b> |

- (1) Includes \$127.5 million in municipal deposits.
- (2) Includes \$138.0 million in municipal deposits.
- (3) Includes \$138.7 million in municipal deposits.
- (4) No investments are pledged to secure the municipal deposits. The municipal deposits are insured by the Public Deposit Insurance Fund administered by the Indiana Board for Depositories.

The following table indicates the amount of jumbo certificates of deposit by time remaining until maturity as of June 30, 2008. Jumbo certificates of deposit require minimum deposits of \$100,000. We did not have any brokered deposits as of June 30, 2008.

| Maturity Period                | Certificates<br>of Deposit<br>(In thousands) |
|--------------------------------|--|
| <b>At June 30, 2008</b>        |  |
| Three months or less           | \$ 12,240                                    |
| Over three through six months  | 16,393                                       |
| Over six through twelve months | 16,288                                       |
| Over twelve months             | 30,919                                       |
| <b>Total</b>                   | <b>\$ 75,840</b>                             |

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The following table sets forth the time deposits classified by rates at the dates indicated.

|       |       | At June 30,    |            |            |
|-------|-------|----------------|------------|------------|
|       |       | 2008           | 2007       | 2006       |
|       |       | (In thousands) |            |            |
| 0.00  | 1.00% | \$ 2,379       | \$ 67      | \$ 41      |
| 1.01  | 2.00% | 362            | 437        | 978        |
| 2.01  | 3.00% | 18,193         | 1,688      | 19,905     |
| 3.01  | 4.00% | 27,195         | 7,825      | 23,729     |
| 4.01  | 5.00% | 58,694         | 37,451     | 48,002     |
| 5.01  | 6.00% | 39,198         | 94,882     | 12,822     |
| 6.01  | 7.00% | 139            | 139        | 186        |
| Total |       | \$ 146,160     | \$ 142,489 | \$ 105,663 |

The following table sets forth the amount and maturities of time deposits classified by rates at June 30, 2008.

|       |       | Amount Due               |                                       |   |  |                            | Total      | Percent of<br>Total<br>Certificate<br>of Deposit<br>Accounts |
|-------|-------|--------------------------|---------------------------------------|---|--|----------------------------|------------|--|
|       |       | Less Than<br>One<br>Year | More Than<br>One Year to<br>Two Years | More Than<br>Two Years to<br>Three<br>Years | More Than<br>Three Years<br>to Four<br>Years | More Than<br>Four<br>Years |            |  |
|       |       | (Dollars in thousands)   |                                       |   |  |                            |            |  |
| 0.00  | 1.00% | \$                       | \$                                    | \$ 2,302                                    | \$ 67  | \$ 10                      | \$ 2,379   | 1.6%   |
| 1.01  | 2.00% | 362                      |                                       |   |  |                            | 362        | 0.3%   |
| 2.01  | 3.00% | 11,241                   | 6,738                                 | 121   | 2  | 91                         | 18,193     | 12.4%  |
| 3.01  | 4.00% | 13,043                   | 11,533                                | 2,554                                       | 11   | 54                         | 27,195     | 18.6%  |
| 4.01  | 5.00% | 41,878                   | 14,092                                | 2,467                                       | 91   | 166                        | 58,694     | 40.2%  |
| 5.01  | 6.00% | 26,531                   | 7,552                                 | 4,954                                       | 137  | 24                         | 39,198     | 26.8%  |
| 6.01  | 7.00% | 6                        |                                       | 133   |  |                            | 139        | 0.1%   |
| Total |       | \$ 93,061                | \$ 39,915                             | \$ 12,531                                   | \$ 308                                       | \$ 345                     | \$ 146,160 | 100.0%   |

The following table sets forth deposit activity for the periods indicated.

|  | Year Ended June 30, |            |            |
|--|---------------------|------------|------------|
|  | 2008                | 2007       | 2006       |
|  | (In thousands)      |            |            |
| Beginning balance                            | \$ 316,051          | \$ 289,807 | \$ 299,379 |
| Increase (decrease) before interest credited | (6,593)             | 15,765     | (17,293)   |
| Interest credited                            | 11,316              | 10,479     | 7,721      |
| Net increase (decrease) in deposits          | 4,723               | 26,244     | (9,572)    |
| Ending balance                               | \$ 320,774          | \$ 316,051 | \$ 289,807 |

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**Borrowings.** We utilize borrowings from the Federal Home Loan Bank of Indianapolis to supplement our supply of funds for loans and investments.

|  | Year Ended June 30,    |          |      |
|--|------------------------|----------|------|
|  | 2008                   | 2007     | 2006 |
|  | (Dollars in thousands) |          |      |
| Maximum amount of advances outstanding at any month end during the period: |                        |          |      |
| FHLB advances  | \$ 5,000               | \$ 9,100 | \$   |
| Average advances outstanding during the period:                            |                        |          |      |
| FHLB advances  | \$ 922                 | \$ 2,050 | \$   |
| Weighted average interest rate during the period:                          |                        |          |      |
| FHLB advances  | 4.01%                  | 4.73%    | (a)  |
| Balance outstanding at end of period:                                      |                        |          |      |
| FHLB advances  | \$ 4,833               | \$       | \$   |
| Weighted average interest rate at end of period:                           |                        |          |      |
| FHLB advances  | 3.20%                  | N/A      | (a)  |

(a) FHLB advances were paid off by the end of each month during the year ended June 30, 2006.

**Results of Operations for the Years Ended June 30, 2008, 2007 and 2006**

**Overview.**

|                                  | 2008                   | 2007     | 2006     | %         | %         |
|----------------------------------|------------------------|----------|----------|-----------|-----------|
|                                  | (Dollars in thousands) |          |          | Change    | Change    |
|                                  |                        |          |          | 2008/2007 | 2007/2006 |
| Net income (loss)                | \$ (1,456)             | \$ 2,494 | \$ 1,038 | (158.4)%  | 140.3%    |
| Return (loss) on average assets  | (0.38)%                | 0.67%    | 0.31%    | (156.7)   | 116.1     |
| Return (loss) on average equity  | (2.48)%                | 3.96%    | 2.53%    | (162.6)   | 56.5      |
| Average equity to average assets | 15.41%                 | 16.92%   | 12.07%   | (8.9)     | 40.2      |

**2008 v. 2007.** Net income decreased \$4.0 million, or 158.4%, for the year ended June 30, 2008 compared to the year ended June 30, 2007. The decrease was the result of an \$849,000 reduction in net interest income, a \$4.0 million increase in the provision for loan loss, a \$651,000 decrease in other income, and a \$600,000 increase in other expense, partially offset by a \$2.1 million decrease in income tax expense.

**2007 v. 2006.** Net income increased \$1.5 million, or 140.3%, for the year ended June 30, 2007 compared to the year ended June 30, 2006. The increase was the result of a \$1.0 million increase in net interest income, a \$1.7 million increase in non-interest income and a \$322,000 reduction in non-interest expenses, partially offset by a \$610,000 increase in provision for loan losses and a \$910,000 increase in income tax expense.

**Net Interest Income.**

**2008 v. 2007.** Net interest income decreased by \$849,000, or 7.6%, to \$10.3 million in the year ended June 30, 2008 as a result of an increase in total interest expense of \$777,000 and a decrease in total interest income of \$72,000.

Total interest income decreased \$72,000, or 0.3%, to \$21.6 million for the year ended June 30, 2008 as compared to the year ended June 30, 2007. Interest income on investment and mortgage-backed securities decreased \$802,000 to \$1.9 million, primarily due to the impact of a decrease in average balance from \$56.2 million to \$38.8 million, partially offset by an increase in average yield from 4.74% to 4.80%. The decrease in average



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balance on investment securities is primarily due to the sale of securities and the redeployment of the proceeds from the sales into commercial real estate loans. Interest income on other interest-earning assets decreased \$330,000 to \$1.1 million, primarily due to a decrease in average yield from 4.09% to 3.08%, partially offset by an increase in average balance from \$34.7 million to \$35.4 million. Interest income on loans increased by \$1.1 million primarily due to an increase in average balance from \$262.0 million to \$286.5 million partially offset by a decrease in average yield from 6.72% to 6.51%. Other interest-earning assets are primarily comprised of cash and interest-bearing deposits in other financial institutions with original maturities of less than ninety days.

Total interest expense increased \$777,000, or 7.3%, in the year ended June 30, 2008. Interest expense on interest-bearing deposits increased by \$837,000, primarily due to the combined effect of an increase in average balance from \$303.8 million to \$318.4 million and an increase in average rate paid from 3.45% to 3.55%. Interest expense on borrowed funds decreased \$60,000 due to a decrease in average borrowings during the year from \$2.1 million to \$922,000.

The changes in the average yields on loans and investments and in the average rates paid on interest-bearing deposits and borrowed funds are primarily the result of changes in market interest rates.

**2007 v. 2006.** Net interest income increased by \$1.0 million, or 9.8%, to \$11.1 million in the year ended June 30, 2007 as a result of an increase in total interest income of \$3.8 million, partially offset by an increase in total interest expense of \$2.8 million.

Total interest income increased by \$3.8 million, or 21.3%, to \$21.7 million for the year ended June 30, 2007 as compared to the year ended June 30, 2006, due to a \$3.6 million, or 25.7%, increase in interest income on loans and a \$455,000, or 47.2%, increase in interest income on other interest-earning assets, partially offset by a \$241,000, or 8.3%, decrease in interest on investment and mortgage-backed securities. The increase in interest income on loans between the periods is due to the combined effect of an increase in average balance from \$219.9 million to \$262.0 million and an increase in average yield from 6.37% to 6.72%. The increase in interest income on other interest-earnings assets is due to the impact of an increase in average balance from \$23.1 million to \$34.7 million, partially offset by a decrease in average yield from 4.17% to 4.09%. Other interest-earning assets are primarily comprised of cash and interest-bearing deposits in other financial institutions with original maturities of less than ninety days. The decrease in interest income on investment and mortgage-backed securities is due to a decrease in average balance from \$78.4 million to \$56.2 million, partially offset by an increase in average yield from 3.71% to 4.74%. The decrease in average balance on investment and mortgage-backed securities is primarily due to the sale of Freddie Mac securities and the redeployment of the proceeds from the sale into primarily commercial real estate loans. The increases in average yields on loans and investments are primarily due to an increase in market interest rates.

Total interest expense increased \$2.8 million, or 36.3%, in the year ended June 30, 2007. Interest expense on interest-bearing deposits increased by \$2.8 million, or 35.7%, primarily due to the effect of an increase in average balance from \$296.5 million to \$303.8 million and an increase in average rate paid from 2.60% to 3.45%. Interest expense on borrowed funds increased \$56,000 due to a slight increase in borrowings during the year to fund loan growth. The increases in average rates paid on interest-bearing deposits and borrowed funds are primarily the result of an increase in market interest rates.

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**Average Balances and Yields.** The following table presents information regarding average balances of assets and liabilities, the total dollar amounts of interest income and dividends from average interest-earning assets, the total dollar amounts of interest expense on average interest-bearing liabilities, and the resulting annualized average yields and costs. The yields and costs for the periods indicated are derived by dividing income or expense by the average balances of assets or liabilities, respectively, for the periods presented. For purposes of this table, average balances have been calculated using month-end balances, and nonaccrual loans are included in average balances only. Management does not believe that the use of month-end balances instead of daily average balances has caused any material differences in the information presented. Loan fees are included in interest income on loans and are insignificant. Yields are not presented on a tax-equivalent basis. Any adjustments necessary to present yields on a tax-equivalent basis are insignificant.

|   | 2008               |                              |                | Year Ended June 30,<br>2007 |                              |                | 2006               |                              |                |
|---|--------------------|------------------------------|----------------|-----------------------------|------------------------------|----------------|--------------------|------------------------------|----------------|
|   | Average<br>Balance | Interest<br>and<br>Dividends | Yield/<br>Cost | Average<br>Balance          | Interest<br>and<br>Dividends | Yield/<br>Cost | Average<br>Balance | Interest<br>and<br>Dividends | Yield/<br>Cost |
| <b>Assets:</b>  |                    |                              |                |                             |                              |                |                    |                              |                |
| Interest-earning assets:  |                    |                              |                |                             |                              |                |                    |                              |                |
| Loans   | \$ 286,520         | \$ 18,663                    | 6.51%          | \$ 262,035                  | \$ 17,603                    | 6.72%          | \$ 219,925         | \$ 14,008                    | 6.37%          |
| Investment securities   | 38,803             | 1,862                        | 4.80           | 56,164                      | 2,664                        | 4.74           | 78,407             | 2,905                        | 3.71           |
| Other interest-earning assets   | 35,376             | 1,090                        | 3.08           | 34,724                      | 1,420                        | 4.09           | 23,142             | 965                          | 4.17           |
| Total interest-earning assets   | 360,699            | 21,615                       | 5.99           | 352,923                     | 21,687                       | 6.14           | 321,474            | 17,878                       | 5.56           |
| Noninterest-earning assets  | 20,544             |                              |                | 19,376                      |                              |                | 18,174             |                              |                |
| Total assets  | \$ 381,243         |                              |                | \$ 372,299                  |                              |                | \$ 339,648         |                              |                |
| <b>Liabilities and equity:</b>  |                    |                              |                |                             |                              |                |                    |                              |                |
| Interest-bearing liabilities:   |                    |                              |                |                             |                              |                |                    |                              |                |
| NOW and money market deposit accounts                                   |                    |                              |                |                             |                              |                |                    |                              |                |
|   | \$ 135,766         | 3,731                        | 2.75           | \$ 133,609                  | 3,834                        | 2.87           | \$ 147,452         | 3,601                        | 2.44           |
| Passbook accounts   | 37,101             | 570                          | 1.54           | 43,889                      | 782                          | 1.78           | 44,986             | 711                          | 1.58           |
| Certificates of deposit   | 145,486            | 7,015                        | 4.82           | 126,285                     | 5,863                        | 4.64           | 104,062            | 3,409                        | 3.28           |
| Total interest-bearing deposits   | 318,353            | 11,316                       | 3.55           | 303,783                     | 10,479                       | 3.45           | 296,500            | 7,721                        | 2.60           |
| FHLB advances   | 922                | 37                           | 4.01           | 2,050                       | 97                           | 4.73           |                    | 41                           | (a)            |
| Total interest-bearing liabilities                                      | 319,275            | 11,353                       | 3.56           | 305,833                     | 10,576                       | 3.46           | 296,500            | 7,762                        | 2.62           |
| Noninterest-bearing liabilities   | 3,200              |                              |                | 3,491                       |                              |                | 2,148              |                              |                |
| Total liabilities   | 322,475            |                              |                | 309,324                     |                              |                | 298,648            |                              |                |
| Total stockholders equity   | \$ 58,768          |                              |                | \$ 62,975                   |                              |                | \$ 41,000          |                              |                |
| Total liabilities and stockholders equity                               | \$ 381,243         |                              |                | \$ 372,299                  |                              |                | \$ 339,648         |                              |                |
| Net interest income   |                    | \$ 10,262                    |                |                             | \$ 11,111                    |                |                    | \$ 10,116                    |                |
| Interest rate spread  |                    |                              | 2.43%          |                             |                              | 2.68%          |                    |                              | 2.94%          |
| Net interest margin   |                    |                              | 2.85%          |                             |                              | 3.15%          |                    |                              | 3.15%          |
| Average interest-earning assets to average interest-bearing liabilities |                    |                              | 112.97%        |                             |                              | 115.40%        |                    |                              | 108.42%        |

- (a) FHLB advances were paid off by the end of each month during the year ended June 30, 2006.



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**Rate/Volume Analysis.** The following table sets forth the effects of changing rates and volumes on our net interest income. The rate column shows the effects attributable to changes in rate (changes in rate multiplied by prior volume). The volume column shows the effects attributable to changes in volume (changes in volume multiplied by prior rate). The net column represents the sum of the prior columns. For purposes of this table, changes attributable to changes in both rate and volume that cannot be segregated have been allocated proportionally based on the changes due to rate and the changes due to volume.

|   | Year Ended<br>June 30,<br>2008 Compared to 2007 |                   |                 | Year Ended<br>June 30,<br>2007 Compared to 2006 |                   |               |
|---|---|-------------------|-----------------|---|-------------------|---------------|
|   | Increase (Decrease)<br>Due to                   |                   |                 | Increase (Decrease)<br>Due to                   |                   |               |
|   | Volume<br>(In thousands)                        | Rate              | Net             | Volume<br>(In thousands)                        | Rate              | Net           |
| <b>Interest and dividend income:</b>      |   |                   |                 |   |                   |               |
| Loans                                     | \$ 1,645  | \$ (585)          | \$ 1,060        | \$ 2,682  | \$ 913            | \$ 3,595      |
| Investment securities                     | (823)   | 21                | (802)           | (824)   | 583               | (241)         |
| Other interest-earning assets             | 27  | (357)             | (330)           | 483   | (28)              | 455           |
| <b>Total interest-earning assets</b>      | <b>848</b>                                      | <b>(920)</b>      | <b>72</b>       | <b>2,341</b>                                    | <b>1,468</b>      | <b>3,809</b>  |
| <b>Interest expense:</b>                  |   |                   |                 |   |                   |               |
| Deposits                                  | 503   | 334               | 837             | 190   | 2,568             | 2,758         |
| FHLB advances                             | (38)  | (22)              | (60)            | 54  | 2                 | 56            |
| <b>Total interest-bearing liabilities</b> | <b>465</b>                                      | <b>312</b>        | <b>777</b>      | <b>244</b>                                      | <b>2,570</b>      | <b>2,814</b>  |
| <b>Net change in net interest income</b>  | <b>\$ 383</b>                                   | <b>\$ (1,232)</b> | <b>\$ (849)</b> | <b>\$ 2,097</b>                                 | <b>\$ (1,102)</b> | <b>\$ 995</b> |

**Provision for Loan Losses.**

**2008 v. 2007.** The provision for loan losses was \$4.7 million for the year ended June 30, 2008 compared to \$730,000 for the year ended June 30, 2007. The increase is primarily due to the increase in nonperforming loans from \$3.2 million to \$7.5 million during the year ended June 30, 2008. The majority of nonperforming loans at June 30, 2008 are comprised of seven commercial loans, involving four loan relationships, totaling \$6.5 million. The nonperforming loans include: 1) a \$1.4 million loan secured by an apartment complex, one-fourth of the tenants of which have lost their subsidized housing grant. At June 30, 2008, the borrower was attempting to improve occupancy and/or sell the property securing the loan; 2) a \$1.6 million loan secured by a mobile home park that has experienced management issues that have, in turn, resulted in decreased occupancy and cash flows. The borrower has hired a management company to attempt to correct these deficiencies; 3) two loans, totaling \$2.0 million, secured by office/warehouses, that have experienced declines in occupancy rates due to increased competition and unfavorable market conditions; 4) three loans, totaling \$1.5 million, secured by real estate, inventory, and other business assets of a landscape nursery, which experienced unfavorable weather and economic conditions. The Bank has entered into a forbearance agreement with the borrower pursuant to which that property has been transferred to a trustee. This property reverted to the Bank on July 31, 2008.

**2007 v. 2006.** The provision for loan losses was \$730,000 in 2007 compared to \$120,000 in 2006. The provision for loan losses increased in 2007 compared to 2006 primarily as a result of an increase in classified assets and the increase in the size of the loan portfolio, as well as an increase of \$2.3 million in nonperforming loans during the year ended June 30, 2007 as compared to the year ended June 30, 2006. The increase in nonperforming loans is primarily the result of three commercial real estate loans totaling \$2.2 million.

An analysis of the changes in the allowance for loan losses is presented under *Risk Management Analysis and Determination of the Allowance for Loan Losses*.

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**Other Income.** The following table shows the components of other income for the years ended June 30, 2008, 2007 and 2006.

|                                       | 2008            | 2007            | 2006            | % Change<br>2008/2007 | % Change<br>2007/2006 |
|---------------------------------------|-----------------|-----------------|-----------------|-----------------------|-----------------------|
| (Dollars in thousands)                |                 |                 |                 |                       |                       |
| Service charges                       | \$ 1,374        | \$ 993          | \$ 915          | 38.4%                 | 8.5%                  |
| Gain on sale loans                    | 25              | 38              | 40              | (34.2)                | (5.0)                 |
| Gain (loss) on sale of investments    | (35)            | 1,221           | (286)           | (102.9)               | 526.9                 |
| Gain on sale of land                  | 275             |                 |                 | 100.0                 |                       |
| Income from Bank Owned Life Insurance | 208             | 225             | 225             | (7.6)                 |                       |
| Other                                 | 350             | 371             | 295             | (5.7)                 | 25.8                  |
| <b>Total</b>                          | <b>\$ 2,197</b> | <b>\$ 2,848</b> | <b>\$ 1,189</b> | <b>(22.9)</b>         | <b>139.5</b>          |

Noninterest income was \$2.2 million for the year ended June 30, 2008, compared to \$2.8 million for 2007. The decrease is primarily due to a \$1.3 million decrease in gain on sale of investments, partially offset by a \$381,000 increase in service charges and a \$275,000 gain on sale of land that did not occur in the prior year. Service charges increased primarily due to increases on fees for deposit accounts. The 2007 gain on sale of investments is primarily related to the sale of securities issued by Freddie Mac. As of June 30, 2008, the Company did not hold any stock in Fannie Mae. In July, 2008 the Company sold all remaining shares of Freddie Mac stock held for a gain of \$91,000.

**Other Expense.** The following table shows the components of other expense and the percentage changes for the years ended June 30, 2008, 2007 and 2006.

|  | 2008            | 2007            | 2006            | % Change<br>2008/2007 | % Change<br>2007/2006 |
|--|-----------------|-----------------|-----------------|-----------------------|-----------------------|
| (Dollars in thousands)                                 |                 |                 |                 |                       |                       |
| Compensation and employee benefits                     | \$ 5,703        | \$ 5,538        | \$ 4,461        | 3.0%                  | 24.1%                 |
| Premises and occupancy expense                         | 952             | 1,121           | 1,010           | (15.1)                | 11.0                  |
| Deposit insurance premium                              | 71              | 35              | 36              | 102.9                 | (2.8)                 |
| Advertising expense                                    | 300             | 294             | 311             | 2.0                   | (5.5)                 |
| Data processing expense                                | 251             | 293             | 289             | (14.3)                | 1.4                   |
| ATM service fees                                       | 356             | 306             | 319             | 16.3                  | (4.1)                 |
| Loss on other than temporary impairment of investments | 101             |                 |                 | 100.0                 |                       |
| Provision for loss on sale of other real estate owned  | 125             |                 |                 | 100.0                 |                       |
| Charitable contributions                               |                 |                 | 1,878           |                       | 100.0                 |
| Other operating expenses                               | 1,991           | 1,663           | 1,268           | 19.7                  | 31.2                  |
| <b>Total</b>   | <b>\$ 9,850</b> | <b>\$ 9,250</b> | <b>\$ 9,572</b> | <b>6.5%</b>           | <b>(3.4)%</b>         |

**2008 v. 2007.** Noninterest expense was \$9.9 million for the year ended June 30, 2008 compared to \$9.3 million for the year ended June 30, 2007. The increase in noninterest expense was primarily the result of an increase of \$101,000 in other than temporary impairment on investments, an increase of \$125,000 in provision for loss on sale of other real estate owned, an increase of \$328,000 in other operating expenses, an increase of \$165,000 in compensation and employee benefits, partially offset by a decrease of \$169,000 in premises and occupancy expense. The increase in other than temporary impairment on investment relates to an investment security with a book value of \$1.3 million and an unrealized loss of \$32,000 at June 30, 2008. The security is a mutual fund that invests primarily in private label and government mortgage backed securities. The deterioration of credit markets has negatively impacted the market value of this fund causing the issuer to enforce a redemption in kind provision. Management has decided to exit this investment within the parameters of the redemption in kind provision to reduce the risk of further loss to the Bank. The increase in compensation and benefit expense is primarily due to an

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increase in stock-based compensation expense of \$270,000 during the year ended June 30, 2008. The increase in the provision for loss on sale of other real estate owned is due to the receipt of recent appraised values of the property held. The increase in other expenses is primarily due to additional expenses associated with being a public company, including compliance with the Sarbanes-Oxley Act of 2002. Other operating expenses are primarily comprised of miscellaneous loan expense, professional fees, bank fees and office expenses. The increase in other operating expenses is primarily due to this being the first full year with operations at our St. Leon branch.

**2007 v. 2006.** For the year ended June 30, 2007, other expenses decreased \$322,000, or 3.4%, from the year ended June 30, 2006. The decrease was primarily the result of a \$1.9 million decrease in charitable contributions, partially offset by a \$1.1 million increase in compensation and benefits expense, and a \$384,000 increase in other operating expenses. The reduction in charitable contributions is due to the absence of the 2006 funding of the United Community Charitable Foundation of \$1.9 million. The increase in compensation and benefit expense is due to the addition of stock-based compensation expenses of \$596,000 during the year ended June 30, 2007 as well as an increase in the number of employees to staff the new Aurora and St. Leon branches. The increase in other expenses is primarily due to a full year of additional expenses associated with being a public company. Other operating expenses are primarily comprised of miscellaneous loan expense, professional fees, bank fees and office expenses.

### **Income Taxes.**

**2008 v. 2007.** Income tax expense decreased \$2.1 million to a benefit of \$653,000 for the year ended June 30, 2008, compared to expense of \$1.5 million for 2007. The decrease in expense is primarily due to a \$6.1 million decrease in pre-tax earnings, partially offset by a \$160,000 valuation allowance for a deferred tax asset for charitable contribution credits that will expire in 2011. The effective tax rate for 2008 is 31.0% compared to 37.3% in 2007. The decrease in the effective rate is primarily attributable to the increase in the valuation allowance during 2008.

**2007 v. 2006.** Income tax expense increased \$910,000 to \$1.5 million for the year ended June 30, 2007, compared to \$575,000 for 2006. The effective tax rate increased to 37.3% in 2007 from 35.6% in 2006. The increase in expense is primarily due to a \$2.4 million increase in pre-tax earnings as well as an increase in the effective tax rate resulting primarily from nondeductible charges related to compensation expense recognized for incentive stock option awards.

### **Risk Management**

**Overview.** Managing risk is an essential part of successfully managing a financial institution. Our most prominent risk exposures are credit risk, interest rate risk and market risk. Credit risk is the risk of not collecting the interest and/or the principal balance of a loan or investment when it is due. Interest rate risk is the potential reduction of net interest income as a result of changes in interest rates. Market risk arises from fluctuations in interest rates that may result in changes in the values of financial instruments, such as available-for-sale securities, that are accounted for on a mark-to-market basis. Other risks that we face are operational risks, liquidity risks and reputation risk. Operational risks include risks related to fraud, regulatory compliance, processing errors, technology and disaster recovery. Liquidity risk is the possible inability to fund obligations to depositors, lenders or borrowers. Reputation risk is the risk that negative publicity or press, whether true or not, could cause a decline in our customer base or revenue.

**Credit Risk Management.** Our strategy for credit risk management focuses on having well-defined credit policies and uniform underwriting criteria and providing prompt attention to potential problem loans. This strategy also emphasizes the origination of one- to four-family mortgage loans, which typically have lower default rates than other types of loans and are secured by collateral that generally tends to appreciate in value.

When a borrower fails to make a required loan payment, we take a number of steps to attempt to have the borrower cure the delinquency and restore the loan to current status. When the loan becomes 15 days past due, a late charge notice is generated and sent to the borrower and phone calls are made. If payment is not then received by the 30th day of delinquency, a further notification is sent to the borrower. If no successful workout can be achieved, after a loan becomes 90 days delinquent, we may commence foreclosure or other legal proceedings. If a foreclosure

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action is instituted and the loan is not brought current, paid in full, or refinanced before the foreclosure sale, the real property securing the loan generally is sold at foreclosure. We may consider loan workout arrangements with certain borrowers under certain circumstances.

Management reports to the Board of Directors monthly regarding the amount of loans delinquent more than 30 days, all loans in foreclosure, all foreclosed and repossessed property that we own.

**Analysis of Nonperforming and Classified Assets.** We consider repossessed assets and loans that are 90 days or more past due to be nonperforming assets. Loans are generally placed on nonaccrual status when they become 90 days delinquent at which time the accrual of interest ceases and the allowance for any uncollectible accrued interest is established and charged against operations. Typically, payments received on a nonaccrual loan are applied to the outstanding principal and interest as determined at the time of collection of the loan.

Real estate that we acquire as a result of foreclosure or by deed-in-lieu of foreclosure is classified as foreclosed assets until it is sold. When property is acquired, it is initially recorded at the lower of its cost, or market, less estimate selling expenses. Holding costs and declines in fair value after acquisition of the property result in charges against income.

The following table provides information with respect to our nonperforming assets at the dates indicated. We did not have any troubled debt restructurings at the dates presented.

|  | 2008                   | 2007            | At June 30,<br>2006 | 2005            | 2004            |
|--|------------------------|-----------------|---------------------|-----------------|-----------------|
|  | (Dollars in thousands) |                 |                     |                 |                 |
| Nonaccrual loans:  |                        |                 |                     |                 |                 |
| Residential real estate:   |                        |                 |                     |                 |                 |
| One- to four-family  | \$ 853                 | \$ 810          | \$ 602              | \$ 597          | \$ 891          |
| Multifamily  | 3,072                  |                 |                     |                 |                 |
| Nonresidential real estate and land  | 2,885                  | 2,264           | 183                 | 532             | 159             |
| Consumer and other loans   | 642                    | 85              | 36                  | 350             | 72              |
| <b>Total</b>   | <b>7,452</b>           | <b>3,159</b>    | <b>821</b>          | <b>1,479</b>    | <b>1,122</b>    |
| Accruing loans past due 90 days or more:                                     |                        |                 |                     |                 |                 |
| Residential real estate:   |                        |                 |                     |                 |                 |
| One- to four-family  |                        |                 |                     |                 |                 |
| Nonresidential real estate and land  |                        |                 |                     |                 |                 |
| <b>Total</b>   |                        |                 |                     |                 |                 |
| <b>Total of nonaccrual loans and accruing loans 90 days or more past due</b> | <b>7,452</b>           | <b>3,159</b>    | <b>821</b>          | <b>1,479</b>    | <b>1,122</b>    |
| Real estate owned  | 2,895                  | 111             | 151                 | 80              | 80              |
| Other nonperforming assets   |                        |                 |                     |                 | 165             |
| <b>Total nonperforming assets</b>  | <b>\$ 10,347</b>       | <b>\$ 3,270</b> | <b>\$ 972</b>       | <b>\$ 1,559</b> | <b>\$ 1,367</b> |
| <b>Total nonperforming loans to total loans</b>                              | <b>2.56%</b>           | <b>1.14%</b>    | <b>0.33%</b>        | <b>0.72%</b>    | <b>0.61%</b>    |
| <b>Total nonperforming loans to total assets</b>                             | <b>1.95</b>            | <b>0.83</b>     | <b>0.23</b>         | <b>0.45</b>     | <b>0.44</b>     |
| <b>Total nonperforming assets to total assets</b>                            | <b>2.70</b>            | <b>0.86</b>     | <b>0.27</b>         | <b>0.47</b>     | <b>0.53</b>     |

Interest income that would have been recorded for the year ended June 30, 2008 had nonaccruing loans been current according to their original terms was, in each case, not material. No interest related to nonaccrual loans was included in interest income for the year ended June 30, 2008.

Federal regulations require us to review and classify our assets on a regular basis. In addition, the OTS has the authority to identify problem assets and, if appropriate, require them to be classified. There are three classifications



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for problem assets: substandard, doubtful and loss. Substandard assets must have one or more defined weaknesses and are characterized by the distinct possibility that we will sustain some loss if the deficiencies are not corrected. Doubtful assets have the weaknesses of substandard assets with the additional characteristic that the weaknesses make collection or liquidation in full on the basis of currently existing facts, conditions and values questionable, and there is a high possibility of loss. An asset classified loss is considered uncollectible and of such little value that continuance as an asset of the institution is not warranted. The regulations also provide for a special mention category, described as assets which do not currently expose us to a sufficient degree of risk to warrant classification but do possess credit deficiencies or potential weaknesses deserving our close attention. When we classify an asset as special mention or substandard, we account for those classifications when establishing a general allowance for loan losses. If we classify an asset as doubtful or loss, we establish a specific allowance for the asset at that time.

The following table shows the aggregate amounts of our classified assets at the dates indicated.

|                                | At June 30,      |                  |
|--------------------------------|------------------|------------------|
|                                | 2008             | 2007             |
|                                | (In thousands)   |                  |
| Special mention assets         | \$ 4,874         | \$ 4,185         |
| Substandard assets             | 7,621            | 10,471           |
| Doubtful assets                |                  |                  |
| Loss assets                    | 2,618            | 635              |
| <b>Total classified assets</b> | <b>\$ 15,113</b> | <b>\$ 15,291</b> |

Other than disclosed in the above tables, there are no other loans at June 30, 2008 that management has serious doubts about the ability of the borrowers to comply with the present loan repayment terms. The increase in classified assets is due to a deterioration in the quality and/or performance of four commercial loan relationships totaling \$6.5 million. Management believes there are adequate allowances and collateral securing these loans to cover losses that may result from these nonperforming loans. All of the loans were more than 90 days delinquent at June 30, 2008.

**Delinquencies.** The following table provides information about delinquencies in our loan portfolio at the dates indicated.

|                                     | 2008                |                     | At June 30, 2007    |                     | 2006                |                     |
|-------------------------------------|---------------------|---------------------|---------------------|---------------------|---------------------|---------------------|
|                                     | 30-59 Days Past Due | 60-89 Days Past Due | 30-59 Days Past Due | 60-89 Days Past Due | 30-59 Days Past Due | 60-89 Days Past Due |
|                                     | (In thousands)      |                     |                     |                     |                     |                     |
| Residential real estate:            |                     |                     |                     |                     |                     |                     |
| One- to four-family                 | \$ 1,561            | \$ 742              | \$ 1,878            | \$ 131              | \$ 1,603            | \$ 901              |
| Multi-family                        |                     | 1,208               | 3,315               | 178                 |                     |                     |
| Nonresidential real estate and land | 324                 | 535                 | 2                   | 968                 | 30                  | 95                  |
| Consumer and other loans            | 73                  | 22                  | 66                  | 13                  | 120                 | 36                  |
| <b>Total</b>                        | <b>\$ 1,958</b>     | <b>\$ 2,507</b>     | <b>\$ 5,261</b>     | <b>\$ 1,290</b>     | <b>\$ 1,753</b>     | <b>\$ 1,032</b>     |

**Analysis and Determination of the Allowance for Loan Losses.** The allowance for loan losses is a valuation allowance for probable credit losses in the loan portfolio. We evaluate the need to establish allowances against losses on loans on a quarterly basis. When additional allowances are necessary, a provision for loan losses is charged to earnings. The recommendations for increases or decreases to the allowance are presented by management to the Board of Directors.

Our methodology for assessing the appropriateness of the allowance for loan losses consists of: (1) a specific allowance on identified problem loans; and (2) a general valuation allowance on the remainder of the loan portfolio. Although we determine the amount of each element of the allowance separately, the entire allowance for loan losses is available for the entire portfolio.



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***Specific Allowance Required for Identified Problem Loans.*** We establish an allowance on certain identified problem loans based on such factors as: (1) the strength of the customer's personal or business cash flows; (2) the availability of other sources of repayment; (3) the amount due or past due; (4) the type and value of collateral; (5) the strength of our collateral position; (6) the estimated cost to sell the collateral; and (7) the borrower's effort to cure the delinquency.

***General Valuation Allowance on the Remainder of the Loan Portfolio.*** We establish a general allowance for loans that are not delinquent to recognize the inherent losses associated with lending activities. This general valuation allowance is determined by segregating the loans by loan category and assigning percentages to each category. The percentages are adjusted for significant factors that, in management's judgment, affect the collectibility of the portfolio as of the evaluation date. These significant factors may include changes in existing general economic and business conditions affecting our primary lending areas and the national economy, staff lending experience, recent loss experience in particular segments of the portfolio, specific reserve and classified asset trends, delinquency trends and risk rating trends. These loss factors are subject to ongoing evaluation to ensure their relevance in the current economic environment.

As a result of our systematic analysis of the adequacy of the allowance for loan losses, the loss factors we presently use to determine the reserve level were updated in 2008 based on various risk factors such as trends in underperforming loans, trends and concentrations in loans and loan volume, economic trends in our market area, particularly the impact of the gaming and tourism industry on the economy of our market area, the effect of which has become significant in recent periods. In order to reflect trends in the composition of our loan portfolio and in our recent historical loan loss experience, we increased the allowance percentage on certain loan categories which demonstrated a higher risk of loss and decreased the allowance percentage on certain loan categories which demonstrated a lower risk of loss. The update to the allowance percentages resulted in a decrease in the amount of the allowance allocated to loans secured by one- to four-family residential properties and an increase in the amount of the allowance allocated to loans secured by multi-family real estate, nonresidential real estate and loans, commercial business loans and consumer loans.

We also identify loans that may need to be charged-off as a loss by reviewing all delinquent loans, classified loans and other loans that management may have concerns about collectibility. For individually reviewed loans, the borrower's inability to make payments under the terms of the loan or a shortfall in collateral value would result in our allocating a portion of the allowance to the loan that was impaired.

At June 30, 2008, our allowance for loan losses represented 1.59% of total gross loans and 62.0% of nonperforming loans. The allowance for loan losses increased \$1.9 million to \$4.6 million at June 30, 2008 from \$2.7 million at June 30, 2007 due to the provision for loan losses of \$4.7 million, partially offset by net charge-offs of \$2.8 million. The provision for loan losses in 2008 reflects an increase in nonaccrual loans from \$3.2 million at June 30, 2007 to \$7.5 million at June 30, 2008. The increase in classified assets is due to a deterioration in the quality and/or performance of four commercial real estate loan relationships totaling \$6.5 million. The increase in nonperforming loans is primarily due to seven commercial real estate loans totaling \$6.5 million. Management believes there are adequate allowances and collateral securing these loans to cover losses that may result from these nonperforming loans.

At June 30, 2007, our allowance for loan losses represented 0.97% of total gross loans and 84.55% of nonperforming loans. The allowance for loan losses increased \$566,000 to \$2.7 million at June 30, 2007 from \$2.1 million at June 30, 2006 due to the provision for loan losses of \$730,000, partially offset by net charge-offs of \$164,000. The provision for loan losses in 2007 reflects an increase in nonaccrual residential real estate loans from \$602,000 at June 30, 2006 to \$810,000 at June 30, 2007, combined with an increase in nonaccrual nonresidential real estate and land loans from \$183,000 at June 30, 2006 to \$2.3 million at June 30, 2007. The allowance for loan losses increased due to the combined effect of increases in assets classified Substandard, Doubtful and Loss from \$3.7 million at June 30, 2006 to \$11.1 million at June 30, 2007 and increases in nonperforming loans from \$821,000 at June 30, 2006 to \$3.2 million at June 30, 2007.



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The following table sets forth the breakdown of the allowance for loan losses by loan category at the dates indicated.

|                                     | 2008                   |                                   |                                       | At June 30, 2007 |                                   |                                       | 2006       |                                   |                                       |
|-------------------------------------|------------------------|-----------------------------------|---------------------------------------|------------------|-----------------------------------|---------------------------------------|------------|-----------------------------------|---------------------------------------|
|                                     | Amount                 | % of Allowance to Total Allowance | % of Loans in Category to Total Loans | Amount           | % of Allowance to Total Allowance | % of Loans in Category to Total Loans | Amount     | % of Allowance to Total Allowance | % of Loans in Category to Total Loans |
|                                     | (Dollars in thousands) |                                   |                                       |                  |                                   |                                       |            |                                   |                                       |
| Residential real estate             | \$ 524                 | 11.3%                             | 61.6%                                 | \$ 331           | 12.4%                             | 58.9%                                 | \$ 484     | 23.0%                             | 55.4%                                 |
| Nonresidential real estate and land | 3,823                  | 82.8                              | 25.2                                  | 1,949            | 73.0                              | 27.5                                  | 1,361      | 64.6                              | 29.6                                  |
| Commercial                          | 7                      | 0.2                               | 2.1                                   | 10               | 0.4                               | 2.1                                   | 14         | 0.7                               | 2.0                                   |
| Consumer                            | 265                    | 5.7                               | 10.2                                  | 381              | 14.2                              | 8.1                                   | 246        | 11.7                              | 8.5                                   |
| Construction                        |                        |                                   | 0.9                                   |                  |                                   | 3.4                                   |            |                                   | 4.5                                   |
| Total allowance for loan losses     | \$ 4,619               | 100.0                             | 100.0                                 | \$ 2,671         | 100.0                             | 100.0                                 | \$ 2,105   | 100.0%                            | 100.0%                                |
| Total loans                         | \$ 289,926             |                                   |                                       | \$ 278,270       |                                   |                                       | \$ 247,806 |                                   |                                       |

|                                     | 2005                   |                                   |                                       | At June 30, 2004 |                                   |                                       |
|-------------------------------------|------------------------|-----------------------------------|---------------------------------------|------------------|-----------------------------------|---------------------------------------|
|                                     | Amount                 | % of Allowance to Total Allowance | % of Loans in Category to Total Loans | Amount           | % of Allowance to Total Allowance | % of Loans in Category to Total Loans |
|                                     | (Dollars in Thousands) |                                   |                                       |                  |                                   |                                       |
| Residential real estate             | \$ 841                 | 37.1%                             | 59.6%                                 | \$ 996           | 64.26%                            | 64.9%                                 |
| Nonresidential real estate and land | 1,102                  | 48.6                              | 28.8                                  | 344              | 22.19                             | 26.4                                  |
| Commercial                          | 52                     | 2.3                               | 2.4                                   | 22               | 1.42                              | 1.1                                   |
| Consumer                            | 271                    | 12.0                              | 6.3                                   | 188              | 12.13                             | 7.0                                   |
| Construction                        |                        |                                   | 2.9                                   |                  |                                   | 0.6                                   |
| Total allowance for loan losses     | \$ 2,266               | 100.0%                            | 100.0%                                | \$ 1,550         | 100.00%                           | 100.0%                                |
| Total loans                         | \$ 205,514             |                                   |                                       | \$ 182,581       |                                   |                                       |

Although we believe that we use the best information available to establish the allowance for loan losses, future adjustments to the allowance for loan losses may be necessary and our results of operations could be adversely affected if circumstances differ substantially from the assumptions used in making the determinations. Furthermore, while we believe we have established our allowance for loan losses in conformity with U.S. generally accepted accounting principles, there can be no assurance that the OTS, in reviewing our loan portfolio, will not request us to increase our allowance for loan losses. The OTS may require us to increase our allowance for loan losses based on judgments different from ours. In addition, because future events affecting borrowers and collateral cannot be predicted with certainty, there can be no assurance that increases will not be necessary should the quality of any loans deteriorate as a result of the factors discussed above. Any material increase in the allowance for loan losses may adversely affect our financial condition and results of operations.



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**Analysis of Loan Loss Experience.** The following table sets forth an analysis of the allowance for loan losses for the periods indicated.

|  | 2008                   | 2007            | Year Ended June 30, |                 | 2004            |
|--|------------------------|-----------------|---------------------|-----------------|-----------------|
|  |                        |                 | 2006                | 2005            |                 |
|  | (Dollars in thousands) |                 |                     |                 |                 |
| Allowance at beginning of period                               | \$ 2,671               | \$ 2,105        | \$ 2,266            | \$ 1,550        | \$ 1,484        |
| Provision for loan losses                                      | 4,718                  | 730             | 120                 | 857             | 120             |
| Charge-offs:   |                        |                 |                     |                 |                 |
| Real estate  | 343                    | 82              | 18                  | 47              | 42              |
| Nonresidential real estate and land                            | 2,440                  |                 |                     | 1               |                 |
| Consumer and other loans                                       |                        | 129             | 271                 | 128             | 34              |
| <b>Total charge-offs</b>                                       | <b>2,783</b>           | <b>211</b>      | <b>289</b>          | <b>176</b>      | <b>76</b>       |
| Recoveries:  |                        |                 |                     |                 |                 |
| Real estate  |                        |                 |                     |                 | 14              |
| Consumer and other loans                                       | 13                     | 47              | 8                   | 35              | 8               |
| <b>Total recoveries</b>  | <b>13</b>              | <b>47</b>       | <b>8</b>            | <b>35</b>       | <b>22</b>       |
| Net charge-offs  | (2,770)                | (164)           | (281)               | (141)           | (54)            |
| <b>Allowance at end of period</b>                              | <b>\$ 4,619</b>        | <b>\$ 2,671</b> | <b>\$ 2,105</b>     | <b>\$ 2,266</b> | <b>\$ 1,550</b> |
| Allowance to nonperforming loans                               | 62.00%                 | 84.55%          | 256.39%             | 153.21%         | 138.15%         |
| Allowance to total loans outstanding at the end of the period  | 1.59%                  | 0.97%           | 0.85%               | 1.10%           | 0.85%           |
| Net charge-offs to average loans outstanding during the period | 1.06%                  | 0.06%           | 0.12%               | 0.07%           | 0.03%           |

**Interest Rate Risk Management.** We manage the interest rate sensitivity of our interest-bearing liabilities and interest-earning assets in an effort to minimize the adverse effects of changes in the interest rate environment. Deposit accounts typically react more quickly to changes in market interest rates than mortgage loans because of the shorter maturities of deposits. As a result, sharp increases in interest rates may adversely affect our earnings while decreases in interest rates may beneficially affect our earnings. To reduce the potential volatility of our earnings, we have sought to improve the match between asset and liability maturities and rates, while maintaining an acceptable interest rate spread. Our strategy for managing interest rate risk emphasizes: adjusting the maturities of borrowings; adjusting the investment portfolio mix and duration; and generally selling in the secondary market newly originated conforming fixed-rate 15-, 20- and 30-year one- to four-family residential real estate loans and available-for-sale securities. We currently do not participate in hedging programs, interest rate swaps or other activities involving the use of derivative financial instruments.

We have an Asset/Liability Committee, which includes members of management and Board members, to communicate, coordinate and control all aspects involving asset/liability management. The committee establishes and monitors the volume, maturities, pricing and mix of assets and funding sources with the objective of managing assets and funding sources to provide results that are consistent with liquidity, growth, risk limits and profitability goals.

Our goal is to manage asset and liability positions to moderate the effects of interest rate fluctuations on net interest income and net income.

**Net Portfolio Value Analysis.** We use a net portfolio value analyses prepared by the OTS to review our level of interest rate risk. This analysis measures interest rate risk by computing changes in net portfolio value of our cash flows from assets, liabilities and off-balance sheet items in the event of a range of assumed changes in market interest rates. Net portfolio value represents the market value of portfolio equity and is equal to the market value of assets minus the market value of liabilities, with adjustments made for off-balance sheet items. These analyses assess the risk of loss in market risk-sensitive instruments in the event of a sudden and sustained 100 to 300 basis

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point increase or 100 and 200 basis point decrease in market interest rates with no effect given to any steps that we might take to counter the effect of that interest rate movement. Because of the low level of market interest rates, these analyses are not performed for decreases of more than 200 basis points.

The following table, which is based on information that we provide to the OTS, presents the change in our net portfolio value at June 30, 2008 that would occur in the event of an immediate change in interest rates based on OTS assumptions, with no effect given to any steps that we might take to counteract that change.

| Basis Point ( bp ) Change in Rates | Net Portfolio Value<br>(Dollars in Thousands) |             |          | Net Portfolio Value as % of<br>Portfolio Value of Assets |             |
|------------------------------------|---|-------------|----------|--|-------------|
|                                    | Amount  | Change      | % Change | NPV Ratio  | Change (bp) |
| 300                                | \$ 54,577                                     | \$ (13,392) | (20)%    | 14.25%   | (273)bp     |
| 200                                | 59,769  | (8,201)     | (12)     | 15.35  | (163)       |
| 100                                | 64,356  | (3,613)     | (5)      | 16.29  | (70)        |
| 0                                  | 67,970  |             |          | 16.98  |             |
| (50)                               | 69,714  | 1,745       | 3        | 17.31  | 33          |
| (100)                              | 71,349  | 3,379       | 5        | 17.60  | 62          |

The OTS uses various assumptions in assessing interest rate risk. These assumptions relate to interest rates, loan prepayment rates, deposit decay rates and the market values of certain assets under differing interest rate scenarios, among others. As with any method of measuring interest rate risk, certain shortcomings are inherent in the methods of analyses presented in the foregoing tables. For example, although certain assets and liabilities may have similar maturities or periods to repricing, they may react in different degrees to changes in market interest rates. Also, the interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types may lag behind changes in market rates. Additionally, certain assets, such as adjustable-rate mortgage loans, have features that restrict changes in interest rates on a short-term basis and over the life of the asset. Further, in the event of a change in interest rates, expected rates of prepayments on loans and early withdrawals from certificates could deviate significantly from those assumed in calculating the table. Prepayment rates can have a significant impact on interest income. Because of the large percentage of loans and mortgage-backed securities we hold, rising or falling interest rates have a significant impact on the prepayment speeds of our earning assets that in turn affect the rate sensitivity position. When interest rates rise, prepayments tend to slow. When interest rates fall, prepayments tend to rise. Our asset sensitivity would be reduced if prepayments slow and vice versa. While we believe these assumptions to be reasonable, there can be no assurance that assumed prepayment rates will approximate actual future mortgage-backed security and loan repayment activity.

**Liquidity Management.** Liquidity is the ability to meet current and future financial obligations of a short-term nature. Our primary sources of funds consist of deposit inflows, loan repayments, maturities and sales of securities and borrowings from the Federal Home Loan Bank of Indianapolis. While maturities and scheduled amortization of loans and securities are predictable sources of funds, deposit flows and loan prepayments are greatly influenced by general interest rates, economic conditions and competition.

We regularly adjust our investments in liquid assets based upon our assessment of: (1) expected loan demands; (2) expected deposit flows, in particular municipal deposit flows; (3) yields available on interest-earning deposits and securities; and (4) the objectives of our asset/liability management policy.

Our most liquid assets are cash and cash equivalents. The levels of these assets depend on our operating, financing, lending and investing activities during any given period. Cash and cash equivalents totaled \$35.7 million at June 30, 2008. Securities classified as available-for-sale whose market value exceeds our cost, which provide additional sources of liquidity, totaled \$6.9 million at June 30, 2008. Total securities classified as available-for-sale were \$38.0 million at June 30, 2008. In addition, at June 30, 2008, we had the ability to borrow a total of approximately \$83.0 million from the Federal Home Loan Bank of Indianapolis.

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At June 30, 2008, we had \$24.1 million in loan commitments outstanding consisting of \$2.6 million in mortgage loan commitments, \$15.8 million in unused home equity lines of credit and \$5.7 million in commercial lines of credit. At June 30, 2008, we also had \$1.3 million of letters of credit outstanding. Certificates of deposit due within one year of June 30, 2008 totaled \$82.7 million. This represented 56.6% of certificates of deposit at June 30, 2008. We believe the large percentage of certificates of deposit that mature within one year reflects customers' hesitancy to invest their funds for long periods in the current low interest rate environment. If these maturing deposits do not remain with us, we will be required to seek other sources of funds, including other certificates of deposit and borrowings. Depending on market conditions, we may be required to pay higher rates on such deposits or other borrowings than we currently pay on the certificates of deposit due on or before June 30, 2008. We believe, however, based on past experience, that a significant portion of our certificates of deposit will remain with us. We have the ability to attract and retain deposits by adjusting the interest rates offered.

The following table presents certain of our contractual obligations as of June 30, 2008.

| Contractual Obligations                                    | Total           | Payments Due by Period |                                      |                     |                   |
|--|-----------------|------------------------|--------------------------------------|---------------------|-------------------|
|  |                 | Less than One Year     | One to Three Years<br>(In thousands) | Three to Five Years | More Than 5 Years |
| <b>At June 30, 2008</b>                                    |                 |                        |                                      |                     |                   |
| Long-term debt obligations                                 | \$ 4,833        | \$ 1,000               | \$ 2,000                             | \$ 1,833            | \$                |
| Operating lease obligations                                | 77              | 36                     | 41                                   |                     |                   |
| Other long-term liabilities reflected on the balance sheet |                 |                        |                                      |                     |                   |
| <b>Total</b>   | <b>\$ 4,910</b> | <b>\$ 1,036</b>        | <b>\$ 2,041</b>                      | <b>\$ 1,833</b>     | <b>\$</b>         |

Our primary investing activities are the origination and purchase of loans and the purchase of securities. Our primary financing activities consist of activity in deposit accounts and Federal Home Loan Bank advances. Deposit flows are affected by the overall level of interest rates, the interest rates and products offered by us and our local competitors and other factors. We generally manage the pricing of our deposits to be competitive and to increase core deposit relationships. Occasionally, we offer promotional rates on certain deposit products to attract deposits.

The following table presents our primary investing and financing activities during the periods indicated.

|   | Year Ended June 30, |             |             |
|---|---------------------|-------------|-------------|
|   | 2008                | 2007        | 2006        |
| (In thousands)  |                     |             |             |
| <b>Investing activities:</b>                                    |                     |             |             |
| Loans disbursed or closed                                       | \$ (75,264)         | \$ (79,849) | \$ (90,397) |
| Loan principal repayments                                       | 61,818              | 51,118      | 46,119      |
| Proceeds from maturities and principal repayments of securities | 18,432              | 32,311      | 31,010      |
| Proceeds from sales of securities available-for-sale            | 5,708               | 1,239       | 8,973       |
| Purchases of securities   | (18,399)            | (177)       | (80,311)    |
| Capital expenditures  | (551)               | (1,764)     | (635)       |
| <b>Financing activities:</b>                                    |                     |             |             |
| Increase (decrease) in deposits                                 | 4,723               | 26,244      | (9,572)     |
| Proceeds from Federal Home Loan Bank advances                   | 5,000               | 30,600      | 30,000      |
| Repayments of Federal Home Loan Bank advances                   | (167)               | (30,600)    | (30,000)    |
| Net proceeds from issuance of common stock                      |                     |             | 33,133      |
| Dividends paid to stockholders                                  | (1,059)             | (1,034)     | (267)       |
| Repurchases of common stock                                     | (6,528)             | (2,239)     |             |

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**Capital Management.** We have managed our capital to maintain strong protection for depositors and creditors. We are subject to various regulatory capital requirements administered by the OTS, including a risk-based capital measure. The risk-based capital guidelines include both a definition of capital and a framework for calculating risk-weighted assets by assigning balance sheet assets and off-balance sheet items to broad risk categories. At June 30, 2008, we exceeded all of our regulatory capital requirements. We are considered well capitalized under regulatory guidelines. See *Regulation and Supervision Regulation of Federal Savings Associations Capital Requirements*, and Note 16 to the consolidated financial statements included in Item 8 to this Annual Report on Form 10-K.

The capital from the March 2006 stock offering increased our consolidated equity by \$30.5 million. The capital from the offering significantly increased our liquidity and capital resources. Over time, our initial level of liquidity will be reduced as net proceeds from the stock offering are used for general corporate purposes, including the funding of lending activities. Our financial condition and results of operations are expected to be enhanced by the capital from the offering, resulting in increased net interest-earning assets and net income. However, the large increase in equity resulting from the capital raised in the offering will, initially, have an adverse impact on our return on equity. We are using capital management tools such as cash dividends and common share repurchases. However, under OTS regulations, we were not allowed to repurchase any shares during the first year following the offering, except to fund the restricted stock awards under the equity incentive plan or, with prior regulatory approval, when extraordinary circumstances exist.

**Off-Balance Sheet Arrangements.** In the normal course of operations, we engage in a variety of financial transactions that, in accordance with U.S. generally accepted accounting principles, are not recorded in our financial statements. These transactions involve, to varying degrees, elements of credit, interest rate and liquidity risk. Such transactions are used primarily to manage customers' requests for funding and take the form of loan commitments, letters of credit and lines of credit. For information about our loan commitments and unused lines of credit, see Note 14 of the notes to the consolidated financial statements. We currently have no plans to engage in hedging activities in the future.

For the years ended June 30, 2008 and June 30, 2007, we engaged in no off-balance sheet transactions reasonably likely to have a material effect on our financial condition, results of operations or cash flows.

## **Effect of Inflation and Changing Prices**

The financial statements and related financial data presented in this report have been prepared in accordance with U.S. generally accepted accounting principles, which require the measurement of financial position and operating results in terms of historical dollars without considering the change in the relative purchasing power of money over time due to inflation. The primary impact of inflation on our operations is reflected in increased operating costs. Unlike most industrial companies, virtually all the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates generally have a more significant impact on a financial institution's performance than do general levels of inflation. Interest rates do not necessarily move in the same direction or to the same extent as the prices of goods and services.

## **Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

The information required by this item is incorporated herein by reference to the section captioned *Risk Management* in Item 7 of this Annual Report on Form 10-K.

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**Item 8. Financial Statements and Supplementary Data**

***Management's Report on Internal Control over Financial Reporting***

Company's management is responsible for establishing and maintaining adequate internal control over financial reporting. The internal control process has been designed under our supervision to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company's financial statements for external reporting purposes in accordance with accounting principles generally accepted in the United States of America.

Management conducted an assessment of the effectiveness of the Company's internal control over financial reporting as of June 30, 2008, utilizing the framework established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, management has determined that the Company's internal control over financial reporting as of June 30, 2008 is effective.

Our internal control over financial reporting includes policies and procedures that pertain to the maintenance of records that accurately and fairly reflect, in reasonable detail, transactions and dispositions of assets; and provide reasonable assurances that: (1) transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America; (2) receipts and expenditures are being made only in accordance with authorizations of management and the directors of the Company; and (3) unauthorized acquisitions, use, or disposition of the Company's assets that could have a material affect on the Company's financial statements are prevented or timely detected.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparations and presentations. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

This annual report does not include an attestation report of the Company's independent registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's independent registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permit the Company to provide only management's report in this annual report.

September 26, 2008

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**Report of Independent Registered**

**Public Accounting Firm**

To the Board of Directors of

United Community Bancorp and Subsidiary:

We have audited the consolidated balance sheets of United Community Bancorp and Subsidiary as of June 30, 2008 and 2007 and the related consolidated statements of income, comprehensive income (loss), changes in stockholders' equity and cash flows for each of the three years in the period ended June 30, 2008. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of United Community Bancorp and Subsidiary as of June 30, 2008 and 2007 and the results of its operations and its cash flows for each of the three years in the period ended June 30, 2008 in conformity with accounting principles generally accepted in the United States of America.

/s/ Clark, Schaefer, Hackett & Co.

Cincinnati, Ohio

September 26, 2008



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## Consolidated Statements of Financial Condition

| <i>(In thousands, except shares)</i>   | <b>June 30,<br/>2008</b> | <b>June 30,<br/>2007</b> |
|--|--------------------------|--------------------------|
| <b><u>Assets</u></b>   |                          |                          |
| Cash and due from banks  | \$ 35,710                | \$ 43,025                |
| Investment securities:   |                          |                          |
| Securities available for sale at estimated market value  | 13,816                   | 17,231                   |
| Securities held to maturity at amortized cost (market approximates cost)   | 200                      | 223                      |
| Mortgage-backed securities available for sale at estimated market value  | 24,211                   | 26,701                   |
| Loans receivable, net  | 284,352                  | 273,605                  |
| Loans available for sale   | 152                      |                          |
| Property and equipment, net  | 6,320                    | 6,734                    |
| Federal Home Loan Bank stock, at cost  | 1,926                    | 1,730                    |
| Accrued interest receivable:   |                          |                          |
| Loans  | 1,090                    | 1,440                    |
| Investments and mortgage-backed securities   | 261                      | 444                      |
| Other real estate owned, net   | 2,895                    | 111                      |
| Cash surrender value of life insurance policies  | 6,570                    | 6,362                    |
| Deferred income taxes  | 3,092                    | 2,349                    |
| Prepaid expenses and other assets  | 2,131                    | 1,106                    |
| <b>Total assets</b>  | <b>\$ 382,726</b>        | <b>\$ 381,061</b>        |
| <b><u>Liabilities and Stockholders' Equity</u></b>   |                          |                          |
| Deposits   | \$ 320,774               | \$ 316,051               |
| Accrued interest on deposits   | 77                       | 74                       |
| Advances from FHLB   | 4,833                    |                          |
| Advances from borrowers for payment of insurance and taxes   | 287                      | 192                      |
| Accrued expenses and other liabilities   | 2,266                    | 2,283                    |
| <b>Total liabilities</b>   | <b>328,237</b>           | <b>318,600</b>           |
| Commitments and contingencies  |                          |                          |
| Stockholders' equity   |                          |                          |
| Preferred stock, \$0.01 par value; 1,000,000 shares authorized, none issued  |                          |                          |
| Common stock, \$0.01 par value; 19,000,000 shares authorized, 7,908,863 shares issued and outstanding at June 30, 2008 and June 30, 2007 | 36                       | 36                       |
| Additional paid-in capital   | 37,965                   | 37,041                   |
| Retained earnings  | 28,581                   | 31,096                   |
| Less shares purchased for stock plans  | (5,057)                  | (5,189)                  |
| Treasury stock, at cost 555,137 and 10,000 shares at June 30, 2008 and June 30, 2007, respectively                                       | (6,649)                  | (121)                    |
| Accumulated other comprehensive loss:  |                          |                          |
| Unrealized loss on securities available for sale, net of income taxes  | (387)                    | (402)                    |
| <b>Total stockholders' equity</b>  | <b>54,489</b>            | <b>62,461</b>            |
| <b>Total liabilities and stockholders' equity</b>  | <b>\$ 382,726</b>        | <b>\$ 381,061</b>        |

See accompanying notes to the consolidated financial statements.



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## Consolidated Statements of Operations

Years ended June 30,

|  | 2008           | 2007          | 2006          |
|--|----------------|---------------|---------------|
| <b>Interest income:</b>                                    |                |               |               |
| Loans  | \$ 18,663      | 17,603        | 14,008        |
| Investments and mortgage backed securities                 | 2,952          | 4,084         | 3,870         |
| <b>Total interest income</b>                               | <b>21,615</b>  | <b>21,687</b> | <b>17,878</b> |
| <b>Interest expense:</b>                                   |                |               |               |
| Deposits   | 11,316         | 10,479        | 7,721         |
| Borrowed funds   | 37             | 97            | 41            |
| <b>Total interest expense</b>                              | <b>11,353</b>  | <b>10,576</b> | <b>7,762</b>  |
| <b>Net interest income</b>                                 | <b>10,262</b>  | <b>11,111</b> | <b>10,116</b> |
| Provision for loan losses                                  | 4,718          | 730           | 120           |
| <b>Net interest income after provision for loan losses</b> | <b>5,544</b>   | <b>10,381</b> | <b>9,996</b>  |
| <b>Other income (loss):</b>                                |                |               |               |
| Service charges  | 1,374          | 993           | 915           |
| Gain on sale of loans                                      | 25             | 38            | 40            |
| Gain (loss) on sale of investments                         | (35)           | 1,221         | (286)         |
| Gain on sale of land                                       | 275            |               |               |
| Income from Bank Owned Life Insurance                      | 208            | 225           | 225           |
| Other  | 350            | 371           | 295           |
| <b>Total other income</b>                                  | <b>2,197</b>   | <b>2,848</b>  | <b>1,189</b>  |
| <b>Other expense:</b>                                      |                |               |               |
| Compensation and employee benefits                         | 5,703          | 5,538         | 4,461         |
| Premises and occupancy expense                             | 952            | 1,121         | 1,010         |
| Deposit insurance premium                                  | 71             | 35            | 36            |
| Advertising expense  | 300            | 294           | 311           |
| Data processing expense                                    | 251            | 293           | 289           |
| ATM service fees   | 356            | 306           | 319           |
| Loss on other than temporary impairment of investments     | 101            |               |               |
| Provision for loss on sale of real estate owned            | 125            |               |               |
| Charitable contribution                                    |                |               | 1,878         |
| Other operating expenses                                   | 1,991          | 1,663         | 1,268         |
| <b>Total other expense</b>                                 | <b>9,850</b>   | <b>9,250</b>  | <b>9,572</b>  |
| <b>Income (loss) before income taxes</b>                   | <b>(2,109)</b> | <b>3,979</b>  | <b>1,613</b>  |
| <b>Income tax provision (benefit)</b>                      | <b>(653)</b>   | <b>1,485</b>  | <b>575</b>    |

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|   |            |         |         |
|---|------------|---------|---------|
| Net income (loss)                           | \$ (1,456) | 2,494   | 1,038   |
| Basic and diluted earnings (loss) per share | \$ (0.19)  | \$ 0.31 | \$ 0.09 |

See accompanying notes to the consolidated financial statements.

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**UNITED COMMUNITY BANCORP AND SUBSIDIARY**

Consolidated Statements of Comprehensive Income (Loss)

For the years ended

*(In thousands)*

|   | <b>2008</b>       | <b>June 30,<br/>2007</b> | <b>2006</b> |
|---|-------------------|--------------------------|-------------|
| Net income (loss)   | \$ (1,456)        | \$ 2,494                 | \$ 1,038    |
| Other comprehensive income (loss), net of tax   |                   |                          |             |
| Unrealized gain (loss) on available for sale securities during the period                               | 105               | 688                      | (1,244)     |
| Less reclassification adjustment for (gains) losses on available for sale securities included in income | (90)              | (806)                    | 189         |
| <b>Total comprehensive income (loss)</b>  | <b>\$ (1,441)</b> | <b>\$ 2,376</b>          | <b>(17)</b> |

See accompanying notes to the consolidated financial statements.

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## Consolidated Statements of Stockholders' Equity

| <i>(In thousands, except per share data)</i>                | Common<br>Stock | Additional<br>Paid-In<br>Capital | Retained<br>Earnings | Shares<br>Purchased for<br>Stock plans | Treasury<br>Stock | Unrealized<br>Gain (Loss)<br>on Securities<br>Available for Sale | Total     |
|---|-----------------|----------------------------------|----------------------|--|-------------------|--|-----------|
| Balance at June 30, 2005                                    |                 |                                  | 28,965               |  |                   | 771  | 29,736    |
| Issuance of common stock                                    | 36              | 36,415                           |                      |  |                   |  | 36,451    |
| Capitalization of mutual holding company                    |                 |                                  | (100)                |  |                   |  | (100)     |
| Purchase of ESOP shares                                     |                 |                                  |                      | (3,318)                                |                   |  | (3,318)   |
| Net income June 30, 2006                                    |                 |                                  | 1,038                |  |                   |  | 1,038     |
| Cash dividends of \$0.07 per share                          |                 |                                  | (267)                |  |                   |  | (267)     |
| Unrealized loss on investments:                             |                 |                                  |                      |  |                   |  |           |
| Net Change during year, net of deferred taxes of \$(692)    |                 |                                  |                      |  |                   | (1,055)  | (1,055)   |
| Balance at June 30, 2006                                    | \$ 36           | \$ 36,415                        | \$ 29,636            | \$ (3,318)                             | \$                | \$ (284)   | \$ 62,485 |
| Net income  |                 |                                  | 2,494                |  |                   |  | 2,494     |
| Cash dividends of \$0.29 per share*                         |                 |                                  | (1,034)              |  |                   |  | (1,034)   |
| Stock-based compensation expense                            |                 | 596                              |                      |  |                   |  | 596       |
| Amortization of ESOP shares                                 |                 | 30                               |                      | 247                                    |                   |  | 277       |
| Shares repurchased  |                 |                                  |                      |  | (2,239)           |  | (2,239)   |
| Unrealized loss on investments:                             |                 |                                  |                      |  |                   |  |           |
| Net change during the period, net of deferred taxes of \$82 |                 |                                  |                      |  |                   | (118)  | (118)     |
| Balance at June 30, 2007                                    | \$ 36           | \$ 37,041                        | \$ 31,096            | \$ (3,071)                             | \$ (2,239)        | \$ (402)   | \$ 62,461 |
| Net income (loss)   |                 |                                  | (1,456)              |  |                   |  | (1,456)   |
| Cash dividends of \$0.33 per share*                         |                 |                                  | (1,059)              |  |                   |  | (1,059)   |
| Stock-based compensation expense                            |                 | 866                              |                      |  |                   |  | 866       |
| Amortization of ESOP shares                                 |                 | 58                               |                      | 132                                    |                   |  | 190       |
| Shares repurchased  |                 |                                  |                      |  | (6,528)           |  | (6,528)   |
| Reclassification of shares purchased for stock plans        |                 |                                  |                      | (2,118)                                | 2,118             |  |           |
| Unrealized loss on investments:                             |                 |                                  |                      |  |                   |  |           |
| Net change during the period, net of deferred taxes of \$82 |                 |                                  |                      |  |                   | 15   | 15        |
| Balance at June 30, 2008                                    | \$ 36           | \$ 37,965                        | \$ 28,581            | \$ (5,057)                             | \$ (6,649)        | \$ (387)   | \$ 54,489 |

\* paid on all shares other than MHC  
See accompanying notes to the consolidated financial statements.

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## Consolidated Statements of Cash Flows

| <i>(In thousands)</i>   | For the year ended June 30, |          |          |
|---|-----------------------------|----------|----------|
|   | 2008                        | 2007     | 2006     |
| <b>Operating activities:</b>  |                             |          |          |
| Net income (loss)   | \$ (1,456)                  | \$ 2,494 | \$ 1,038 |
| Adjustments to reconcile net income to net cash provided by operating activities: |                             |          |          |
| Depreciation  | 490                         | 457      | 433      |
| Provision for loan losses   | 4,718                       | 730      | 120      |
| Provision for loss on real estate owned   | 125                         |          |          |
| Deferred loan origination fees (costs)  | (81)                        | (21)     | (106)    |
| Amortization of premium on investments  | 110                         | 88       | 101      |
| Proceeds from sale of loans   | 1,802                       | 2,284    | 2,405    |
| Loans disbursed for sale in the secondary market                                  | (1,942)                     | (2,267)  | (2,386)  |
| Gain on sale of loans   | (25)                        | (38)     | (40)     |
| Loss (gain) on sale of available for sale investment securities                   | 34                          | (1,221)  | 286      |
| Loss (gain) on sale of other real estate owned                                    | 30                          | 69       | (31)     |
| Other than temporary impairment charge on investment securities                   | 101                         |          |          |
| Gain on sale of property and equipment  | (275)                       |          |          |
| ESOP shares committed to be released  | 132                         | 277      |          |
| Stock-based compensation expense  | 924                         | 596      |          |
| Deferred income taxes   | (753)                       | (304)    | (652)    |
| Effects of change in operating assets and liabilities:                            |                             |          |          |
| Accrued interest receivable   | 533                         | 55       | (485)    |
| Prepaid expenses and other assets   | (1,025)                     | 171      | (260)    |
| Accrued interest on deposits  | 3                           | (40)     | 52       |
| Accrued expenses and other  | (17)                        | 131      | 97       |
| Net cash provided by operating activities   | 3,428                       | 3,461    | 572      |
| <b>Investing activities:</b>  |                             |          |          |
| Proceeds from maturity of available for sale investment securities                | 13,081                      | 24,379   | 18,300   |
| Proceeds from sale of available for sale investment securities                    | 588                         | 1,239    | 8,973    |
| Proceeds from maturity of held to maturity investment securities                  | 23                          | 22       | 20       |
| Proceeds from repayment of mortgage-backed securities available for sale          | 5,328                       | 7,910    | 12,690   |
| Proceeds from sale of mortgage-backed securities available for sale               | 5,120                       |          |          |
| Proceeds from sale of other real estate owned                                     | 527                         | 304      | 320      |
| Proceeds from sale of Federal Home Loan Bank stock                                |                             | 76       |          |
| Proceeds from sale of property and equipment                                      | 750                         |          |          |
| Purchases of mortgage-backed securities available for sale                        | (7,728)                     |          | (29,433) |
| Purchases of available for sale investment securities                             | (10,671)                    | (177)    | (50,878) |
| Purchases of Federal Home Loan Bank stock   | (196)                       | (119)    |          |
| Net (increase) decrease in loans  | (18,870)                    | (30,092) | (44,027) |
| Increase in cash surrender value of life insurance                                | (208)                       | (238)    | (225)    |
| Capital expenditures  | (551)                       | (1,764)  | (635)    |
| Net cash provided (used) by investing activities                                  | (12,807)                    | 1,540    | (84,895) |
| <b>Financing activities:</b>  |                             |          |          |
| Net increase (decrease) in deposits   | 4,723                       | 26,244   | (9,572)  |
| Proceeds from Federal Home Loan Bank advances                                     | 5,000                       | 30,600   | 30,000   |
| Repayments of Federal Home Loan Bank advances                                     | (167)                       | (30,600) | (30,000) |
| Proceeds from stock issuance, net of conversion cost                              |                             |          | 33,133   |

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|  |         |         |          |
|--|---------|---------|----------|
| Capitalization of mutual holding company                                   |         |         | (100)    |
| Dividends paid to stockholders   | (1,059) | (1,034) | (267)    |
| Repurchases of common stock  | (6,528) | (2,239) |          |
| Net increase in advances from borrowers for payment of insurance and taxes | 95      | 43      | (124)    |
| Net cash provided by financing activities                                  | 2,064   | 23,014  | 23,070   |
| Net increase (decrease) in cash and cash equivalents                       | (7,315) | 28,015  | (61,253) |
| Cash and cash equivalents at beginning of period                           | 43,025  | 15,010  | 76,263   |
| Cash and cash equivalents at end of period                                 | 35,710  | 43,025  | 15,010   |

See accompanying notes to consolidated financial statements.



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**UNITED COMMUNITY BANCORP**

Notes to Consolidated Financial Statements

**NOTE 1 BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

United Community Bancorp (the Company) is a Federally-chartered corporation, which was organized to be the mid-tier holding company for United Community Bank (the Bank), which is a Federally-chartered, FDIC-insured savings bank. The Company was organized in conjunction with the Bank's reorganization from a mutual savings bank to the mutual holding company structure on March 30, 2006 (NOTE 2). Financial statements prior to the reorganization were the financial statements of the Bank. United Community MHC, a Federally-chartered corporation, is the mutual holding company parent of the Company. United Community MHC owns 55% of the Company's outstanding common stock and must always own at least a majority of the voting stock of the Company. In addition to the shares of the Company, United Community MHC was capitalized with \$100,000 in cash from the Company. The Company, through the Bank, operates in a single business segment providing traditional banking services through its office and branches in Southeastern Indiana.

**PRINCIPLES OF CONSOLIDATION** The consolidated financial statements include the accounts of the Company and the Bank. All significant intercompany balances and transactions have been eliminated.

**USE OF ESTIMATES IN THE PREPARATION OF FINANCIAL STATEMENTS** The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). In preparing consolidated financial statements in accordance with GAAP, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The most significant estimates and assumptions in the Company's financial statements are recorded in the allowance for loan losses and deferred income taxes. Actual results could differ significantly from those estimates.

During the year ended June 30, 2008, Real Estate Management Holdings LLC (REMH) was formed as a wholly-owned subsidiary of the Bank. This entity was formed for the purpose of holding real estate assets that are acquired by the Bank through, or in lieu of, foreclosure.

**CASH AND CASH EQUIVALENTS** For purposes of reporting cash flows, cash and cash equivalents include cash and interest-bearing deposits in other financial institutions with original maturities of less than ninety days.

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**INVESTMENT SECURITIES** Investment and mortgage-backed securities are classified upon acquisition into one of three categories: held to maturity, trading, and available for sale, in accordance with Statement of Financial Accounting Standards ( SFAS ) No., 115, Accounting for Certain Investments in Debt and Equity Securities . Debt securities that the Bank has the positive intent and ability to hold to maturity are classified as held to maturity securities and reported at amortized cost. Debt and equity securities that are bought and held principally for the purpose of selling in the near-term are classified as trading securities and reported at fair value, with unrealized gains and losses included in earnings. The Bank had no trading securities at June 30, 2008 and 2007. Debt and equity securities not classified as either held to maturity securities or trading securities are classified as available for sale securities and reported at fair value, with unrealized gains or losses excluded from earnings and reported as a separate component of stockholders' equity, net of deferred taxes.

Securities are recorded net of applicable premium or discount with the premium or discount being amortized on the interest method over the estimated average life of the investment.

The Bank designates its investments in U. S. League Intermediate-Term Portfolio, Federal Home Loan Mortgage Corporation Common Stock, certain municipal bonds, and mortgage-backed securities as available for sale.

Gains and losses realized on the sale of investment securities are accounted for on the trade date using the specific identification method.

**LOANS RECEIVABLE** Loans receivable that management has the intent and ability to hold until maturity or payoff are reported at their outstanding unpaid principal balances reduced by any charge-offs or specific valuation accounts and net of any deferred fees or costs on originated loans, or unamortized premiums or discounts on purchased loans. Interest on loans is calculated by using the simple interest method on daily balances of the principal amount outstanding. Loans held for sale are recorded at lower of cost or market determined in the aggregate. The Bank had one loan designated as held for sale at June 30, 2008 with a book value of \$152,000, compared to no loans held for sale at June 30, 2007.

The Bank defers all loan origination fees, net of certain direct loan origination costs, and amortizes them over the contractual life of the loan as an adjustment of yield in accordance with SFAS No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases.

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The Bank retains the servicing on loans sold and agrees to remit to the investor loan principal and interest at agreed-upon rates. These rates can differ from the loan's contractual interest rate resulting in a yield differential. In addition to previously deferred loan origination fees and cash gains, gains on sale of loans can represent the present value of the future yield differential less normal servicing fees, capitalized over the estimated life of the loans sold. Normal servicing fees are determined by reference to the stipulated minimum servicing fee set forth by the government agencies to whom the loans are sold. Such servicing fees are amortized to operations over the life of the loans using the interest method. If prepayments are higher than expected, an immediate charge to operations is made. If prepayments are lower than original estimates, then the related adjustments are made prospectively.

The mortgage servicing rights recorded by the Bank are segregated into pools for valuation purposes using as pooling criteria the loan term and coupon rate in accordance with SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities-a replacement of FASB Statement No. 125. Once pooled, each grouping of loans is evaluated on a discounted earnings basis to determine the present value of the future earnings that a purchaser could expect to realize from each portfolio. Earnings are projected from a variety of sources including loan-servicing fees, interest earned on float, net interest earned on escrows, miscellaneous income and costs to service the loans. The present value of future earnings is the economic value for the pool.

The allowance for loan and real estate losses is increased by charges to income and decreased by charge-offs (net of recoveries). Management's periodic evaluation of the adequacy of the allowance is based on the Bank's past loan loss experience, known and inherent risks such as amount of loan, type of loan, concentrations, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, and current economic conditions. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance for loan losses. Such agencies may require the Bank to recognize additions to the allowance based on judgments different from those of Management.

Although Management uses the best information available to make these estimates, future adjustments to the allowance may be necessary due to economic, operating, regulatory and other conditions that may be beyond the Bank's control.

The Bank's internal asset review committee reviews each loan with three or more delinquent payments, and each loan ninety days or more past due, and decides on whether the circumstances involved give reason to place the loan on non-accrual status. The Board of Directors reviews this information as determined by the internal asset review committee each month. Loans may be returned to accrual status when all principal and interest amounts contractually due (including arrearages) are reasonably assured of repayment within an acceptable period of time, and there is a sustained period of repayment performance by the borrower, in accordance with the contractual terms of interest and principal. While a loan is classified as non-accrual, interest income is generally recognized on a cash basis.

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A loan is defined as impaired when, based on current information and events, it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement. The Bank considers its investment in one-to-four family residential loans and consumer installment loans to be homogeneous and therefore excluded from separate identification for evaluation of impairment. With respect to the Bank's investment in multi-family and nonresidential loans, such loans are collateral dependent and, as a practical expedient, are carried at the lower of cost or fair value. Collateral dependent loans which are more than ninety days delinquent are considered to constitute more than a minimum delay in repayment are evaluated for impairment at that time.

**CONCENTRATION OF CREDIT RISK** The Bank grants primarily residential loans to customers in local counties in Southeastern Indiana. Although the Bank has a diversified loan portfolio, a substantial portion of its debtors' ability to honor their contracts is dependent upon the local economy.

Management may, at times, maintain deposit accounts with financial institutions in excess of federal deposit insurance limits. The Company has not experienced any losses in such accounts. The Company believes it is not exposed to any significant credit risk on cash and cash equivalents.

**OTHER REAL ESTATE OWNED** Real estate properties acquired through, or in lieu of, loan foreclosure are initially recorded at fair value at the date of foreclosure, and are transferred to the Bank's wholly-owned subsidiary, Real Estate Management Holdings LLC (REMH). Holding costs are expensed when incurred. Valuations are periodically performed by Management, and an allowance for losses is established by a charge to operations if the carrying value of a property exceeds its estimated net realizable value.

**PROPERTY AND EQUIPMENT** Property and equipment is carried at cost. Depreciation is provided on the straight-line method over the estimated useful lives of the assets. The estimated useful lives are as follows:

|                         |               |
|-------------------------|---------------|
| Land improvements       | 7 - 15 years  |
| Buildings               | 15 - 39 years |
| Furniture and equipment | 3 - 10 years  |

Significant renewals and betterments are charged to the property and equipment account. Maintenance and repairs are charged to operations in the period incurred.

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**INCOME TAXES** The Company accounts for income taxes in accordance with SFAS No. 109, Accounting for Income Taxes. Pursuant to the provisions of SFAS No. 109, a deferred tax liability or deferred tax asset is computed by applying the current statutory tax rates to net taxable or deductible differences between the tax basis of an asset or liability and its reported amount in the consolidated financial statements that will result in taxable or deductible amounts in future periods. Deferred tax assets are recorded only to the extent that the amount of net deductible or taxable temporary differences or carry forward attributes may be utilized against current period earnings, carried back against prior years earnings, offset against taxable temporary differences reversing in future periods, or utilized to the extent of management's estimate of future taxable income. A valuation allowance is provided for deferred tax assets to the extent that the value of net deductible temporary differences and carry forward attributes exceeds management's estimates of taxes payable on future taxable income. Deferred tax liabilities are provided on the total amount of net temporary differences taxable in the future.

The Company's principal temporary differences between pretax financial income and taxable income result primarily from timing differences for certain components of compensation and post-retirement expense and book and tax bad debt deductions. Additional temporary differences result from depreciation expense computed utilizing accelerated methods for tax purposes, and for limitations on annual deductions related to charitable contributions to the UCB Charitable Foundation (NOTE 2).

**EMPLOYEE STOCK OWNERSHIP PLAN** The Company accounts for the United Community Bank Employee Stock Ownership Plan ( ESOP ) in accordance with AICPA Statement of Position (SOP) 93-6, Employers Accounting for Employee Stock Ownership Plans . In accordance with SOP 93-6, ESOP shares pledged as collateral are reported as unearned ESOP shares in stockholders' equity. As shares are committed to be released from collateral, the Bank will record compensation expense equal to the current market price of the shares. To the extent that the fair value of the ESOP shares differs from the cost of such charges, the difference is recorded to stockholders' equity as additional paid-in capital. Additionally, the shares become outstanding for basic net income per share computations.

**STOCK-BASED COMPENSATION** The Company applies the provisions of SFAS No. 123(R), Share-Based Payment to stock-based compensation, which requires the Company to measure the cost of employee services received in exchange for awards of equity instruments and to recognize this cost in the financial statements over the period during which the employee is required to provide such services. The Company has elected to recognize compensation cost associated with its outstanding stock-based compensation awards with graded vesting on an accelerated basis pursuant to SFAS No. 123(R). The expense is calculated for stock options at the date of grant using the Black-Scholes option pricing model. The expense associated with restricted stock awards is calculated based upon the value of the common stock on the date of grant.

**EARNINGS PER SHARE** Basic earnings per share ( EPS ) is based on the weighted average number of common shares actually outstanding, adjusted for ESOP shares not yet committed to be released. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock, such as unvested restricted stock awards and outstanding stock options, were exercised or converted into common stock or

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resulted in the issuance of common stock. Diluted EPS is calculated by adjusting the weighted average number of shares of common stock outstanding to include the effects of contracts or securities exercisable or which could be converted into common stock, if dilutive, using the treasury stock method.

The following is a reconciliation of the basic and diluted weighted average number of common shares outstanding.

|   | <b>June 30,</b>  |                  |
|---|------------------|------------------|
|   | <b>2008</b>      | <b>2007</b>      |
| Basic weighted average outstanding shares             | 7,691,130        | 8,069,868        |
| Effect of dilutive stock options and restricted stock |                  | 15,600           |
| <b>Diluted weighted average outstanding shares</b>    | <b>7,691,130</b> | <b>8,085,468</b> |

Due to the timing of the Bank's reorganization into the mutual holding company form and the completion of the Company's initial public offering on March 30, 2006, earnings per share for 2006 is based solely on earnings subsequent to that date. The weighted average shares outstanding for the period March 30, 2006 through June 30, 2006 totaled 8,132,212 for both basic and diluted EPS purposes. Net income for the same period was \$701,000.

**COMPREHENSIVE INCOME (LOSS)** The Company presents in the consolidated statement of comprehensive income (loss) those amounts from transactions and other events which currently are excluded from the consolidated statement of operations and are recorded directly to stockholders' equity.

**FAIR VALUE OF FINANCIAL INSTRUMENTS** SFAS No. 107, Disclosures about Fair Value of Financial Instruments, requires disclosure of the fair value of financial instruments, both assets and liabilities, whether or not recognized in the consolidated balance sheet, for which it is practicable to estimate the value. For financial instruments where quoted market prices are not available, fair values are estimated using present value or other valuation methods.

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The following methods and assumptions are used in estimating the fair values of financial instruments:

### Cash and cash equivalents

The carrying values presented in the consolidated statements of position approximate fair value.

### Investments and mortgage-backed securities

For investment securities (debt instruments) and mortgage-backed securities, fair values are based on quoted market prices, where available. If a quoted market price is not available, fair value is estimated using quoted market prices of comparable instruments.

### Loans receivable

The fair value of the loan portfolio is estimated by evaluating homogeneous categories of loans with similar financial characteristics. Loans are segregated by types, such as residential mortgage, commercial real estate, and consumer. Each loan category is further segmented into fixed and adjustable rate interest, terms, and by performing and non-performing categories. The fair value of performing loans, except residential mortgage loans, is calculated by discounting contractual cash flows using estimated market discount rates which reflect the credit and interest rate risk inherent in the loan. For performing residential mortgage loans, fair value is estimated by discounting contractual cash flows adjusted for prepayment estimates using discount rates based on secondary market sources. The fair value for significant non-performing loans is based on recent internal or external appraisals. Assumptions regarding credit risk, cash flow, and discount rates are judgmentally determined by using available market information.

### Federal Home Loan Bank stock

The carrying values presented in the consolidated statements of position approximate fair value.

### Deposits

The fair value of passbook accounts, NOW accounts, and money market savings and demand deposits approximates their carrying values. The fair value of fixed maturity certificates of deposit is estimated using a discounted cash flow calculation that applies interest rates currently offered for deposits of similar maturities.

### Off-balance sheet items

Carrying value is a reasonable estimate of fair value. These instruments are generally variable rate or short-term in nature, with minimal fees charged.

**ADVERTISING** The Bank expenses advertising costs as incurred. Advertising costs consist primarily of television, radio, newspaper and billboard advertising.

**RECLASSIFICATIONS** Certain 2007 and 2006 amounts have been reclassified to conform to the 2008 presentation.

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**EFFECT OF RECENT ACCOUNTING PRONOUNCEMENTS**

In July 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* – an interpretation of FASB Statement No. 109 (FIN 48), which clarifies the accounting for uncertainty in tax positions. This interpretation requires the recognition in the financial statements of the impact of a tax position, if that position is more likely than not of being sustained on audit, based on the technical merits of the position. The provisions of FIN 48 are effective for fiscal years beginning after December 15, 2006, with the cumulative effect of the change in accounting principle recorded as an adjustment to beginning retained earnings. The adoption of FIN 48 did not have a material effect on the Company's consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. This statement applies under other accounting pronouncements that require or permit fair value measurements, which concluded in those pronouncements that fair value is a relevant measurement attribute. Accordingly, this statement does not require any new fair value measurements. The pronouncement is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The Company does not expect the adoption of SFAS No. 157 to have a material effect on its consolidated financial statements.

In September 2006, the Emerging Issues Task Force (EITF) reached a consensus on EITF Issue No. 06-4, *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements*. The issue requires that an employer who issues an endorsement split-dollar life insurance arrangement that provides a benefit to an employee to recognize a liability for future benefits in accordance with SFAS No. 106, *Employers Accounting for Postretirement Benefits Other Than Pensions*, if in substance a postretirement plan exists, or Accounting Principles Board (APB) Opinion No. 12, *Omnibus Opinion*, if the arrangement is, in substance, an individual deferred compensation contract, based on the substantive agreement with the employee. This issue is effective for fiscal years beginning after December 31, 2007 with earlier application permitted. Management does not believe that this issue will be material to the Company's financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* – including an amendment of FASB Statement No. 155. SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. This statement is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. Early adoption is permitted as of the beginning of a fiscal year that begins on or before November 15, 2007, provided the entity also elects to apply the provisions of SFAS No. 157. The Company does not anticipate electing the fair value option for any of its financial assets or financial liabilities.



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In November 2007, the SEC issued Staff Accounting Bulletin No. 109 (SAB 109), "Written Loan Commitments Recorded at Fair Value Through Earnings." SAB 109 supersedes SAB No. 105, "Application of Accounting Principles to Loan Commitments" by requiring the expected net future cash flows related to the servicing of a loan to be included in the measurement of all written loan commitments that are accounted for at fair value through earnings. SAB 109 is applicable to all written loan commitments issued or modified in fiscal quarters beginning after December 15, 2007. The application of this statement has not had a material impact on the Company's consolidated financial statements.

**NOTE 2 PLAN OF REORGANIZATION AND STOCK ISSUANCE**

On March 30, 2006, the Bank completed its reorganization into a mutual holding company structure and the Company completed its related initial stock offering. A total of 3,647,984 shares of common stock were sold in the offering for total gross proceeds of \$36,479,840. In addition, 4,655,200 shares were issued to United Community MHC, the federally chartered mutual holding company formed in connection with the reorganization. The Bank contributed \$250,000 and 160,816 shares of the Company's common stock to UCB Charitable Foundation (Foundation), which was established by the Bank in connection with the reorganization. The contribution to the Foundation resulted in expense of \$1,858,000 in the Company's consolidated statement of income for the year ended June 30, 2006.

Reorganization and stock issuance costs of \$1,637,000 were incurred during the year ended June 30, 2006. No such costs were incurred during the years ended June 30, 2008 or 2007. These costs have been accounted for as a reduction of the stock proceeds.

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NOTE 3 INVESTMENT SECURITIES

Investment securities available for sale at June 30, 2008 consist of the following:

|  | Amortized<br>Cost      | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Estimated<br>Market<br>Value |
|--|------------------------|------------------------------|-------------------------------|------------------------------|
|  | (Dollars in thousands) |                              |                               |                              |
| U.S. League Intermediate Term Portfolio                  | \$ 1,785               |                              | 67                            | 1,718                        |
| Callable bonds-U.S. Government corporations and agencies | 8,943                  | 6                            | 85                            | 8,864                        |
| Federal Home Loan Mortgage Corporation Common Stock      | 9                      | 146                          |                               | 155                          |
| Municipal bonds  | 3,040                  | 4                            | 115                           | 2,929                        |
| Other equity securities                                  | 211                    |                              | 61                            | 150                          |
|  | \$ 13,988              | 156                          | 328                           | 13,816                       |

Investment securities held to maturity at June 30, 2008 consist of the following:

|                 | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Estimated<br>Market<br>Value |
|-----------------|-------------------|------------------------------|-------------------------------|------------------------------|
|                 | (in thousands)    |                              |                               |                              |
| Municipal bonds | \$ 200            |                              |                               | \$ 200                       |

Investment securities available for sale at June 30, 2007, consist of the following:

|  | Amortized<br>Cost      | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Estimated<br>Market<br>Value |
|--|------------------------|------------------------------|-------------------------------|------------------------------|
|  | (Dollars in thousands) |                              |                               |                              |
| U.S. League Intermediate Term Portfolio                  | \$ 2,069               |                              | 56                            | 2,013                        |
| Callable bonds-U.S. Government corporations and agencies | 13,843                 |                              | 233                           | 13,610                       |
| Federal Home Loan Mortgage Corporation Common Stock      | 9                      | 565                          |                               | 574                          |
| Municipal bonds  | 960                    |                              | 7                             | 953                          |
| Other equity securities                                  | 78                     | 3                            |                               | 81                           |
|  | \$ 16,959              | 568                          | 296                           | 17,231                       |

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Investment securities held to maturity at June 30, 2007, consist of the following:

|                 | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Estimated<br>Market<br>Value |
|-----------------|-------------------|------------------------------|-------------------------------|------------------------------|
|                 | (in thousands)    |                              |                               |                              |
| Municipal bonds | \$ 223            |                              |                               | 223                          |

The callable bonds and municipal bonds available for sale have the following maturities at June 30, 2008:

|  | Amortized<br>cost | Estimated<br>market value |
|--|-------------------|---------------------------|
|  | (in thousands)    |                           |
| Due or callable in one year or less      | \$ 390            | 394                       |
| Due or callable in 1 - 5 years           | 7,627             | 7,557                     |
| Due or callable in 5 - 10 years          | 1,588             | 1,569                     |
| Due or callable in greater than 10 years | 2,378             | 2,273                     |
|  | \$ 11,983         | \$ 11,793                 |

All of the other securities available for sale at June 30, 2008 are due, callable or saleable within one year. The investment securities held to maturity at June 30, 2008 are due on April 15, 2009.

Gross proceeds on sale of investment and mortgage-backed securities were \$5,708,000, \$1,239,000, and \$8,973,000, for the years ended June 30, 2008, 2007, and 2006, respectively. Gross realized gains for the years ended June 30, 2008, 2007, and 2006 were \$0, \$1,221,000, and \$0, respectively. Gross realized losses for the years ended June 30, 2008, 2007, and 2006 were \$35,000, \$0, and \$286,000, respectively.

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The table below indicates the length of time individual investment securities and mortgage-backed securities have been in a continuous loss position at June 30, 2008 and 2007:

|  | Less than 12 Months<br>Fair<br>Value | Unrealized<br>Losses | 12 Months or Longer<br>Fair<br>Value | Unrealized<br>Losses | Fair<br>Value | Total<br>Unrealized<br>Losses |
|--|--------------------------------------|----------------------|--------------------------------------|----------------------|---------------|-------------------------------|
| <b>(Dollars in thousands)</b>  |                                      |                      |                                      |                      |               |                               |
| <b>June 30, 2008</b>   |                                      |                      |                                      |                      |               |                               |
| U.S. League Intermediate Term Portfolio & Callable Government agencies | \$ 5,549                             | 70                   | 3,678                                | 82                   | 9,227         | 152                           |
| Municipal bonds  | 2,535                                | 115                  |                                      |                      | 2,535         | 115                           |
| Mortgage-backed securities   | 7,332                                | 223                  | 13,322                               | 268                  | 20,654        | 491                           |
| Other equity securities  | 153                                  | 61                   |                                      |                      | 153           | 61                            |
|  | \$ 15,569                            | 469                  | 17,000                               | 350                  | 32,569        | 819                           |
| Number of investments  |                                      | 21                   |                                      | 26                   |               | 47                            |
| <b>June 30, 2007</b>   |                                      |                      |                                      |                      |               |                               |
| U.S. League Intermediate Term Portfolio & Callable Government agencies | \$                                   |                      | 15,623                               | 289                  | 15,623        | 289                           |
| Municipal bonds  |                                      |                      | 953                                  | 7                    | 953           | 7                             |
| Mortgage-backed securities   |                                      |                      | 26,002                               | 953                  | 26,002        | 953                           |
|  | \$                                   |                      | 42,578                               | 1,249                | 42,578        | 1,249                         |
| Number of investments  |                                      |                      |                                      | 57                   |               | 57                            |

Securities available for sale are reviewed for possible other-than-temporary impairment on a quarterly basis. During this review, Management considers the severity and duration of the unrealized losses as well as its intent and ability to hold the securities until recovery, taking into account balance sheet management strategies and its market view and outlook. Management also assesses the nature of the unrealized losses taking into consideration factors such as changes in risk-free interest rates, general credit spread widening, market supply and demand, creditworthiness of the issuer or any credit enhancement providers, and the quality of the underlying collateral. During the year ended June 30, 2008, Management recognized \$101,000 of other-than-temporary impairment charges on a mutual fund that invests primarily in private label and government mortgage-backed securities.

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The detail of interest and dividends on investment securities is as follows for June 30:

|                            | 2008           | 2007  | 2006  |
|----------------------------|----------------|-------|-------|
|                            | (in thousands) |       |       |
| Taxable interest income    | \$ 2,879       | 4,012 | 3,779 |
| Nontaxable interest income | 61             | 40    | 42    |
| Dividends                  | 12             | 32    | 49    |
|                            | \$ 2,952       | 4,084 | 3,870 |

**NOTE 4 MORTGAGE-BACKED SECURITIES**

Mortgage-backed securities available for sale at June 30, 2008 consist of the following:

|       | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Estimated<br>Market<br>Value |
|-------|-------------------|------------------------------|-------------------------------|------------------------------|
| FNMA  | \$ 13,123         | 18                           | 258                           | 12,883                       |
| FHLMC | 11,205            | 1                            | 229                           | 10,977                       |
| GNMA  | 355               |                              | 4                             | 351                          |
|       | \$ 24,683         | 19                           | 491                           | 24,211                       |

Mortgage-backed securities available for sale at June 30, 2007 consist of the following:

|       | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Estimated<br>Market<br>Value |
|-------|-------------------|------------------------------|-------------------------------|------------------------------|
| FNMA  | \$ 18,137         | 9                            | 564                           | 17,582                       |
| FHLMC | 9,084             | 3                            | 368                           | 8,719                        |
| GNMA  | 421               |                              | 21                            | 400                          |
|       | \$ 27,642         | 12                           | 953                           | 26,701                       |

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The maturity of the mortgage-backed securities is based on the repayment of the underlying mortgages and is as follows at June 30, 2008:

|                              | Amortized<br>cost<br>(amounts in thousands) | Estimated<br>market value<br>(amounts in thousands) |
|------------------------------|---|---|
| Due in 2 - 5 years           | \$ 461                                      | \$ 465  |
| Due in 5 - 10 years          | 11,880                                      | 11,725  |
| Due in greater than 10 years | 12,342                                      | 12,021  |
|                              | \$ 24,683                                   | \$ 24,211   |

**NOTE 5 LOANS RECEIVABLE**

Loans receivable at June 30, 2008 and 2007 consist of the following:

|   | June 30,<br>2008<br>(in thousands) | June 30,<br>2007<br>(in thousands) |
|---|------------------------------------|------------------------------------|
| Residential real estate                 |                                    |                                    |
| One-to-four family                      | \$ 134,965                         | \$ 126,398                         |
| Multi family                            | 43,671                             | 37,500                             |
| Construction                            | 2,493                              | 9,507                              |
| Nonresidential real estate and land     | 73,238                             | 76,333                             |
| Consumer and other loans                | 35,559                             | 28,532                             |
|   | 289,926                            | 278,270                            |
| Less:                                   |                                    |                                    |
| Allowance for losses                    | 4,619                              | 2,671                              |
| Undisbursed portion of loans in process | 1,184                              | 2,294                              |
| Deferred loan fees (costs)              | (381)                              | (300)                              |
|   | \$ 284,504                         | \$ 273,605                         |

As of June 30, 2008 and 2007, the Bank was servicing loans for the benefit of others in the amount of \$30,154,000 and \$32,133,000, respectively. The Bank recognized \$25,000, \$38,000, and \$21,000 of pre-tax gains on sale of loans related primarily to capitalized mortgage servicing rights during the years ended June 30, 2008, 2007 and 2006, respectively. The carrying value of mortgage servicing rights approximated \$219,000 and \$231,000 as of June 30, 2008 and 2007, respectively. No impairment has been recognized on the mortgage service assets and correspondingly, no valuation allowance has been recognized as of June 30, 2008 and 2007.

The amount of loans classified as nonaccrual totaled approximately \$7,452,000 and \$3,159,000 June 30, 2008 and 2007, respectively. Interest income from these nonaccrual loans during the years ended June 30, 2008, 2007 and 2006 was immaterial. All loans classified as nonaccrual had allowances determined in accordance with SFAS No. 114, Accounting by Creditors for Impairment of a Loan and SFAS No. 118, Accounting by Creditors for Impairment of a Loan - Income Recognition and Disclosures. At June 30, 2008 and 2007 the recorded investment in loans for which impairment has been recognized was approximately \$7,042,000 and \$2,231,000, respectively, with related reserves of \$2,595,000 and \$635,000, respectively. The average

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balance of impaired loans was approximately \$6,935,000, \$1,698,000, and \$803,000 for the years ended June 30, 2008, 2007, and 2006, respectively. Interest received on impaired loans for the years ended June 30, 2008, 2007 and 2006 was immaterial. The amount of loans over 90 days past due totaled \$7,452,000 and \$3,200,000 at June 30, 2008 and 2007, respectively. As of June 30, 2008, the Bank has no commitments to loan additional funds to these borrowers.

The Company sells loans in the secondary market. Mortgage loan sales totaled \$1,790,000, \$2,267,000, and \$2,386,000 during the years ended June 30, 2008, 2007 and 2006, respectively. The Bank had \$152,000 and \$0 in loans designated as held for sale at June 30, 2008 and 2007, respectively. It is generally management's intention to hold all other loans originated to maturity or earlier repayment.

Changes in the allowance for losses on loans for the year ended June 30 are as follows:

|                              | 2008     | 2007<br>(in thousands) | 2006  |
|------------------------------|----------|------------------------|-------|
| Balance at beginning of year | \$ 2,671 | 2,105                  | 2,266 |
| Provisions charged to income | 4,718    | 730                    | 120   |
| Charge-offs                  | (2,783)  | (211)                  | (289) |
| Recoveries                   | 13       | 47                     | 8     |
| Balance at end of year       | \$ 4,619 | 2,671                  | 2,105 |

**NOTE 6 OTHER REAL ESTATE OWNED**

Other real estate owned consists of the following at June 30:

|   | 2008<br>(in thousands) | 2007   |
|---|------------------------|--------|
| One to four family                        | \$ 567                 | 111    |
| Land                                      | 340                    |        |
| Commercial real estate                    | 2,109                  |        |
| Provision for losses on real estate owned | (111)                  |        |
|   | \$ 2,895               | \$ 111 |

Activity in the allowance for losses on real estate owned is as follows for years ended June 30,:

|   | 2008<br>(in thousands) | 2007 | 2006 |
|---|------------------------|------|------|
| Balance, beginning of period              | \$                     |      | 20   |
| Allowance for losses on real estate owned | 125                    |      | (20) |
| Charged off upon sale of property         | (14)                   |      |      |
| Balance, end of period                    | \$ 111                 |      |      |

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## NOTE 7 PROPERTY AND EQUIPMENT

Property and equipment at June 30, 2008 and 2007 is summarized as follows:

|                                     | June 30,<br>2008      2007<br>(in thousands) |       |
|-------------------------------------|--|-------|
| Land and land improvements          | \$ 1,830                                     | 2,242 |
| Buildings and building improvements | 4,538  | 4,407 |
| Furniture and equipment             | 2,721  | 2,375 |
|                                     | 9,089  | 9,024 |
| Less: accumulated depreciation      | 2,769  | 2,290 |
|                                     | \$ 6,320                                     | 6,734 |

At June 30, 2008, the Company sold part of a parcel of land on which a branch was previously built for \$750,000, and recorded a gain on the sale of land of \$275,000. This land was included in land and land improvements at June 30, 2007.

## NOTE 8 DEPOSITS

Deposits at June 30, 2008 and 2007 consist of the following:

|                                    | 2008                        |            | 2007                        |         |
|------------------------------------|-----------------------------|------------|-----------------------------|---------|
|                                    | (dollars in thousands)      |            |                             |         |
|                                    | Weighted<br>Average<br>Rate | Balance    | Weighted<br>Average<br>Rate | Balance |
| Demand deposit accounts            | 1.68%                       | \$ 64,206  | 1.92%                       | 63,540  |
| Passbook                           | 1.15%                       | 41,787     | 1.93%                       | 42,166  |
| Money market deposit accounts      | 2.15%                       | 68,621     | 3.85%                       | 67,856  |
| Total demand and passbook deposits |                             | 174,614    |                             | 173,562 |
| Certificate of deposits:           |                             |            |                             |         |
| Less than 12 months                | 4.45%                       | 82,696     | 5.14%                       | 60,970  |
| 12 months to 24 months             | 3.88%                       | 32,189     | 5.18%                       | 44,536  |
| 24 months to 36 months             | 3.68%                       | 6,960      | 4.03%                       | 7,141   |
| More than 36 months                | 3.27%                       | 364        | 4.25%                       | 7,840   |
| Individual retirement accounts     | 4.62%                       | 23,951     | 4.74%                       | 22,002  |
| Total certificate of deposits      |                             | 146,160    |                             | 142,489 |
| Total deposit accounts             |                             | \$ 320,774 |                             | 316,051 |



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Interest paid and accrued on deposits is as follows:

|                               | <b>For the years ended June 30</b> |             |             |
|-------------------------------|------------------------------------|-------------|-------------|
|                               | <b>2008</b>                        | <b>2007</b> | <b>2006</b> |
|                               | <b>(dollars in thousands)</b>      |             |             |
| NOW and money market accounts | \$ 7,015                           | 3,834       | 3,601       |
| Savings                       | 570                                | 782         | 711         |
| Certificate of deposits       | 3,731                              | 5,863       | 3,409       |
|                               | \$ 11,316                          | 10,479      | 7,721       |

The aggregate amount of time deposits with a minimum denomination of \$100,000 was approximately \$75,840,000 and \$76,017,000 at June 30, 2008 and 2007, respectively. Individual deposits with denominations of more than \$100,000 are not federally insured.

Total non-interest bearing deposits were \$13,643,000 and \$11,668,000 at June 30, 2008 and 2007, respectively. Municipal deposits totaled \$127,545,000 and \$138,019,000 at June 30, 2008 and 2007, respectively.

Maturities of certificate accounts at June 30, 2008 and 2007 are approximately as follows:

|                  | <b>2008</b>           | <b>2007</b>           |
|------------------|-----------------------|-----------------------|
|                  | <b>(In Thousands)</b> | <b>(In Thousands)</b> |
| One year or less | \$ 93,061             | 106,991               |
| 1 2 years        | 39,915                | 21,229                |
| 2 3 years        | 12,531                | 9,761                 |
| 3 4 years        | 308                   | 4,182                 |
| 4 5 years        | 293                   | 280                   |
| Over 5 years     | 52                    | 46                    |
|                  | \$ 146,160            | 142,489               |

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## NOTE 9 FINANCIAL INSTRUMENTS

The estimated fair values of the Company's financial instruments at June 30, 2008 and 2007 are as follows:

|  | 2008                |                                 | 2007                |               |
|--|---------------------|---------------------------------|---------------------|---------------|
|  | Carrying<br>Amounts | Fair<br>Value<br>(In thousands) | Carrying<br>Amounts | Fair<br>Value |
| <b>Financial assets:</b>                 |                     |                                 |                     |               |
| Cash and interest bearing deposits       | 35,710              | 35,710                          | 43,025              | 43,025        |
| Investment securities available for sale | 13,816              | 13,816                          | 17,231              | 17,231        |
| Investment securities held to maturity   | 200                 | 200                             | 223                 | 223           |
| Mortgage-backed securities               | 24,211              | 24,211                          | 26,701              | 26,701        |
| Loans receivable                         | 284,504             | 284,491                         | 273,605             | 266,520       |
| Accrued interest receivable              | 1,351               | 1,351                           | 1,884               | 1,884         |
| Investment in FHLB stock                 | 1,926               | 1,926                           | 1,730               | 1,730         |
| <b>Financial liabilities:</b>            |                     |                                 |                     |               |
| Deposits                                 | \$ 320,774          | 322,281                         | 316,051             | 322,175       |
| Accrued interest payable                 | 77                  | 77                              | 74                  | 74            |
| FHLB Advances                            | 4,833               | 4,733                           |                     |               |
| <b>Off-balance sheet items</b>           |                     |                                 |                     |               |

## NOTE 10 BORROWED FUNDS

Pursuant to collateral agreements with the FHLB, advances are secured by all stock in the FHLB and a blanket pledge agreement for qualifying first mortgage loans. The Bank had \$4,833,000 and \$0 in outstanding FHLB advances at June 30, 2008 and 2007. At June 30, 2008, the Bank had only one advance from the FHLB. The original amount of the advance was \$5,000,000 at a fixed interest rate of 3.2%. Principal payments of \$83,000 are due on a monthly basis until the loan is paid in full in April, 2013. Interest payments are also due at the time that the principal payment is made.

## NOTE 11 EMPLOYEE BENEFIT PLANS

401(k) Profit Sharing Plan

The Bank has a standard 401(k) profit sharing plan. Eligible participants must be at least 18 years of age and have one year of service. The Bank makes matching contributions based on each employee's deferral contribution. Total expense under the plan for the years ended June 30, 2008, 2007 and 2006 totaled \$122,000, \$120,000 and \$111,000, respectively.

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### ESOP

Effective upon the consummation of the reorganization (NOTE 2) in March 2006, the United Community Bank Employee Stock Ownership Plan (ESOP) was established for eligible employees. Eligible participants must be at least 18 years of age and have one year of service.

The ESOP used \$3,318,000 in proceeds from a term loan obtained from the Company to purchase 331,788 shares of Company common stock during the year ended June 30, 2006. As of June 30, 2008 and 2007, the ESOP owned 275,538 and 313,717 shares, respectively, of the Company's common stock, which were held in a suspense account until released for allocation to the participants. Additionally, as of June 30, 2008, the Company has committed to release 6,600 shares. The Company recognized compensation expense of \$193,000, \$186,000 and \$60,000 during the years ended June 30, 2008, 2007, and 2006 respectively, which equals the fair value of the ESOP shares during the periods in which they became committed to be released. The fair value of the unearned ESOP shares approximated \$2,141,000 at June 30, 2008.

Contributions to the ESOP and shares released from the suspense account will be allocated to each eligible participant based on the ratio of each such participant's compensation, as defined in the ESOP, to the total compensation of all eligible plan participants. Participants become 100% vested in their accounts upon three years of service. Participants with less than three years of service are 0% vested in their accounts.

The term loan, which bears interest at 7.75%, is payable in fifteen annual installments of \$370,000 through December 31, 2020. Shares purchased with the loan proceeds are initially pledged as collateral for the term loan and are held in a suspense account for future allocation to the ESOP participants. Each plan year, in addition to any discretionary contributions, the Company shall contribute cash to the ESOP to enable the ESOP to make its principal and interest payments under the term loan. Company contributions may be reduced by any investment earnings attributable to such contributions and any cash dividends paid with respect to Company stock held by the ESOP.

### Deferred Compensation

In March 2002, the Bank adopted a supplemental retirement income program with selected officers and board members. To fund this plan, the Bank purchased single-premium life insurance policies on each officer and director, at a cumulative total cost of \$5,100,000. The cash surrender value of these policies was \$6,570,000 and \$6,362,000 at June 30, 2008 and 2007, respectively. The directors' liability is accrued based on life expectancies, return on investment and a discount rate. For the officers, an annual contribution based on actuarial assumptions is made to a secular trust with the employee as beneficiary. Deferred compensation payments are funded by available assets in the secular trust. No further funding is required by the Bank, with the exception that upon a change in control of the Bank, the plan provides for full supplemental benefits which would have occurred at age 65.

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Future expected contributions for the funding of officers' deferred compensation are as follows:

|                     |                     |
|---------------------|---------------------|
| 2009                | 197,000             |
| 2010                | 197,000             |
| 2011                | 197,000             |
| 2012                | 197,000             |
| 2013                | 197,000             |
| 2014 and thereafter | 768,000             |
|                     | <b>\$ 1,753,000</b> |

At June 30, 2008 and 2007, the Bank had accrued directors' supplemental retirement expense of \$1,221,000 and \$1,172,000, respectively. Officers and directors supplemental retirement expense totaled \$414,000, \$426,000, and \$297,000 for the years ended June 30, 2008, 2007 and 2006, respectively.

**Supplemental Executive Retirement Plan**

Effective upon the consummation of the reorganization in March 2006 (NOTE 2), a Supplemental Executive Retirement Plan (SERP) was established to provide participating executives (as determined by the Company's Board of Directors) with benefits that cannot be provided under the 401(k) Profit Sharing Plan or ESOP as a result of limitations imposed by the Internal Revenue Code. The SERP will also provide benefits to eligible employees if they retire or are terminated following a change in control before the complete allocation of shares under the ESOP. SERP expense totaled \$7,000 and \$9,000 for the years ended June 30, 2008 and 2007. The Company incurred no expense for the year ended June 30, 2006.

**Employee Severance Compensation Plan**

Effective upon the consummation of the reorganization in March 2006 (NOTE 2), an Employee Severance Compensation Plan (Severance Plan) was established to provide eligible employees with severance benefits if a change in control of the Bank occurs causing involuntary termination of employment in a comparable position. Employees are eligible upon the completion of one year of service. Under the Severance Plan, eligible employees will be entitled to severance benefits ranging from one month of compensation, as defined in the plan, up to 199% of compensation. Such benefits are payable within five business days from termination of employment.

**NOTE 12 STOCK-BASED COMPENSATION**

In November 2006, the Company adopted the United Community Bancorp 2006 Equity Incentive Plan (Equity Incentive Plan) for the issuance of restricted stock, incentive stock options and non-statutory stock options to employees, officers and directors of the Company. The aggregate number of shares of common stock reserved and available for issuance pursuant to awards granted under the Equity Incentive Plan is 580,630. Of the total shares available, 414,736 may be issued in connection with the exercise of stock options and 165,894 may be issued as restricted stock. The maximum number of shares of common stock that may be covered by options granted under the Equity Incentive Plan to any one person during any one calendar year is 103,684.

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In December 2006, the Board of Directors of the Company authorized the funding of a trust that purchased 165,894 shares of the Company's outstanding common stock to be used to fund restricted stock awards under the Equity Incentive Plan.

In December 2006, the Company granted restricted stock awards for a total of 149,297 shares of common stock, incentive stock option awards for a total of 219,446 shares of common stock and non-statutory stock option awards for a total of 153,815 shares of common stock. These awards vest at 20% annually from January 2008 through January 2012. The restricted stock awards were valued at the stock price on the date of grant, or \$11.53 per share. The stock options were valued using the following assumptions: expected volatility of 11.49%, risk-free interest rate of 4.6%, expected term of ten years and expected dividend yield of 2.3%.

As of June 30, 2007, all granted awards remained outstanding and unvested. Total recognized compensation expense for the year ended June 30, 2007 was \$596,000. During the year ended June 30, 2008, 29,859 restricted share awards and 74,652 stock options became fully vested. Additionally, during the year ended June 30, 2008, 8,627 unvested restricted share awards and 21,566 unvested stock options were forfeited. These forfeitures exceeded the Company's estimated forfeiture rate and, therefore, approximately \$70,000 in previously-recognized stock-based compensation expense was reversed during the year ended June 30, 2008. The remaining unvested expense as of June 30, 2008, that will be recorded as expense in future periods, is \$1,003,000. The weighted average time over which this expense will be recorded is 42 months.

Information related to stock options for the years ended June 30, 2008 and 2007 is as follows:

|                              | Shares   | Weighted<br>Average<br>Exercise<br>Price | Weighted<br>Average<br>Remaining<br>Contractual<br>Term |
|------------------------------|----------|--|---|
| Outstanding at June 30, 2006 |          | \$                                       |   |
| Granted                      | 373,261  | 11.53                                    |   |
| Forfeited                    |          |  |   |
| Exercised                    |          |  |   |
| Outstanding at June 30, 2007 | 373,261  | 11.53                                    |   |
| Granted                      |          |  |   |
| Forfeited                    | (26,957) | 11.53                                    |   |
| Exercised                    |          |  |   |
| Outstanding at June 30, 2008 | 346,304  | 11.53                                    | 8.5 years   |
| Exercisable at June 30, 2008 | 74,652   | 11.53                                    | 8.5 years   |
| Fair value of options        |          | \$ 2.37                                  |   |

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A summary of the status of unvested stock options for the year ended June 30, 2008 is as follows:

|                              | Shares   | Weighted<br>Average<br>Exercise<br>Price |
|------------------------------|----------|--|
| Outstanding at June 30, 2007 | 373,261  | \$ 11.53                                 |
| Granted                      |          |  |
| Vested                       | (74,652) | 11.53                                    |
| Forfeited                    | (21,566) | 11.53                                    |
| Outstanding at June 30, 2008 | 277,043  | 11.53                                    |

Information related to restricted stock grants for the years ended June 30, 2008 and 2007 is as follows:

|                              | Shares   | Weighted<br>Average<br>Grant Date<br>Fair Value |
|------------------------------|----------|---|
| Outstanding at June 30, 2006 |          |   |
| Granted                      | 149,297  | \$ 11.53  |
| Vested                       |          |   |
| Forfeited                    |          |   |
| Outstanding at June 30, 2007 | 149,297  | 11.53   |
| Granted                      |          |   |
| Vested                       | (29,859) | (11.53)   |
| Forfeited                    | (8,627)  | (11.53)   |
| Outstanding at June 30, 2008 | 10,811   | \$ 11.53  |

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NOTE 13 SUPPLEMENTAL CASH FLOW INFORMATION

|  | For the years ended June 30 |        |         |
|--|-----------------------------|--------|---------|
|  | 2008                        | 2007   | 2006    |
| Supplemental disclosure of cash flow information is as follows:                        |                             |        |         |
| Cash paid during the year for:   |                             |        |         |
| Income taxes   | \$ 1,000                    | 1,512  | 1,524   |
| Interest   | \$ 11,350                   | 10,616 | 7,722   |
| Supplemental disclosure of non-cash investing and financing activities is as follows:  |                             |        |         |
| Unrealized gains (losses) on securities designated as available for sale, net of taxes | \$ 15                       | (118)  | (1,055) |
| Transfers of loans to other real estate owned  | \$ 2,733                    | 331    | 375     |

NOTE 14 COMMITMENTS

Leases

The Bank is party to various operating leases for property and equipment. Lease expense for the years ended June 30, 2008, 2007, and 2006 was \$41,000, \$40,000, and \$109,000, respectively.

Future minimum lease payments under these lease agreements are as follows as of June 30, 2008:

|      |           |
|------|-----------|
| 2009 | \$ 36,000 |
| 2010 | 26,000    |
| 2011 | 15,000    |
|      | \$ 77,000 |

The Bank entered into lease agreements with various tenants who lease space from the Bank in certain locations where the Bank has a branch office. Revenue from these leases for the years ended June 30, 2008, 2007 and 2006 was \$142,000, \$143,000, and \$107,000, respectively.

Future minimum lease payments under these lease agreements are as follows as of June 30, 2008:

|      |            |
|------|------------|
| 2009 | \$ 66,000  |
| 2010 | 42,000     |
| 2011 | 24,000     |
|      | \$ 132,000 |

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**Loans**

In the ordinary course of business, the Bank has various outstanding commitments to extend credit that are not reflected in the accompanying consolidated financial statements. These commitments involve elements of credit risk in excess of the amounts recognized in the balance sheet.

The Bank uses the same credit policies in making commitments for loans as it does for loans that have been disbursed and recorded in the consolidated balance sheet. The Bank generally requires collateral when it makes loan commitments, which generally consists of the right to receive first mortgages on improved or unimproved real estate when performance under the contract occurs.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since some portions of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Certain of these commitments are for fixed rate loans, and, therefore, their value is subject to market risk as well as credit risk.

At June 30, 2008, the Bank's total commitment to extend credit at variable rates was approximately \$30.9 million. The amount of fixed rate commitments was approximately \$122,000 at June 30, 2008. The fixed rate loan commitments at June 30, 2008 have interest rates ranging from 5.00% to 6.00%. In addition, the Bank had approximately \$1,269,000 of letters of credit outstanding at June 30, 2008. Generally, these commitments do not extend beyond 90 days.

**NOTE 15 RELATED PARTY TRANSACTIONS**

Loans to executive officers, directors and their affiliated companies, totaled \$3,393,000 and \$3,216,000 at June 30, 2008 and 2007, respectively. All loans were current at June 30, 2008 and 2007, respectively. Loans to employees totaled \$7,371,000 and \$7,397,000 at June 30, 2008 and 2007, respectively.

The activity in loans to related parties for the years ended June 30, 2008 and 2007 is as follows:

|                   | <b>June 30,</b>       |             |
|-------------------|-----------------------|-------------|
|                   | <b>2008</b>           | <b>2007</b> |
|                   | <b>(in thousands)</b> |             |
| Beginning balance | \$ 10,614             | 9,539       |
| New loans         | 986                   | 2,149       |
| Payments on loans | (836)                 | (1,074)     |
| Ending balance    | \$ 10,764             | 10,614      |

Deposits from officers and directors totaled \$2,127,000 and \$2,792,000 at June 30, 2008 and 2007, respectively. Employee deposits totaled \$2,032,000 and \$1,428,000 at June 30, 2008 and 2007, respectively.



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NOTE 16 REGULATORY CAPITAL

The Bank is subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and prompt corrective action regulation involve quantitative measures of assets, liabilities, and certain off balance sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can initiate regulatory action that, if undertaken, could have a direct material effect on the consolidated financial statements.

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept broker deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required. At April 2, 2007, the most recent regulatory notifications categorized the Bank as well capitalized. There are no conditions or events since that notification that management believes have changed the institution's category. Management believes that, under current regulatory capital regulations, the Bank will continue to meet its minimum capital requirements in the foreseeable future. Actual and required capital amounts and ratios are presented below:

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The following tables summarize the Bank's capital amounts and the ratios required:

|   | Actual    |        | For capital adequacy purposes |       | To be well capitalized under prompt corrective action provisions |       |
|---|-----------|--------|-------------------------------|-------|--|-------|
|   | Amount    | Ratio  | Amount                        | Ratio | Amount   | Ratio |
| <b>June 30, 2008</b>                      |           |        |                               |       |  |       |
| Tier 1 capital to risk-weighted assets    | \$ 49,655 | 19.70% | 10,081                        | 4.0%  | 15,122   | 6.0%  |
| Total capital to risk-weighted assets     | 51,680    | 20.51% | 20,163                        | 8.0%  | 25,204   | 10.0% |
| Tier 1 capital to adjusted total assets   | 49,655    | 13.00% | 15,281                        | 4.0%  | 19,101   | 5.0%  |
| Tangible capital to adjusted total assets | 49,655    | 13.00% | 5,730                         | 1.5%  |  |       |
| <b>June 30, 2007</b>                      |           |        |                               |       |  |       |
| Tier 1 capital to risk-weighted assets    | \$ 50,945 | 21.24% | 9,594                         | 4.0%  | 14,391   | 6.0%  |
| Total capital to risk-weighted assets     | 50,564    | 20.27% | 19,956                        | 8.0%  | 24,945   | 10.0% |
| Tier 1 capital to adjusted total assets   | 50,945    | 13.42% | 15,185                        | 4.0%  | 18,981   | 5.0%  |
| Tangible capital to adjusted total assets | 50,945    | 13.42% | 5,694                         | 1.5%  |  |       |

**NOTE 17 FEDERAL INCOME TAXES**

The components of the provision for income taxes are summarized as follows:

|                                       | 2008           | 2007  | 2006  |
|---------------------------------------|----------------|-------|-------|
|                                       | (in thousands) |       |       |
| <b>Current tax expense (benefit):</b> |                |       |       |
| Federal                               | \$ 114         | 1,464 | 976   |
| State                                 | (14)           | 325   | 251   |
|                                       | 100            | 1,789 | 1,227 |
| <b>Deferred tax benefit:</b>          |                |       |       |
| Federal                               | (633)          | (253) | (551) |
| State                                 | (120)          | (51)  | (101) |
|                                       | (753)          | (304) | (652) |
|                                       | \$ (653)       | 1,485 | 575   |

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The tax effect of temporary differences that give rise to significant portions of deferred tax assets and deferred tax liabilities at June 30, 2008 and 2007 are as follows:

|  | <b>June 30,</b>       |             |
|--|-----------------------|-------------|
|  | <b>2008</b>           | <b>2007</b> |
|  | <b>(in thousands)</b> |             |
| Deferred tax assets arising from:                |                       |             |
| Loan loss reserve                                | \$ 1,829              | 1,058       |
| Reserve for loss on real estate owned            | 51                    |             |
| Vacation and bonus accrual                       | 137                   | 210         |
| Supplemental retirement                          | 401                   | 375         |
| Stock-based compensation                         | 328                   | 189         |
| Contribution to UCB Charitable Foundation        | 356                   | 367         |
| Unrealized loss on securities available for sale | 257                   | 268         |
| State depreciation                               | 67                    | 80          |
| Other-than-temporary impairment                  | 40                    |             |
| Post-retirement health care benefits             | 51                    | 56          |
| <br>   |                       |             |
| Total deferred tax assets                        | 3,517                 | 2,603       |
| Deferred tax liabilities arising from:           |                       |             |
| Mortgage servicing rights                        | (87)                  | (91)        |
| Depreciation                                     | (150)                 | (133)       |
| Other  | (28)                  | (30)        |
| <br>   |                       |             |
| Total deferred tax liabilities                   | (265)                 | (254)       |
| <br>   |                       |             |
| Valuation allowance                              | (160)                 |             |
| <br>   |                       |             |
| Net deferred tax asset                           | \$ 3,092              | 2,349       |

During the year ended June 30, 2006, the Company contributed \$1,858,000 to fund the UCB Charitable Foundation (NOTE 2). The deduction for federal income tax purposes is limited to ten percent of federal taxable income. The non-deductible portion, which approximates \$1,046,000 at June 30, 2008, is available for future deduction through the year ended June 30, 2011. At June 30, 2008, the Company has recorded a valuation allowance of \$160,000, based on the level of anticipated future taxable income. Net deferred tax liabilities and federal income tax expense in future years can be significantly affected by changes in enacted tax rates.

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The rate reconciliation for years ended June 30, 2008, 2007 and 2006 is as follows:

|  | 2008     | 2007  | 2006 |
|--|----------|-------|------|
| Federal income taxes at statutory rate                 | \$ (718) | 1,394 | 548  |
| State taxes, net of federal benefit                    | (88)     | 214   | 100  |
| Increase (decrease) in taxes resulting primarily from: |          |       |      |
| Non-taxable income on Bank-owned life insurance        | (71)     | (77)  | (77) |
| Non-deductible stock-based compensation                | 76       | 51    |      |
| Increase in valuation allowance                        | 160      |       |      |
| Other  | (12)     | (97)  | 4    |
|  | \$ (653) | 1,485 | 575  |

A bill repealing the thrift bad debt reserve was signed into law and is effective for taxable years beginning after December 31, 1995. All savings banks and thrifts were required to account for tax reserves for bad debts in the same manner as banks. Such entities with assets less than \$500 million are now required to maintain a moving average expense based reserve and are no longer able to calculate a reserve based on a percentage of taxable income.

Tax reserves accumulated after 1987 are automatically subject to recapture. The recapture will occur in equal amounts over six years beginning in 1997 and can be deferred up to two years, depending on the level of loans originated.

As a result of the tax law change, the Bank is expected to ultimately recapture \$748,478 of tax reserves accumulated after 1987, resulting in additional tax payments of \$255,000. The recapture of these reserves will not result in any significant income statement effect to the Bank. Pre-1988 tax reserves will not have to be recaptured unless the Bank or successor institution liquidates, redeems shares or pays a dividend in excess of earnings and profits.

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NOTE 18 PARENT ONLY FINANCIAL STATEMENTS

The following condensed financial statements summarize the financial position of United Community Bancorp (parent company only) as of June 30, 2008 and 2007, and the results of its operations and cash flows for the fiscal years ended June 30, 2008, 2007 and 2006 (all amounts in thousands):

UNITED COMMUNITY BANCORP

STATEMENTS OF FINANCIAL CONDITION

June 30, 2008 and 2007

|   | 2008      | 2007      |
|---|-----------|-----------|
| <b>ASSETS</b>   |           |           |
| Cash and cash equivalents                               | \$ 2,613  | \$ 10,440 |
| Securities available for sale at estimated market value | 150       | 80        |
| Accrued interest receivable                             | 118       | 148       |
| Deferred income taxes                                   | 219       | 365       |
| Prepaid expenses and other assets                       | 3,280     | 3,087     |
| Investment in United Community Bank                     | 49,295    | 50,565    |
|   | \$ 55,675 | \$ 64,685 |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>              |           |           |
| Other liabilities                                       | \$ 1,186  | 2,224     |
| Stockholders equity                                     | 54,489    | 62,461    |
|   | \$ 55,675 | \$ 64,685 |

UNITED COMMUNITY BANCORP

STATEMENTS OF OPERATIONS

June 30, 2008, 2007 and 2006

|  | 2008    | 2007   | 2006    |
|--|---------|--------|---------|
| <b>Interest income:</b>                            |         |        |         |
| ESOP loan  | \$ 232  | \$ 253 | 63      |
| Securities   | 137     | 394    | 80      |
| <b>Other income:</b>                               |         |        |         |
| Equity in earnings (loss) of United Community Bank | (1,322) | 2,344  | 676     |
| Net revenue  | (953)   | 2,991  | 819     |
| <b>Operating expenses:</b>                         |         |        |         |
| Charitable contributions                           |         |        | 1,857   |
| Other operating expenses                           | 336     | 401    | 101     |
| Net operating expenses                             | 336     | 401    | 1,958   |
| Income (loss) before income taxes                  | (1,289) | 2,590  | (1,139) |

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|                              |            |          |          |
|------------------------------|------------|----------|----------|
| Income tax expense (benefit) | 167        | 96       | (615)    |
| Net income (loss)            | \$ (1,456) | \$ 2,494 | \$ (524) |

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UNITED COMMUNITY BANCORP

STATEMENTS OF CASH FLOWS

June 30, 2008, 2007 and 2006

|  | 2008       | 2007      | 2006       |
|--|------------|-----------|------------|
| <b>Operating activities:</b>   |            |           |            |
| Net earnings (loss)  | \$ (1,456) | \$ 2,494  | \$ (524)   |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: |            |           |            |
| Amortization of discounts on investments   |            |           | (10)       |
| Equity in earnings (loss) of United Community Bank                                       | 1,322      | (2,344)   | (676)      |
| Amortization and expense of stock-based compensation plans                               | 1,056      | 873       |            |
| Deferred income taxes  | 171        | 163       | (529)      |
| Effects of change in assets and liabilities  | (1,201)    | (788)     | (221)      |
|  | \$ (108)   | \$ 398    | \$ (1,960) |
| <b>Investing activities:</b>   |            |           |            |
| Proceeds from investment securities  |            | 7,075     | 1,000      |
| Purchases of securities  | (132)      | (80)      | (8,063)    |
|  | (132)      | 6,995     | (7,063)    |
| <b>Financing activities:</b>   |            |           |            |
| Net proceeds from stock issuance   |            |           | 33,133     |
| Capitalization of mutual holding company   |            |           | (100)      |
| Capital contribution in Bank   |            |           | (17,423)   |
| Purchase of treasury stock   | (6,528)    | (2,239)   |            |
| Dividends paid to stockholders   | (1,059)    | (1,034)   | (267)      |
|  | (7,587)    | (3,273)   | 15,343     |
| Net increase (decrease) in cash and cash equivalents                                     | (7,827)    | 4,120     | 6,320      |
| Cash and cash equivalents at beginning of year   | \$ 10,440  | \$ 6,320  |            |
| Cash and cash equivalents at end of year   | \$ 2,613   | \$ 10,440 | \$ 6,320   |

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NOTE 19 QUARTERLY FINANCIAL DATA (UNAUDITED)

The following tables present quarterly financial information for the Company for 2008 and 2007:

|   | For the year ended June 30, 2008<br>(in thousands) |               |                |               |
|---|--|---------------|----------------|---------------|
|   | Fourth quarter                                     | Third quarter | Second quarter | First quarter |
| Interest income                                     | \$ 5,191   | 5,272         | 5,569          | 5,583         |
| Interest expense                                    | 2,419  | 2,871         | 3,054          | 3,009         |
| Net interest income                                 | 2,772  | 2,401         | 2,515          | 2,574         |
| Provision for loan losses                           | 1,018  | 2,030         | 690            | 980           |
| Net interest income after provision for loan losses | 1,754  | 371           | 1,825          | 1,594         |
| Other income  | 820  | 497           | 487            | 393           |
| Other expense                                       | 2,398  | 2,481         | 2,559          | 2,412         |
| Income before income taxes                          | 176  | (1,613)       | (247)          | (425)         |
| Provision for income taxes                          | 250  | (631)         | (93)           | (179)         |
| Net income  | \$ (74)  | (982)         | (154)          | (246)         |

|   | For the year ended June 30, 2007<br>(in thousands) |               |                |               |
|---|--|---------------|----------------|---------------|
|   | Fourth quarter                                     | Third quarter | Second quarter | First quarter |
| Interest income                                     | \$ 5,965   | 5,429         | 5,202          | 5,091         |
| Interest expense                                    | 3,046  | 2,737         | 2,568          | 2,225         |
| Net interest income                                 | 2,919  | 2,692         | 2,634          | 2,866         |
| Provision for loan losses                           | 95   | 95            | 495            | 45            |
| Net interest income after provision for loan losses | 2,824  | 2,597         | 2,139          | 2,821         |
| Other income  | 493  | 1,001         | 987            | 367           |
| Other expense                                       | 2,498  | 2,318         | 2,259          | 2,175         |
| Income before income taxes                          | 819  | 1,280         | 867            | 1,013         |
| Provision for income taxes                          | 260  | 567           | 307            | 351           |
| Net income  | \$ 559   | 713           | 560            | 662           |



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**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

Not applicable.

**Item 9A(T). Controls and Procedures**

The Company's management, including the Company's principal executive officer and principal financial officer, have evaluated the effectiveness of the Company's disclosure controls and procedures, as such term is defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended, (the Exchange Act). Based upon their evaluation, the principal executive officer and principal financial officer concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures were effective for the purpose of ensuring that the information required to be disclosed in the reports that the Company files or submits under the Exchange Act with the Securities and Exchange Commission (the SEC): (1) is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and (2) is accumulated and communicated to the Company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure.

Management's annual report on internal control over financial reporting is incorporated herein by reference to Item 8 in this Annual Report on Form 10-K. This annual report does not include an attestation report of the Company's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permit the Company to provide only Management's report in this report.

There was no change in the Company's internal control over financial reporting that occurred during the Company's fiscal quarter ended June 30, 2008 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

**Item 9B. Other Information**

Not applicable.

**PART III**

**Item 10. Directors, Executive Officers and Corporate Governance**

**Directors**

The information contained under the section captioned *Proposal I Election of Directors* in the Company's definitive proxy statement for the Company's 2008 Annual Meeting of Stockholders (the Proxy Statement) is incorporated herein by reference.

**Executive Officers**

The information required regarding executive officers is incorporated herein by reference to the section captioned, *Executive Officers of United Community Bancorp and United Community Bank*, in Item 1 of this Annual Report on Form 10-K.

**Compliance with Section 16(a) of the Exchange Act**

The information contained under the section captioned *Section 16(a) Beneficial Ownership Reporting Compliance* in the Proxy Statement is incorporated herein by reference.

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**Code of Ethics**

The Company has adopted a Code of Ethics that applies to the Company's officers, directors and employees. For information concerning the Company's code of ethics, the information contained under the section captioned *Code of Ethics and Business Conduct* in the Proxy Statement is incorporated by reference. A copy of the code of ethics is available, without charge, upon written request to c/o Corporate Secretary, 92 Walnut Street, Lawrenceburg, Indiana 47025.

**Corporate Governance**

For information regarding the audit committee and its composition and the audit committee financial expert, the section captioned *Corporate Governance and Board Matters - Audit Committee* in the Proxy Statement are incorporated herein by reference.

**Item 11. Executive Compensation**

**Executive Compensation**

The information required by this item is incorporated herein by reference to the sections titled *Executive Compensation* and *Directors Compensation* in the Proxy Statement.

**Corporate Governance**

The information required by this item is incorporated herein by reference to the sections titled *Corporate Governance and Board Matters* in the Proxy Statement.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

**(a) Security Ownership of Certain Beneficial Owners**

The information required by this item is incorporated herein by reference to the section captioned *Stock Ownership* in the Proxy Statement.

**(b) Security Ownership of Management**

The information required by this item is incorporated herein by reference to the section captioned *Stock Ownership* in the Proxy Statement.

**(c) Changes in Control**

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

**(d) Equity Compensation Plans**

The Company has adopted the 2006 Equity Incentive Plan, pursuant to which equity may be awarded to participants. The plan has been approved by stockholders.

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The following table sets forth certain information with respect to the Company's equity compensation plan as of June 30, 2008.

|  | (a)   | (b)   | (c)  |
|--|---|---|--|
| Plan Category  | Number of securities to be issued upon exercise of outstanding options, warrants and rights | Weighted-average exercise price of outstanding options, warrants and rights | Number of securities remaining available for future issuance under equity compensation plan (excluding securities reflected in column (a)) |
| Equity compensation plan approved by security holders      | 522,558   | \$8.24(1)   | 58,072   |
| Equity compensation plans not approved by security holders |   |   |  |
| Total (2)  | 522,558   | \$8.24(1)   | 58,072   |

- (1) The weighted-average exercise price of outstanding stock options is \$11.53. Restricted stock grants do not have an exercise price and are subject to vesting provisions only.
- (2) The 2006 Equity Incentive Plan provides for a proportionate adjustment to the number of shares reserved thereunder in the event of a stock split, stock dividend, reclassification or similar event.

**Item 13. Certain Relationships and Related Transactions, and Director Independence**

**Certain Relationships and Related Transactions**

The information required by this item is incorporated herein by reference to the sections titled *Policies and Procedures for Approval of Related Persons Transactions*, and, *Transactions with Related Persons* in the Proxy Statement.

**Director Independence**

The information related to director independence required by this item is incorporated herein by reference to the section titled *Corporate Governance and Board Matters - Director Independence* in the Proxy Statement.

**Item 14. Principal Accounting Fees and Services**

The information required by this item is incorporated herein by reference to the sections captioned *Proposal 2 - Ratification of Independent Registered Public Accountants*, and, *Audit Related Matters*, in the Proxy Statement.

**PART IV**

**Item 15. Exhibits and Financial Statement Schedules**

**List of Documents Filed as Part of This Report**

(1) *Financial Statements*. The following consolidated financial statements are filed under Item 8 hereof:

Report of Independent Registered Public Accounting Firm

Consolidated Statements of Financial Condition as of June 30, 2008 and 2007

Consolidated Statements of Operations for the Years Ended June 30, 2008, 2007 and 2006

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Consolidated Statements of Comprehensive Income (Loss) for the Years Ended June 30, 2008, 2007 and 2006

Consolidated Statements of Stockholders' Equity for the Years Ended June 30, 2008, 2007 and 2006

Consolidated Statements of Cash Flows for the Years Ended June 30, 2008, 2007 and 2006 Notes to Consolidated Financial Statements

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(2) *Financial Statement Schedules.* All schedules for which provision is made in the applicable accounting regulations are either not required under the related instructions or are inapplicable, and therefore have been omitted.

(3) *Exhibits.* The following is a list of exhibits as part of this Annual Report on Form 10-K and is also the Exhibit Index.

| <b>No.</b> | <b>Description</b>  |
|------------|---|
| 3.1        | Charter of United Community Bancorp (1)   |
| 3.2        | Amended and Restated Bylaws of United Community Bancorp (2)   |
| 4.1        | Specimen Stock Certificate of United Community Bancorp (1)  |
| 10.1       | United Community Bank Employee Stock Ownership Plan and Trust Agreement*(1)   |
| 10.2       | Form of ESOP Loan Documents*(1)   |
| 10.3       | United Community Bank 401(k) Profit Sharing Plan and Trust and Adoption Agreement*(1)   |
| 10.4       | United Community Bank Employee Severance Compensation Plan*(1)  |
| 10.5       | United Community Bank Supplemental Executive Retirement Plan*(1)  |
| 10.6       | Employment Agreement between United Community Bancorp and William F. Ritzmann*(1)   |
| 10.7       | Employment Agreement between United Community Bancorp and Elmer G. McLaughlin*(1)   |
| 10.8       | Employment Agreement between United Community Bancorp and Vicki A. March*(1)  |
| 10.9       | Employment Agreement between United Community Bank and William F. Ritzmann, as amended*(1)  |
| 10.10      | Employment Agreement between United Community Bank and Elmer G. McLaughlin, as amended*(1)  |
| 10.11      | Employment Agreement between United Community Bank and James W. Kittle, as amended*(1)  |
| 10.12      | Employment Agreement between United Community Bank and W. Michael McLaughlin, as amended*(3)  |
| 10.13      | United Community Bank Directors Retirement Plan*(1)   |
| 10.14      | Executive Supplemental Retirement Income Agreements between United Community Bank and William F. Ritzmann, Elmer G. McLaughlin and James W. Kittle and Grantor Trust Agreements thereto*(1) |
| 10.15      | Rabbi Trust related to Directors Retirement Plan and Executive Supplemental Retirement Income Agreements*(1)  |
| 21         | Subsidiaries  |
| 23         | Consent of Clark, Schaefer, Hackett & Co.   |
| 31.1       | Rule 13(a)-14(a) Certification of Chief Executive Officer   |
| 31.2       | Rule 13(a)-14(a) Certification of Chief Financial Officer   |
| 32         | Certifications Pursuant to 18 U.S.C. Section 1350   |

\* Management contract or compensation plan or arrangement.

- (1) Incorporated herein by reference to the Company's Registration Statement on Form S-1, as amended, as initially filed with the SEC on December 14, 2005 (File No. 333-130302).
- (2) Incorporated herein by reference to the Company's Current Report on Form 8-K filed with the SEC on October 3, 2007 (File No. 0-51800).
- (3) Incorporated herein by reference to the Company's Annual Report on Form 10-K filed with the SEC on September 28, 2006.

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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

UNITED COMMUNITY BANCORP

Date: September 26, 2008

By: /s/ William F. Ritzmann  
William F. Ritzmann  
President and Chief Executive Officer  
(Duly Authorized Representative)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of the registrant in the capacities and on the dates indicated.

By: /s/ William F. Ritzmann  
William F. Ritzmann  
President, Chief Executive Officer and Director  
(Principal Executive Officer) September 26, 2008

By: /s/ Vicki A. March  
Vicki A. March  
Senior Vice President, Chief Financial Officer and  
Treasurer  
(Principal Financial and Accounting Officer) September 26, 2008

By: /s/ Ralph B. Sprecher  
Ralph B. Sprecher  
Chairman of the Board September 26, 2008

By: /s/ Robert J. Ewbank  
Robert J. Ewbank  
Director September 26, 2008

By: /s/ Jerry W. Hacker  
Jerry W. Hacker  
Director September 26, 2008

By: /s/ Elmer G. McLaughlin  
Elmer G. McLaughlin  
Chief Operating Officer and Director September 26, 2008

By: /s/ Anthony C. Meyer  
Anthony C. Meyer  
Director September 26, 2008

By: /s/ George M. Seitz  
George M. Seitz  
Director September 26, 2008

By: /s/ Eugene B. Seitz  
Eugene B. Seitz September 26, 2008

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Director

By: /s/ Richard C. Strzynski  
Richard C. Strzynski  
Director

September 26, 2008