

STURGIS BANCORP INC
Form 10-Q
November 15, 2002

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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20429
Form 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2002

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

For the transition period from _____ to _____

STURGIS BANCORP, INC.

(Exact name of registrant as specified in its charter)

MICHIGAN

(State of incorporation or organization)

0-49613

38-3609814

(Commission File No.)

(I.R.S. Employer Identification No.)

113-125 E. Chicago Road, Sturgis, Michigan 49091

(Address of principal executive offices)

(269) 651-9345

(Issuer's telephone number)

(Former name, former address and former fiscal year, if changed since last report.)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange of 1934 Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

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

| Class | Outstanding at November 13, 2002 |
|--------------------------------|-------------------------------------|
| Common Stock, \$1.00 par value | 2,838,819 |

Transitional Small Business Disclosure Format (check one); Yes No

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Certification of Chief Financial Officer

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PART I. FINANCIAL INFORMATION

Throughout this Form 10-Q, Sturgis Bancorp, Inc. will be referred to as Bancorp and Sturgis Bank and Trust Company and its subsidiaries will be referred to as the Bank. Bancorp is a financial holding company under the Bank Holding Company Act of 1956, as amended. The Bank is a wholly owned subsidiary of Bancorp.

Table of Contents**ITEM 1. FINANCIAL STATEMENTS**

STURGIS BANCORP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

| | September 30, 2002 | December 31, 2001 |
|--|-----------------------|----------------------|
| (Unaudited) | | |
| ASSETS | | |
| Cash and due from banks | \$ 11,319,713 | \$ 10,629,027 |
| Interest-bearing deposits in banks | 26,606,641 | 15,042,616 |
| Securities Available-for-sale | 1,303,831 | 259,735 |
| Securities Held-to-maturity | 12,698,867 | 3,904,413 |
| Federal Home Loan Bank stock, at cost | 4,115,400 | 4,115,400 |
| Loans held for sale | 3,554,531 | 4,414,906 |
| Loans, net | 221,432,003 | 219,113,940 |
| Real estate owned | 823,104 | 451,173 |
| Bank owned life insurance | 6,251,046 | 6,002,959 |
| Accrued interest receivable | 1,856,017 | 1,724,681 |
| Investment in limited partnership | 210,580 | 224,080 |
| Premises and equipment, net | 6,317,159 | 6,370,160 |
| Goodwill, net of accumulated amortization | 5,109,419 | 5,109,419 |
| Other intangible assets | 1,664,536 | 1,281,208 |
| Other assets | 1,005,893 | 1,145,555 |
| | \$ 304,268,740 | \$ 279,789,272 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Liabilities: | | |
| Deposit accounts: | | |
| Noninterest-bearing | \$ 15,188,762 | \$ 10,862,894 |
| Interest-bearing | 192,465,290 | 168,266,933 |
| Borrowings from Federal Home Loan Bank | 67,051,190 | 70,076,863 |
| Deferred federal income taxes | 292,083 | 248,333 |
| Accrued interest payable | 877,203 | 993,783 |
| Other liabilities | 767,519 | 843,532 |
| | 276,642,047 | 251,292,338 |
| Stockholders equity: | | |
| Common stock \$1 par value: Authorized 4,000,000 shares | | |
| Issued and outstanding 2,872,349 shares at Sept. 30, 2002 and 3,101,534 shares at December 31, 2001 | 2,872,349 | 3,101,534 |
| Additional paid-in capital | 18,430,023 | 20,435,912 |
| Retained earnings | 6,324,321 | 4,959,488 |
| | 27,626,693 | 28,496,934 |
| | \$ 304,268,740 | \$ 279,789,272 |

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STURGIS BANCORP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME

| | Three Months Ended September 30, | |
|---|-------------------------------------|------------------|
| | 2002 | 2001 |
| | (Unaudited) | |
| Interest income | \$ 4,416,668 | \$ 4,962,617 |
| Interest expense | 2,155,329 | 2,537,644 |
| | <u>2,261,339</u> | <u>2,424,973</u> |
| Net interest income | 2,261,339 | 2,424,973 |
| Provision for loan losses | 248,635 | 151,881 |
| | <u>2,012,704</u> | <u>2,273,092</u> |
| Net interest income after provision for loan losses | 2,012,704 | 2,273,092 |
| Noninterest income: | | |
| Service charges and other fees | 393,716 | 402,332 |
| Commission income | 222,852 | 194,850 |
| Mortgage banking activities | 425,634 | 408,859 |
| Trust fee income | 113,337 | 106,124 |
| Increase in cash surrender value of life insurance | 84,089 | |
| Other income | 28,326 | 26,483 |
| | <u>1,267,954</u> | <u>1,138,648</u> |
| Total noninterest income | 1,267,954 | 1,138,648 |
| Other expenses: | | |
| Salaries and employee benefits | 1,157,548 | 1,049,368 |
| Office occupancy and equipment | 336,581 | 349,868 |
| Deposit insurance premiums | 8,218 | 8,368 |
| Deposit account expenses | 52,559 | 49,915 |
| Service bureau expense | 156,348 | 151,102 |
| Professional fees and services | 74,221 | 62,154 |
| Amortization of intangibles | | 144,472 |
| Other | 441,354 | 435,283 |
| | <u>2,226,829</u> | <u>2,250,530</u> |
| Total other expenses | 2,226,829 | 2,250,530 |
| Income before provision for federal income tax | 1,053,829 | 1,161,210 |
| Provision for federal income tax | 336,141 | 381,723 |
| | <u>717,688</u> | <u>779,487</u> |
| Net income | \$ 717,688 | \$ 779,487 |
| Basic earnings per share | \$ 0.24 | \$ 0.25 |
| Diluted earnings per share | \$ 0.24 | \$ 0.25 |
| Dividends declared per share | \$ 0.07 | \$ 0.07 |

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STURGIS BANCORP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME

| | Nine Months Ended September 30, | |
|---|------------------------------------|---------------|
| | 2002 | 2001 |
| | (Unaudited) | |
| Interest income | \$ 13,116,140 | \$ 15,194,199 |
| Interest expense | 6,328,852 | 8,089,681 |
| Net interest income | 6,787,288 | 7,104,518 |
| Provision for loan losses | 1,063,892 | 419,979 |
| Net interest income after provision for loan losses | 5,723,396 | 6,684,539 |
| Noninterest income: | | |
| Service charges and other fees | 1,135,094 | 1,230,424 |
| Commission income | 715,504 | 586,779 |
| Mortgage banking activities | 1,284,935 | 981,665 |
| Trust fee income | 364,114 | 392,070 |
| Increase in cash surrender value of life insurance | 248,087 | |
| Other income | 51,952 | 30,303 |
| Total noninterest income | 3,799,686 | 3,221,241 |
| Other expenses: | | |
| Salaries and employee benefits | 3,455,508 | 3,126,758 |
| Office occupancy and equipment | 963,859 | 1,103,818 |
| Deposit insurance premiums | 24,234 | 25,189 |
| Deposit account expenses | 147,162 | 167,353 |
| Service bureau expense | 471,607 | 422,748 |
| Professional fees and services | 274,358 | 202,035 |
| Amortization of intangibles | | 431,164 |
| Other | 1,335,971 | 1,248,820 |
| Total other expenses | 6,672,699 | 6,727,885 |
| Income before provision for federal income tax | 2,850,382 | 3,177,895 |
| Provision for federal income tax | 854,410 | 1,045,502 |
| Net income | \$ 1,995,972 | \$ 2,132,393 |
| Basic earnings per share | \$ 0.67 | \$ 0.69 |
| Diluted earnings per share | \$ 0.67 | \$ 0.69 |
| Dividends declared per share | \$ 0.21 | \$ 0.19 |

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| | Nine Months Ended September 30 | |
|--|-----------------------------------|----------------------|
| | 2002 | 2001 |
| OPERATING ACTIVITIES: | (Unaudited) | (Unaudited) |
| Net Income | 1,995,972 | 2,132,393 |
| Depreciation | 445,152 | 521,242 |
| Amortization of goodwill | | 431,164 |
| Amortization/accretion on securities | 37,508 | 1,384 |
| Gain on sale of loans | (721,197) | (472,091) |
| Proceeds from the sale of loans held for sale | 61,498,898 | 48,916,334 |
| Loans originated for sale | (59,917,326) | (48,833,643) |
| Loss on sale of fixed assets | | 74,210 |
| Loss of equity of limited partnership | 13,500 | 13,500 |
| Income from bank owned life insurance | (248,087) | |
| Provision for loan losses | 1,063,892 | 419,979 |
| Decrease (increase) in accrued interest/other assets | 362,017 | (564,658) |
| Increase in other liabilities | (69,168) | (1,323,351) |
| NET CASH PROVIDED BY OPERATING ACTIVITIES: | 4,461,161 | 1,316,463 |
| INVESTING ACTIVITIES: | | |
| Net increase in interest-bearing deposits in banks | (11,564,025) | (15,124,477) |
| Proceeds from maturities of securities held-to-maturity | 1,105,000 | 4,585,000 |
| Purchases of securities held-to-maturity | (10,213,698) | (1,425,000) |
| Principal reductions securities held-to-maturity | 276,735 | 177,541 |
| Purchase of Federal Home Loan Bank stock | | (617,900) |
| Purchase of other securities | (1,044,096) | (2,051,120) |
| Net decrease (increase) in loans | (4,490,903) | 3,326,611 |
| Purchase of premises and equipment | (392,151) | (83,342) |
| Proceeds from sale of fixed assets | | 275,000 |
| NET CASH USED IN INVESTING ACTIVITIES: | (26,323,138) | (10,937,687) |
| FINANCING | | |
| Net increase in demand, now and savings account deposits | 7,831,776 | 8,117,944 |
| Net increase in time deposits | 20,692,450 | 11,521 |
| Payments to FHLB | (26,401,560) | (22,049,706) |
| Advances from FHLB | 23,375,887 | 21,000,000 |
| (Decrease) increase in advances for taxes and insurance | (79,677) | 324,751 |
| Stock redemption | (2,235,074) | |
| Cash dividends | (631,139) | (589,292) |
| NET CASH PROVIDED BY FINANCING ACTIVITIES: | 22,552,663 | 6,815,218 |
| NET INCREASE (DECREASE) IN CASH | 690,686 | (2,806,006) |
| BALANCE BEGINNING OF PERIOD: | \$ 10,629,027 | \$ 11,697,647 |
| BALANCE END OF PERIOD: | \$ 11,319,713 | \$ 8,891,641 |

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STURGIS BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note A: FINANCIAL STATEMENTS.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of Management, all adjustments (consisting only of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the nine-month period ended September 30, 2002 are not necessarily indicative of the results that may be expected for the year ended December 31, 2002. For further information, refer to the consolidated financial statements and footnotes thereto included in the Bancorp's Annual Report on Form 10-K for the year ended December 31, 2001.

Note B: ORGANIZATION AND ACCOUNTING POLICIES.

The following is a summary of the significant accounting policies followed in the preparation of the consolidated financial statements of Sturgis Bancorp and subsidiaries (individually and collectively referred to as Bancorp).

Organization

Bancorp is chartered as a financial holding company. Bancorp's primary asset is Sturgis Bank & Trust Company (Bank), a Michigan savings bank. The Bank, as a state-chartered stock savings bank and as a member of the Federal Home Loan Bank System (FHLB), is required to maintain an investment in the capital stock of the FHLB.

The Federal Deposit Insurance Corporation (FDIC) insures deposit accounts within certain limitations. A premium is required by the FDIC for the insurance of such accounts.

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**STURGIS BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited), Continued.**

Note B: ORGANIZATION AND ACCOUNTING POLICIES, Continued.

Principles of Consolidation

The consolidated financial statements include the accounts of Bancorp, the Bank and all wholly-owned subsidiaries. All significant intercompany accounts and transactions are eliminated in consolidation.

Use of Estimates in the Preparation of Financial Statements

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

The allowance for loan losses is a material estimate that is particularly susceptible to change in the near term. While management uses available information to recognize losses on loans, future additions to the allowance or write-downs may be necessary based on changes in economic conditions. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the allowance for loan losses. Such agencies could require Bancorp to recognize additions to the allowance or write-downs based on their judgment of information available to them at the time of their examination.

Securities

Debt securities that management has the positive intent and ability to hold to maturity are classified as held to maturity and recorded at amortized cost. Securities not classified as held to maturity or trading are classified as available for sale and recorded at fair value, with unrealized gains and losses excluded from earnings and reported as other comprehensive income.

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Declines in the fair value of held to maturity and available for sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. Gains and losses on the sale of securities are recorded on the trade date.

Loans

Substantially all of Bancorp's loan activity is with customers located in southwestern and southcentral lower Michigan with a major concentration in single-family residential lending.

Generally, loans are collateralized by real estate. Bancorp expects loans to be repaid from cash flow or proceeds from the sale of selected assets of the borrower. Bancorp's policy for requiring collateral is dependent upon management's credit evaluation of the borrower.

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**STURGIS BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited), Continued.**

Note B: ORGANIZATION AND ACCOUNTING POLICIES, Continued.

Interest on loans is accrued and credited to income based upon the principal amount outstanding. The accrual of interest income is generally discontinued when a loan becomes 90 days past due as to principal or interest or when, in the opinion of management, full collection of principal or interest is unlikely. When a loan is in non-accrual status, interest income is recognized only to the extent of cash received and when the full collection of principal is not in doubt. Management may elect to continue the accrual of interest when the estimated fair value of collateral is sufficient to cover the principal balance and accrued interest.

Loan origination fees and certain direct loan origination costs are deferred and the net amount amortized as an adjustment of the related loan yield over the contractual life of the loans. Amortization of deferred amounts is suspended when a loan becomes non-accrual.

Loans Held for Sale

The Bank sells a portion of its mortgage loan production into the secondary market. Loans held for sale are carried at the lower of cost or market until sold. Whenever loan cost exceeds market value on a net aggregate basis, a valuation allowance is recorded.

Allowance For Possible Loan Losses

The allowance for possible loan losses is maintained at a level considered by management to be adequate to absorb losses inherent in existing loans and commitments. The adequacy of the allowance is based on evaluations that take into consideration such factors as prior loss experience, changes in the nature and volume of the portfolio, overall portfolio quality, loan concentrations, specific impaired or problem loans and commitments, and current economic conditions that may affect the borrower's ability to pay.

Office Properties and Equipment

Office properties and equipment are carried at cost, less accumulated depreciation. Depreciation is computed on the straight-line method based on the estimated useful lives of the related assets.

Real Estate Owned

Real estate owned includes properties acquired through foreclosure proceedings or by acceptance of a deed in lieu of foreclosure. Real estate owned is recorded at the lower of its cost or the estimated fair market value (as determined by recent appraisals) less estimated selling costs. Any write-down of the loan balance to estimated fair market value (less estimated selling costs) when the property is foreclosed is charged to the allowance for loan losses. Subsequent market write-downs, operating expenses and gains or losses on disposition of real estate owned are charged to current earnings.

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**STURGIS BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited), Continued.**

Note B: ORGANIZATION AND ACCOUNTING POLICIES, Continued.

Investment In Limited Partnership

First Michiana Development Corporation, a wholly-owned subsidiary of the Bank, has an investment in a Michigan limited partnership, which is structured to generate low-income housing tax credits. The investment is accounted for using the equity method whereby Bancorp annually records its proportionate share of partnership losses as an adjustment to the carrying value of the investment.

Goodwill

Until adoption of FAS 142 in January of 2002, goodwill was amortized using accelerated methods over fifteen years. Beginning in January of 2002, the Bank no longer amortizes goodwill in accordance with FAS 142. On an ongoing basis, management assesses the recoverability of the goodwill. If an assessment of the goodwill indicates that its recoverability is impaired, a charge to expense is recorded for the amount of the impairment.

Mortgage Servicing Rights

Servicing assets are recognized as separate assets when rights are acquired through purchase or through sale of financial assets. Capitalized servicing rights are amortized into noninterest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets. Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to amortized cost. Impairment is determined by stratifying rights by predominant characteristics, such as interest rates and terms. Fair value is determined using prices for similar assets with similar characteristics, when available, or based upon discounted cash flows using market-based assumptions. Impairment is recognized through a valuation allowance for an individual stratum, to the extent that fair value is less than the capitalized amount for the stratum. There was no valuation allowance associated with capitalized servicing rights at September 30, 2002 or December 31, 2001.

Federal Income Taxes

Deferred tax assets and liabilities are recognized for temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. 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. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized.

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STURGIS BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited), Continued.

Note B: ORGANIZATION AND ACCOUNTING POLICIES, Continued.

Bancorp has qualified under provisions of the Internal Revenue Code, which permits it to deduct from taxable income a provision for bad debts in excess of such provision charged to income in the consolidated financial statements. Accordingly, retained earnings at September 30, 2002 includes approximately \$918,000 for which no provision for federal income taxes has been made. Unrecognized deferred tax on this amount is approximately \$312,000. If, in the future, this portion of retained earnings is used for any purpose other than to absorb bad debt losses, federal income taxes would be imposed at the then applicable rates.

Statement of Cash Flows

For the purposes of the consolidated statements of cash flows, Bancorp considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

| | Nine Months Ended September 30, | |
|---|------------------------------------|--------------|
| | 2002 | 2001 |
| Supplemental cash flow information: | | |
| Cash paid during the periods for: | | |
| Interest | \$ 6,445,432 | \$ 8,155,945 |
| Income taxes | 791,071 | 1,325,136 |
| Noncash investing and financing activities: | | |
| Loans transferred to real estate owned | 1,108,949 | 593,968 |
| Tax benefit of stock options exercised | | |

Earnings Per Share

Basic earnings per share is computed by dividing net income by the weighted average number of shares of common stock outstanding. Accordingly, for the three and nine month periods ended September 30, 2002 the weighted average number of common shares used in the computation of basic earnings per share was 2,929,611 and 2,987,758, respectively. The weighted average number of common shares for the three and nine month periods ended September 30, 2001 was 3,101,534.

Diluted earnings per share is computed by dividing net income by the weighted average number of shares of common stock outstanding plus the dilutive effect of outstanding stock options. For the three and nine month periods ended September 30, 2002 the weighted average number of common shares used in the computation of diluted earnings per share was 2,932,999 and 2,989,773, respectively. The weighted average number of common shares for the three and nine month periods ended September 30, 2001 was 3,101,534.

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**STURGIS BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited), Continued.**

Note B: ORGANIZATION AND ACCOUNTING POLICIES, Concluded.

Recent Accounting Pronouncements

In June 2001, Statement of Financial Accounting Standards No. 142 (FAS 142), *Goodwill and Other Intangible Assets* was issued and is effective for fiscal years beginning after December 15, 2001. Under FAS 142, identifiable intangible assets that meet certain criteria will continue to be amortized over their estimated useful lives. However, goodwill and non-identifiable intangible assets will no longer be amortized. Instead, these assets will be evaluated for impairment on an annual basis. If an asset is deemed to be impaired, the asset will be written down through an adjustment to current earnings. As a result of adopting FAS 142, Bancorp will no longer be amortizing goodwill.

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STURGIS BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited), Continued.

Note C: LOANS RECEIVABLE, NET.

A summary of the balances of loans follows:

| | <u>September 30, 2002</u> | <u>December 31, 2001</u> |
|---|-------------------------------|------------------------------|
| | (Unaudited) | |
| Mortgage loans on real estate: | | |
| Residential 1-4 family | \$ 140,564,791 | \$ 151,766,803 |
| Commercial | 48,926,328 | 34,872,863 |
| Construction loans residential | 7,804,726 | 7,931,916 |
| Construction loans commercial | 3,721,000 | 440,000 |
| | <u>201,016,845</u> | <u>195,011,582</u> |
| Commercial nonmortgage loans | 14,513,310 | 12,906,602 |
| Consumer and installment loans: | | |
| Loans secured by deposits | 464,943 | 571,739 |
| Other consumer and installment | 12,816,416 | 15,299,376 |
| | <u>13,281,359</u> | <u>15,871,115</u> |
| Subtotal | 228,811,514 | 223,789,299 |
| Less: | | |
| Allowance for possible loan losses | 1,803,434 | 1,300,000 |
| Unearned interest | 19,125 | 26,013 |
| Undisbursed portion of loans in process | 5,571,571 | 3,257,555 |
| Deferred loan fees | (14,619) | 91,791 |
| Loans receivable, net | <u>\$ 221,432,003</u> | <u>\$ 219,113,940</u> |

Note D: DEPOSITS.

Interest-bearing deposits are summarized as follows:

| | <u>September 30, 2002</u> | <u>December 31, 2001</u> |
|---------------------------------|-------------------------------|------------------------------|
| | (Unaudited) | |
| Passbook and statement savings | \$ 41,473,342 | \$ 38,075,301 |
| NOW accounts | 49,514,787 | 49,406,921 |
| Time: | | |
| \$100,000 and over | 34,862,168 | 15,096,975 |
| Under \$100,000 | 66,614,993 | 65,687,736 |
| Total interest-bearing deposits | <u>\$ 192,465,290</u> | <u>\$ 168,266,933</u> |

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STURGIS BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited), Concluded.

Note E: ADVANCES FROM FEDERAL HOME LOAN BANK.

Advances from the Federal Home Loan Bank of Indianapolis (FHLB) are collateralized by FHLB stock, all non-employee residential mortgage loans, certain U.S. Treasury and agency securities and mortgage-backed securities issued or guaranteed by the Federal Home Loan Mortgage Corporation, the Federal National Mortgage Association or the Government National Mortgage Association.

Bancorp had \$67.1 million and \$70.1 million in advances from FHLB at September 30, 2002 and December 31, 2001, respectively. Interest rates range from 2.20% to 7.34% with maturities ranging from October 2002 to February 2012.

Annual principal payments of FHLB advances are as follows:

| Twelve Months Ending September 30, | Amount | Weighted Rate |
|---------------------------------------|---------------|------------------|
| 2003 | \$ 13,019,167 | 4.08% |
| 2004 | 7,128,740 | 6.43% |
| 2005 | 2,557,211 | 6.73% |
| 2006 | 3,346,072 | 5.70% |
| 2007 | | |
| 2008 and thereafter | 41,000,000 | 4.75% |
| Total | \$ 67,051,190 | 4.92% |

Note F: CASH DIVIDENDS

Bancorp paid a cash dividend of \$.07 per share on its issued and outstanding common stock on September 13, 2002 to shareholders of record of August 15, 2002. Total dividends paid on September 13, 2002 were \$206,469.

Bancorp paid a cash dividend of \$.07 per share on its issued and outstanding common stock on June 17, 2002 to shareholders of record of May 17, 2002. Total dividends paid on June 17, 2002 were \$207,562.

Bancorp paid a cash dividend of \$.07 per share on its issued and outstanding common stock on March 29, 2002 to shareholders of record as of February 28, 2002. Total dividends paid on March 29, 2002 were \$217,107.

Note G: EMPLOYEE BENEFIT PLANS

The Bank has a Defined Contribution Plan and Trust/401(k). The plan permits eligible employees to contribute a percentage of their compensation with the Bank contributing 25% of the employee's pre-tax contribution, not to exceed 10% of the employee's total compensation, as defined in the agreement. The plan also permits the Bank to make discretionary contributions.

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

Forward Looking Statements

This report contains statements that constitute forward-looking statements. These statements appear in several places in this report and include statements regarding intent, belief, outlook, objectives, efforts, estimates or expectations of Bancorp, primarily with respect to future events and the future financial performance of the Bancorp. Any such forward-looking statements are not guarantees of future events or performance and involve risks and uncertainties, and actual results may differ materially from those in the forward-looking statement. Factors that could cause a difference between an ultimate actual outcome and a preceding forward-looking statement include, but are not limited to, changes in interest rates and interest rate relationships; demand for products and services; the degree of competition by traditional and non-traditional competitors; changes in banking laws and regulations; changes in tax laws; changes in prices, levies, and assessments; the impact of technological advances; government and regulatory policy changes; the outcome of any pending and future litigation and contingencies; trends in consumer behavior and ability to repay loans; and changes of the world, national and local economies. The Bancorp undertakes no obligation to update, amend or clarify forward-looking statements as a result of new information, future events, or otherwise.

Financial Condition

Assets. Bancorp's total assets at September 30, 2002 were \$304.3 million compared to \$279.8 million at December 31, 2001, an increase of \$24.5 million or 8.7%.

Loans held for sale. The decrease of \$0.9 million in loans held for sale from December 31, 2001 to September 30, 2002 is due to the timing of loan sales. Loans held for sale typically are sold within two weeks of origination.

Loans. Bancorp's net loans increased to \$221.4 million at September 30, 2002 from \$219.1 million at December 31, 2001. This increase was primarily due to growth in commercial mortgage loans, which offset the effect of unusually high residential mortgage loan refinances. Adjustable-rate mortgage loans were refinanced into fixed-rate mortgages to lock in low rates. Bancorp sells long-term, fixed-rate, residential mortgages in the secondary market, so the residential mortgage loans decreased to \$140.6 million at September 30, 2002 from \$151.8 million at December 31, 2001. The composition of Bancorp's loan portfolio continued to shift from residential mortgages to commercial mortgages. The commercial mortgage portfolio increased to \$48.9 million, or 21.4% of gross loans, at September 30, 2002, compared to \$34.9 million, or 15.6% of gross loans, at December 31, 2001. During the first nine months of 2002 and 2001, Bancorp sold residential originations of fixed-rate mortgages with terms of 10 years or greater into the secondary market. The demand for fixed-rate mortgage loans was higher in 2002 than 2001 due to lower interest rates. The proceeds from the sale of loans (fixed-rate, residential mortgages) were \$61.5 million and \$48.9 million for the nine months ended September 30, 2002 and 2001, respectively. The mortgage loans originated for sale (\$59.9 million during the nine months ended September 30, 2002 and \$48.8 million during the nine months ended September 30, 2001) were primarily funded by the secondary mortgage market sales. At September 30, 2002, total outstanding loan commitments were \$12.6 million and \$20.0 million on fixed and variable-rate loans, respectively. The Bank will fund these loan commitments with interest-bearing deposits, other short-term investments, maturing assets, and additional FHLB borrowings, if needed. The

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decision to sell fixed-rate mortgages with original maturities of 10 years or greater protects Bancorp from the interest rate risk inherent in holding these longer fixed-rate loans and provides a source of liquidity to fund loan demand.

Mortgage loans serviced for others increased by \$26.8 million to \$161.6 million at September 30, 2002 from \$134.8 million at December 31, 2001. The entire servicing portfolio consists of loans originated by the Bank and sold in the secondary mortgage market with servicing retained by Bancorp. Bancorp has not purchased any mortgage servicing rights.

Allowance for loan losses. The Bank makes provisions for loan losses in accordance with the changes in the credit risk of the loan portfolio. The provisions are based on the historic loss experience of the Bank, adjusted for the increasing credit risk inherent in the growing commercial loan portfolio. The Bank makes general provisions by loan category; residential mortgages, nonresidential mortgages, commercial loans, home equity loans, second mortgages, consumer loans and deposit account loans. Commercial loans and nonresidential mortgages are graded on an 8-point scale, based on the credit quality. Loan grades are reviewed at least annually. The grade of the loan determines the allowance for losses. Loans graded 6 or higher are reviewed for specific reserves, determined by management's assessment of risk.

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The Bank maintains general reserves against possible loan losses, calculated as a percentage of total loans based on historic loss experience. The following table provides an analysis of the allowance for loan losses:

| | Nine Months Ended Sept. 30, 2002 | For the year ended December 31, | | |
|--|--|---------------------------------|------------|------------|
| | | 2001 | 2000 | 1999 |
| Balance at the beginning of the period | 1,300,000 | \$ 803,744 | \$ 730,000 | \$ 686,896 |
| Charge-offs: | | | | |
| Residential mortgages | 324,769 | 226,230 | 117,403 | 15,000 |
| Commercial mortgages | 9,942 | 42,900 | | |
| Construction loans residential | | | | |
| Construction loans commercial | | | | |
| Commercial nonmortgage loans | 180,718 | 175,675 | 25,061 | |
| Loans secured by deposits | | | | |
| Other consumer and installment loans | 89,642 | 162,412 | 188,219 | 127,890 |
| Total charge-offs | 605,071 | 607,217 | 330,683 | 142,890 |
| Recoveries | | | | |
| Residential mortgages | | 21,344 | 54,261 | 3,000 |
| Commercial mortgages | | | | |
| Construction loans residential | | | | |
| Construction loans commercial | | | | |
| Commercial nonmortgage loans | 16,548 | 3,021 | 2,044 | |
| Loans secured by deposits | | | | |
| Other consumer and installment loans | 28,065 | 22,914 | 39,122 | 78,994 |
| Total recoveries | 44,613 | 47,279 | 95,427 | 81,994 |
| Net charge-offs | 560,458 | 559,938 | 235,256 | 60,896 |
| Provision for loan losses | 1,063,892 | 1,056,194 | 309,000 | 104,000 |
| Balance at the end of the period | \$ 1,803,434 | \$ 1,300,000 | \$ 803,744 | \$ 730,000 |
| Ratio of net charge-offs during the period to Average loans outstanding during the period | 0.26% | 0.25% | 0.11% | 0.03% |
| Allowance for loan losses to total loans | 0.79% | 0.58% | 0.36% | 0.35% |
| Nonperforming assets to total assets | 1.63% | 1.55% | 0.86% | 0.80% |
| Allowance for loan losses to nonperforming assets | 36.47% | 29.91% | 34.50% | 36.50% |

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The following table shows the allocation of the allowance for loan losses at the dates indicated by loan type:

| | <u>September 30, 2002</u> | | <u>December 31, 2001</u> | | <u>December 31, 2000</u> | | <u>December 31, 1999</u> | |
|--|---------------------------|---|--------------------------|---|--------------------------|---|--------------------------|---|
| | <u>Amount</u> | <u>Percent of Loans in Each Category to Total Loans</u> | <u>Amount</u> | <u>Percent of Loans in Each Category to Total Loans</u> | <u>Amount</u> | <u>Percent of Loans in Each Category to Total Loans</u> | <u>Amount</u> | <u>Percent of Loans in Each Category to Total Loans</u> |
| Residential mortgages | \$ 395,199 | 60.15% | \$ 304,503 | 67.13% | \$ 391,768 | 71.96% | \$ 358,027 | 73.33% |
| Commercial mortgages | 554,659 | 22.10% | 470,459 | 15.92% | 189,927 | 11.73% | 92,273 | 9.60% |
| Construction loans | | | | | | | | |
| residential | 12,313 | 3.52% | 35,014 | 3.62% | 23,871 | 2.14% | | 3.43% |
| commercial | 42,184 | 1.68% | | 0.20% | | 0.14% | | 0.13% |
| Commercial nonmortgage loans | 149,101 | 6.55% | 165,188 | 5.89% | 92,594 | 5.72% | 125,077 | 5.61% |
| Loans secured by deposits | | 0.21% | | 0.26% | | 0.19% | | 0.08% |
| Other consumer and installment | 649,978 | 5.79% | 324,836 | 6.98% | 105,584 | 8.14% | 154,623 | 7.82% |
| Total allowance for loan losses | \$ 1,803,434 | 100.00% | \$ 1,300,000 | 100.00% | \$ 803,744 | 100.00% | \$ 730,000 | 100.00% |

Loans in nonaccrual status at September 30, 2002 consisted primarily of residential and commercial real estate loans, for which foreclosure has begun or full collection of the loan is questionable. The following table presents the aggregate amount of troubled loan categories as of the date indicated:

| | <u>Sept. 30, 2002</u> | <u>2001</u> | <u>December 31, 2000</u> | <u>1999</u> |
|---|-----------------------|---------------------|--------------------------|---------------------|
| Past due - 90 days or greater | \$ 1,115,762 | \$ 1,073,625 | \$ 1,314,288 | \$ 1,142,680 |
| Nonaccrual loans | 3,006,479 | 2,821,965 | 911,610 | 487,574 |
| Real estate owned | 823,104 | 451,173 | 103,500 | 369,952 |
| Total nonperforming assets | 4,945,345 | 4,346,763 | 2,329,398 | 2,000,206 |
| Restructured assets | 1,372,363 | 1,381,920 | 1,030,858 | 514,746 |
| Total troubled assets | \$ 6,317,708 | \$ 5,728,683 | \$ 3,360,256 | \$ 2,514,952 |
| Ratio of troubled assets to total loans | 2.76% | 2.56% | 1.50% | 1.22% |
| Ratio of troubled assets to total assets | 2.08% | 2.05% | 1.24% | 1.00% |

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Interest-bearing Deposits in Banks. Interest-bearing deposits in banks were \$26.6 million at September 30, 2002, compared to \$15.0 million at December 31, 2001, an increase of \$11.6 million. During the nine months ended September 30, 2002, growth in deposits provided funds for increased overnight investments at FHLB and investments in \$100,000 certificates of deposit in domestic financial institutions.

Securities Available-for-sale. Securities available-for-sale were \$1.3 million at September 30, 2002, compared to \$259,735 at December 31, 2001, an increase of \$1.0 million. This increase is primarily due to Bancorp's purchase of shares in a mutual fund investing in adjustable-rate mortgages.

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Securities Held-to-Maturity. Investment securities consisting of U.S. Treasury and agency securities, municipal obligations, and mortgage-backed securities were \$12.7 million at September 30, 2002 compared to \$3.9 million at December 31, 2001, an increase of \$8.8 million. This increase was due to the purchase of municipal securities, Small Business Administration pool securities and trust preferred securities.

Goodwill, net of Accumulated Amortization. Goodwill, net of accumulated amortization was \$5.1 million at September 30, 2002 and at December 31, 2001. Because the Bank adopted FAS 142 effective January 2002, the Bank recognized no amortization expense for the nine months ended September 30, 2002 (see Goodwill disclosure in Accounting Policies). The Bank recorded amortization expense of \$431,164 for the nine months ended September 30, 2001.

Deposits and Borrowed Funds. Deposits were \$207.7 million at September 30, 2002 compared to \$179.1 million at December 31, 2001, an increase of \$28.5 million or 15.9%. The increase is primarily in certificates of deposit. The Bank positioned itself to increase net interest income in a rising interest rate environment by extending liability maturities in the historically low interest rate market.

The Bank's certificates of deposit increased from \$80.8 million at December 31, 2001 to \$101.5 million at September 30, 2002. Bancorp accepted brokered certificates of deposit of \$7.0 million. The Bank will continue to manage the rates offered on its time deposits and use borrowed funds when that strategy enhances net interest income.

The Bank had \$67.1 million and \$70.1 million in advances from FHLB at September 30, 2002 and December 31, 2001, respectively. Interest rates range from 2.20% to 7.34% with maturities ranging from October 2002 to February 2012.

Liquidity

Bancorp maintains certain levels of liquid assets (the most liquid of which are cash and cash equivalents and investment securities) in order to meet demands from loan commitments, savings withdrawals and other obligations. Bancorp manages liquidity by maintaining a portion of its liquid assets in overnight accounts and by keeping various maturities in its portfolio of investment securities. The primary sources of liquidity are loan repayments and sales, maturing investments, deposit accounts, and FHLB borrowings.

For the nine months ended September 30, 2002, net cash increased \$691,000. For the nine months ended September 30, 2001, net cash decreased by \$2.8 million. Comparing the cash flows for the two periods, the \$3.1 million increase in cash provided by operating activities primarily relates to other liabilities. The \$15.4 million increase in cash used in investing activities resulted primarily from the net changes in interest-bearing deposits in FDIC-insured financial institutions, investment activity and loans. The \$15.7 million increase in cash provided by financing activities is due to deposit growth, payments of borrowings from FHLB and stock redemption.

Capital Resources

The stockholders' equity of Bancorp was \$27.6 million at September 30, 2002 compared to \$28.5 million at December 31, 2001, a decrease of \$870,241 or 3.1%. During January 2002, the Board of Bancorp approved a program to repurchase up to 10 percent of Bancorp's issued and

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outstanding common stock in the open market and in privately negotiated transactions. Through September 30, 2002, Bancorp had redeemed 229,185 shares at a total redemption price of approximately \$2.2 million. The program authorizes purchases of an additional 80,968 shares at market prices. If purchased at the closing price of September 30, 2002, the additional repurchase would be approximately \$820,000.

The Federal Reserve Board (FRB) has adopted risk-based capital guidelines applicable to Bancorp. These guidelines require that financial holding companies, such as Bancorp, maintain capital commensurate with both on and off balance sheet credit risks of their operations. Under the guidelines, a financial holding company must have a minimum ratio of total capital to risk-weighted assets of 8.0%.

In addition, a financial holding company must maintain a minimum ratio of Tier 1 capital equal to 4.0% of risk-weighted assets. Tier 1 capital includes common stockholders equity, qualifying perpetual preferred stock and minority interest in equity accounts of consolidated subsidiaries less goodwill.

As a supplement to the risk-based capital requirements, the FRB has also adopted leverage capital ratio requirements. The leverage ratio requirements establish a minimum ratio of Tier 1 capital to total assets, less goodwill, of 3% for the most highly rated financial holding companies. All other financial holding companies are required to maintain additional Tier 1 capital yielding a leverage ratio of 4%-5%, depending on the particular circumstances and risk profile of the institution.

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The following table summarizes the capital ratios of Bancorp at September 30, 2002 and the Bank at December 31, 2001 (prior to the formation of Bancorp):

| | <u>September 30, 2002</u> | <u>December 31, 2001</u> |
|------------------|-------------------------------|------------------------------|
| Equity to assets | 9.1% | 10.2% |
| Tier I leverage | 7.8% | 8.6% |
| Risk-based: | | |
| Tier I Capital | 11.1% | 12.6% |
| Total Capital | 12.0% | 13.3% |

Results of Operations

Bancorp reported net income of \$717,688 or \$0.24 per share for the three months ended September 30, 2002 compared to net income of \$779,487 or \$0.25 per share for the three months ended September 30, 2001. Bancorp reported net income of \$1,995,972 or \$0.67 per share for the nine months ended September 30, 2002 compared to net income of \$2,132,393 or \$0.69 per share for the nine months ended September 30, 2001.

Net Interest Income

Three Months Ended September 30, 2002 Compared to Three Months Ended September 30, 2001. Net interest income decreased \$163,634 to \$2.3 million from \$2.4 million. This decrease was caused by the changes in the average interest-earning assets and interest-paying liabilities. Average interest-earning assets increased \$11.4 million to \$268.5 million for the three months ended September 30, 2002, compared to \$257.1 million for the three months ended September 30, 2001. Average interest-paying liabilities increased \$17.9 million to \$265.0 million for the three months ended September 31, 2002 from \$247.1 million for the three months ended September 30, 2001. The decrease in market interest rates to historically low levels also contributed to the decrease in net interest income.

Nine Months Ended September 30, 2002 Compared to Nine Months Ended September 30, 2001. Net interest income decreased \$317,230 to \$6.8 million from \$7.1 million. This decrease was caused by the changes in the average interest-earning assets and interest-paying liabilities. Average interest-earning assets increased \$4.3 million to \$258.3 million for the nine months ended September 30, 2002, compared to \$254.0 million for the nine months ended September 30, 2001. Average interest-paying liabilities increased \$10.0 million to \$256.1 million for the nine months ended September 30, 2002 from \$246.1 million for the nine months ended September 30, 2001. The decrease in market interest rates to historically low levels also contributed to the decrease in net interest income.

Provision for Loan Losses

Three Months Ended September 30, 2002 Compared to Three Months Ended September 30, 2001. The provision for loan losses was \$248,635 for the quarter ended September 30, 2002 and \$151,881 for the quarter ended September 30, 2001. The increase is due to the depressed economy, which has increased past due and classified loans, and Bancorp's gradually changing portfolio to include more commercial loans. The provision for loan losses was based upon management's assessment of relevant factors, including types and amounts of non-performing loans, historical and anticipated loss experience on such types of loans, and current and projected economic conditions.

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Nine Months Ended September 30, 2002 Compared to Nine Months Ended September 30, 2001. The provision for loan losses was \$1,063,892 for the nine months ended September 30, 2002 and \$419,979 for the nine months ended September 30, 2001. The increase is due to the depressed economy, which has increased past due and classified loans, and Bancorp's gradually changing portfolio to include more commercial loans.

The provision for loan losses, net of charge-offs and recoveries, for the nine months ended September 30, 2002 increases the allowance as a percentage of total loans from 0.58% at December 31, 2001 to 0.79% at September 30, 2002.

Noninterest Income

Three Months Ended September 30, 2002 Compared to Three Months Ended September 30, 2001. Noninterest income was \$1.3 million for the three months ended September 30, 2002 compared to \$1.1 million for the three months ended September 30, 2001, an increase of \$129,306 or 11.4%. Several components of noninterest income lead to the overall change between the three month periods ended September 30, 2002 and 2001. Income from mortgage banking activities (net) was \$425,634 for the three months ended September 30, 2002 and \$408,859 for the three months ended September 30, 2001. This increase is due to the increase in loan sales during the third quarter of 2002 compared to the third quarter of 2001. Commission income was \$222,852 for the three months ended September 30, 2002 as compared to \$194,850 for the three months ended September 30, 2001. This increase is due to growth in account relationships at Oakleaf Financial Services, Inc., the Bank's wholly owned investment subsidiary. During the three months ended September 30, 2002, Bancorp recognized an increase in cash surrender value of life insurance totaling \$84,089 as compared to \$0 for the same period in the prior year related to insurance policies on key personnel that were purchased in December 2001.

Nine Months Ended September 30, 2002 Compared to Nine Months Ended September 30, 2001. Noninterest income was \$3.8 million for the nine months ended September 30, 2002 compared to \$3.2 million for the nine months ended September 30, 2001, an increase of \$578,445 or 18.0%. The major component of this increase was mortgage banking activities, net of amortization of originated mortgage servicing rights. Income from mortgage banking activities (net) was \$1,284,935 for the nine months ended September 30, 2002 and \$981,665 for the nine months ended September 30, 2001. This increase is due to the increase in loan sales, caused by the lower interest rates on fixed-rate residential mortgages. Other significant changes in noninterest income for the nine months ended September 30, 2002 as compared to the nine months ended September 30, 2001 include an increase in commission income of \$128,725 and an increase in cash surrender value of life insurance totaling \$248,087. The reasons for these changes are the same as noted above for the three months ended September 30, 2002 and 2001.

Noninterest Expense

Three Months Ended September 30, 2002 Compared to Three Months Ended September 30, 2001. Noninterest expense was \$2.2 million for the three months ended September 30, 2002 compared to \$2.3 million for the three months ended September 30, 2001, a decrease of \$23,701. Amortization expense was not recognized in 2002, due to adoption of FAS 142. Amortization expense for the three months ended September 30, 2001 was \$144,472. Salaries and employee benefits increased by \$108,180 due to staffing changes, salary adjustments and cost of living increases that took effect January 2002.

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Nine Months Ended September 30, 2002 Compared to Nine Months Ended September 30, 2001. Noninterest expense was \$6.7 million for the nine months ended September 30, 2002 compared to \$6.7 million for the nine months ended September 30, 2001, a decrease of \$55,186. Amortization expense was not recognized in 2002, due to adoption of FAS 142. Amortization expense for the nine months ended September 30, 2001 was \$431,164. The largest component of noninterest expense is salaries and employee benefits which increased \$328,750 due to staffing changes, salary adjustments and cost of living increases that took effect January 2002.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The information concerning quantitative and qualitative disclosures about market risk contained under the captions *Asset/Liability Management* and *Effect of Interest Rate Fluctuations* on pages 13 through 17 (inclusive) of Sturgis Bank & Trust's Annual Report to Shareholders for the year ended December 31, 2001 is herein incorporated by reference. Such Annual Report was previously filed as Exhibit 13.1 to Sturgis Bank & Trust's Annual Report on Form 10-K for the year ended December 31, 2001. This Form 10-K was filed by Sturgis Bancorp, Inc. as the successor issuer to Sturgis Bank & Trust Company pursuant to paragraph (g) of Rule 12g-3 under the Securities Exchange Act of 1934.

Copies of the Bank's filings with the FDIC under the Securities Exchange Act of 1934 can be obtained from Sturgis Bank & Trust Company by contacting Leonard L. Eishen at Sturgis Bank & Trust Company, 113-125 E. Chicago Road, Sturgis, Michigan 49091, telephone number (269) 651-9345 or, for a nominal fee, from Ms. Marcia Fields at the FDIC, telephone number (202) 898-8913 or fax number (202) 898-3909. Filings of Bancorp can be obtained from Bancorp by contacting Leonard L. Eishen at Sturgis Bancorp, Inc., 113-125 E. Chicago Road, Sturgis, Michigan 49091, telephone number (269) 651-9345 or through the Securities and Exchange Commission Edgar System at www.sec.gov.

Asset/Liability Management

The primary component of Bancorp's earnings is net interest income. Bancorp's asset/liability management strategy is to maximize net interest income over time by reducing the impact of fluctuating interest rates. This is accomplished by matching the mix and maturities of its assets and liabilities. At the same time Bancorp's asset/liability strategies for managing interest rate risk must also accommodate customer demands for particular types of deposit and loan products. Bancorp uses various asset/liability management techniques in an attempt to maintain a profitable mix of financial assets and liabilities, provide deposit and loan products that meet the needs of its market area, and maintain control over interest rate risk resulting from changes in interest rates.

Strategies employed by Bancorp to manage the rate sensitivity of its assets include origination of adjustable rate mortgage and consumer loans and purchase of adjustable rate and short-term fixed rate investments. Bancorp also attempts to reduce the rate sensitivity of its liabilities by emphasizing core deposits, which are less sensitive to changes in interest rates, attracting longer term certificates of deposits when the market permits, and using long term Federal Home Loan Bancorp advances when such rates are competitive. Management will continue to monitor the impact of its borrowings and lending policies on Bancorp's sensitivity to interest rate fluctuations.

Bancorp faces market risk to the extent that both earnings and the fair values of its financial instruments are affected by changes in interest rates. Bancorp manages this risk with static GAP analysis and simulation modeling. Throughout the first nine months of 2002, the results of these measurement techniques were within Bancorp's policy guidelines for rising interest-rate scenarios. Bancorp does not believe that there have been material changes in the nature of Bancorp's primary market risk exposures, including the categories of market risk to which Bancorp is exposed and the particular markets that present the primary risk of loss to Bancorp. As of the date of this Form 10-Q Quarterly Report, Bancorp does not know of or expect any material change in the general nature of its primary market risk exposure in the near term.

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The methods by which Bancorp manages its primary market risk exposures, as described in the sections of its annual report incorporated by reference in response to this item, have not changed materially during the current year. As of the date of this Form 10-Q Quarterly Report, Bancorp does not expect to change those methods in the near term. However, Bancorp may change those methods in the future to adapt to changes in circumstances or to implement new techniques.

Bancorp's market risk exposure is mainly comprised of its vulnerability to interest rate risk. Prevailing interest rates and interest rate relationships in the future will be primarily determined by market factors, which are outside of Bancorp's control. All information provided in response to this item consists of forward-looking statements. Reference is made to the section captioned "Forward Looking Statements" at the end of Management's Discussion and Analysis of Financial Condition and Results of Operations in this Form 10-Q Quarterly Report for a discussion of the limitations on Bancorp's responsibility for such statements.

ITEM 4. CONTROLS AND PROCEDURES

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

Bancorp's chief executive officer and chief financial officer have concluded that Bancorp's disclosure controls (as defined in Exchange Act Rule 13a-14(c)) are sufficiently effective to ensure that the information required to be disclosed by Bancorp in the reports it files under the Exchange Act is gathered, analyzed and disclosed with adequate timeliness, accuracy and completeness, based on an evaluation of such controls and procedures conducted within 90 days prior to the date hereof.

CHANGES IN INTERNAL CONTROLS

There have been no significant changes in Bancorp's internal controls or in other factors that could significantly affect these controls subsequent to the date of the evaluation referred to above.

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There are no material legal proceedings other than the ordinary routine proceedings of Bancorp.

ITEM 2. CHANGES IN SECURITIES

The information contained in the section captioned "Market Information" in the 2001 Annual Report to Stockholders is incorporated herein by reference. Such Annual Report was previously filed as Exhibit 13.1 to Sturgis Bank & Trust's Annual Report on Form 10-K for the year ended December 31, 2001. This Form 10-K was filed by Sturgis Bancorp, Inc. as the successor issuer to Sturgis Bank & Trust Company pursuant to paragraph (g) of Rule 12g-3 under the Securities Exchange Act of 1934. In addition to the information incorporated by reference, there have been no sales of unregistered securities by Bancorp during the nine months ended September 30, 2002.

ITEM 6. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

| (a) Exhibit Listing | Exhibit Number | Description | |
|----------------------------|-----------------------|--|-----|
| | 2.1 | Plan of Reorganization and Merger Agreement (1) | |
| | 2.2 | Consolidation Agreement (1) | |
| | 3.1 | Articles of Incorporation of Sturgis Bancorp, Inc. (1) | |
| | 3.2 | Bylaws of Sturgis Bancorp, Inc. (1) | |
| | 10.1 | Sturgis Federal Savings Bank Non-Employee Director Stock Option Plan (2) | |
| | 10.2 | Sturgis Federal Savings Bank Director Stock Option Plan (2) | |
| | 10.3 | Sturgis Federal Savings Bank Employee Stock Option Plan (3) | |
| | 10.4 | Employment Agreement with Eric L. Eishen (4) | |
| | 10.5 | Employment Agreement with Brian P. Hoggatt (4) | |
| | 10.6 | Employment Agreement with David E. Watters (4) | |
| | 10.7 | Employment Agreement with Ronald W. Scheske (4) | |
| | 10.8 | Employment Agreement with Steven Gage | E-1 |
| | 13.1 | Annual Report to Stockholders (5) | |
| | 21 | Subsidiaries of Registrant (5) | |

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| | |
|------|---|
| 23 | Consents of Independent Auditors (5) |
| 99.1 | Certification of the CEO Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 99.2 | Certification of the CFO Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |

- (1) Incorporated by reference from the Proxy Statement dated November 21, 2001 of Sturgis Bank & Trust Company.
- (2) Incorporated by reference from 1994 Form 10-KSB of Sturgis Federal Savings Bank, the predecessor of Sturgis Bank & Trust Company.
- (3) Incorporated by reference from 1995 Form 10-KSB of Sturgis Federal Savings Bank, the predecessor of Sturgis Bank & Trust Company.
- (4) Incorporated by reference from Form 10-Q of Sturgis Bancorp, Inc. for the quarter ended June 30, 2002
- (5) Incorporated by reference from 2001 Form 10-K for Sturgis Bancorp, Inc.

(b) Reports on Form 8-K

During the first quarter of 2002, there was one report filed on Form 8-K, on February 4, 2002, announcing the deemed registration of the Bancorp stock under Section 12(g) of the Securities Exchange Act of 1934 pursuant to Rule 12g-3(a). Bancorp filed no reports on Form 8-K during the quarters ended June 30, 2002 and September 30, 2002.

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SIGNATURES

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

STURGIS BANCORP, INC.
(Registrant)

Date November 13, 2002

/s/ Leonard L. Eishen

Leonard L. Eishen, President
and Chief Executive Officer

Date November 13, 2002

/s/ Brian P. Hoggatt

Brian P. Hoggatt, Chief Financial Officer

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I, Leonard L. Eishen, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Sturgis Bancorp, Inc.
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
 - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the Evaluation Date); and
 - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date November 13, 2002

/s/ Leonard L. Eishen

Leonard L. Eishen, President,
Chief Executive Officer

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I, Brian P. Hoggatt, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Sturgis Bancorp, Inc.
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
 - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the Evaluation Date); and
 - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date November 13, 2002

/s/ Brian P. Hoggatt

Brian P. Hoggatt, Chief Financial Officer

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| Exhibit Number | Description | |
|-----------------------|---|-----|
| 2.1 | Plan of Reorganization and Merger Agreement (1) | |
| 2.2 | Consolidation Agreement (1) | |
| 3.1 | Articles of Incorporation of Sturgis Bancorp, Inc. (1) | |
| 3.2 | Bylaws of Sturgis Bancorp, Inc. (1) | |
| 10.1 | Sturgis Federal Savings Bank Non-Employee Director Stock Option Plan (2) | |
| 10.2 | Sturgis Federal Savings Bank Director Stock Option Plan (2) | |
| 10.3 | Sturgis Federal Savings Bank Employee Stock Option Plan (3) | |
| 10.4 | Employment Agreement with Eric L. Eishen (4) | |
| 10.5 | Employment Agreement with Brian P. Hoggatt (4) | |
| 10.6 | Employment Agreement with David E. Watters (4) | |
| 10.7 | Employment Agreement with Ronald W. Scheske (4) | |
| 10.8 | Employment Agreement with Steven Gage | E-1 |
| 13.1 | Annual Report to Stockholders (5) | |
| 21 | Subsidiaries of Registrant (5) | |
| 23 | Consents of Independent Auditors (5) | |
| 99.1 | Certification of the CEO Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 | |
| 99.2 | Certification of the CFO Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 | |

(1) Incorporated by reference from the Proxy Statement dated November 21, 2001 of Sturgis Bank & Trust Company.

(2) Incorporated by reference from 1994 Form 10-KSB of Sturgis Federal Savings Bank, the predecessor of Sturgis Bank & Trust Company.

(3) Incorporated by reference from 1995 Form 10-KSB of Sturgis Federal Savings Bank, the predecessor of Sturgis Bank & Trust Company.

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- (4) Incorporated by reference from Form 10-Q of Sturgis Bancorp, Inc. for the quarter ended June 30, 2002
- (5) Incorporated by reference from 2001 Form 10-K for Sturgis Bancorp, Inc.

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