

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

FORM 10-Q

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

For the quarterly period ended March 31, 2010

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 0-28312

FIRST FEDERAL BANCSHARES OF ARKANSAS, INC.
(Exact name of registrant as specified in its charter)

Texas

(State or other jurisdiction of incorporation
or organization)

71-0785261

(I.R.S. Employer
Identification Number)

1401 Highway 62-65 North
Harrison, Arkansas

(Address of principal executive office)

72601

(Zip Code)

(870) 741-7641

(Registrant's telephone number, including area code)

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

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: As of May 4, 2010, there were issued and outstanding 4,846,785 shares of the Registrant's Common Stock, par value \$.01 per share.

FIRST FEDERAL BANCSHARES OF ARKANSAS, INC.

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Part I. Financial Information

Item 1. Financial Statements.

FIRST FEDERAL BANCSHARES OF ARKANSAS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(In thousands, except share data)
(Unaudited)

	March 31, 2010	December 31, 2009
ASSETS		
Cash and cash equivalents	\$ 29,387	\$ 22,149
Investment securities held to maturity	119,262	135,531
Federal Home Loan Bank stock	2,422	3,125
Loans receivable, net of allowance of \$32,652 and \$32,908	460,104	481,542
Loans held for sale	395	1,012
Accrued interest receivable	3,672	4,229
Real estate owned, net	33,623	35,155
Office properties and equipment, net	23,236	23,567
Cash surrender value of life insurance	21,424	21,226
Prepaid expenses and other assets	3,404	3,534
TOTAL ASSETS	\$ 696,929	\$ 731,070
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES:		
Deposits	\$ 613,104	\$ 624,624
Other borrowings	35,526	59,546
Advance payments by borrowers for taxes and insurance	905	695
Other liabilities	3,395	2,905
Total liabilities	652,930	687,770
STOCKHOLDERS' EQUITY:		
Preferred stock, no par value, 5,000,000 shares authorized; Series A fixed rate cumulative perpetual; liquidation preference of \$1,000 per share; 16,500 shares issued and outstanding	\$ 16,211	\$ 16,195
Common stock, \$.01 par value, 20,000,000 shares authorized, 10,307,502 shares issued, 4,846,785 shares outstanding	103	103
Additional paid-in capital	56,986	56,986
Retained earnings-substantially restricted	41,317	40,634
	114,617	113,918
Treasury stock, at cost, 5,460,717 shares at March 31, 2010 and December 31, 2009	(70,618)	(70,618)
Total stockholders' equity	43,999	43,300
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 696,929	\$ 731,070

See notes to unaudited condensed consolidated financial statements.

FIRST FEDERAL BANCSHARES OF ARKANSAS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except share data)
(Unaudited)

	Three Months Ended	
	March 31, 2010	March 31, 2009
INTEREST INCOME:		
Loans receivable	\$ 6,829	\$ 7,555
Investment securities:		
Taxable	1,315	1,348
Nontaxable	272	216
Other	15	3
Total interest income	8,431	9,122
INTEREST EXPENSE:		
Deposits	2,549	3,781
Other borrowings	242	645
Total interest expense	2,791	4,426
NET INTEREST INCOME	5,640	4,696
PROVISION FOR LOAN LOSSES	53	3,521
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	5,587	1,175
NONINTEREST INCOME:		
Deposit fee income	1,190	1,192
Earnings on life insurance policies	198	197
Gain on sale of loans	136	148
Other	297	370
Total noninterest income	1,821	1,907
NONINTEREST EXPENSES:		
Salaries and employee benefits	2,798	2,967
Occupancy expense	670	677
Real estate owned, net	801	395
FDIC insurance premium	515	241
Data processing	379	408
Professional fees	406	291
Advertising and public relations	64	111
Postage and supplies	161	240
Other	808	519
Total noninterest expenses	6,602	5,849
INCOME (LOSS) BEFORE INCOME TAXES	806	(2,767)
INCOME TAX BENEFIT	(99)	(1,264)
NET INCOME (LOSS)	905	(1,503)
PREFERRED STOCK DIVIDENDS AND ACCRETION OF PREFERRED STOCK DISCOUNT	222	62
NET INCOME (LOSS) AVAILABLE TO COMMON SHAREHOLDERS	\$ 683	\$ (1,565)
EARNINGS (LOSS) PER COMMON SHARE:		
Basic	\$ 0.14	\$ (0.32)
Diluted	\$ 0.14	\$ (0.32)
Cash Dividends Declared	\$ --	\$ 0.01

See notes to unaudited condensed consolidated financial statements.

FIRST FEDERAL BANCSHARES OF ARKANSAS, INC.
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
FOR THE THREE MONTHS ENDED MARCH 31, 2010

(In thousands, except share data)

(Unaudited)

	<u>Preferred Stock</u>		<u>Common Stock</u>		<u>Additional Paid-In Capital</u>	<u>Retained Earnings (Substantially Restricted)</u>	<u>Treasury Stock</u>		<u>Total Stockholders' Equity</u>
	<u>Shares</u>	<u>Amount</u>	<u>Shares</u>	<u>Amount</u>			<u>Shares</u>	<u>Amount</u>	
Balance, January 1, 2010	16,500	\$ 16,195	10,307,502	\$ 103	\$ 56,986	\$ 40,634	5,460,717	\$ (70,618)	\$ 43,300
Net income						905			905
Preferred stock dividends						(206)			(206)
Accretion of preferred stock discount		16				(16)			--
Balance, March 31, 2010	<u>16,500</u>	<u>\$ 16,211</u>	<u>10,307,502</u>	<u>\$ 103</u>	<u>\$ 56,986</u>	<u>\$ 41,317</u>	<u>5,460,717</u>	<u>\$ (70,618)</u>	<u>\$ 43,999</u>

See notes to unaudited condensed consolidated financial statements.

FIRST FEDERAL BANCSHARES OF ARKANSAS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In Thousands)
(Unaudited)

	Three Months Ended March 31,	
	2010	2009
OPERATING ACTIVITIES:		
Net income (loss)	\$ 905	\$ (1,503)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Provision for loan losses	53	3,521
Provision for real estate losses	579	164
Deferred tax provision (benefit)	153	(1,919)
Deferred tax asset valuation allowance	(252)	--
Accretion of discounts on investment securities	(16)	(23)
Federal Home Loan Bank stock dividends	(3)	(6)
Loss (gain) on sale of repossessed assets	51	(22)
Originations of loans held for sale	(6,754)	(10,797)
Proceeds from sales of loans held for sale	7,507	11,310
Gain on sale of loans originated to sell	(136)	(148)
Depreciation	363	377
Amortization of deferred loan costs	93	98
Earnings on life insurance policies	(198)	(197)
Changes in operating assets and liabilities:		
Accrued interest receivable	557	1,675
Prepaid expenses and other assets	274	68
Other liabilities	383	564
Net cash provided by operating activities	3,559	3,162
INVESTING ACTIVITIES:		
Purchases of investment securities held to maturity	--	(68,571)
Proceeds from maturities/calls of investment securities held to maturity	16,285	69,591
Federal Home Loan Bank stock redeemed	1,181	468
Federal Home Loan Bank Stock purchased	(475)	--
Loan participations purchased	(783)	(485)
Net loan repayments	21,243	6,364
Proceeds from sales of repossessed assets	1,749	205
Improvements to real estate owned	(159)	(12)
Purchases of office properties and equipment	(32)	(96)
Net cash provided by investing activities	39,009	7,464
FINANCING ACTIVITIES:		
Net increase (decrease) in deposits	(11,520)	15,717
Repayment of advances from FHLB	(6,020)	(9,816)
Short-term FHLB advances, net	(18,000)	--
Net decrease in Federal Reserve Bank advances	--	(10,030)
Net increase in advance payments by borrowers for taxes and insurance	210	214
Proceeds from issuance of preferred stock and related common stock warrant	--	16,500
Net cash provided by (used in) financing activities	(35,330)	12,585
Net increase in cash and cash equivalents	7,238	23,211

FIRST FEDERAL BANCSHARES OF ARKANSAS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In Thousands)
(Unaudited)

	Three Months Ended March 31,	
	2010	2009
CASH AND CASH EQUIVALENTS:		
Beginning of period	\$ 22,149	\$ 9,367
End of period	\$ 29,387	\$ 32,578
 SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid for:		
Interest	\$ 2,806	\$ 4,480
Income taxes	\$ --	\$ 568
 SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES:		
Real estate and other assets acquired in settlement of loans	\$ 3,721	\$ 5,425
Loans to facilitate sales of real estate owned	\$ 2,889	\$ 2,346
Investment securities purchased – not settled	\$ --	\$ 5,570
Preferred stock dividends accrued, not paid	\$ 206	\$ --

(Concluded)

See notes to unaudited condensed consolidated financial statements.

FIRST FEDERAL BANCSHARES OF ARKANSAS, INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Basis of Presentation and Principles of Consolidation

First Federal Bancshares of Arkansas, Inc. (the "Company") is a unitary holding company which owns all of the stock of First Federal Bank (the "Bank"). The Bank provides a broad line of financial products to individuals and small- to medium-sized businesses. The unaudited condensed consolidated financial statements also include the accounts of the Bank's wholly-owned subsidiary, First Harrison Service Corporation ("FHSC"), which is inactive.

The accompanying unaudited condensed consolidated financial statements of the Company have been prepared in accordance with instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. However, such information reflects all adjustments which are, in the opinion of management, necessary for a fair statement of results for the interim periods.

The accompanying unaudited condensed consolidated financial statements include the accounts of the Company and the Bank. All material intercompany transactions have been eliminated in consolidation.

The results of operations for the three months ended March 31, 2010, are not necessarily indicative of the results to be expected for the year ending December 31, 2010. The unaudited condensed consolidated financial statements and notes thereto should be read in conjunction with the audited financial statements and notes thereto for the year ended December 31, 2009, contained in the Company's 2009 Annual Report to Stockholders.

Note 2 - Going Concern

The consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business for the foreseeable future. However, the events and circumstances described below create an uncertainty about the Company's ability to continue as a going concern. The unaudited condensed consolidated financial statements do not include any adjustment that might result from the outcome of this uncertainty.

The Company recorded a net loss of \$45.5 million in 2009, primarily due to the level of nonperforming assets, the provision for loan losses of \$44.4 million, real estate owned expenses of \$8.4 million, and FDIC insurance premiums of \$1.7 million. Our losses were largely a result of nonperforming loans and real estate owned. Our net loss also included the establishment of a valuation allowance against the realization of our deferred tax asset of \$18.1 million.

At March 31, 2010, the Company was above the regulatory minimums for tangible, core, total risk-based and tier 1 risk-based capital. On April 12, 2010, the Company and the Bank each consented to the terms of Cease and Desist Orders issued by the Office of Thrift Supervision ("OTS") (the "Bank Order" and the "Company Order" and, together, the "Orders"). The Orders impose certain operations restrictions on the Company and, to a greater extent, the Bank, including lending and dividend restrictions. The Orders also require the Company and the Bank to take certain actions, including the submission to the OTS of capital plans and business plans to, among other things, preserve and enhance the capital of the Company and the Bank and strengthen and improve the consolidated Company's operations, earnings and profitability. The Bank Order specifically requires the Bank to achieve and maintain, by December 31, 2010, a tier 1 (core) capital ratio of at least 8% and a total risk-based capital ratio of at least 12.0% and maintain these higher ratios for as long as the Bank Order is in effect. At March 31, 2010, the Bank's core and total risk-based capital ratios were 6.17% and 10.64%. Had the Bank been required to meet these capital requirements at March 31, 2010, it would have needed additional capital of approximately \$12.8 million.

Management has developed and will continue to refine capital and strategic plans which take into consideration available information in the development of future financial projections, which includes, but is not limited to, twelve months from the balance sheet date of December 31, 2009. The expected results of these plans, forecasts and strategic initiatives, which are based on multiple scenarios and stress tested cases, provide for the enhancement and preservation of capital. Management's plans to preserve and enhance its capital levels depend on various factors, some of which are outside the control of management. These factors include improvement in the economy, the ability to raise capital, the ability to reduce nonperforming assets, and the ability to maintain the Company's liquidity.

The Company is continuing to aggressively pursue various available alternatives to improve its capital ratios, including operating strategies designed to increase profitability, through, among others, a reduction of nonperforming assets and reduction of operating costs, shrinking the balance sheet, and raising capital. There can be no assurance that the economic conditions that caused the deterioration in loan quality, profits and capital will improve, and should the Bank's capital and related ratios continue to deteriorate, the OTS could impose more severe directives on the

Bank. The projected results of operations in 2010 and balance sheet shrinkage will not be sufficient to comply with the Orders. Currently, the Company intends to raise capital in the third or fourth quarter of 2010 to comply with the requirements of the Orders.

The Company's ability to raise additional capital will depend on conditions in the capital markets at that time, which are outside the Company's control. Accordingly, the Company cannot be certain of its ability to raise additional capital on acceptable terms. The Company's potential inability to raise capital and comply with the terms of the Order raises substantial doubt about its ability to continue as a going concern.

Note 3 – Recently Adopted Accounting Standards

On June 12, 2009, the Financial Accounting Standards Board ("FASB") issued ASC 860, formerly FAS 166, *Accounting for Transfers of Financial Assets*, which is a revision to ASC 860, formerly FAS 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, and requires more information about transfers of financial assets, including securitization transactions, and where companies have continuing exposure to the risks related to transferred financial assets. The statement also eliminates the concept of a "qualifying special-purpose entity", changes the requirements for derecognizing financial assets and requires additional disclosures. It was effective for financial statements issued for interim and annual periods ending after November 15, 2009. The recognition and measurement provisions shall be applied to transfers that occur on or after the effective date. The Bank adopted this statement on January 1, 2010, as required. The adoption of this statement did not have a material effect on the consolidated financial statements.

On June 12, 2009, the FASB issued ASC 860, formerly FAS 167, *Amendments to FASB Interpretation No. 46(R)*, which changed the way entities account for securitizations and special-purpose entities. The statement is a revision to ASC 810, formerly FASB Interpretation No. 46(R), *Consolidation of Variable Interest Entities*, and changes how a company determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. The determination of whether a company is required to consolidate an entity is based on, among other things, an entity's purpose and design and a company's ability to direct the activities of the entity that most significantly impact the entity's economic performance. It was effective for financial statements issued for interim and annual periods ending after November 15, 2009. The Bank adopted this statement on January 1, 2010, as required. The adoption of this statement did not have a material effect on the consolidated financial statements.

In February 2010, the FASB issued ASU No. 2010-09, *Subsequent Events (Topic 855): Amendments to Certain Recognition and Disclosure Requirements*. The amendments remove the requirement for an SEC registrant to disclose the date through which subsequent events were evaluated as this requirement would have potentially conflicted with SEC reporting requirements. Removal of the disclosure requirement did not have an effect on the nature or timing of subsequent events evaluations performed by the Company. ASU 2010-09 became effective upon issuance.

In January 2010, the FASB issued ASU No. 2010-06, *Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements*. ASU 2010-06 revises two disclosure requirements concerning fair value measurements and clarifies two others. It requires separate presentation of significant transfers into and out of Levels 1 and 2 of the fair value hierarchy and disclosure of the reasons for such transfers. It will also require the presentation of purchases, sales, issuances, and settlements within Level 3 on a gross basis rather than a net basis. The amendments also clarify that disclosures should be disaggregated by class of asset or liability and that disclosures about inputs and valuation techniques should be provided for both recurring and non-recurring fair value measurements. The Company's disclosures about fair value measurements are presented in Note 10. These new disclosure requirements were effective for the period ended March 31, 2010, except for the requirement concerning gross presentation of Level 3 activity, which is effective for fiscal years beginning after December 15, 2010. There was no significant effect on the Company's financial statement disclosure upon adoption of this ASU.

Note 4 – Preferred Stock

On March 6, 2009, as part of the Troubled Asset Relief Program ("TARP") Capital Purchase Program, the Company entered into a Securities Purchase Agreement (the "Purchase Agreement") with the United States Department of the Treasury ("Treasury"), pursuant to which the Company, for a purchase price of \$16.5 million in cash, (i) sold 16,500 shares of the Company's Fixed Rate Cumulative Perpetual Preferred Stock, Series A (the "Series A Preferred Stock") and (ii) issued a warrant (the "Warrant") to purchase 321,847 shares of the Company's common stock, par value \$1.00 per share (the "Common Stock"), at an exercise price of \$7.69 per share. The Series A Preferred Stock qualifies as Tier 1 capital and is entitled to cumulative dividends. The preferred stock dividend reduces earnings available to common shareholders and is computed at an annual rate of 5% per annum for the first five years, and 9% per annum thereafter. The Series A Preferred Stock is non-voting, other than class voting rights on certain matters that could adversely affect the Series A Preferred Stock. The Series A Preferred Stock may be redeemed by the Company with regulatory approval and when such preferred shares are redeemed, the Treasury shall liquidate

the Warrant associated with such preferred shares. The Warrant has a 10-year term and was immediately exercisable upon its issuance, with an exercise price, subject to anti-dilution adjustments, equal to \$7.69 per share of the Common Stock. Treasury has agreed not to exercise voting power with respect to any shares of Common Stock issued upon exercise of the Warrant that it holds.

Upon receipt of the aggregate consideration from the Treasury on March 6, 2009, the Company allocated the \$16.5 million proceeds on a pro rata basis to the Series A Preferred Stock and the Warrant based on relative fair values. In estimating the fair value of the Warrant, the Company utilized an option pricing model which includes assumptions regarding the Company's common stock prices, stock price volatility, dividend yield, the risk free interest rate and the estimated life of the Warrant. The fair value of the Series A Preferred Stock was determined using a discounted cash flow methodology and a discount rate of 12%. As a result, the Company assigned \$358,000 of the aggregate proceeds to the Warrant and \$16.1 million to the Series A Preferred Stock. The value assigned to the Series A Preferred Stock will be accreted up to the \$16.5 million liquidation value of such preferred stock, with the cost of such accretion being reported as additional preferred stock dividends. This results in a total dividend with a constant effective yield of 5.50% over a five-year period, which is the expected life of the Series A Preferred Stock. In addition, the Purchase Agreement (i) grants the holders of the Series A Preferred Stock, the Warrant and the Warrant Common Stock certain registration rights, (ii) subjects the Company to certain of the executive compensation limitations included in the EESA (which are discussed below) and (iii) allows the Treasury to unilaterally amend any of the terms of the Purchase Agreement to the extent required to comply with any changes after March 6, 2009 in applicable federal statutes. On April 2, 2009, the Company filed a "shelf" registration statement on Form S-3 with the Securities and Exchange Commission (the "Commission") for the purpose of registering the Warrant and the Warrant Common Stock in order to permit the sale of such securities by the U.S. Treasury at any time after effectiveness of the registration statement. On April 28, 2009, the Company was notified by the Commission that the "shelf" registration statement was deemed effective.

Immediately prior to the execution of the Purchase Agreement, the Company amended its compensation, bonus, incentive and other benefit plans, arrangements and agreements to the extent necessary to comply with the executive compensation and corporate governance requirements of Section 111(b) of the EESA and applicable guidance or regulations issued by the Treasury on or prior to March 6, 2009. The applicable executive compensation requirements apply to the compensation of the Company's chief executive officer, chief financial officer and three other most highly compensated executive officers (collectively, the "senior executive officers"). In addition, in connection with the closing of the Treasury's purchase of the Series A Preferred Stock each of the senior executive officers was required to execute a waiver of any claim against the United States or the Company for any changes to his or her compensation or benefits that are required in order to comply with the regulation issued by the Treasury as published in the Federal Register on October 20, 2008.

The Company's ability to repurchase its shares is restricted. Consent of the Treasury generally is required for the Company to make any stock repurchase until the third anniversary of the investment by Treasury unless all of the Series A Preferred Stock has been redeemed or transferred to a third party. Further, common, junior preferred or *pari passu* preferred shares may not be repurchased if the Company is in arrears on the Series A Preferred Stock dividends. Under the terms of the Purchase Agreement, the Company's ability to declare or pay dividends on any of its shares is restricted. Specifically, the Company may not declare dividend payments on common, junior preferred or *pari passu* preferred shares if it is in arrears on the dividends on the Series A Preferred Stock. In addition, the Company may not increase the dividends on its Common Stock above the amount of the last quarter cash dividend per share declared prior to October 14, 2008, which was \$0.16 per share, without the Treasury's approval until the third anniversary of the investment unless all of the Series A Preferred Stock has been redeemed or transferred to a third party.

The Company and the Bank are subject to a regulatory order which prohibits the Company and the Bank from paying dividends on any of its stock, including the Series A Preferred Stock, without prior written non-objection of the OTS. As a result, the Company elected to defer payment of its Series A Preferred Stock dividends beginning with the dividend payment that was due February 15, 2010. However, the Company will continue to accrue these dividends and at March 31, 2010 dividends of approximately \$312,000 were accrued in other liabilities on the consolidated statement of financial condition related to these dividend payments.

Note 5 - Earnings per Common Share

The weighted average number of common shares used to calculate earnings per share for the periods ended March 31, 2010 and 2009 were as follows:

	Three months ended March 31,	
	2010	2009
Basic weighted - average common shares	4,846,785	4,848,785
Effect of dilutive securities	--	--
Diluted weighted - average common shares	4,846,785	4,848,785

The calculation of diluted earnings per share excludes 15,482 and 17,242 options outstanding for the three months ended March 31, 2010 and 2009, respectively, which were antidilutive. In addition, the calculation excludes the Warrant to purchase 321,847 shares of common stock outstanding for the three month periods ended March 31, 2010 and 2009, which was antidilutive.

Note 6 – Investment Securities

Investment securities consisted of the following (in thousands):

	March 31, 2010			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Held To Maturity				
Municipal securities	\$ 24,846	\$ 236	\$ (232)	\$ 24,850
U.S. Government and Agency obligations	94,416	218	(786)	93,848
Total	<u>\$ 119,262</u>	<u>\$ 454</u>	<u>\$ (1,018)</u>	<u>\$ 118,698</u>
	December 31, 2009			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Held To Maturity				
Municipal securities	\$ 25,480	\$ 247	\$ (269)	\$ 25,458
U.S. Government and Agency obligations	110,051	21	(3,021)	107,051
Total	<u>\$ 135,531</u>	<u>\$ 268</u>	<u>\$ (3,290)</u>	<u>\$ 132,509</u>

The following tables summarize the gross unrealized losses and fair value of the Company's investments with unrealized losses that are not deemed to be other-than-temporarily impaired ("OTTI") (in thousands), aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position:

	March 31, 2010					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Municipal securities	\$ 3,750	\$ 77	\$ 2,476	\$ 155	\$ 6,226	\$ 232
U.S. Government and Agency obligations	30,387	236	19,186	550	49,573	786
	<u>\$ 34,137</u>	<u>\$ 313</u>	<u>\$ 21,662</u>	<u>\$ 705</u>	<u>\$ 55,799</u>	<u>\$ 1,018</u>
	December 31, 2009					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Municipal securities	\$ 5,156	\$ 92	\$ 2,453	\$ 177	\$ 7,609	\$ 269
U.S. Government and Agency obligations	100,142	2,908	2,888	113	103,030	3,021
	<u>\$ 105,298</u>	<u>\$ 3,000</u>	<u>\$ 5,341</u>	<u>\$ 290</u>	<u>\$ 110,639</u>	<u>\$ 3,290</u>

On a quarterly basis, management conducts a formal review of securities for the presence of OTTI. Management assesses whether an OTTI is present when the fair value of a security is less than its amortized cost basis at the balance sheet date. For such securities, OTTI is considered to have occurred if the Company intends to sell the security, if it is more likely than not the Company will be required to sell the security before recovery of its amortized cost basis or if the present values of expected cash flows is not sufficient to recover the entire amortized cost.

The unrealized losses are primarily a result of increases in market yields from the time of purchase. In general, as market yields rise, the fair value of securities will decrease; as market yields fall, the fair value of securities will increase. Management generally views changes in fair value caused by changes in interest rates as temporary; therefore, these securities have not been classified as other-than-temporarily impaired. Additionally, the unrealized losses are also considered temporary because scheduled coupon payments have been made, it is anticipated that the entire principal balance will be collected as scheduled, and management neither intends to sell the securities nor is it more likely than not that the Company will be required to sell the securities before the recovery of the remaining amortized cost amount.

The Company has pledged investment securities held to maturity with carrying values of approximately \$42.8 million at March 31, 2010, and \$59.5 million at December 31, 2009 as collateral for certain deposits in excess of \$250,000.

The scheduled maturities of debt securities at March 31, 2010, by contractual maturity are shown below (in thousands). Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	March 31, 2010	
	Amortized Cost	Fair Value
Within one year	\$ 200	\$ 203
Due from one year to five years	3,345	3,341
Due from five years to ten years	7,195	7,147
Due after ten years	108,522	108,007
Total	<u>\$ 119,262</u>	<u>\$ 118,698</u>

As of March 31, 2010 and December 31, 2009, investments with carrying values of approximately \$112.4 million and \$127.6 million, respectively, have call options held by the issuer, of which approximately \$89.4 million and \$99.2 million, respectively, are or were callable within one year.

Note 7 – Impaired Loans

Impaired loans consisted of the following as of the dates indicated (in thousands):

	March 31, 2010			December 31, 2009 (1)		
	Recorded Investment	Valuation Allowance	Carrying Value	Recorded Investment	Valuation Allowance	Carrying Value
Nonaccrual loans with a valuation allowance	\$ 33,586	\$ 8,638	\$ 24,948	\$ 24,095	\$ 7,476	\$ 16,619
Nonaccrual loans without a valuation allowance	21,605	--	21,605	26,248	--	26,248
Total nonaccrual loans	55,191	8,638	46,553	50,343	7,476	42,867
Performing restructured loans (2)	4,846	--	4,846	4,609	--	4,609
Other impaired loans (3)	10,581	--	10,581	6,334	--	6,334
Total impaired loans	\$ 70,618	\$ 8,638	\$ 61,980	\$ 61,286	\$ 7,476	\$ 53,810
			Three Months Ended			Year Ended
			March 31, 2010			December 31, 2009
Average investment in impaired loans			\$ 57,848			\$ 48,609
Interest income recognized on impaired loans			\$ 415			\$ 1,747
Interest based on original terms			\$ 1,182			\$ 4,355

- (1) Subsequent to the issuance of the Company's 2009 consolidated financial statements included in its Annual Report on Form 10-K, filed on April 15, 2010, management identified an immaterial error in the disclosure of impaired loans in the table above. Impaired loans of \$20.5 million were omitted from the previously presented disclosure as of December 31, 2009. This amount primarily represents impaired non-homogeneous loans less than \$500,000 and borrower relationships less than \$1.0 million. The disclosed amounts of impaired loans without valuation allowance and impaired loans with a valuation allowance previously presented have been restated to include these impaired loans and restated to conform with the current presentation. The previously omitted loans did not impact the consolidated statements of financial condition, operations or cash flows for the year ended December 31, 2009.
- (2) Performing restructured loans represent (1) loans that were not already on nonaccrual status before the restructuring that have been restructured so as to be reasonably assured of repayment and of performance according to prudent modified terms or (2) loans that have had sustained historical repayment performance for a reasonable period of time after the restructuring, generally a minimum of six months. After a restructured loan has performed satisfactorily for a period of at least 12 months, it is generally no longer reported as a restructured loan for financial reporting purposes.
- (3) Other impaired loans generally include loans for which there may be doubt about the ultimate timing of collection of principal and interest compared to the original terms of the note but where the payment history has been satisfactory and collateral coverage is estimated to be adequate to pay principal and interest in full. Total accrued interest for these loans was \$110,000 at March 31, 2010, and \$52,000 at December 31, 2009. At March 31, 2010, other impaired loans included three loans totaling \$3.0 million with accrued interest of \$22,000 that were 30-59 days past due and one loan of \$234,000 with accrued interest of \$5,000 that was 60-89 days past due.

Note 8 – Allowances for Loan and Real Estate Losses

A summary of the activity in the allowances for loan and real estate losses is as follows for the three months ended March 31 (in thousands):

	Three Months Ended		Three Months Ended	
	March 31, 2010		March 31, 2009	
	Loans	Real Estate	Loans	Real Estate
Balance—beginning of period	\$ 32,908	\$ 5,543	\$ 6,441	\$ --
Provisions for estimated losses	53	579	3,521	164
Recoveries	70	--	60	--
Losses charged off	(379)	(199)	(464)	(164)
Balance—end of period	\$ 32,652	\$ 5,923	\$ 9,558	\$ --

The allowance for loan losses as of March 31, 2010 and 2009 includes general valuation allowances of \$24.0 million and \$4.7 million, respectively, and specific valuation allowances of \$8.6 million and \$4.9 million, respectively. The provision for loan losses decreased between the periods listed above primarily due to decreases in loan balances offset by increases in total nonaccrual loans and in the loss factors used in certain allowance categories, as well as an increase in specific loan loss allowances, in each respect due to deteriorating economic conditions.

Note 9 – Income Taxes

The provisions (benefits) for income taxes are summarized as follows (in thousands):

	<u>Three Months Ended</u>	
	<u>March 31, 2010</u>	<u>March 31, 2009</u>
Income tax provision (benefit):		
Current:		
Federal	\$ --	\$ 645
State	--	10
Total current	<u>--</u>	<u>655</u>
Deferred:		
Federal	101	(1,615)
State	52	(304)
Valuation allowance	(252)	--
Total deferred	<u>(99)</u>	<u>(1,919)</u>
Total	<u>\$ (99)</u>	<u>\$ (1,264)</u>

The reasons for the differences between the statutory federal income tax rates and the effective tax rates are summarized as follows (in thousands):

	<u>Three Months Ended March 31,</u>			
	<u>2010</u>		<u>2009</u>	
Taxes at statutory rate	\$ 274	34.0%	\$ (941)	34.0%
Increase (decrease) resulting from:				
State income tax—net	35	4.3	(168)	6.1
Valuation allowance	(252)	(31.3)	--	--
Earnings on life insurance policies	(67)	(8.3)	(67)	2.4
Nontaxable investments	(89)	(11.0)	(67)	2.4
Other—net	--	--	(21)	0.8
Total	<u>\$ (99)</u>	<u>(12.3)%</u>	<u>\$ (1,264)</u>	<u>45.7%</u>

The Company's net deferred tax liability account was comprised of the following (in thousands):

	<u>March 31, 2010</u>	<u>December 31, 2009</u>
Deferred tax assets:		
Allowance for loan losses	\$ 10,233	\$ 11,054
Real estate owned	3,621	3,426
NOL carryovers	4,790	4,432
Other	190	190
Total deferred tax assets	<u>18,834</u>	<u>19,102</u>
Valuation allowance	<u>(17,872)</u>	<u>(18,124)</u>
Deferred tax asset, net of valuation allowance	<u>962</u>	<u>978</u>
Deferred tax liabilities:		
Office properties	(903)	(928)
Federal Home Loan Bank stock	(202)	(300)
Pension plan contribution	(47)	(94)
Prepaid expenses	(185)	(130)
Total deferred tax liabilities	<u>(1,337)</u>	<u>(1,452)</u>
Deferred tax liability, net	<u>\$ (375)</u>	<u>\$ (474)</u>

A deferred tax asset or liability is recognized for the tax consequences of temporary differences in the recognition of revenue and expense, and unrealized gains and losses, for financial and tax reporting purposes. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some or all

of the deferred tax assets will not be realized. The Company conducted an analysis to assess the need for a valuation allowance at March 31, 2010. As part of this assessment, all available evidence, including both positive and negative, was considered to determine whether, based on the weight of such evidence, a valuation allowance on the Company's deferred tax assets was needed. In accordance with ASC Topic 740-10, Income Taxes (ASC 740), a valuation allowance is deemed to be needed when, based on the weight of the available evidence, it is more likely than not (a likelihood of more than 50%) that some portion or all of a deferred tax asset will not be realized. The future realization of the deferred tax asset depends on the existence of sufficient taxable income within the carryback and carryforward periods. The carryback and carryforward periods for federal tax are two years and twenty years, respectively. The state tax carryforward period is five years with no carryback period allowed.

As part of its analysis, the Company considered the following positive evidence:

- The Company has a long history of earnings profitability.
- The Company is projecting future taxable income sufficient to utilize all net operating loss carryforwards prior to expiration.
- Future reversals of certain deferred tax liabilities.
- The Federal Reserve has indicated that the economy has exited the recession.

As part of its analysis, the Company considered the following negative evidence:

- The Company recorded a large net loss in 2009.
- The Company did not meet its financial goals in 2009.
- The Company may not meet its projections concerning future taxable income.

At March 31, 2010, we determined that a valuation allowance relating to both the federal and state portion of our deferred tax asset was necessary. This determination for the state deferred tax asset was based largely on the negative evidence represented by the level of state tax exempt interest income which reduces state taxable income to a level that makes it unlikely the Company will realize its state deferred tax asset. Therefore, valuation allowances of \$14.5 million and \$3.4 million at March 31, 2010 were recorded for a portion of the federal deferred tax asset and all of the state deferred tax asset, respectively.

Specifically exempted from deferred tax recognition requirements are bad debt reserves for tax purposes of U.S. savings and loans in the institution's base year, as defined. Base year reserves totaled approximately \$4.2 million. Consequently, a deferred tax liability of approximately \$1.6 million related to such reserves was not provided for in the consolidated statements of financial condition at March 31, 2010 and December 31, 2009. Payment of dividends to shareholders out of retained earnings deemed to have been made out of earnings previously set aside as bad debt reserves may create taxable income to the Bank. No provision has been made for income tax on such a distribution as the Bank does not anticipate making such distributions.

The Company files income tax returns in the U.S. federal jurisdiction and the state of Arkansas. The Company is subject to U.S. federal and state income tax examinations by tax authorities for tax years ended December 31, 2007 and forward. The Company's 2007 federal income tax return was subject to a limited scope examination by the Internal Revenue Service during the first quarter of 2009. As a result of the examination, the Company was assessed approximately \$45,000, including interest, for the 2007 tax year. The Company recognizes interest and penalties on income taxes as a component of income tax expense.

Note 10 – Fair Value Measurement

ASC 820, formerly SFAS 157, *Fair Value Measurement*, provides a framework for measuring fair value and defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. ASC 820 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. ASC 820 describes three levels of inputs that may be used to measure fair value:

- Level 1 Unadjusted, quoted prices in active markets for identical assets or liabilities at the measurement date.
- Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data at the measurement date for substantially the full term of the assets or liabilities.
- Level 3 Unobservable inputs that reflect management's best estimate of what market participants would use in pricing the asset or liability at the measurement date.

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

Loans Receivable

Loans which meet certain criteria are evaluated individually for impairment. A loan is considered impaired when, based upon current information and events, it is probable the Bank will be unable to collect all amounts due, including principal and interest, according to the contractual terms of the loan agreement. Substantially all of the Bank's impaired loans at March 31, 2010 are secured by real estate. These impaired loans are individually assessed to determine that the carrying value of the loan is not in excess of the fair value of the collateral, less estimated selling costs. Fair value is estimated through current appraisals, real estate brokers or listing prices. Fair values may be adjusted by management to reflect current economic and market conditions and, as such, are classified as Level 3. Impaired loans recorded at fair value with partial charge-offs and specific valuation allowances were \$35.7 million net of specific valuation allowances of \$8.6 million at March 31, 2010.

Real Estate Owned, net ("REO")

REO represents real estate acquired as a result of foreclosure or by deed in lieu of foreclosure and is carried at the lower of cost or fair value less estimated selling costs. Fair value is estimated through current appraisals, real estate brokers or listing prices. As these properties are actively marketed, estimated fair values may be adjusted by management to reflect current economic and market conditions and, as such, are classified as Level 3. REO at March 31, 2010 was \$33.6 million. During the three months ended March 31, 2010, charge-offs to the allowance for loan losses related to loans that were transferred to REO were \$153,000 on transfers to REO of \$3.7 million. Write downs related to REO that were charged to expense were \$579,000 for the three months ended March 31, 2010.

The following table provides the level of valuation assumption used to determine the carrying value of the Company's assets measured at fair value on a non-recurring basis at March 31, 2010:

	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans	\$ 35,717	\$ --	\$ --	\$ 35,717
REO, net (1)	34,549	--	--	34,549
	<u>\$ 70,266</u>	<u>\$ --</u>	<u>\$ --</u>	<u>\$ 70,266</u>

(1) The amounts listed reflect fair value measurements of the properties before deducting estimated costs to sell.

FAIR VALUE OF FINANCIAL INSTRUMENTS

The estimated fair value amounts have been determined by the Company using available market information and appropriate valuation methodologies. However, considerable judgment is required to interpret market data to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Company could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts. The estimated fair values of financial instruments are as follows (in thousands):

	March 31, 2010		December 31, 2009	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
ASSETS:				
Cash and cash equivalents	\$ 29,387	\$ 29,387	\$ 22,149	\$ 22,149
Investment securities—held to maturity	119,262	118,698	135,531	132,509
Federal Home Loan Bank stock	2,422	2,422	3,125	3,125
Loans receivable—net	460,104	463,834	481,542	483,127
Loans held for sale	395	395	1,012	1,012
Cash surrender value of life insurance	21,424	21,424	21,226	21,226
Accrued interest receivable	3,672	3,672	4,229	4,229
LIABILITIES:				
Deposits:				
Checking, money market and savings accounts	213,355	213,355	245,287	245,287
Certificates of deposit	399,749	401,670	379,337	383,187
Other borrowings	35,526	36,107	59,546	60,203
Accrued interest payable	459	459	474	474
Advance payments by borrowers for taxes and insurance	905	905	695	695

For cash and cash equivalents, Federal Home Loan Bank stock, cash surrender value of life insurance and accrued interest receivable, the carrying value is a reasonable estimate of fair value, primarily because of the short-term nature of the instruments or, as to Federal Home Loan Bank stock, the ability to sell the stock back to the Federal Home Loan Bank at cost. The fair value of investment securities is based on quoted market prices, dealer quotes and prices obtained from independent pricing services. The fair value of variable rate loans is based on repricing dates. Fixed rate loans were valued using discounted cash flows. The discount rates used to determine the present value of these loans were based on interest rates currently being charged by the Bank on comparable loans as to credit risk and term.

The fair value of checking accounts, savings accounts and money market deposits is the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposit and Federal Home Loan Bank advances is estimated using the rates currently offered for deposits of similar terms and advances of similar remaining maturities at the reporting date. For advance payments by borrowers, for taxes and insurance, accrued interest payable and Federal Reserve Bank advances, the carrying value is a reasonable estimate of fair value, primarily because of the short-term nature of the instruments.

The fair value estimates presented herein are based on pertinent information available to management as of March 31, 2010 and December 31, 2009. Although management is not aware of any factors that would significantly affect the estimated fair value amounts, such amounts have not been comprehensively revalued for purposes of these financial statements since the reporting date and, therefore, current estimates of fair value may differ significantly from the amounts presented herein.

Note 11 – Regulatory Matters

The Bank is subject to various regulatory capital requirements administered by the OTS. Failure to meet minimum capital requirements can initiate certain mandatory—and possible additional discretionary—actions by regulators that, if undertaken, could have a direct and material effect on the Bank’s financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank’s assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Bank’s capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table) of tangible capital (as defined) to tangible assets (as defined) and core capital (as defined) to adjusted tangible assets (as defined), and of total risk-based capital (as defined) to risk-weighted assets (as defined). Tier 1 (core) capital includes common stockholders’ equity and qualifying preferred stock less certain other deductions. Total capital includes tier 1 capital plus the allowance for loan losses, subject to limitations.

As the following table indicates, at March 31, 2010, the Bank was above the regulatory adequacy minimums for tangible, core, total risk-based and tier 1 risk-based capital. At December 31, 2009, the Bank was below the regulatory adequacy minimum for total risk-based capital and above the regulatory adequacy minimums for tangible, core, and tier 1 risk-based capital. The Bank had historically been categorized as well-capitalized in periods prior to December 31, 2009.

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

	Actual		For Capital Adequacy Purposes		To be Categorized as Adequately Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of March 31, 2010:						
Tangible Capital to Tangible Assets	\$ 43,030	6.17%	\$ 10,459	1.50%	N/A	N/A
Core Capital to Adjusted Tangible Assets	43,030	6.17%	34,862	5.00%	\$ 34,862	5.00%
Total Capital to Risk-Weighted Assets	49,014	10.64%	46,077	10.00%	46,077	10.00%
Tier I Capital to Risk-Weighted Assets	43,030	9.34%	N/A	N/A	18,431	4.00%

	Actual		For Capital Adequacy Purposes		To be Categorized as Adequately Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2009:						
Tangible Capital to Tangible Assets	\$ 42,042	5.75%	\$ 10,965	1.50%	N/A	N/A
Core Capital to Adjusted Tangible Assets	42,042	5.75%	36,550	5.00%	\$ 36,550	5.00%
Total Capital to Risk-Weighted Assets	48,344	9.97%	48,512	10.00%	48,512	10.00%
Tier I Capital to Risk-Weighted Assets	42,042	8.67%	N/A	N/A	19,405	4.00%

As discussed further in Part I, Item 2 under the section “Executive Summary – Regulatory Enforcement Actions”, on April 12, 2010, the Company and the Bank each consented to the terms of Cease and Desist Orders issued by the OTS. The Orders became effective on April 14, 2010. The Bank Order states that no later than December 31, 2010, the Bank shall achieve and maintain a Tier 1 (Core) capital ratio of at least 8% and a total risk-based capital ratio of at least 12%. The Bank had previously agreed with the OTS to maintain a core capital ratio of at least 5% and a total risk-based capital ratio of at least 10%. These are the requirements that were in effect at March 31, 2010 and the Bank’s ratios were in excess of the ratios otherwise required under the capital adequacy requirements. The requirement to meet and maintain a specific capital level means that the Bank may not be deemed to be well-capitalized for the purposes of prompt corrective action.

The Bank Order also states that by June 30, 2010, the Bank shall submit to the OTS a written capital plan to achieve and maintain the foregoing capital levels. At a minimum, the plan shall: (i) address the amount of additional capital that will be necessary to meet the foregoing capital levels under different, progressively stressed economic environments; (ii) address the requirements and restrictions imposed by the Order and the Bank’s most recent examination; (iii) address the Bank’s level of classified assets, allowance for loan and lease losses, earnings, asset concentrations, liquidity needs, and trends in this area; (iv) address current and projected trends in real estate market conditions; (v) address the Bank’s capital preservation and enhancement strategies; and (vi) identify specific sources of additional capital and the timeframes and methods by which additional capital will be raised.

Under the regulatory framework for prompt corrective action, the Bank’s capital status may preclude the Bank from access to borrowings from the Federal Reserve System through the discount window. Also, as required by the framework, the Bank must submit to the OTS a written capital plan as described above. The Bank believes it can attain these ratios by December 31, 2010 through improved operating results, shrinkage in asset size, potential branch sales, and raising capital in the third or fourth quarter of 2010. Management’s plan is subject to economic conditions and assumes no significant further deterioration of the Bank’s loan portfolio.

Dividend Restrictions. The principal source of the Company’s revenues is dividends from the Bank. The Company’s ability to pay dividends to our shareholders depends to a large extent upon the dividends we receive from the Bank. On November 19, 2009, the OTS issued written directives to the Company and the Bank which require the Company and the Bank to obtain prior written non-objection of the OTS in order to make or declare any dividends or payments on their outstanding securities.

Note 12 – Subsequent Events

The Bank is a participant in a non-contributory multiemployer defined benefit pension plan covering all qualified employees. On April 30, 2010, the Board of Directors of the Bank elected to freeze the plan effective July 1, 2010. Freezing the plan eliminates all future benefit accruals for participants in the plan and closes the plan to new participants as of that date. After July 1, 2010, the Bank will continue to incur costs consisting of administration and Pension Benefit Guaranty Corporation insurance expenses as well as amortization charges based on the funding level of the plan.

On April 30, 2010, the Board of Directors of the Company approved the cancellation of the Company’s treasury shares and the return of such shares of common stock to the status of authorized but unissued.

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

EXECUTIVE SUMMARY

Management's discussion and analysis of financial condition and results of operations is intended to assist a reader in understanding the consolidated financial condition and results of operations of the Company for the periods presented. The information contained in this section should be read in conjunction with the unaudited condensed consolidated financial statements and the notes to such financial statements found in this report under "Part I, Item 1, Consolidated Financial Statements".

The Bank is a federally chartered stock savings and loan association that was formed in 1934. First Federal conducts business from its main office and nineteen full-service branch offices, all of which are located in a six county area in Northcentral and Northwest Arkansas comprised of Benton, Marion, Washington, Carroll, Baxter and Boone counties. The Bank's focus will continue in this six county area. The Bank is a community-oriented financial institution offering a wide range of retail and commercial deposit accounts, including noninterest bearing and interest bearing checking, savings and money market accounts, certificates of deposit, and individual retirement accounts. Loan products offered by the Bank include residential real estate, consumer, construction, lines of credit, commercial real estate and commercial business loans. However, the Bank is currently subject to comprehensive lending restrictions as a result of the provisions of the Bank Order. See "Regulatory Enforcement Actions" on the following page for further information. Other financial services include investment products offered through First Federal Investment Services, Inc.; automated teller machines; 24-hour telephone banking; internet banking, including account access, e-statements, bill payment and online loan applications; Bounce Protection™ overdraft service; debit cards; and safe deposit boxes.

First Federal's lending focus has traditionally been on permanent residential real estate. However, between 2003 and 2005, an increased emphasis was placed on commercial real estate lending and construction lending based on opportunities in Washington and Benton counties. Beginning in late 2005, we reduced our focus on construction lending due to an oversupply of homes and lots in Northwest Arkansas. While oversupply continues to be a significant issue, the market in Northwest Arkansas continues to outperform the national and state economies with lower unemployment and continued population growth. Washington and Benton County are the headquarters of the state's two largest employers, Wal-Mart and Tyson Foods. These employers attract suppliers who establish offices in the area and create jobs, fostering demand for housing and office space. As of February 2010, unemployment in the Fayetteville/Springdale/Rogers metro area was 7.0% (not seasonally adjusted), compared to the Arkansas rate of 7.7% and the U.S. rate of 9.7%, both seasonally adjusted.

Certificates of deposit continue to comprise the majority of our deposit accounts. However, in recent years, increased emphasis has been placed on growth in checking accounts. The Bank focused its marketing efforts to increase checking accounts by offering a checking product which has a higher interest rate than the Bank's other checking account products. To earn the maximum rate under the new product, customers must qualify based on usage of electronic banking services such as debit card transactions, e-statements, and direct deposits or automatic payments. The Bank will continue to promote checking accounts as they are an attractive source of funds for the Bank as they offer overall low-interest deposits, fee income potential, and the opportunity to cross-sell other financial services.

The Company's results of operations depend primarily on its net interest income, which is the difference between interest income on interest earning assets, such as loans and investments, and interest expense on interest bearing liabilities, such as deposits and borrowings. Net interest income is affected by the level of nonperforming assets as they provide no interest earnings to the Bank. The Company's results of operations are also affected by the provision for loan losses, the level of its noninterest income and expenses, and income tax expense.

Noninterest income is generated primarily through deposit account fee income, profit on sale of loans, loan fee income, and earnings on life insurance policies.

Noninterest expense consists primarily of employee compensation and benefits, office occupancy expense, data processing expense, real estate owned expense, net, and other operating expense.

Like many banks, First Federal Bank's greatest challenge in this economic environment is reducing the level of nonperforming assets and managing both interest rate risk and asset quality. We strive to maintain the asset quality of our loan portfolio at acceptable levels through sound underwriting procedures, including the use of credit scoring; a thorough loan review function; active collection procedures for delinquent loans; and, in the event of repossession, prompt and efficient liquidation of real estate, automobiles and other forms of collateral. We have experienced a significant increase in nonperforming assets, primarily due to the housing market oversupply issue in Northwest Arkansas as well as the downturn in the general economy. We attempt to work with troubled borrowers to return their

loans to performing status where possible. However, given current market conditions, the trend of increasing nonperforming assets may continue for the foreseeable future. Both the board of directors and senior management place a high priority on reducing our nonperforming assets and managing asset quality.

In addition, management is also challenged with managing interest rate risk. The Bank's current interest rate risk position as measured by our regulator, the OTS, is at a minimal level as defined by Thrift Bulletin 13a. The movement of interest rates impacts the level of interest rate risk and the timing and magnitude of assets repricing compared to liabilities repricing. The Bank attempts to reduce the impact of changes in interest rates on its net interest income by managing the repricing gap.

Corporate Overview and Strategic Initiatives

Overview. As a community-oriented financial institution serving the borrowing and deposit needs of its primary market area of Northcentral and Northwest Arkansas, the Bank's loan portfolio grew as a reflection of the economic strength and expansion of its primary market area. Between December 31, 2002 and December 31, 2005, the Bank's loan portfolio grew from \$507.0 million to \$790.6 million, primarily as a result of increased construction, commercial real estate, and land lending. However, beginning in late 2005, the Bank began to note an oversupply of homes and lots in the Northwest Arkansas market and limited its construction loan activity. Construction loan originations dropped from \$195.8 million in 2005 to \$93.6 million in 2006, \$39.0 million in 2007, \$15.1 million in 2008, and \$12.5 million in 2009. This oversupply and, beginning in 2007, the current recession, resulted in an increase in nonperforming assets, which amounted to \$80.2 million or 11.50% of total assets at March 31, 2010 compared to \$78.0 million or 10.67% of total assets at December 31, 2009. As discussed further below, management has taken various actions to address its operational issues and will continue to devote substantial resources toward the resolution of all delinquent and nonperforming assets.

Regulatory Enforcement Actions.

The OTS is the primary federal regulator of the Bank. As a result of the loss in 2009 and the increase in nonperforming assets and based on a regulatory examination of the Company and the Bank in the fall of 2009, on April 12, 2010, the Company and the Bank each consented to the terms of Cease and Desist Orders issued by the OTS. The Orders became effective on April 14, 2010.

The Company Order, among other things, provides that:

- By June 30, 2010, the Company shall submit to the OTS a written capital plan to preserve and enhance the capital of the Company and the Bank to ensure that the Bank complies with the capital requirements imposed by the Bank Order. At a minimum, the plan shall: (i) address the requirements and restrictions imposed by the Orders; (ii) detail the Company's capital preservation and enhancement strategies; (iii) identify specific sources of additional capital and the timeframes and methods by which additional capital will be raised; (iv) establish an alternative strategy, which includes, but is not limited to, seeking a merger or acquisition partner for the Company and/or the Bank to be implemented if the primary strategy to raise additional capital is unsuccessful; and (v) require management to submit monthly reports to the Board regarding the Company and the Bank's compliance with their respective capital plans.
- By June 30, 2010, the Company shall submit to the OTS a business plan for the remainder of the calendar year 2010 and calendar years 2011 and 2012 that is acceptable to the OTS Regional Director. At a minimum, the plan shall include: (i) actions to address the requirements contained in the Order issued to the Company and the comments contained within the Company's most recent examination by the OTS; (ii) strategies for capital enhancement with the capital maintenance requirements of the foregoing capital plan; (iii) plans and strategies to strengthen and improve the consolidated Company's operations, earnings and profitability; (iv) a detailed discussion of the Company's current financial position and resources; (v) quarterly pro forma financial projections; (vi) identification of all relevant assumptions and documentation; (v) a contingency plan that addresses, under different, progressively stressed economic environments: projected short and long-term sources of liquidity and cash flow; the payment of the Company's operating expenses; and the payment of dividends on preferred stock without reliance on capital distributions or any other payments from the Bank.
- Effective immediately, the Company shall not declare or pay any cash dividends or capital distributions on the Company's stock or repurchase such shares without the prior written non-objection of the OTS.
- Effective immediately, the Company shall not issue a new class of stock or change the terms of any existing classes of stock, or convert any class of stock into another class of stock without the prior written non-objection of the OTS.

- Effective immediately, the Company shall not incur, renew or increase any debt without the prior written non-objection of the OTS.
- Effective immediately, the Company shall not enter into, renew, extend or revise any contractual arrangements related to compensation or benefits with any director or senior executive officer of the Company without first providing OTS prior written notice.
- Effective immediately, the Company shall not make any "golden parachute payment" or any prohibited indemnification payment unless the Company complies with 12 C.F.R. Part 359.
- Effective immediately, the Company shall comply with the OTS prior notification requirements for changes in directors and senior executive officers set forth in 12 C.F.R. Part 563, Subpart H.
- Effective immediately, the Company shall not engage in any new transactions with the Bank except exempt transactions under 12 C.F.R. 223 and intercompany cost-sharing transactions and tax sharing transactions without the prior written non-objection of the OTS.

The Company Order will remain in effect until terminated, modified or suspended by the OTS.

Among other things, the Bank Order provides that:

- No later than December 31, 2010, the Bank shall achieve and maintain a Tier 1 (Core) Capital Ratio of at least 8.0% and a Total Risk-Based Capital Ratio of at least 12.0%.
- By June 30, 2010, the Bank shall submit to the OTS a written capital plan to achieve and maintain the foregoing capital levels. At a minimum, the plan shall address: (i) the amount of additional capital that will be necessary to meet the foregoing capital levels under different, progressively stressed economic environments; (ii) the requirements and restrictions imposed by the Order and the Bank's most recent examination; (iii) the Bank's level of classified assets, allowance for loan and lease losses ("ALLL"), earnings, asset concentrations, liquidity needs, and trends in these areas; (iv) current and projected trends in real estate market conditions; (v) the Bank's capital preservation and enhancement strategies; and (vi) identify specific sources of additional capital and the timeframes and methods by which additional capital will be raised.
- In the event the Bank fails to meet the capital requirements of the Order, fails to comply with the capital plan or at the request of the OTS, the Bank shall prepare and submit a contingency plan to the OTS within 30 days of such event. The contingency plan shall detail actions to be taken to achieve either a merger or acquisition of the Bank by another depository institution or a voluntary liquidation of the Bank.
- Effective immediately, the Bank shall not, without the prior written non-objection of the OTS, increase its total assets during any quarter in excess of an amount equal to net interest credited on deposit liabilities during the prior quarter.
- By June 30, 2010, the Bank shall submit to the OTS a new business plan and budget for the remainder of the calendar year 2010 and calendar years 2011 and 2012 that is acceptable to the OTS Regional Director. At a minimum, the plan shall include: (i) plans and strategies to restructure the Bank's operations, improve earnings, reduce expenses and achieve positive core income; (ii) strategies for ensuring the Bank has the financial and personnel resources necessary to implement and adhere to the plan; (iii) quarterly pro forma financial projections; and (iv) identification of all relevant assumptions made in formulating the plan.
- Effective immediately, the Bank shall not accept, renew or roll over any brokered deposit without a specific waiver from the OTS and the FDIC.
- Effective immediately, the Bank shall develop an internal system to monitor the interest rates offered on all interest bearing accounts to ensure compliance with 12 C.F.R. 337.6(b).
- Effective immediately, the Bank shall review its liquidity position and prepare a daily liquidity report setting forth the uses and sources of funds for the Bank's operations and cash flow projections for a 180 day period. The liquidity report is required to be submitted daily to the OTS Regional Director and the Bank's Asset/Liability Committee.
- Effective immediately, the Bank shall not declare or pay dividends or make any other capital distributions without the prior written approval of the OTS.

- Effective immediately, the Bank shall not make, purchase, or commit to make or purchase a commercial real estate (CRE) loan or an extension of credit for the purpose of land acquisition, development, and/or construction without the prior written non-objection of the OTS, except for construction of an owner occupied one-to-four family dwelling with at least a 20 percent down payment or that is subject to a binding pre-sold commitment.
- Effective immediately, the Bank shall not make, purchase, or refinance or commit to make, purchase, or refinance an extension of credit if any of the proceeds of the loan will be used for the payment of interest on any loan or will be used for the establishment of an interest carry reserve on a loan without the prior written non-objection of the OTS.
- Effective immediately, the Bank shall not make or purchase, or commit to make or purchase an extension of credit that is in excess of the supervisory loan-to-value limits set forth in the Appendix to 12 C.F.R. 560.101 without the prior written non-objection of the OTS.
- Within twenty-five (25) days after the end of each quarter, beginning with the quarter ended March 31, 2010, the Bank shall submit a written report to the Bank's Board of Directors setting forth the ALLL analysis for the Bank's assets and all assumptions used to determine the adequacy of the ALLL, given current economic conditions and the Bank's risk profile. The written report is required to be submitted to the OTS Regional Director within thirty (30) days after the end of each quarter. This report was submitted as required.
- Effective immediately, the Bank shall evaluate and classify its assets and establish ALLL and specific valuation allowances in accordance with applicable laws, regulations, and regulatory guidance.
- Effective immediately, the Bank shall implement and maintain an internal asset review program independent of the loan underwriting and approval functions to identify and grade loans with potential credit weaknesses in accordance with applicable regulations and regulatory guidance regarding internal asset reviews.
- By April 1, 2010, the Bank shall engage a qualified independent consultant to perform an on-site internal asset review and analyses of the assets on the Bank's books as of December 31, 2009, including: (i) all non-owner occupied mortgage loans exceeding two hundred fifty thousand dollars (\$250,000); (ii) all other nonhomogeneous loans exceeding five hundred thousand dollars (\$500,000); and (iii) all homogeneous loans designated as special mention or watch exceeding five hundred thousand dollars (\$500,000). The review shall be completed by May 31, 2010 and the Bank shall submit the consultant's report to the OTS by June 30, 2010. The Bank has already engaged a qualified independent consultant to meet this requirement.
- By June 30, 2010, the Bank shall submit a comprehensive classified asset reduction plan to reduce classified assets that is acceptable to the OTS Regional Director. At a minimum, such plan shall include: (i) targets for the level of classified assets as a percentage of Tier 1 (Core) capital and ALLL and the timeframe for each such target; (ii) a description of the manner of, and methods for, reducing the Bank's level of classified assets to the targets set forth therein; and (iii) all relevant assumptions and projections based on different scenarios, and documentation supporting such assumptions and projections.
- By June 30, 2010, the Bank shall submit a Loan-to-Value Plan to reduce the aggregate amount of all loans in excess of the supervisory loan-to-value limits set forth in the Appendix to 12 C.F.R. 560.101. At a minimum, the plan shall include: (i) targets for the aggregate amount of all loans in excess of such supervisory loan-to-value limits; (ii) targets for the aggregate amount of all commercial loans, agricultural loans, multifamily loans, or loans secured by properties other than owner occupied one-to-four family residential properties in excess of such supervisory loan-to-value limits; (iii) a description of the manner of, and methods for, reducing the Bank's level of loans in excess of such supervisory loan-to-value limits to the targets set forth therein; and (iv) all relevant assumptions and projections based on a best-case scenario, a worst-case scenario, and a most probable case scenario, and documentation supporting such assumptions and projections.
- By May 31, 2010, the Bank will submit to the OTS a certified written report regarding the transactions that do not comply with the requirements of 12 U.S.C. 1464 and 12 C.F.R. 560.30, specifically related to all real estate transactions and real estate transfer transactions conducted from January 1, 2008 through January 31, 2010.
- By June 30, 2010, the Bank shall submit a plan to divest of any impermissible asset that is acceptable to the OTS Regional Director.
- By June 30, 2010, the Bank shall submit a commercial real estate concentration plan to the OTS, subject to OTS Regional Director acceptance, that, at a minimum, addresses: (i) the reduction of the amount of the Bank's existing CRE loans to two hundred percent (200%) or less of Tier 1 (Core) capital and ALLL; (ii) the

reduction of each category of assets within the CRE portfolio to one hundred percent (100%) or less of Tier 1 (Core) capital and ALLL; (iii) the time frames for reaching each such target; and (iv) the assessment, monitoring, and control of the risks associated with the Bank's CRE portfolio in accordance with applicable regulatory guidance.

- Effective immediately, the Bank shall not engage in any new transaction with an affiliate unless the Bank has complied with certain regulatory requirements.
- Effective immediately, the Bank shall not enter into any arrangement or contract with a third party service provider that is significant to the overall operation or financial condition of the Bank or outside the Bank's normal course of business without obtaining written non-objection from the OTS.
- Effective immediately, the Bank shall not enter into, renew, extend or revise any contractual arrangement relating to compensation or benefits for any senior executive officer or director unless prior written notice is provided to the OTS.
- Effective immediately, the Bank shall not increase any salaries, bonuses or director's fees or make any other similar payments to directors or senior executive officers without prior written non-objection from the OTS.
- Effective immediately, the Bank shall not make any "golden parachute payments" or prohibited indemnification payment unless the Bank has complied with 12 C.F.R. Part 359 and 12 C.F.R. Section 545.121.
- Effective immediately, the Bank shall comply with the prior notification requirements for changes in directors and senior executive officers set forth in 12 C.F.R. Part 563, Subpart H.
- By April 30, 2010, the Bank shall retain an independent third party consultant acceptable to the OTS Regional Director to conduct a review of supervision of the Bank's lending operations by the Board and management. At a minimum, the Management Study shall include: (i) the identification of present and future staffing requirements for the Bank's lending operations; (ii) an evaluation of the performance of management with respect to the Bank's lending operations, including an assessment of whether compensation is commensurate with job performance and responsibilities in compliance with 12 C.F.R. § 563.161(b); (iii) the establishment of standards by which management's effectiveness in the Bank's lending operations will be measured; (iv) an assessment of the adequacy of communication regarding the Bank's lending operations between management and the Board and the quality and timeliness of reporting to the Board; and (v) recommendations on whether to expand the scope, frequency, and sufficiency of information regarding the Bank's lending operations provided to the Board by management. By July 30, 2010, the Board shall adopt a written plan to address any identified weaknesses or deficiencies noted in such study. The Bank shall provide such plan to the OTS within fifteen (15) days after the board meeting. The Bank retained the independent third party consultant and this consultant has already begun work towards compliance with this requirement of the Bank Order.

The Bank Order will remain in effect until terminated, modified or suspended by the OTS. Copies of the stipulations and the Orders are included as Exhibits 10.7 to 10.10 to the Company's 2009 Annual Report on Form 10-K filed with the SEC on April 15, 2010. The descriptions of the Orders set forth herein do not purport to be complete, and are qualified by reference to the full text of the Orders.

The Company and the Bank have taken such actions as necessary to comply with the provisions of the Orders which are currently effective and are continuing to work toward compliance with the provisions of the Orders with future compliance dates. Any material failure by the Company and the Bank to comply with the provisions of the Orders could result in further enforcement actions by the OTS. While the Company and the Bank intend to take such actions as may be necessary to comply with the requirements of the Orders, there can be no assurance that the Company or the Bank will be able to comply fully with the Orders, or that efforts to comply with the Orders will not have adverse effects on the operations and financial condition of the Company or the Bank. See "Risk Factors."

Report of Independent Registered Public Accounting Firm. The report of the Company's independent registered public accounting firm for the year ended December 31, 2009 contained an explanatory paragraph as to the Company's ability to continue as a going concern primarily due to the Company's loss of \$45.5 million in 2009, the Bank's significant level of criticized assets and the decline in the Bank's capital position. See Note 2 of the Notes to the Unaudited Condensed Consolidated Financial Statements included in Part I, Item 1 herein.

Strategic Initiatives. In response to the operational issues which have arisen as a result of the level of the Bank's nonperforming assets and the difficult economic and banking environment, management has taken a number of cost saving actions, implemented various strategic initiatives and aggressively addressed the nature and level of its nonperforming assets.

During 2009, the Company reviewed all aspects of its cost structure and implemented the following cost saving measures which continue in 2010:

- Reductions in compensation and benefits through
 - decreased executive and senior management salaries,
 - reduced director fees,
 - reduced staffing levels,
 - eliminated Company's 401(k) match,
 - suspended pay increases and bonuses;
- Reductions in discretionary expenses such as travel and entertainment, professional education and contributions;
- Reductions in advertising and public relations costs; and
- Reductions in third-party contract provider costs.

In order to complement the cost saving of the actions described above and to provide the Company with greater operational flexibility, the Company has taken the following actions:

- Significantly reduced lending, particularly construction and land loans;
- Increased liquidity;
- Suspended cash dividends on common and preferred stock; and
- Maintained the level of its interest rate spread and net interest margin.

The Company continues to work through the credit problems presented by the oversupply of homes and lots in the Company's Northwest Arkansas market area, the housing market downturn and current market conditions. In order to address the Company's nonperforming assets, the Company has taken the following steps in 2010:

- Hired an independent third party contractor to conduct a thorough review and analysis of its loan portfolio, including a review of collateral valuations;
- Hired an experienced former bank regulator as the Bank's Credit Risk and Loan Review Manager; and
- Hired an Appraisal Review Officer.

During 2010, the Company intends to continue to proactively address the challenges presented by the economy. The Company will focus on the following primary objectives during 2010:

- Addressing and resolving problem assets;
- Further reducing costs to achieve greater efficiency;
- Addressing and complying with all terms and conditions of the Orders; and
- Raising capital.

The Orders require the Company and the Bank to, among other things, submit a capital plan to the OTS to preserve and enhance the capital of the Company and the Bank. In addition, the Bank Order requires the Bank to achieve and maintain a tier one core capital ratio and a total risk-based capital ratio of at least 8% and 12%, respectively, by December 31, 2010. While the Company will consider all strategic alternatives available to it, including the reduction of assets, the Company currently intends to raise capital in the third or fourth quarter of 2010.

CRITICAL ACCOUNTING POLICIES

Various elements of our accounting policies, by their nature, are inherently subject to estimation techniques, valuation assumptions and other subjective assessments. In particular, the following estimates, due to the judgments, estimates and assumptions inherent in those policies, are critical to preparation of our financial statements.

- Determination of our allowance for loan losses
- Valuation of real estate owned
- Valuation of our deferred tax assets

These policies and the judgments, estimates and assumptions are described in greater detail in subsequent sections of Management's Discussion and Analysis and in the notes to the unaudited condensed consolidated financial statements included herein. We believe that the judgments, estimates and assumptions used in the preparation of our consolidated financial statements are appropriate given the factual circumstances at the time. However, given the sensitivity of our consolidated financial statements to these critical accounting policies, the use of other judgments, estimates and assumptions could result in material differences in our results of operations or financial condition.

In estimating the amount of credit losses inherent in our loan portfolio, various judgments and assumptions are made. For example, when assessing the condition of the overall economic environment, assumptions are made regarding market conditions and their impact on the loan portfolio. In the event the economy were to sustain a prolonged downturn, the loss factors applied to our portfolios may need to be revised, which may significantly impact the measurement of the allowance for loan losses. For impaired loans that are collateral dependent and for real estate owned, the estimated fair value of the collateral may deviate significantly from the proceeds received when the collateral is sold.

We recognize deferred tax assets and liabilities for the future tax consequences related to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, and for tax credits. We evaluate our deferred tax assets for recoverability using a consistent approach that considers the relative impact of negative and positive evidence, including our historical profitability and projections of future taxable income. We are required to establish a valuation allowance for deferred tax assets if we determine, based on available evidence at the time the determination is made, that it is more likely than not that some portion or all of the deferred tax assets will not be realized. In evaluating the need for a valuation allowance, we estimate future taxable income based on management-approved business plans and ongoing tax planning strategies. This process involves significant management judgment about assumptions that are subject to change from period to period based on changes in tax laws or variances between our projected operating performance, our actual results and other factors.

CHANGES IN FINANCIAL CONDITION

Changes in financial condition between March 31, 2010 and December 31, 2009 are presented in the following table (dollars in thousands). Material changes between the periods are discussed in the sections which follow the table.

	March 31, 2010	December 31, 2009	Increase (Decrease)	Percentage Change
ASSETS				
Cash and cash equivalents	\$ 29,387	\$ 22,149	\$ 7,238	32.7%
Investment securities held to maturity	119,262	135,531	(16,269)	(12.0)
Federal Home Loan Bank stock	2,422	3,125	(703)	(22.5)
Loans receivable, net	460,104	481,542	(21,438)	(4.5)
Loans held for sale	395	1,012	(617)	(61.0)
Accrued interest receivable	3,672	4,229	(557)	(13.2)
Real estate owned, net	33,623	35,155	(1,532)	(4.4)
Office properties and equipment, net	23,236	23,567	(331)	(1.4)
Prepaid expenses and other assets	24,828	24,760	68	0.3
TOTAL	\$ 696,929	\$ 731,070	\$ (34,141)	(4.7)%
LIABILITIES AND STOCKHOLDERS' EQUITY				
LIABILITIES:				
Deposits	\$ 613,104	\$ 624,624	\$ (11,520)	(1.8)%
Other borrowings	35,526	59,546	(24,020)	(40.3)
Other liabilities	4,300	3,600	700	19.4
Total liabilities	652,930	687,770	(34,840)	(5.1)
STOCKHOLDERS' EQUITY	43,999	43,300	699	1.6
TOTAL	\$ 696,929	\$ 731,070	\$ (34,141)	(4.7)%
BOOK VALUE PER COMMON SHARE	\$ 5.73	\$ 5.59		
COMMON EQUITY TO ASSETS	4.0%	3.7%		
TOTAL EQUITY TO ASSETS	6.3%	5.9%		

Loans Receivable. Changes in loan composition between March 31, 2010 and December 31, 2009 are presented in the following table (dollars in thousands).

	March 31, 2010	December 31, 2009	Increase (Decrease)	% Change
One- to four-family residences	\$ 234,588	\$ 235,990	\$ (1,402)	(0.6)%
Home equity lines of credit and second mortgage	24,022	27,022	(3,000)	(11.1)
Multifamily	24,285	25,368	(1,083)	(4.3)
Commercial real estate	106,810	107,237	(427)	(0.4)
Land	40,030	41,405	(1,375)	(3.3)
Construction:				
One- to four-family residences	5,511	7,102	(1,591)	(22.4)
Speculative one-to four-family residences	6,959	8,849	(1,890)	(21.4)
Multifamily	13,628	14,178	(550)	(3.9)
Commercial real estate	1,772	9,717	(7,945)	(81.8)
Land development	8,974	9,449	(475)	(5.0)
Total construction loans	<u>36,844</u>	<u>49,295</u>	<u>(12,451)</u>	<u>(25.3)</u>
Total mortgage loans	<u>466,579</u>	<u>486,317</u>	<u>(19,738)</u>	<u>(4.1)</u>
Commercial	<u>13,352</u>	<u>14,575</u>	<u>(1,223)</u>	<u>(8.4)</u>
Automobile	5,897	6,810	(913)	(13.4)
Other	9,791	11,052	(1,261)	(11.4)
Total consumer	<u>15,688</u>	<u>17,862</u>	<u>(2,174)</u>	<u>(12.2)</u>
Total loans receivable	495,619	518,754	(23,135)	(4.5)
Undisbursed loan funds	(2,842)	(4,327)	1,485	(34.3)
Deferred loan costs (fees) – net	(21)	23	(44)	(191.3)
Allowance for loan losses (1)	<u>(32,652)</u>	<u>(32,908)</u>	<u>256</u>	<u>(0.8)</u>
Loans receivable, net	<u>\$ 460,104</u>	<u>\$ 481,542</u>	<u>\$ (21,438)</u>	<u>(4.5)%</u>

(1) The allowance for loan losses at March 31, 2010 and December 31, 2009, is comprised of specific valuation allowances of \$8.6 million and \$7.5 million, respectively, and general valuation allowances of \$24.0 million and \$25.4 million, respectively.

The decrease in the Bank's loan portfolio was primarily due to a decrease in loan originations as a result of continued softening of the housing market in the Bank's market area and transfers of nonperforming loans to REO, net of loans to facilitate sales of REO. Market data indicates an overall decrease in home sales in Benton and Washington counties in 2009, 2008 and 2007. Although the Northwest Arkansas region's economy continues to experience population growth and a relatively good job market, the supply of new residential lots and new speculative homes for sale continues to outpace demand. We expect this trend to continue for the foreseeable future given the level of oversupply in the market.

Asset Quality. The following table sets forth the amounts, net of specific valuation allowances, and categories of the Bank's nonperforming assets at the dates indicated (dollars in thousands).

	March 31, 2010		December 31, 2009		Increase (Decrease)
	Net	% Assets	Net	% Assets	
Nonaccrual Loans:					
One- to four-family residential	\$ 12,721	1.83%	\$ 11,941	1.63%	\$ 780
Home equity and second mortgage	978	0.14	1,174	0.16	(196)
Speculative one- to four-family construction	849	0.12	1,081	0.15	(232)
Multifamily residential	3,939	0.57	1,431	0.20	2,508
Land development	5,694	0.82	6,144	0.84	(450)
Land	14,556	2.09	13,709	1.88	847
Commercial real estate	7,187	1.03	6,795	0.93	392
Commercial loans	383	0.05	463	0.06	(80)
Consumer loans	246	0.03	129	0.01	117
Total nonaccrual loans	46,553	6.68%	42,867	5.86%	3,686
Real estate owned	33,623	4.82	35,155	4.81	(1,532)
Total nonperforming assets	80,176	11.50	78,022	10.67	2,154
Performing restructured loans	4,846	0.70	4,609	0.63	237
Total nonperforming assets and performing restructured loans (1)	\$ 85,022	12.20%	\$ 82,631	11.30%	\$ 2,391

(1) The table above does not include substandard impaired loans of \$10.6 million and \$6.3 million as of March 31, 2010 and December 31, 2009, respectively. These impaired loans generally include loans for which there may be doubt about the ultimate timing of collection of principal and interest compared to the original terms of the note but where the payment history has been satisfactory and collateral coverage is estimated to be adequate to pay principal and interest in full. See Note 7 to the unaudited condensed consolidated financial statements. The table also does not include substandard loans which were judged not to be impaired totaling \$24.3 million and \$37.3 million at March 31, 2010 and December 31, 2009, respectively.

The increase in net nonaccrual loans from \$42.9 million at December 31, 2009 to \$46.6 million at March 31, 2010 was primarily related to an increase in nonaccrual multifamily residential loans. The increase in nonaccrual multifamily loans was primarily due to a \$2.9 million construction loan on a 56 unit apartment complex in Rogers, Arkansas that matured April 1, 2010. Based on estimated costs to complete the project and a July 2009 appraisal, a specific loan loss allowance of approximately \$600,000 was recorded for this loan as of March 31, 2010. Nonaccrual land and land development loans comprise over 43% of nonaccrual loans at March 31, 2010. Nonaccrual land and land development loans with balances in excess of \$1.0 million at March 31, 2010 are listed in the table below (in thousands).

	Location	Date to Nonaccrual	Comments	Loan Balance	Specific Valuation Allowance	Net of SVA	Valuation Date	Source
Land Development								
42 developed single family lots	Cave Springs, AR	3Q2007	A	\$ 1,040	\$ --	\$ 1,040	November 2009	F
52 single family lots and 25 acres of undeveloped land	Fayetteville, AR	1Q2009	B	3,649	--	3,649	November 2009	F
40 acres, proposed residential subdivision	Farmington, AR	3Q2009	C	1,060	55	1,005	December 2009	F
				<u>\$ 5,749</u>	<u>\$ 55</u>	<u>\$ 5,694</u>		
Land								
80 acres for future residential development	Fayetteville, AR	1Q2009	D	\$ 2,223	\$ --	\$ 2,223	February 2010	G
29 acres for future commercial development	Springdale, AR	1Q2009	D	2,039	10	2,029	March 2010	G
24 acres, commercial zoned	Lowell, AR	1Q2009	D	1,947	--	1,947	March 2010	G
96 developed single family lots	Fayetteville, AR	1Q2009	E	2,735	370	2,365	March 2010	F
60 acres, residential zoned	Fayetteville, AR	1Q2009	B	2,005	777	1,228	February 2010	G
35 acres, proposed residential subdivision	Fayetteville, AR	3Q2009	C	3,447	2,308	1,139	January 2010	G
Other - 27 loans under \$1 million each				4,353	728	3,625		
				<u>\$ 18,749</u>	<u>\$ 4,193</u>	<u>\$ 14,556</u>		

- A – This loan has been nonperforming for an extended period while the Bank exercised forbearance with the borrowers to allow them to market and maintain the property. The Bank is currently foreclosing on the property.
- B – These two loans are related to the same borrower. The loans matured in January 2010 and are now in foreclosure.
- C – These two loans are related to the same borrower group. These loans have been sent to legal counsel for collection/foreclosure.
- D – These loans are all related to the same borrower and all are in foreclosure.
- E – This loan is in foreclosure. This property is also the subject of litigation related to bonds that were sold without satisfying the first mortgage with the Bank.
- F – This valuation is based on discounted cash flow analysis.
- G – This valuation is based on comparable sales.

We expect a significant amount of the nonaccrual real estate loans to eventually migrate to real estate owned as \$30.3 million of the nonaccrual real estate loans, net of specific valuation allowances of \$4.6 million, are in bankruptcy or some stage of the foreclosure process as of March 31, 2010. Therefore, we expect real estate owned and associated expenses to continue to remain at elevated levels in future periods as such loans migrate from loans to real estate owned.

The following table sets forth the amounts and categories of the Bank's real estate owned at the dates indicated.

	<u>March 31, 2010</u>	<u>December 31, 2009</u>	<u>Increase (Decrease)</u>	<u>Percentage Change</u>
	(Dollars in Thousands)			
Real estate owned				
One- to four-family residential	\$ 9,076	\$ 10,216	\$ (1,140)	(11.2)%
Speculative one- to four-family construction ⁽¹⁾	3,095	3,186	(91)	(2.9)
Multifamily	377	545	(168)	(30.8)
Land ⁽²⁾	13,782	13,952	(170)	(1.2)
Commercial real estate	7,293	7,256	37	0.5
Total real estate owned	<u>\$ 33,623</u>	<u>\$ 35,155</u>	<u>\$ (1,532)</u>	<u>(4.4)%</u>

(1) At March 31, 2010, \$2.6 million of these properties were 100% complete. The remainder range from 73% to 98% complete.

(2) At March 31, 2010, \$8.5 million of the land balance represented 294 developed subdivision lots and \$2.5 million represented four unimproved commercial lots. The remaining \$2.8 million consisted of raw land.

The land component of real estate owned is made up of the following at March 31, 2010 (in thousands):

	<u>Location</u>	<u>Date to real estate owned</u>	<u>Balance</u>	<u>Valuation Date</u>	<u>Source</u>
Land					
35 developed single family lots	Pea Ridge, AR	12/30/2008	\$ 385	1/14/2010	1
48 developed single family lots	Elm Springs, AR	10/21/2008	1,230	1/27/2010	1
110 developed single family lots	Springdale, AR	4/17/2008	3,534	1/14/2010	1
60 developed single family lots	Lowell, AR	5/30/2008	1,662	1/15/2010	1
30.7 acres for future residential development	Lowell, AR	5/30/2008	1,257	3/29/2010	2
63.3 acres for future residential development	Elm Springs, AR	10/21/2008	888	1/27/2010	2
10 developed single family lots	Farmington, AR	7/2/2009	564	12/30/2009	2
1 unimproved commercial lot	Rogers, AR	10/29/2009	1,879	1/27/2010	2
3 unimproved commercial lots	Springdale, AR	11/19/2009	664	1/25/2010	1
Other - 36 properties			1,719		
			<u>\$ 13,782</u>		

1 – This valuation is based on discounted cash flow.

2 – This valuation is based on comparable sales.

The Bank is diligently working to dispose of its REO and has several team members dedicated to this effort, including an experienced special assets officer who is working full-time to liquidate the Bank's properties in the Northwest Arkansas market. Each property is evaluated on a case-by-case basis to determine the best course of action with respect to liquidation. Properties are marketed directly by the Bank or listed with local real estate agents utilizing appraisals, market information from realtors, market research reports, and our own market evaluations to make pricing and selling decisions. The Bank's Chief Lending Officer, loan officers, credit manager, special assets officer, and team members in the collections department all work together in this endeavor. The Bank's goal is to liquidate these properties in an orderly and efficient manner without incurring extraordinary losses due to quick sale pricing. During the quarter ended March 31, 2010, the Bank's net sales proceeds from REO sales were \$4.6 million, which included \$2.9 million of loans to facilitate the sales of REO.

Classified Assets. Federal regulations require that each insured savings association classify its assets on a regular basis. In addition, in connection with examinations of insured institutions, federal examiners have authority to identify problem assets and, if appropriate, classify them. There are three classifications for problem assets: "substandard," "doubtful" and "loss." Substandard assets have one or more defined weaknesses and are characterized by the distinct possibility that the insured institution 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. At March 31, 2010, the Bank had \$119.2 million of classified assets, all of which were classified as substandard, including \$46.6 million of nonaccrual loans and \$33.6 million of real estate

owned. Substandard loans include \$39.0 million of loans not included in the nonperforming assets table. Such loans have been reviewed and determined not to be impaired or if impaired, were estimated to have no loss. As a result, such loans remained on accrual status at March 31, 2010.

In addition, at March 31, 2010, the Bank had \$41.5 million of assets designated as special mention. Special mention assets have potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or the institution's credit position at some future date.

Potential Problem Loans. Based on the oversupply of lots in Northwest Arkansas, our land development portfolio poses a higher risk of default. These loans are typically structured with interest due at maturity and lot sales as the source of repayment. Since lot sales in the Northwest Arkansas market are significantly slower than when these loans were originated, our borrowers typically must rely on a secondary source of funds to pay the interest as it becomes due. Due to the relatively large balances of these types of loans, the interest due at maturity is usually significant. At March 31, 2010, gross land development loans totaled \$9.0 million. Of this total, \$5.7 million is on nonaccrual status with \$1.2 million in nonaccrual interest, and \$3.1 million with \$22,000 in accrued interest is classified as substandard and remains on accrual.

Delinquent Loans. The following table represents loans past due 30 – 89 days not on nonaccrual status as of March 31, 2010 and December 31, 2009 (in thousands). The amounts presented represent the total outstanding principal balances of the related loans, rather than the actual payment amounts that are past due.

	March 31, 2010	December 31, 2009
One- to four-family residential	\$ 4,468	\$ 2,759
Home equity and second mortgage	557	201
Multifamily residential	22	--
Land	781	1,156
Commercial real estate	3,491	974
Commercial loans	707	1,668
Consumer loans	176	118
	<u>\$ 10,202</u>	<u>\$ 6,876</u>
Percentage of Portfolio	2.06%	1.33%

Past due loans not on nonaccrual status are up since December 31, 2009 in the categories of single family, home equity and commercial real estate loans. We believe the negative trend in the single family and home equity categories is due to economic conditions and we have provided for this in our General Valuation Allowances ("GVA") in these categories accordingly. Past due commercial real estate loans are up at March 31, 2010 compared to December 31, 2009 due to a \$2.8 million loan collateralized by two commercial buildings that was 30 days past due as of March 31, 2010. The borrower operates a furniture store and has struggled to stay current on the loan, primarily due to the effect economic conditions have had on his business. We have obtained appraisals on the properties within the past year and updated them this quarter. Based on the appraisals and related update, we do not expect to incur a significant loss on this loan.

Allowance for Loan Losses. A summary of the activity in the allowance for loan losses is as follows (in thousands):

	Three Months Ended	
	March 31,	
	2010	2009
Balance at beginning of period	\$ 32,908	\$ 6,441
Provisions for estimated losses	53	3,521
Recoveries	70	60
Losses charged off	(379)	(464)
Balance at end of period	<u>\$ 32,652</u>	<u>\$ 9,558</u>

A summary of the activity in the allowance for losses by category for the three months ended March 31, 2010 is presented below (in thousands):

	December 31, 2009	Charge-offs ⁽¹⁾	Recoveries	Provisions	March 31, 2010
One- to four-family residential	\$ 4,436	\$ (81)	\$ 9	\$ --	\$ 4,364
Home equity and second mortgage	1,688	(78)	2	--	1,612
Speculative one- to four-family construction	884	--	--	--	884
Multifamily residential	3,915	--	--	--	3,915
Land development	1,181	--	--	--	1,181
Land	8,589	--	16	--	8,605
Commercial real estate	9,077	(57)	--	--	9,020
Commercial loans	2,578	(67)	1	--	2,512
Consumer loans	560	(96)	42	53	559
	<u>\$ 32,908</u>	<u>\$ (379)</u>	<u>\$ 70</u>	<u>\$ 53</u>	<u>\$ 32,652</u>

(1) As noted in the table above, charge-offs for the three months ended March 31, 2010, were \$379,000. At March 31, 2010, specific valuation allowances were \$8.6 million. Due to the level of specific valuation allowances, we expect charge-offs to increase in future periods.

The composition of the allowance for loan losses by component and category as of March 31, 2010 and December 31, 2009 is presented below (in thousands):

	March 31, 2010			December 31, 2009		
	Specific Valuation Allowance	General Valuation Allowance	GVA % of Portfolio	Specific Valuation Allowance	General Valuation Allowance	GVA % of Portfolio
One- to four-family residential	\$ 705	\$ 3,659	1.53%	\$ 405	\$ 4,031	1.66%
Home equity and second mortgage	313	1,299	5.48	305	1,384	5.18
Speculative one- to four-family construction	123	761	11.13	120	764	8.75
Multifamily residential	1,206	2,709	7.38	547	3,368	8.09
Land development	55	1,126	12.62	70	1,110	11.83
Land	4,193	4,412	12.31	3,923	4,665	12.45
Commercial real estate	1,461	7,559	7.06	1,708	7,368	6.54
Commercial loans	459	2,053	15.92	291	2,286	16.00
Consumer loans	123	436	2.80	107	456	2.57
	<u>\$ 8,638</u>	<u>\$ 24,014</u>	4.93%	<u>\$ 7,476</u>	<u>\$ 25,432</u>	4.97%

Changes in the composition of the allowance for loan losses between March 31, 2010 and December 31, 2009 are presented in the following table (in thousands):

	March 31, 2010	December 31, 2009	Increase (Decrease)
General	\$ 24,014	\$ 25,432	\$ (1,418)
Specific	8,638	7,476	1,162
	<u>\$ 32,652</u>	<u>\$ 32,908</u>	<u>\$ (256)</u>

The general component of the allowance for loan losses decreased primarily due to decreases in certain of the related loan balances. The specific component of the allowance for loan losses increased primarily due to allowances established since December 31, 2009 on multifamily loans. See "Asset Quality."

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes it is likely that a loan balance is uncollectible. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses represents management's estimate of incurred credit losses inherent in the Company's loan portfolio as of the balance sheet date. The estimation of the allowance is based on a variety of factors, including past loan loss experience, the current credit profile of the Company's borrowers, adverse situations that have occurred that may affect the borrowers' ability to repay, the estimated value of underlying collateral, and general economic conditions, including unemployment, bankruptcy trends, vacancy rates and home sales. Losses are recognized when available information indicates that it is probable that a loss has been incurred and the amount of the loss can be reasonably estimated. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available or conditions change.

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral

value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the short fall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent. Multifamily residential, commercial real estate, land and land development, and commercial loans that are delinquent or where the borrower's total loan relationship exceeds \$1 million are evaluated on a loan-by-loan basis at least annually.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Bank does not separately identify individual consumer and residential loans for impairment disclosures. Homogeneous loans are those that are considered to have common characteristics that provide for evaluation on an aggregate or pool basis. The Bank considers the characteristics of (1) one- to four-family residential mortgage loans; (2) unsecured consumer loans; and (3) collateralized consumer loans to permit consideration of the appropriateness of the allowance for losses of each group of loans on a pool basis. The primary methodology used to determine the appropriateness of the allowance for losses includes segregating certain specific, poorly performing loans based on their performance characteristics from the pools of loans as to type, valuing these loans, and then applying a loss factor to the remaining pool balance based on several factors including past loss experience, inherent risks, and economic conditions in the primary market areas.

In estimating the amount of credit losses inherent in our loan portfolio, various judgments and assumptions are made. For example, when assessing the condition of the overall economic environment, assumptions are made regarding market conditions and their impact on the loan portfolio. For impaired loans that are collateral dependent, the estimated fair value of the collateral may deviate significantly from the proceeds received when the collateral is sold in the event that the Bank has to foreclose or repossess the collateral.

Although we consider the allowance for loan losses of approximately \$32.6 million, which consists of a general valuation allowance of \$24.0 million and a specific valuation allowance of \$8.6 million, adequate to cover losses inherent in our loan portfolio at March 31, 2010, no assurance can be given that we will not sustain loan losses that are significantly different from the amount recorded, or that subsequent evaluations of the loan portfolio, in light of factors then prevailing, would not result in a significant change in the allowance for loan losses. Either of these occurrences could materially and adversely affect our financial condition and results of operations.

Investment Securities. Changes in the composition of investment securities held to maturity between March 31, 2010 and December 31, 2009 are presented in the following table (in thousands).

	March 31, 2010	December 31, 2009	Increase (Decrease)
U.S. Government and agency obligations	\$ 94,416	\$ 110,051	\$ (15,635)
Municipal securities	24,846	25,480	(634)
Total	<u>\$ 119,262</u>	<u>\$ 135,531</u>	<u>\$ (16,269)</u>

During the first three months of 2010, investment securities totaling \$16.3 million with an average tax equivalent yield of 5.27% matured or were called and no investments were purchased during the period.

At March 31, 2010, estimated fair values of investment securities held to maturity were as follows (in thousands):

	Amortized Cost	Fair Value
U.S. Government and agency obligations	\$ 94,416	\$ 93,848
Municipal securities	24,846	24,850
Total	<u>\$ 119,262</u>	<u>\$ 118,698</u>

Accrued Interest Receivable. The decrease in accrued interest receivable was primarily due to a decrease in the loans receivable balance and a decrease in the loan yield at March 31, 2010 compared to December 31, 2009.

Real Estate Owned, net. Changes in the composition of real estate owned between March 31, 2010 and December 31, 2009 are presented in the following table (dollars in thousands).

	December 31, 2009	Additions	Fair Value Adjustments	Net Sales Proceeds ⁽¹⁾	Loss	March 31, 2010
One- to four-family residential	\$ 10,216	\$ 3,208	\$ (272)	\$ (4,073)	\$ (3)	\$ 9,076
Speculative one- to four-family	3,186	200	(127)	(164)	--	3,095
Multifamily	545	--	--	(126)	(42)	377
Land	13,952	180	(100)	(244)	(6)	13,782
Commercial real estate	7,256	117	(80)	--	--	7,293
	<u>\$ 35,155</u>	<u>\$ 3,705</u>	<u>\$ (579)</u>	<u>\$ (4,607)</u>	<u>\$ (51)</u>	<u>\$ 33,623</u>

(1) Net sales proceeds include \$2.9 million of loans made by the Bank to facilitate the sale of real estate owned.

Deposits. Changes in the composition of deposits between March 31, 2010 and December 31, 2009 are presented in the following table (dollars in thousands).

	March 31, 2010	December 31, 2009	Increase (Decrease)	Percentage Change
Checking accounts	\$ 136,776	\$ 166,707	\$ (29,931)	(18.0)%
Money Market accounts	49,729	53,597	(3,868)	(7.2)
Savings accounts	26,850	24,983	1,867	7.5
Certificates of deposit	399,749	379,337	20,412	5.4
Total deposits	<u>\$ 613,104</u>	<u>\$ 624,624</u>	<u>\$ (11,520)</u>	(1.8)%

Deposits decreased in the comparison period, primarily due to a decrease in public school checking accounts, offset by an increase in certificates of deposit. The Bank views checking accounts as an attractive source of funds and will continue to promote such accounts as they offer overall low-interest deposits, fee income potential, and the opportunity to cross-sell other financial services.

Other Borrowings. The Bank experienced a \$24.0 million or 40.3% decrease in FHLB of Dallas borrowings during the quarter. The FHLB of Dallas advances at March 31, 2010 of \$35.5 million consisted of \$23.5 million of fixed rate advances with an average cost of 3.36% and \$12.0 million of floating rate advances with an average cost of 0.37%.

Stockholders' Equity. Stockholders' equity increased approximately \$699,000 from December 31, 2009 to March 31, 2010. The increase in stockholders' equity was primarily due to net income of \$905,000 during the first three months of 2010. In addition, during the three months ended March 31, 2010, preferred dividends of approximately \$206,000 were accrued. See the Unaudited Condensed Consolidated Statement of Stockholders' Equity for the three months ended March 31, 2010 for more detail.

Average Balance Sheets

The following table sets forth certain information relating to the Company's average balance sheets and reflects the average yield on assets and average cost of liabilities for the periods indicated. Such yields and costs are derived by dividing income or expense by the average balance of assets or liabilities, respectively, for the periods presented. Average balances are based on daily balances during the period.

	Three Months Ended March 31,					
	2010			2009		
	Average Balance	Interest	Average Yield/ Cost	Average Balance	Interest	Average Yield/ Cost
	(Dollars in Thousands)					
Interest-earning assets:						
Loans receivable(1)	\$ 499,334	\$ 6,829	5.47%	\$ 567,745	\$ 7,555	5.32%
Investment securities(2)	133,510	1,587	4.76	126,240	1,564	4.96
Other interest-earning assets	26,755	15	0.23	14,740	3	0.10
Total interest-earning assets	659,599	8,431	5.11	708,725	9,122	5.15
Noninterest-earning assets	70,308			84,406		
Total assets	<u>\$ 729,907</u>			<u>\$ 793,131</u>		
Interest-bearing liabilities:						
Deposits	\$ 617,274	2,549	1.65	\$ 628,829	3,781	2.41
Other borrowings	64,016	242	1.51	78,382	645	3.29
Total interest-bearing liabilities	681,290	2,791	1.64	707,211	4,426	2.50
Noninterest-bearing liabilities	4,750			7,822		
Total liabilities	686,040			715,033		
Stockholders' equity	43,867			78,098		
Total liabilities and stockholders' equity	<u>\$ 729,907</u>			<u>\$ 793,131</u>		
Net interest income		<u>\$ 5,640</u>			<u>\$ 4,696</u>	
Net earning assets	<u>\$ (21,691)</u>			<u>\$ 1,514</u>		
Interest rate spread			<u>3.47%</u>			<u>2.65%</u>
Net interest margin			<u>3.42%</u>			<u>2.65%</u>
Ratio of interest-earning assets to interest-bearing liabilities			<u>96.82%</u>			<u>100.21%</u>

(1) Includes nonaccrual loans.

(2) Includes FHLB of Dallas stock.

Rate/Volume Analysis

The table below sets forth certain information regarding changes in interest income and interest expense of the Company for the periods indicated. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to (i) changes in volume (changes in average volume multiplied by prior rate); (ii) changes in rate (change in rate multiplied by prior average volume); (iii) changes in rate-volume (changes in rate multiplied by the change in average volume); and (iv) the net change.

	Three Months Ended March 31, 2010 vs. 2009			Total Increase (Decrease)
	Increase (Decrease)			
	Due to			
Volume	Rate	Rate/ Volume		
(In Thousands)				
Interest income:				
Loans receivable	\$ (910)	\$ 209	\$ (25)	\$ (726)
Investment securities	90	(63)	(4)	23
Other interest-earning assets	3	5	4	12
Total interest-earning assets	<u>(817)</u>	<u>151</u>	<u>(25)</u>	<u>(691)</u>
Interest expense:				
Deposits	(69)	(1,184)	21	(1,232)
Other borrowings	(118)	(349)	64	(403)
Total interest-bearing liabilities	<u>(187)</u>	<u>(1,533)</u>	<u>85</u>	<u>(1,635)</u>
Net change in net interest income	<u>\$ (630)</u>	<u>\$ 1,684</u>	<u>\$ (110)</u>	<u>\$ 944</u>

CHANGES IN RESULTS OF OPERATIONS

The table below presents a comparison of results of operations for the three months ended March 31, 2010 and 2009 (dollars in thousands). Specific changes in captions are discussed in the sections which follow the table.

	Three Months Ended March 31,		Increase (Decrease)
	2010	2009	2010 vs 2009
Interest income:			
Loans receivable	\$ 6,829	\$ 7,555	\$ (726)
Investment securities	1,587	1,564	23
Other	15	3	12
Total interest income	<u>8,431</u>	<u>9,122</u>	<u>(691)</u>
Interest expense:			
Deposits	2,549	3,781	(1,232)
Other borrowings	242	645	(403)
Total interest expense	<u>2,791</u>	<u>4,426</u>	<u>(1,635)</u>
Net interest income before provision for loan losses	5,640	4,696	944
Provision for loan losses	53	3,521	(3,468)
Net interest income after provision for loan losses	<u>5,587</u>	<u>1,175</u>	<u>4,412</u>
Noninterest income:			
Deposit fee income	1,190	1,192	(2)
Earnings on life insurance policies	198	197	1
Gain on sale of loans	136	148	(12)
Other	297	370	(73)
Total noninterest income	<u>1,821</u>	<u>1,907</u>	<u>(86)</u>
Noninterest expenses:			
Salaries and employee benefits	2,798	2,967	(169)
Real estate owned, net	801	395	406
FDIC insurance premium	515	241	274
Professional fees	406	291	115
Advertising and public relations	64	111	(47)
Other	2,018	1,844	174
Total noninterest expenses	<u>6,602</u>	<u>5,849</u>	<u>753</u>
Income (loss) before income taxes	806	(2,767)	3,573
Income tax benefit	(99)	(1,264)	1,165
Net income (loss)	905	(1,503)	2,408
Preferred stock dividends and accretion of preferred stock discount	222	62	160
Net income (loss) available to common shareholders	<u>\$ 683</u>	<u>\$ (1,565)</u>	<u>\$ 2,248</u>
Basic earnings (loss) per common share	<u>\$ 0.14</u>	<u>\$ (0.32)</u>	<u>\$ 0.46</u>
Diluted earnings (loss) per common share	<u>\$ 0.14</u>	<u>\$ (0.32)</u>	<u>\$ 0.46</u>
Interest rate spread	<u>3.47%</u>	<u>2.65%</u>	
Net interest margin	<u>3.42%</u>	<u>2.65%</u>	
Average full-time equivalents	<u>249</u>	<u>291</u>	
Full-service offices	<u>20</u>	<u>20</u>	

Net Interest Income. Net interest income is determined by the Company's interest rate spread (i.e., the difference between the yields earned on its interest-earning assets and the rates paid on its interest-bearing liabilities) and the relative amounts of interest-earning assets and interest-bearing liabilities.

INTEREST INCOME AND INTEREST EXPENSE

Dollar changes in interest income and interest expense for the comparison periods are presented in the Rate/Volume Analysis table which appears on a previous page.

Interest Income. The decrease in interest income for the three month comparative period was primarily due to a decrease in the average balance of loans receivable. The average balance of loans receivable decreased due to repayments and maturities as well as a decrease in loan originations.

Interest Expense. The decrease in interest expense for the three month comparative period was primarily due to a decrease in the average rates paid on deposits and other borrowings as well as a decrease in the related average balances. The decrease in the average rates paid on deposit accounts and other borrowings reflects decreases in market interest rates.

Provision for Loan Losses. The provision for loan losses includes charges to maintain an allowance for loan losses adequate to cover probable credit losses related to specifically identified loans as well as probable credit losses inherent in the remainder of the loan portfolio that have been incurred as of the balance sheet date. Such provision and the adequacy of the allowance for loan losses is evaluated quarterly by management of the Bank based on the Bank's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral and current economic conditions.

The provision for loan losses decreased \$3.5 million to \$53,000 for the quarter ended March 31, 2010 compared to \$3.5 million for the quarter ended March 31, 2009. During the first quarter of 2010, the loan portfolio held for investment shrank from \$518.7 million to \$495.6 million. The \$23.1 million decrease in the loan portfolio was primarily responsible for the \$1.4 million decline in the general valuation allowance between December 31, 2009 and March 31, 2010. This was offset somewhat by a \$1.2 million increase in specific valuation allowances, \$600,000 of which was due to a multifamily residential construction loan. See "Asset Quality."

NONINTEREST EXPENSE

Noninterest expense. Noninterest expenses are up overall for the quarter ended March 31, 2010, compared to the same quarter in 2009, primarily due to the effects of the level of nonperforming loans and related collection costs, the level of real estate owned and related costs, and costs incurred as a result of the Company Order and the Bank Order, as illustrated below.

	Three Months Ended March 31,		Increase
	2010	2009	
Real estate owned, net	\$ 801	\$ 395	\$ 406
FDIC insurance	515	241	274
Supervisory assessments	106	48	58
Professional fees	406	291	115
Consultant fees	182	57	125
Loan collection expenses	157	--	157
Total	<u>\$ 2,167</u>	<u>\$ 1,032</u>	<u>\$ 1,135</u>

In order to offset the effects of the increased costs, the Company has worked to control other costs where possible, as illustrated below.

	Three Months Ended March 31,		Decrease
	2010	2009	
Salaries and employee benefits	\$ 2,798	\$ 2,967	\$ (169)
Occupancy expense	670	677	(7)
Data processing	379	408	(29)
Advertising and public relations	64	111	(47)
Postage and supplies	161	240	(79)
Other	363	414	(51)
Total	<u>\$ 4,435</u>	<u>\$ 4,817</u>	<u>\$ (382)</u>

Salaries and Employee Benefits. The changes in the composition of this line item are presented below (in thousands):

	Three Months Ended March 31,		Increase (Decrease)
	2010	2009	2010 vs 2009
Salaries	\$ 2,293	\$ 2,467	\$ (174)
Payroll taxes	206	230	(24)
Insurance	142	158	(16)
401(k)(1)	--	37	(37)
Defined benefit plan contribution	123	39	84
Other	34	36	(2)
Total	<u>\$ 2,798</u>	<u>\$ 2,967</u>	<u>\$ (169)</u>

(1) Represents Company matching contributions on the 401(k) plan. Effective February 16, 2009, the Company discontinued its matching contributions to the 401(k) plan.

The decrease in salaries and benefits was primarily due to a reduction in full time equivalent employees as well as cessation of the Company's 401(k) matching contribution in February 2009.

The Bank is a participant in the multiemployer Pentegra Defined Benefit Plan (the "Plan"). The Plan is non-contributory and covers all qualified employees. Since the Plan is a multiemployer plan, contributions of participating employers are commingled and invested on a pooled basis without allocation to specific employers or employees. On April 30, 2010, the Board of Directors of the Bank elected to freeze the Plan effective July 1, 2010, eliminating all future benefit accruals for participants in the Plan and closing the Plan to new participants as of that date. The Bank currently anticipates annual cost savings from freezing the Plan of approximately \$140,000. Actual cost savings will depend on a number of factors, including, but not limited to, administrative and other costs, the level of interest rates in the future and the performance of Plan assets. After July 1, 2010, the Bank will continue to incur costs consisting of administration and Pension Benefit Guaranty Corporation insurance expenses as well as amortization charges based on the funding level of the Plan. The level of amortization charges is determined by the Plan's funding shortfall, which is determined by comparing Plan liabilities to Plan assets. Based on current interest rates and Plan assets, the Bank anticipates that the funding shortfall may increase, resulting in increased amortization charges effective July 1, 2010. Increased amortization charges will decrease cost savings associated with freezing the Plan.

Real Estate Owned, net. The changes in the composition of this line item are presented below (in thousands):

	Three Months Ended March 31,		Increase (Decrease)
	2010	2009	2010 vs 2009
Loss provisions	\$ 579	\$ 164	\$ 415
Net loss (gain) on sales	51	(22)	73
Taxes and insurance	97	184	(87)
Other	74	69	5
Total	<u>\$ 801</u>	<u>\$ 395</u>	<u>\$ 406</u>

Real estate owned is expected to increase in the foreseeable future and real estate owned expenses associated with maintaining the properties are expected to increase accordingly. Future levels of loss provisions and net gains or losses on sales of real estate owned will be dependent on market conditions.

FDIC Insurance Premium. FDIC insurance increased during the three month comparison period due to an increase in the premium rate for 2010. FDIC premium expense is expected to continue to increase. See "Part II, Item 1A Risk Factors – Future FDIC insurance premiums or special assessments may impact our earnings."

Professional Fees. Professional fees increased primarily due to an increase in audit fees and to a lesser degree an increase in legal fees related to nonaccrual loans. We expect professional fees to remain at an elevated level due to the amount of nonaccrual loans and the increased legal, accounting, and other fees associated with reporting and compliance requirements.

Advertising and Public Relations. The decrease in 2010 is primarily related to a decrease in direct mail, print media and broadcast media advertising.

Income Taxes. The income tax benefit decreased primarily due to the increase in taxable income as well as the fact that there is a valuation allowance on the deferred tax asset as of March 31, 2010 and there was no such valuation allowance as of March 31, 2009. See also Note 9 to the unaudited condensed consolidated financial statements included in Part I, Item 1 herein for further information regarding income taxes.

OFF-BALANCE SHEET ARRANGEMENTS

The Company, in the normal course of business, makes commitments to buy or sell assets or to incur or fund liabilities. Commitments include, but are not limited to:

- the origination, purchase or sale of loans;
- the fulfillment of commitments under letters-of-credit, extensions of credit on home equity lines of credit, construction loans, and predetermined overdraft protection limits; and
- the commitment to fund withdrawals of certificates of deposit at maturity.

At March 31, 2010, the Bank's off-balance sheet arrangements principally included lending commitments, which are described below. At March 31, 2010, the Company had no interests in non-consolidated special purpose entities.

At March 31, 2010, commitments included:

- total approved commitments to originate or purchase loans amounting to \$2.2 million;
- rate lock agreements with customers of \$2.6 million, all of which have been locked with an investor;
- funded mortgage loans committed to sell of \$395,000;
- unadvanced portion of construction loans of \$2.8 million;
- unused lines of credit of \$13.7 million;
- outstanding standby letters of credit of approximately \$3.5 million;
- total predetermined overdraft protection limits of \$12.1 million; and
- certificates of deposit scheduled to mature in one year or less totaling \$252.2 million.

Total unfunded commitments to originate loans for sale and the related commitments to sell of \$2.6 million meet the definition of a derivative financial instrument. The related asset and liability are considered immaterial at March 31, 2010.

Historically, a very small percentage of predetermined overdraft limits have been used. At March 31, 2010, overdrafts of accounts with Bounce Protection™ represented usage of 3.51% of the limit. We expect utilization of these overdraft limits to remain at comparable levels in the future.

Based on historical experience, management believes that a significant portion of maturing deposits will remain with the Bank. We anticipate that we will continue to have sufficient funds, through repayments, deposits and borrowings, to meet our current commitments.

LIQUIDITY AND CAPITAL RESOURCES

Liquidity management is both a daily and long-term function of business management. The Bank's liquidity, represented by cash and cash equivalents and eligible investment securities, is a product of its operating, investing and financing activities. The Bank's primary sources of funds are deposits, borrowings, payments on outstanding loans, maturities and calls of investment securities and other short-term investments and funds provided from operations. While scheduled loan amortization and maturing investment securities and short-term investments are relatively predictable sources of funds, deposit flows and loan prepayments are greatly influenced by general interest rates, economic conditions and competition. Calls of investment securities are determined by the issuer and are generally influenced by the level of market interest rates at the bond's call date compared to the coupon rate of the bond. The Bank manages the pricing of its deposits to maintain deposit balances at levels commensurate with the operating, investing and financing activities of the Bank. In addition, the Bank invests excess funds in overnight deposits and other short-term interest-earning assets that provide liquidity to meet lending requirements and pay deposit withdrawals. When funds from the retail deposit market are inadequate for the liquidity needs of the Bank or the pricing of deposits is not as favorable as other sources, the Bank has borrowed from the FHLB of Dallas. Borrowings from the FRB discount window may currently be used only when other sources of liquidity are not available to the Bank.

In April 2008, based on the FHLB rating criteria, the Bank was notified of the replacement of its FHLB blanket lien with a restricted custody collateral arrangement, whereby the FHLB has custody and endorsement of the loans that collateralize the Bank's outstanding borrowings with the FHLB. Qualifying loans (i) must not be 90 days or more past due; (ii) must not have been in default within the most recent twelve-month period, unless such default has been cured in a manner acceptable to the FHLB; (iii) must relate to real property that is covered by fire and hazard insurance in an amount at least sufficient to discharge the mortgage loan in case of loss and as to which all real estate taxes are current; (iv) must not have been classified as substandard, doubtful, or loss by the Bank's regulatory authority or the Bank; and (v) must not secure the indebtedness to any director, officer, employee, attorney, or agent of the Bank or of any FHLB. The FHLB currently allows an aggregate collateral or lendable value on the qualifying loans of approximately 75% of the outstanding balance of the loans pledged to the FHLB.

During the first quarter of 2010, the use of FHLB borrowings decreased by \$24.0 million or 40.3%. At March 31, 2010, the Bank's borrowing capacity with FHLB was \$81.6 million, comprised of qualifying loans collateralized by first-lien one- to four-family mortgages with a collateral value of \$87.6 million and qualifying investment securities with a collateral value of \$29.6 million less outstanding advances at March 31, 2010 of \$35.5 million. The Bank may transfer additional eligible collateral to the FHLB to provide additional borrowing capacity if needed. Due to the Bank's restricted status at the FHLB, the Bank may only borrow short-term FHLB advances with maturities up to thirty days.

The Bank was notified in December 2009 by the FRB of various restrictions and collateral requirements. The Bank is required to pledge collateral with a value of \$16 million to secure account transaction settlements. This collateral may also be available to access the secondary discount window if unencumbered for transaction settlement and when other sources of funding are not available to the Bank. In addition, the Bank is required to maintain an account balance at the FRB to cover charges to the Bank's transaction account to avoid any daylight overdrafts.

The Bank uses qualifying investment securities and qualifying commercial real estate loans as collateral for the discount window and to secure transactions settlements. In September 2008, a subordination agreement was secured with the FHLB based on its blanket lien of commercial real estate loans. This agreement provides the Bank the ability to pledge commercial real estate loans to the FRB discount window and to secure transaction settlements. The loan collateral was held by the Bank through the FRB's Borrower in Custody of Collateral Program until December 2009, when the FRB notified the Bank that custody must be transferred to the FRB.

The FRB will not accept loans that: (i) are 30 days or more past due; (ii) are classified as substandard, doubtful, or loss by the Bank's regulating authority or the Bank; (iii) are illegal investments for the Bank; (iv) secure the indebtedness to any director, officer, employee, attorney, affiliate or agent of the Bank; or that (v) exhibit collateral and credit documentation deficiencies. The lendable value of commercial real estate of approximately \$16.8 million at March 31, 2010 was 57% of the fair market value of the loans as determined by the FRB taking into consideration the rate and duration of the loans pledged. In addition, at March 31, 2010, the Bank pledged qualifying investment securities with a collateral value of approximately \$3.3 million for the discount window and to secure transaction settlements.

At March 31, 2010, the Bank had short-term funds availability of approximately \$169.4 million or 24.3% of assets consisting of borrowing capacity at the FHLB and the FRB, unpledged investment securities, and overnight funds including the balances maintained at the FRB. The Bank anticipates it will continue to rely primarily on deposits, calls of investment securities, loan repayments, and funds provided from operations to provide liquidity. As necessary, the sources of borrowed funds described above will be used to augment the Bank's other funding sources.

The Bank uses its sources of funds primarily to meet its ongoing commitments, to pay maturing savings certificates and savings withdrawals, to repay maturing borrowings, to fund loan commitments, and to purchase investment securities. As of March 31, 2010, the Bank had outstanding commitments to originate loans of \$2.2 million, including \$682,000 of loans committed to sell; unadvanced portion of construction loans of \$2.8 million; and commitments to extend funds to, or on behalf of, customers pursuant to lines and letters of credit of \$17.2 million. Scheduled maturities of certificates of deposit for the Bank during the twelve months following March 31, 2010 amounted to \$252.2 million. Based on historical experience, management believes that a significant portion of maturing deposits will remain with the Bank. Management anticipates the Bank will continue to have sufficient funds, through loan repayments, deposits, and borrowings, to meet our current commitments. This expectation assumes that the FHLB will continue to extend credit based on our borrowing capacity and that core deposits do not experience a substantial decline.

The Bank emphasizes deposit growth and retention throughout our retail branch network to enhance our liquidity position. Effective with the Bank Order in April 2010, the Bank must comply with federal restrictions on the interest rates we may offer to our depositors. Under these restrictions, we may pay up to 75 basis points over the national average rates set by the FDIC for each deposit product. Although we do not believe these rate restrictions will have a significant impact on the level of new and existing deposits, we cannot predict the impact on our liquidity. We have historically paid rates the middle of the market for regular term certificates of deposit and paid above average rates locally for certificates of deposit with special terms.

The Bank is participating in the FDIC's Transaction Account Guarantee Program ("TAGP") which fully insures noninterest bearing transaction deposit accounts, NOW accounts paying less than 0.5% per annum through June 30, 2010, when the threshold rate lowers to 0.25%, and Interest on Lawyers Trust Accounts, regardless of dollar amount. This program, originally set to expire on December 31, 2009 was extended to December 31, 2010. An annualized 15 to 25 basis point assessment on balances in qualifying accounts that exceed the existing deposit insurance limit of \$250,000 will be assessed on a quarterly basis. The assessment rate will depend on the institution's risk category. At March 31, 2010, the Bank had approximately \$4.1 million in transaction deposit accounts included in the TAGP with \$1.6 million in excess of \$250,000 normal insurance coverage.

As of November 19, 2009 and in accordance with the directive from the OTS, the Bank may no longer accept, renew or roll over brokered deposits without the written non-objection of the regional director of the OTS. The Bank has not relied on brokered deposits as a primary source of funding. As of March 31, 2010 the Bank had \$9.9 million or 2% of deposits in brokered deposits. Approximately \$4.4 million of the brokered accounts mature in 2010. Based on the current minimal level of brokered deposits, management does not anticipate that the restrictions imposed by the OTS on brokered deposits will have a significant impact on the Bank's liquidity position.

In the first quarter of 2010, management took additional steps to strengthen the Bank's liquidity position including the transfer of additional collateral in the form of qualifying one- to four-family loans to the FHLB of Dallas, a decrease in the Bank's loan portfolio, establishment of a repurchase agreement to utilize our investment portfolio for liquidity, and membership in an internet service in order to bid for non-brokered certificates of deposit as another source of liquidity.

The Bank's liquidity risk management program assesses our current and projected funding needs to ensure that sufficient funds or access to funds exist to meet those needs. The program also includes effective methods to achieve and maintain sufficient liquidity and to measure and monitor liquidity risk, including the preparation and submission of liquidity reports on a regular basis to the board of directors and to the OTS. The program also contains a Contingency Funding Plan that forecasts funding needs and funding sources under different stress scenarios. The Contingency Funding Plan approved by the board of directors is designed to respond to an overall decline in the economic environment, the banking industry or a problem specific to our Bank. A number of different contingency funding conditions may arise which may result in strains or expectation of strains in the Bank's normal funding activities including customer reaction to negative news of the banking industry, in general, or us, specifically. As a result of negative news, some depositors may reduce the amount of deposits held at the Bank if concerns persist, which could affect the level and composition of the Bank's deposit portfolio and thereby directly impact the Bank's liquidity, funding costs and net interest margin. The Bank's funding costs may also be adversely affected in the event that activities of the Federal Reserve Board and the U.S. Department of the Treasury to provide liquidity for the banking system and improvement in capital markets are curtailed or are unsuccessful. Such events could reduce liquidity in the markets, thereby increasing funding costs to the Bank or reducing the availability of funds to the Bank to finance its existing operations and thereby adversely affect the Company's results of operations, financial condition, future prospects, profitability, and stock price.

For 2009, the Company declared dividends of \$0.01 per share in each of the first, second, and third quarters. No dividend was declared for the first quarter of 2010. Future dividend payments are subject to restrictions. See Part 1. Item 2 "Regulatory Enforcement Actions" for further information regarding dividend restrictions.

Since the Company is a holding company and does not conduct operations, its primary source of liquidity is dividends from the Bank. The Company has no borrowings from outside sources. The Company and the Bank are currently not allowed to declare or pay dividends or make any other capital distributions without the prior written approval of the OTS. The Company suspended its common stock dividend in the fourth quarter of 2009 and deferred the payment of the dividend for the quarter ended March 31, 2010 on its Fixed Rate Cumulative Perpetual Preferred Stock, Series A issued to the Treasury on March 6, 2009 as part of the Capital Purchase Program. The Company funds its expenses from cash deposits maintained in the Bank and from repayments on the loan to the Bank subsidiary. The deposits in the Bank and the loan to the Bank amounted to \$1.6 million at March 31, 2010. Management believes the Company has sufficient resources to fund expenses throughout 2010.

At March 31, 2010, the Bank's tangible, core and risk-based capital ratios amounted to 6.17%, 6.17% and 10.64%, respectively, compared to OTS capital adequacy standards of 1.5%, 4% and 8%. Effective May 2009, the Bank agreed with its primary regulator, the OTS, to maintain a core capital ratio of at least five percent and a risk-based capital ratio of at least ten percent. Further, the Bank Order requires the Bank to achieve and maintain a tier 1 core capital ratio and total risk-based capital ratio of 8% and 12%, respectively, by December 31, 2010. The Bank was not in compliance with this requirement as of March 31, 2010.

FORWARD-LOOKING STATEMENTS

The Company's Quarterly Report on Form 10-Q contains certain forward-looking statements and information relating to the Company that are based on the beliefs of management as well as assumptions made by and information currently available to management. In addition, in this document, the words "anticipate", "believe," "estimate," "expect," "intend," "should" and similar expressions, or the negative thereof, as they relate to the Company or the Company's management, are intended to identify forward-looking statements. Such statements reflect the current views of the Company with respect to future looking events and are subject to certain risks, uncertainties and assumptions. Should one or more of these risks or uncertainties materialize or should underlying assumptions prove incorrect, actual results may vary materially from those described herein as anticipated, believed, estimated, expected or intended. The Company does not intend to update these forward-looking statements.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There has been no material change in the market value of the Bank's portfolio equity since December 31, 2009. Similarly, while there has been no material change in the Company's asset and liability position since such time, the Bank's level of nonperforming assets continued to impact the level of net interest income during the three months ended March 31, 2010. The Bank's net interest margin decreased slightly from 3.49% for the three months ended December 31, 2009 to 3.42% for the three months ended March 31, 2010. Based on the level of nonperforming assets and competitive pressures on loan and deposit rates, management anticipates continued pressure on the Bank's interest rate spread and net interest margin for the second quarter of 2010, although maturing certificates of deposit repricing to lower rates will somewhat offset the pressure on the interest rate spread and margin.

The ability to maximize net interest income is largely dependent upon the achievement of a positive interest rate spread that can be sustained during fluctuations in prevailing interest rates. Interest rate sensitivity is a measure of the difference between amounts of interest earning assets and interest bearing liabilities that either reprice or mature within a given period of time. The difference, or the interest rate repricing "gap", provides an indication of the extent to which an institution's interest rate spread will be affected by changes in interest rates. A gap is considered positive when the amount of interest rate-sensitive assets exceeds the amount of interest rate-sensitive liabilities, and is considered negative when the amount of interest rate-sensitive liabilities exceeds the amount of interest rate-sensitive assets. Generally, during a period of rising interest rates, a negative gap within shorter maturities would adversely affect net interest income, while a positive gap within shorter maturities would result in an increase in net interest income, and during a period of falling interest rates, a negative gap within shorter maturities would result in an increase in net interest income while a positive gap within shorter maturities would have the opposite effect. Based on the Bank's negative gap position, a rising rate environment will negatively affect our interest rate spread and net interest margin.

Item 4. CONTROLS AND PROCEDURES

Our management evaluated, with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are operating effectively.

No change in the Company's internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act) occurred during the most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Part II

Item 1. Legal Proceedings

Neither the Company nor the Bank is involved in any other pending legal proceedings other than non-material legal proceedings occurring in the ordinary course of business.

Item 1A. Risk Factors

You should carefully consider the following risk factors, as well as other information in this Form 10-Q and the information contained in our other filings with the SEC. You should carefully consider the following risks in light of our current operating environment and regulatory status. The occurrence of any of the events described below could materially adversely affect our liquidity, results of operations and financial condition and our ability to continue as a going concern. Additional risks not presently known by us or that we currently deem immaterial may also have a material adverse impact.

The current economic environment poses significant challenges for the Company and could continue to adversely affect its financial condition and results of operations.

The Company is operating in a challenging and uncertain economic environment, including generally uncertain national and local conditions. Financial institutions continue to be affected by sharp declines in the real estate market and constrained financial markets. Dramatic declines in the housing market over the past year, with falling home prices and increasing foreclosures and unemployment, have resulted in significant write-downs of asset values by the Bank and other financial institutions. Continued declines in real estate values, home sales volumes, and financial stress on borrowers as a result of the uncertain economic environment could continue to have an adverse effect on the Bank's borrowers or their customers, which could adversely affect the Company's financial condition and results of operations. A worsening of these conditions would likely exacerbate the adverse effects on the Company and others in the financial services industry. For example, further deterioration in local economic conditions in the Company's markets could drive losses beyond that which is provided for in its allowance for loan losses. The Company may also face the following risks in connection with these events:

- Economic conditions that negatively affect housing prices and the job market have resulted, and may continue to result, in deterioration in credit quality of the Bank's loan portfolio, and such deterioration in credit quality has had, and could continue to have, a negative impact on the Company's business and financial condition.
- Market developments may affect consumer confidence levels and may cause adverse changes in payment patterns, causing increases in delinquencies and default rates on loans and other credit facilities.
- The processes the Company uses to estimate the allowance for loan losses may no longer be reliable because they rely on complex judgments, including forecasts of economic conditions, which may no longer be capable of accurate estimation.
- The Bank's ability to assess the creditworthiness of its customers may be impaired if the processes and approaches it uses to select, manage, and underwrite its customers become less predictive of future charge-offs.
- The Company expects to face increased regulation of its industry, and compliance with such regulation may increase its costs, limit its ability to pursue business opportunities, and increase compliance challenges.

As these conditions or similar ones continue to exist or worsen, the Company could experience continuing or increased adverse effects on its financial condition and results of operations.

Our failure to comply with applicable regulatory requirements and regulatory enforcement actions could result in further restrictions and enforcement actions.

The Bank is subject to supervision and regulation by the OTS. As a federally chartered stock savings and loan association, the Bank's good standing with its regulators is of fundamental importance to the continuation of its business. As more fully described in Part I, Item 2, "Regulatory Enforcement Actions", on April 12, 2010, the Company and the Bank both consented to the Orders issued by the OTS. The Orders require the Company and the Bank to, among other things, file with the OTS an updated business plan and capital plan and submit to the OTS, on a quarterly basis with respect to the business plan and monthly with respect to the capital plan, variance reports related to the plans. The Order issued to the Bank also substantially restricts the Bank's lending activities. We have incurred and

expect to continue to incur significant additional regulatory compliance expense in connection with the Orders, and we will incur ongoing expenses attributable to compliance with the terms of the Orders. In addition, the OTS must approve any deviation from our business plan, which could limit our ability to make any changes to our business, which could negatively impact the scope and flexibility of our business activities. We cannot predict the further impact of the Orders upon our business, financial condition or results of operations.

Any material failure by the Company and the Bank to comply with the provisions of the Orders could result in further enforcement actions by the OTS. While the Company and the Bank intend to take such actions as may be necessary to comply with the requirements of the Orders, there can be no assurance that the Company or the Bank will be able to comply fully with the Orders, or that efforts to comply with the Orders will not have adverse effects on the operations and financial condition of the Company or the Bank.

Our capital levels currently are not sufficient to achieve compliance with the higher capital requirements we must meet by December 31, 2010.

The Bank Order directs the Bank to raise its tier 1 core capital and total risk-based capital ratios to 8% and 12%, respectively, by December 31, 2010. At March 31, 2010, we did not meet these requirements and would have needed approximately \$12.8 million in additional capital based on assets at such date to meet these requirements. The Company currently does not have any capital available to invest in the Bank. We are considering various strategies to help us achieve these capital levels by December 31, 2010, but there is no assurance that any capital raising strategy can be completed successfully by that date. Moreover, any further increases to our allowance for loan losses and operating losses would negatively impact our capital levels and make it more difficult to achieve the capital levels directed by the OTS. If we fail to meet the required capital levels by December 31, 2010, the OTS could take additional enforcement action against us, including the imposition of further operating restrictions. The OTS also could direct us to seek a merger partner or to liquidate the Bank.

The decline in the Bank's capital in 2009 as a result of the Company's loss and the significant level of the Bank's criticized assets were noted by the Company's independent registered public accounting firm as primary factors in including an explanatory paragraph in their audit opinion for the year ended December 31, 2009, which expressed uncertainty about the Company's ability to continue as a going concern.

We have a high percentage of nonperforming loans and classified assets relative to our total assets. If our allowance for loan losses is not sufficient to cover our actual loan losses, our results of operations will be adversely affected.

At March 31, 2010, our nonperforming loans totaled \$46.6 million, representing 9.4% of total loans and 6.7% of total assets. Further, loans classified by management as substandard, including nonperforming loans, totaled \$119.2 million, representing 24.6% of total loans and 17.1% of total assets. At March 31, 2010, our allowance for loan losses was \$32.6 million, consisting of \$24.0 million of general loan loss allowances and \$8.6 million of specific valuation allowances. The general valuation allowance represents 51.6% of nonperforming loans. In the event our loan customers do not repay their loans according to their terms and the collateral securing the payment of these loans is insufficient to pay any remaining loan balance, we may experience significant loan losses, which could have a material adverse effect on our operating results.

Management maintains an allowance for loan losses based upon, among other things:

- historical experience;
- repayment capacity of borrowers;
- an evaluation of local, regional and national economic conditions;
- regular reviews of delinquencies and loan portfolio quality;
- collateral evaluations;
- current trends regarding the volume and severity of problem loans;
- the existence and effect of concentrations of credit; and
- results of regulatory examinations.

Based on those factors, management makes various assumptions and judgments about the ultimate collectibility of the respective loan portfolios. The determination of the appropriate level of the allowance for loan losses inherently involves a high degree of subjectivity and requires management to make significant estimates of current credit risks and future trends, all of which may undergo material changes. In addition, our board of directors and the OTS periodically review our allowance for loan

losses and may require an increase in the provision for possible loan losses or the recognition of further loan charge-offs. The OTS' judgments may differ from those of our management. The amount of future loan losses is susceptible to changes in economic, operating and other conditions, which may be beyond our control, including changes in interest rates, and these losses may exceed current estimates. Federal regulatory agencies, as an integral part of their examination process, review our loans and allowance for loan losses. The most recent OTS examination was completed in December 2009. While we believe that the allowance for loan losses is adequate to cover current losses, we cannot provide assurances that we will not need to increase our allowance for loan losses or that regulators will not require an increase in our allowance. Either of these occurrences could materially and adversely affect our financial condition and results of operations.

Liquidity needs could adversely affect our results of operations and financial condition.

The Bank's primary sources of funds are deposits, maturing or called securities, and loan repayments. While scheduled loan repayments are a relatively stable source of funds, they are subject to the ability of borrowers to repay the loans. The ability of borrowers to repay loans can be adversely affected by a number of factors outside of our control, including changes in economic conditions, adverse trends or events affecting business industry groups, reductions in real estate values or markets, business closings or lay-offs, inclement weather, natural disasters and international instability. Additionally, deposit levels may be affected by a number of factors, including rates paid by competitors, general interest rate levels, returns available to customers on alternative investments, financial condition or regulatory status of the Bank, actions by the OTS and general economic conditions. Accordingly, we may be required from time to time to rely on secondary sources of liquidity to meet withdrawal demands or otherwise fund operations. Those sources may include Federal Home Loan Bank advances, repurchase agreements and the Federal Reserve discount window. Currently, however, the Bank may only borrow from the Federal Home Loan Bank on a short-term basis.

Our financial flexibility will be constrained if we continue to incur losses and are unable to maintain our access to funding or if adequate financing is not available at acceptable interest rates. We may seek additional debt in the future. Additional borrowings, if sought, may not be available to us or, if available, may not be available on reasonable terms. If additional financing sources are unavailable, or are not available on reasonable terms, our financial condition, results of operations and future prospects could be materially adversely affected. Finally, if we are required to rely more heavily on more expensive funding sources to support future growth, our revenues may not increase proportionately to cover our costs. In addition, we may be required to slow or discontinue capital expenditures or make other investments or liquidate assets should those sources not be adequate.

There are increased risks involved with commercial real estate, construction, commercial business and consumer lending activities.

Our loan portfolio includes loans secured by existing commercial real estate. In addition, our portfolio includes loans for the construction of single-family residential real estate and land development loans. Commercial real estate and construction lending generally is considered to involve a higher degree of risk than single-family residential lending due to a variety of factors, including generally larger loan balances, the dependency on successful completion or operation of the project for repayment, the difficulties in estimating construction costs and loan terms which often do not require full amortization of the loan over its term and, instead, provide for a balloon payment at stated maturity. Our loan portfolio also includes commercial business loans to small- to medium-sized businesses, which generally are secured by various equipment, machinery and other corporate assets, and a variety of consumer loans, including automobile loans, deposit account secured loans and unsecured loans. Although commercial business loans and consumer loans generally have shorter terms and higher interest rates than mortgage loans, they generally involve more risk than mortgage loans because of the nature of, or in certain cases the absence of, the collateral which secures such loans. The Bank's lending activities are currently restricted as a result of the Orders. For a further discussion of the Orders, see Part I, Item 2, "Regulatory Enforcement Actions."

We may experience an ownership change which would result in a limitation of the use of our net operating losses.

In general, under Section 382 of the Code, a corporation that undergoes an "ownership change" is subject to limitations on its ability to utilize its pre-change net operating losses ("NOLs") to offset future taxable income. If we undergo an ownership change in the future as a result of issuances of our common stock or otherwise, our ability to utilize NOLs could be further limited by Section 382 of the Code. In the event of an ownership change, Section 382 imposes an annual limitation on the amount of

post-ownership change taxable income a corporation may offset with pre-ownership change NOL carryforwards and certain recognized built-in losses.

We may issue additional shares of our common stock in the future, which would dilute existing stockholder's ownership if they did not, or were not permitted to, invest in the additional issuances.

The Bank has been directed by the OTS to raise its tier 1 core capital and total risk-based capital ratios to 8% and 12%, respectively, by December 31, 2010. Had the Bank been required to meet these capital requirements at March 31, 2010, it would have needed additional capital of approximately \$12.8 million. To meet these capital requirements and for other purposes, we expect to seek to raise capital during the third or fourth quarter of 2010. Our ability to raise additional capital, if needed, will depend on conditions in the capital markets at that time, which are outside our control, and on our financial condition and performance. Accordingly, we cannot make assurances that we will be able to raise additional capital if needed on terms that are acceptable to us, or at all. If we cannot raise additional capital when needed, the OTS could take additional enforcement action against us, including the imposition of further operating restrictions. The OTS also could direct us to seek a merger partner or to liquidate the Bank. Our certificate of incorporation makes available additional authorized shares of common stock and preferred stock for issuance from time to time at the discretion of our board of directors, without further action by the shareholders, except where shareholder approval is required by law or the Nasdaq Capital Market requirements. The issuance of any additional shares of common stock, preferred stock, or convertible securities could be substantially dilutive to shareholders of our common stock. Holders of our shares of common stock have no preemptive rights that entitle them to purchase their *pro rata* share of any offering of shares of any class or series and, therefore, our shareholders may not be permitted to invest in future issuances of our common stock and as a result will be diluted.

Future FDIC insurance premiums or special assessments may adversely impact our earnings.

On May 22, 2009, the FDIC adopted a final rule levying a five basis point special assessment on each insured depository institution's assets minus Tier 1 capital as of June 30, 2009. We recorded an expense of approximately \$350,000 during the quarter ended June 30, 2009, to reflect the special assessment. The final rule permitted the FDIC to levy up to two additional special assessments of up to five basis points each during 2009 if the FDIC estimated that the Deposit Insurance Fund reserve ratio will fall to a level that the FDIC believes would adversely affect public confidence or to a level that will be close to or below zero. No additional levies were assessed in 2009. In addition, the FDIC increased the general assessment rate and, therefore, our FDIC general insurance premium expense will increase compared to prior periods.

On November 12, 2009, the FDIC adopted a final rule pursuant to which insured depository institutions will be required to prepay their estimated assessments for the fourth quarter of 2009, and for all of 2010, 2011 and 2012. This pre-payment was due on December 30, 2009. Under the rule, the assessment rate for the fourth quarter of 2009 and for 2010 is based on each institution's total base assessment rate for the third quarter of 2009, modified to assume that the assessment rate in effect on September 30, 2009 had been in effect for the entire third quarter, and the assessment rate for 2011 and 2012 would be equal to the modified third quarter assessment rate plus an additional 3 basis points. In addition, each institution's base assessment rate for each period is calculated using its third quarter assessment base, adjusted quarterly for an estimated 5% annual growth rate in the assessment base through the end of 2012. The Bank received an exemption from this prepayment requirement but will pay each quarterly assessment as it becomes due. The Bank received an exemption from this prepayment requirement due to its potential impact on the Bank's liquidity position.

Recent insured institution failures, as well as deterioration in banking and economic conditions, have significantly increased the loss provisions of the FDIC, resulting in a decline in the designated reserve ratio to historical lows. The FDIC expects a higher rate of insured institution failures in the next few years compared to recent years. Therefore, the reserve ratio may continue to decline. These developments have caused the premiums assessed on us by the FDIC to increase and materially increase FDIC insurance expense. We are unable to predict the effect in future periods if the economic crisis continues.

We are heavily regulated, and that regulation could limit or restrict our activities and adversely affect our earnings.

We operate in a highly regulated industry and are subject to examination, supervision, and comprehensive regulation by various federal and state agencies, including the OTS and the FDIC. Our

compliance with these regulations is costly and may restrict some of our activities, including payment of dividends, mergers and acquisitions, investments, loans and interest rates and locations of offices.

In light of current conditions in the global financial markets and the global economy, regulators have increased their focus on the regulation of the financial services industry. Over the past year and a half, the U.S. financial regulators responding to directives of the Obama Administration and Congress have intervened on an unprecedented scale. New legislative proposals continue to be introduced in the U.S. Congress that could further substantially increase regulation of the financial services industry and impose restrictions on the operations and general ability of firms within the industry to conduct business consistent with historical practices, including with respect to compensation, interest rates and the effect of bankruptcy proceedings on consumer real property mortgages. Further, federal and state regulatory agencies may adopt changes to their regulations and/or change the manner in which existing regulations are applied. We cannot predict the substance or effect of pending or future legislation or regulation or the application of laws and regulation to us. Compliance with current and potential regulation and scrutiny may significantly increase our costs, impede the efficiency of our internal business processes, require us to increase our regulatory capital and limit our ability to pursue business opportunities in an efficient manner by requiring us to expend significant time, effort and resources to ensure compliance. Additionally, evolving regulations concerning executive compensation may impose limitations on us that affect our ability to compete successfully for executive and management talent.

In addition, given the current economic and financial environment, our regulators may elect to alter standards or the interpretation of the standards used to measure regulatory compliance or to determine the adequacy of liquidity, certain risk management or other operational practices for financial services companies in a manner that impacts our ability to implement our strategy and could affect us in substantial and unpredictable ways and could have an adverse effect on our business, financial condition and results of operations. Furthermore, the regulatory agencies have extremely broad discretion in their interpretation of the regulations and laws and their interpretation of the quality of our loan portfolio, securities portfolio and other assets. If any regulatory agency's assessment of the quality of our assets differs from our assessment, we may be required to take additional charges that would have the effect of materially reducing our earnings, capital ratios and stock price.

In November 2009, the Federal Reserve Board issued a final rule that, effective July 1, 2010, prohibits financial institutions from charging consumers fees for paying overdrafts on automated teller machine and one-time debit card transactions, unless a consumer consents, or opts in, to the overdraft service for those types of transactions. Consumers must be provided a notice that explains the financial institution's overdraft services, including the fees associated with the service, and the consumer's choices. Because the Company's customers must provide advance consent to the overdraft service for automated teller machine and one-time debit card transactions, the Company cannot provide any assurance as to the ultimate impact of this rule on the amount of overdraft/insufficient funds charges reported in future periods.

Changes in interest rates could have a material adverse effect on our operations.

The operations of financial institutions such as the Bank are dependent to a large extent on net interest income, which is the difference between the interest income earned on interest earning assets such as loans and investment securities and the interest expense paid on interest bearing liabilities such as deposits and borrowings. Changes in the general level of interest rates can affect our net interest income by affecting the difference between the weighted average yield earned on our interest earning assets and the weighted average rate paid on our interest bearing liabilities, or interest rate spread, and the average life of our interest earning assets and interest bearing liabilities. Changes in interest rates also can affect our ability to originate loans; the value of our interest earning assets; our ability to obtain and retain deposits in competition with other available investment alternatives; and the ability of our borrowers to repay adjustable or variable rate loans. Interest rates are highly sensitive to many factors, including governmental monetary policies, domestic and international economic and political conditions and other factors beyond our control. There can be no assurance that our results of operations would not be adversely affected during any period of changes in interest rates due to a number of factors which can have a material impact on the Bank's interest rate risk position. Such factors include among other items, call features and interest rate caps and floors on various assets and liabilities, prepayments, the current interest rates on assets and liabilities to be repriced in each period, and the relative changes in interest rates on different types of assets and liabilities.

The Company is subject to restrictions on its ability to declare or pay dividends and repurchase its shares as a result of its participation in the Treasury's Troubled Asset Relief Program Capital Purchase Program. The Company and the Bank are prohibited from paying dividends or repurchasing common stock.

On March 6, 2009, the Company issued to the Treasury for aggregate consideration of \$16.5 million (i) 16,500 shares of Series A Preferred Stock and (ii) a Warrant to purchase 321,847 shares of the Company's Common Stock pursuant to the terms of the Purchase Agreement. Under the terms of the Purchase Agreement, the Company's ability to declare or pay dividends on any of its shares is restricted. Specifically, the Company may not declare dividend payments on common, junior preferred or *pari passu* preferred shares if it is in arrears on the dividends on the Series A Preferred Stock. In addition, the Company may not increase the dividends on its Common Stock above the amount of the last quarter cash dividend per share declared prior to October 14, 2008, which was \$0.16 per share, without the Treasury's approval until the third anniversary of the investment unless all of the Series A Preferred Stock has been redeemed or transferred. The Company is currently restricted from making or declaring any payments on its outstanding securities, including the dividends payable on the Series A Preferred Stock, without prior written non-objection from the OTS. The Company deferred payment of the dividend on the Series A Preferred Stock in the first quarter of 2010.

The Company's ability to repurchase its shares is also restricted under the terms of the Purchase Agreement. The Treasury's consent generally is required for the Company to make any stock repurchases until the third anniversary of the investment by the Treasury unless all of the Series A Preferred Stock has been redeemed or transferred. Further, common, junior preferred or *pari passu* preferred shares may not be repurchased if the Company is in arrears on the Series A Preferred Stock dividends. Under the Company Order, the Company may not repurchase shares of its common stock without the prior written non-objection of the OTS.

We are subject to restrictions on executive compensation as a result of our participation in the CPP.

Under the terms of the CPP, the U.S. Treasury has imposed specified standards for executive compensation and corporate governance for the period during which the U.S. Treasury holds any equity or warrants issued pursuant to the CPP. These standards generally apply to our chief executive officer, chief financial officer, chief operating officer, and the two next most highly compensated senior executive officers. The standards include:

- ensuring that incentive compensation for senior executives does not encourage unnecessary and excessive risks that threaten our value;
- required clawback of any bonus or incentive compensation paid to a senior executive based on statements of earnings, gains or other criteria that are later proven to be materially inaccurate;
- prohibition on making golden parachute payments to senior executives; and
- agreement not to deduct for tax purposes executive compensation in excess of \$500,000 for each senior executive.

Under the American Recovery and Reinvestment Act of 2009 (the "ARRA"), further compensation restrictions, including significant limitations on incentive compensation, have been imposed on our senior executive officers and most highly compensated employees. Those restrictions, and any future restrictions on executive compensation that may be adopted, could adversely affect our ability to hire and retain senior executive officers.

We may incur increased employee benefit costs.

The Bank is a participant in a non-contributory multiemployer defined benefit pension plan covering all qualified employees. On April 30, 2010, the Board of Directors of the Bank elected to freeze the plan effective July 1, 2010. Freezing the plan eliminates all future benefit accruals for participants in the plan and closes the plan to new participants as of that date. After July 1, 2010, the Bank will continue to incur costs consisting of administration and Pension Benefit Guaranty Corporation insurance expenses as well as amortization charges based on the funding level of the plan. The level of amortization charges is determined by the plan's funding shortfall, which is determined by comparing plan liabilities to plan assets. Based on current interest rates and plan assets, the Bank anticipates that the funding shortfall may increase, resulting in increased amortization charges effective July 1, 2010. Future pension funding requirements, and the timing of funding payments, may be subject to changes in legislation.

We face strong competition that may adversely affect our profitability.

We are subject to vigorous competition in all aspects and areas of our business from banks and other financial institutions, including savings and loan associations, savings banks, finance companies, credit unions and other providers of financial services, such as money market mutual funds, brokerage firms, consumer finance companies and insurance companies. We also compete with non-financial institutions, including retail stores that maintain their own credit programs and governmental agencies that make available low cost or guaranteed loans to certain borrowers. Certain of our competitors are larger financial institutions with substantially greater resources, lending limits, larger branch systems and a wider array of banking services. Competition from both bank and non-bank organizations will continue.

Our ability to successfully compete may be reduced if we are unable to make technological advances.

The banking industry is experiencing rapid changes in technology. In addition to improving customer services, effective use of technology increases efficiency and enables financial institutions to reduce costs. As a result, our future success will depend in part on our ability to address our customers' needs by using technology. We cannot assure that we will be able to effectively develop new technology-driven products and services or be successful in marketing these products to our customers. Many of our competitors have greater resources than we have to invest in technology.

We are subject to security and operational risks relating to our use of technology that could damage our reputation and our business.

Security breaches in our internet banking activities could expose us to possible liability and damage our reputation. Any compromise of our security also could deter customers from using our internet banking services that involve the transmission of confidential information. We rely on standard internet security systems to provide the security and authentication necessary to effect secure transmission of data. These precautions may not protect our systems from compromises or breaches of our security measures that could result in damage to our reputation and our business. Additionally, we outsource our data processing to a third party. If our third party provider encounters difficulties or if we have difficulty in communicating with such third party, it could significantly affect our ability to adequately process and account for customer transactions, which could significantly affect our business operations. The Bank has never incurred a material security breach nor encountered any significant down time with our outsourced partners.

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

The Company did not repurchase any securities during the first quarter of 2010. The Company is in its 19th announced repurchase program, which was approved by the board of directors on July 25, 2006, and publicly announced on November 8, 2006. Total shares approved to be purchased in this program are 245,197 of which 214,587 have been purchased as of March 31, 2010. All treasury stock purchases are made under publicly announced repurchase programs. The repurchase program is currently suspended. The Company Order prohibits the Company from repurchasing shares of its common stock without the prior written non-objection of the OTS.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Removed and reserved.

Item 5. Other Information

None.

Item 6. Exhibits

Exhibit 31.1 – Certification of Chief Executive Officer,
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350)
Exhibit 31.2 – Certification of Chief Financial Officer,
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350)
Exhibit 32.1 – Certification of Chief Executive Officer,
Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350)
Exhibit 32.2 – Certification of Chief Financial Officer,
Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350)

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.

FIRST FEDERAL BANCSHARES OF ARKANSAS, INC.

Date: May 17, 2010

By: /s/ Larry J. Brandt
Larry J. Brandt
Chief Executive Officer

Date: May 17, 2010

By: /s/ Sherri R. Billings
Sherri R. Billings
Chief Financial Officer and Chief Accounting Officer

**PURSUANT TO RULES 13a-14 AND 15d-14 OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTION 302
OF THE SARBANES-OXLEY ACT OF 2002
CERTIFICATION OF THE CHIEF EXECUTIVE OFFICER**

I, Larry J. Brandt, certify that:

1. I have reviewed this quarterly report on Form 10-Q of First Federal Bancshares of Arkansas, Inc. (the "Registrant");
2. Based on my knowledge, this 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 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 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-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, 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) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and
5. The Registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, 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 and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

Date: May 17, 2010

By: /s/ Larry J. Brandt
Larry J. Brandt
Chief Executive Officer

**PURSUANT TO RULES 13a-14 AND 15d-14 OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTION 302
OF THE SARBANES-OXLEY ACT OF 2002
CERTIFICATION OF CHIEF FINANCIAL OFFICER**

I, Sherri R. Billings, certify that:

1. I have reviewed this quarterly report on Form 10-Q of First Federal Bancshares of Arkansas, Inc. (the "Registrant");
2. Based on my knowledge, this 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 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 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-15e and 15d-15e) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, 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) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and
5. The Registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, 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 and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

Date: May 17, 2010

By: /s/ Sherri R. Billings
Sherri R. Billings
Chief Financial Officer

CERTIFICATION OF CHIEF EXECUTIVE OFFICER

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350)

The undersigned executive officer of First Federal Bancshares of Arkansas, Inc. (the "Registrant") hereby certifies that the Registrant's Form 10-Q for the three months ended March 31, 2010 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that the information contained therein fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

By: /s/ Larry J. Brandt
Larry J. Brandt
Chief Executive Officer

Date: May 17, 2010

CERTIFICATION OF CHIEF FINANCIAL OFFICER

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350)

The undersigned executive officer of First Federal Bancshares of Arkansas, Inc. (the "Registrant") hereby certifies that the Registrant's Form 10-Q for the three months ended March 31, 2010 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that the information contained therein fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

By: /s/ Sherri R. Billings
Sherri R. Billings
Chief Financial Officer

Date: May 17, 2010