

PRUDENTIAL BANCORP INC OF PENNSYLVANIA  
Form 10-K  
December 22, 2006

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

FORM 10-K  
FOR ANNUAL AND TRANSITION REPORTS  
PURSUANT TO SECTIONS 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

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

For The Fiscal Year Ended September 30, 2006

-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: 0-51214

PRUDENTIAL BANCORP, INC. OF PENNSYLVANIA  
(Exact Name of Registrant as Specified in its Charter)

PENNSYLVANIA  
(State or other jurisdiction of  
incorporation or organization)

68-0593604  
(IRS Employer Identification No.)

1834 OREGON AVENUE  
PHILADELPHIA, PENNSYLVANIA  
(Address of Principal Executive Offices)

Registrant's telephone number: (including area code) (215) 755-1500

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

Title Of Each Class	Name Of Each Exchange On Which Registered
Common Stock (par value \$0.01 per share)	The Nasdaq Stock Market, LLC

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

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

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

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

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filing requirements for the past 90 days. YES  NO

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

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

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer

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

The aggregate market value of the voting stock held by non-affiliates of the Registrant based on the closing price of \$13.50 on March 31, 2006, the last business day of the Registrant's second quarter was \$66,194,307 (12,367,650 shares outstanding less 7,464,368 shares held by affiliates at \$13.50 per share). Although directors and executive officers of the Registrant and certain employee benefit plans were assumed to be "affiliates" of the Registrant for purposes of the calculation, the classification is not to be interpreted as an admission of such status.

As of the close of business on December 11, 2006 there were 12,017,750 shares of the Registrant's Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

1. Portions of the Definitive Proxy Statement for the 2007 Annual Meeting of Stockholders are incorporated by reference in Part III.

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For The Fiscal Year Ended September 30, 2006

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## PART I

### ITEM 1. BUSINESS

#### GENERAL

Our Company, Prudential Bancorp, Inc. of Pennsylvania (the "Company" or "Prudential Bancorp"), is a Pennsylvania corporation which was organized as a mid-tier holding company for our bank, Prudential Savings Bank, a Pennsylvania-chartered, FDIC-insured savings bank (the "Bank" or "Prudential Savings Bank"). Our Bank is a wholly owned subsidiary of the Company. The Company's results of operations are primarily dependent on the results of the Bank. As of September 30, 2006, the Company, on a consolidated basis, had total assets of approximately \$472.4 million, total deposits of approximately \$347.3 million, and total stockholders' equity of approximately \$87.4 million.

The Company was formed when the Bank reorganized from a mutual savings bank to a mutual holding company structure in March 2005. Prudential Mutual Holding Company, a Pennsylvania corporation, is the mutual holding company parent of the Company. As of September 30, 2006, Prudential Mutual Holding Company owns 57.3% (6,910,062) of the Company's outstanding common stock and must continue to own at least a majority of the outstanding voting stock of the Company.

Our Bank is a community-oriented savings bank headquartered in south Philadelphia which was originally organized in 1886 as a Pennsylvania-chartered building and loan association known as "The South Philadelphia Building and Loan Association No. 2." We grew through a number of mergers with other mutual institutions with our last merger being with Continental Savings and Loan Association in 1983. We converted to a Pennsylvania-chartered savings bank in August 2004. Our banking office network currently consists of our headquarters and main office and five full-service branch offices. Five of our banking offices are located in Philadelphia (Philadelphia County) and one is in Drexel Hill in neighboring Delaware County, Pennsylvania. We maintain ATMs at five of our banking offices. We also provide on-line banking services. A seventh office in the Old City section of Philadelphia is scheduled to be opened in Spring 2007.

We are primarily engaged in attracting deposits from the general public and using those funds to invest in loans and securities. Our principal sources of funds are deposits, repayments of loans and mortgage-backed

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securities, maturities of investment securities and interest-bearing deposits, funds provided from operations and funds borrowed from the Federal Home Loan Bank of Pittsburgh. These funds are primarily used for the origination of various loan types including single-family residential mortgage loans, construction and land development loans, non-residential or commercial real estate mortgage loans, home equity loans and lines of credit, commercial business loans and consumer loans. We are an active originator of residential home mortgage loans and construction and land development loans in our market area. Traditionally, our Bank focused on originating or purchasing fixed-rate, long-term single-family residential mortgage loans for portfolio. In recent years, we have substantially increased our involvement in construction and land development lending. Such loans typically have higher yields as compared to single-family residential mortgage loans and have adjustable rates of interest and/or shorter terms to maturity. As a result of such emphasis, our construction and land development loans have grown from \$17.0 million or 8.9% of the total loan portfolio at September 30, 2002 to \$82.8 million or 32.3% of our total loan portfolio at September 30, 2006. We expect to continue to emphasize such lending but have not established any target level of investment. However, as long as market conditions are favorable for this activity, we would expect such lending to experience further growth, increasing both in terms of the amount of investment as well as a percentage of the total loan portfolio.

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The investment and mortgage-backed security portfolio has decreased over the last several years from \$236.0 million at September 30, 2004 to \$225.8 million at September 30, 2006 as maturing and called securities have been reinvested into the loan portfolio, in particular adjustable rate construction loans. A significant portion of our investment securities consist of securities with "step-up" interest rate adjustment features and an investment in a mutual fund which invests primarily in high quality adjustable-rate mortgage-backed and floating-rate securities. We have designated the substantial majority of our investment and mortgage-backed securities as held to maturity since we have both the intent and ability to hold them until their maturity. Although we chose to invest in such securities rather than originate long-term, fixed-rate loans at historically low rates, such course of action was not free of interest rate risk. At September 30, 2006, our \$182.4 million of investment and mortgage-backed securities held to maturity had an aggregate gross unrealized loss of \$3.5 million due to the recent increases in market rates of interest. However, with the recent rises in market rates of interest, we will consider increasing our single-family residential mortgage loan origination and purchase activities. During 2006, we classified mortgage-backed securities purchased of \$4.6 million as available for sale and may also consider designating more of our securities purchased in the future as available for sale rather than as held to maturity in order to increase our ability to adjust our asset mix as market and competitive conditions change.

In addition to offering loans and deposits we also offer, on an agency basis, securities and insurance products to our customers through an affiliation with a third-party broker-dealer.

Even though we have increased and expanded our involvement in construction and land development lending in recent years, at the same time we have been able to maintain our high asset and credit quality. At September 30, 2006, our total non-performing assets amounted to \$151,000 or 0.03% of total assets and have steadily declined from the high point during the past several years of \$1.8 million or 0.51% of total assets at September 30, 2002. Loan charge-offs, net of recoveries, averaged \$15,000 for fiscal years 2006, 2005 and 2004. At September 30, 2006, the ratio of our allowance for loan losses to

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non-performing loans was 409.7%. We attribute our credit quality to careful underwriting and the knowledge and experience of our management team.

Our executive offices are located at 1834 Oregon Avenue, Philadelphia, Pennsylvania and our telephone number is (215) 755-1500.

### MARKET AREA AND COMPETITION

Our primary market area is Philadelphia, in particular South Philadelphia and Center City, as well as Delaware County. We also are involved in Bucks, Chester and Montgomery Counties which, along with Delaware County, comprise the suburbs of Philadelphia. We also make loans in contiguous counties in southern New Jersey. This area is referred to as the Delaware Valley region. The Philadelphia metropolitan area is one of the leading regions for biotech and pharmaceutical research with many of the largest pharmaceutical companies maintaining a presence in the region. It is also a major health care area with a number of teaching and research hospitals being operated.

We face significant competition in originating loans and attracting deposits. This competition stems primarily from commercial banks, other savings banks and savings associations and mortgage-banking companies. Many of the financial service providers operating in our market area are significantly larger, and have greater financial resources, than us. We face additional competition for deposits from short-term money market funds and other corporate and government securities funds, mutual funds and from other non-depository financial institutions such as brokerage firms and insurance companies.

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### LENDING ACTIVITIES

GENERAL. At September 30, 2006, our net loan portfolio totaled \$219.4 million or 46.4% of total assets. Historically, our principal lending activity has been the origination of loans collateralized by one- to four-family, also known as "single-family," residential real estate loans secured by properties located in our market area. In addition, while we have been making construction loans to developers and homebuilders for more than 25 years, we substantially increased our construction and land development lending activities beginning in fiscal 2000. We also originate, to a substantially lesser degree, multi-family and commercial real estate loans, home equity loans and lines of credit, commercial business loans and consumer loans.

During fiscal 2002 and 2003, due to concerns over the interest rate risk inherent in originating or purchasing for portfolio long-term, fixed-rate loans bearing historically very low interest rates, we reduced our emphasis on originating and purchasing such loans or retaining those loans already in portfolio which were being refinanced. Prior to fiscal 2002, a substantial portion of our single-family residential mortgage loans had adjustable rates. As market rates of interest declined, many of our borrowers with adjustable-rate residential mortgage loans determined to refinance their mortgages, obtaining long-term, fixed-rate loans. However, due to our concern over the interest rate risk inherent in increasing our investment in long-term, fixed-rate loans bearing historically low rates of interest, we were unwilling to offer rates as attractive as many of our competitors. As a result, many of our customers refinanced their residential mortgage loans with other lenders. Moreover, we did not originate as many new loans as we had in prior periods due to our unwillingness to originate or purchase for portfolio retention single-family residential mortgage loans bearing low interest rates. This was particularly the case in fiscal 2003. As a result, the amount of single-family residential loans

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in portfolio declined from \$158.9 million or 83.1% of the total loan portfolio at September 30, 2002 to \$114.9 million or 75.3% of the total loan portfolio at September 30, 2003. In view of the modest increases in market rates of interest experienced in 2004 through 2006, the level of single-family residential loans has stabilized, increasing moderately to \$155.5 million at September 30, 2006, although such loans, as a percentage of our total loan portfolio, continue to decline.

The types of loans that we may originate are subject to federal and state laws and regulations. Interest rates charged by us on loans are affected principally by the demand for such loans and the supply of money available for lending purposes and the rates offered by our competitors. These factors are, in turn, affected by general and economic conditions, the monetary policy of the federal government, including the Federal Reserve Board, legislative tax policies and governmental budgetary matters.

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LOAN PORTFOLIO COMPOSITION. The following table shows the composition of our loan portfolio by type of loan at the dates indicated.

	September 30,						Amount
	2006		2005		2004		
	Amount	%	Amount	%	Amount	%	
	(Dollars in Thousands)						
Real estate loans:							
One- to four-family residential(1)	\$155,454	60.69%	\$135,394	67.22%	\$124,085	71.54%	\$115,8
Multi-family residential	5,074	1.98	2,541	1.26	3,181	1.84	3,5
Commercial real estate	11,339	4.42	9,875	4.90	5,608	3.23	7,4
Construction and land development	82,800	32.33	52,093	25.86	39,217	22.61	24,1
Total real estate loans	254,667	99.42	199,903	99.24	172,091	99.22	151,0
Commercial business loans	234	0.09	188	0.09	145	0.08	1
Consumer loans	1,239	0.49	1,347	0.67	1,206	0.70	1,2
Total loans	256,140	100.00%	201,438	100.00%	173,442	100.00%	152,5
Less:							
Undisbursed portion of construction loans in process	36,257		25,824		21,338		13,7
Deferred loan fees	(153)		(35)		(19)		2
Allowance for loan losses	618		558		558		5
Net loans	\$219,418		\$175,091		\$151,565		\$137,9

(1) Includes home equity loans and lines of credit.

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CONTRACTUAL TERMS TO FINAL MATURITIES. The following table shows the scheduled contractual maturities of our loans as of September 30, 2006, before giving effect to net items. Demand loans, loans having no stated schedule of repayments and no stated maturity, and overdrafts are reported as due in one year or less. The amounts shown below do not take into account loan prepayments.

	One- To Four-Family Residential -----	Multi-Family Residential -----	Commercial Real Estate -----	Construction And Land Development -----	Comm Bus Lo -----
(In Thousands)					
Amounts due after September 30, 2006					
in:					
One year or less	\$ 368	\$1,248	\$ 268	\$39,667	\$
After one year through two years	1,858	--	1,481	39,429	
After two years through three years	1,330	165	--	3,704	
After three years through five years	4,088	183	997	--	
After five years through ten years	19,827	2,252	5,494	--	
After ten years through fifteen years	86,463	1,154	2,988	--	
After fifteen years	41,520	72	111	--	
	-----	-----	-----	-----	
Total	\$155,454	\$5,074	\$11,339	\$82,800	\$
	=====	=====	=====	=====	=

The following table shows the dollar amount of all loans due after one year from September 30, 2006, as shown in the table above, which have fixed interest rates or which have floating or adjustable interest rates.

	Fixed-Rate -----	Floating Or Adjustable-Rate -----	Total -----
(In Thousands)			
One- to four-family residential	\$136,694	\$18,392	\$155,086
Multi-family residential	3,563	263	3,826
Commercial real estate	9,089	1,982	11,071
Construction and land development	--	43,133	43,133
Commercial business	19	70	89
Consumer	1,117	50	1,167
	-----	-----	-----
Total	\$150,482	\$63,890	\$214,372
	=====	=====	=====

LOAN ORIGINATIONS. Our lending activities are subject to underwriting standards and loan origination procedures established by our board of directors and management. Loan originations are obtained through a variety of sources, primarily existing customers as well as new customers obtained from referrals and local advertising and promotional efforts. We also use loan correspondents and brokers as a source for a substantial part of our residential mortgage loans, either having them originate such loans using our documentation or purchasing such loans from them immediately upon closing. Consumer loan applications are taken at any of our offices while loan applications for all

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other types of loans are taken only at our main office. All loan applications are processed and underwritten centrally at our main office.

Our single-family residential mortgage loans are written on standardized documents used by the Federal Home Loan Mortgage Corporation ("FHLMC" or "Freddie Mac") and Federal National Mortgage Association ("FNMA" or "Fannie Mae"). Property valuations of loans secured by real estate are undertaken by independent third-party appraisers approved by our board of directors.

In addition to originating loans, we purchase single-family residential loans from correspondents due to limited demand in our primary market area. However, all of such loans are underwritten by us using our underwriting criteria and approved by the executive committee or the full board of directors prior to purchase. We also occasionally purchase participation interests in larger balance loans, typically commercial real estate loans, from other financial institutions in our market area. Such participations are reviewed for compliance with our underwriting criteria and are approved by the executive committee or the full board before they are purchased. Generally, loan purchases have been without any recourse to the seller. However, we actively monitor the performance of such loans through the receipt of regular reports from the lead lender regarding the loan's performance, physically inspecting the loan security property on a periodic basis, discussing the loan with the lead lender on a regular basis and receiving copies of updated financial statements from the borrower.

In addition, we have sold participation interests in construction and land development loans originated by us to other institutions in our market area. In addition, beginning in fiscal 2002, we have sold to the Federal Home Loan Bank of Pittsburgh pursuant to the Mortgage Partnership Finance program long-term, fixed-rate single-family loans originated which had interest rates below certain levels established by the board of directors. Such sales provide for a limited amount of recourse. At September 30, 2006, our recourse exposure was approximately \$64,000. When we have sold participation interests, it has been done without recourse. We generally have sold participation interests in loans only when a loan would exceed our loan-to-one borrower limits. With respect to the sale of participation interests in such loans, we have received commitments to purchase such participation interests prior to the time the loan is closed. Under applicable Pennsylvania law, we are permitted to make loans to one borrower in an aggregate amount of up to 15% of the capital accounts of the Bank which consist of the aggregate of its capital, surplus, undivided profits, capital securities and reserve for loan losses. At September 30, 2006, the Bank's loans to one borrower limit was approximately \$10.5 million. As of September 30, 2006, the Bank had extended a number of loans to various partnerships in which a number of the same individuals participate as limited partner investors. If such relationships were construed as being so interrelated as to constitute a single borrower for purposes of the loans to one borrower limitation, then the Bank's extensions of credit to such partnerships would have exceeded the permissible limit at September 30, 2006. In order to eliminate any potential issue, the Bank sold additional participation interests in one of the loans extended to such partnerships. As a consequence, as of the date of this filing the largest loans to one borrower relationship was approximately \$10.3 million. All of such loans were performing in accordance with their terms and consist of loans to fund single-family residential condominium construction projects. For more information on such loans, see "Construction and Land Acquisition Lending".



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The following table shows our total loans originated, purchased, sold and repaid during the periods indicated.

	Year Ended September 30,		
	2006	2005	2004
	-----		
	-----		
	-----		
	(In Thousands)		
Loan originations:			
One- to four-family residential	\$46,368	\$24,775	\$26,974
Multi-family residential	2,631	802	480
Commercial real estate	1,365	6,012	298
Construction and land development	40,257	26,749	26,236
Commercial business	920	40	659
Consumer	455	562	2,559
	-----		
Total loan originations	91,996	58,940	57,206
Loans purchased	--	17,787	11,053
	-----		
Total loans originated and purchased	91,996	76,727	68,259
	-----		
Loans sold(1)	--	--	354
Loan principal repayments	47,943	53,455	54,902
	-----		
Total loans sold and principal repayments	47,943	53,455	55,256
Increase or (decrease) due to other items, net(2)	274	254	636
	-----		
Net increase (decrease) in loan portfolio	\$44,327	\$23,526	\$13,639
	=====	=====	=====

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 (1) For the year ended September 30, 2004, consists of a participation interest sold to another financial institution.

(2) Other items consist of loans in process, deferred fees and the allowance for loan losses.

ONE-TO FOUR-FAMILY RESIDENTIAL MORTGAGE LENDING. Our primary lending activity continues to be the origination or purchase of loans secured by first mortgages on one- to four-family residences located in our market area. The majority of our single-family residential mortgage loans are obtained through correspondents. At September 30, 2006, \$155.5 million of our total loan portfolio consisted of single-family residential mortgage loans. Due primarily to increased mortgage loan prepayments due to refinance activity as a result of the low interest rate environment prevailing during recent years, our concerns over originating or purchasing for portfolio long-term, fixed-rate loans bearing low interest rates as well as our increased emphasis on construction and land development loans, the percentage of single-family residential mortgage loans in our portfolio has decreased from 84.8% at September 30, 2001 to 60.7% at September 30, 2006. However, as market rates increase, we will consider increasing our investment in single-family residential mortgage loans.

Our single-family residential mortgage loans generally are underwritten on terms and documentation conforming with guidelines issued by Freddie Mac and Fannie Mae. Applications for one-to four-family residential mortgage loans are accepted only at our main office. We generally have retained for portfolio a substantial portion of the single-family residential mortgage loans that we originate, only selling certain long-term, fixed-rate loans bearing interest rates below certain levels established by the board. All of such sales have been sold to the Federal Home Loan Bank of Pittsburgh pursuant to the Mortgage Partnership Finance Program. We service all loans that we have

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originated, including loans that we subsequently sell. We currently originate fixed-rate, fully amortizing mortgage loans with maturities of 15, 20 or 30 years. We also offer adjustable rate mortgage ("ARM") loans. However, due to local market conditions, our originations of such loans have been limited in recent years. At September 30, 2006, \$17.8 million, or 13.0%, of our one- to four-family residential loan portfolio (excluding home equity loans and lines of credit) consisted of ARM loans.

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We underwrite one- to four-family residential mortgage loans with loan-to-value ratios of up to 95%, provided that the borrower obtains private mortgage insurance on loans that exceed 80% of the appraised value or sales price, whichever is less, of the secured property. We also require that title insurance, hazard insurance and, if appropriate, flood insurance be maintained on all properties securing real estate loans. A licensed appraiser appraises all properties securing one- to four-family first mortgage loans. Our mortgage loans generally include due-on-sale clauses which provide us with the contractual right to deem the loan immediately due and payable in the event the borrower transfers ownership of the property. Due-on-sale clauses are an important means of adjusting the yields of fixed-rate mortgage loans in portfolio and we generally exercise our rights under these clauses.

Our single-family residential mortgage loans also include home equity loans and lines of credit, which amounted to \$14.6 million and \$7.8 million, respectively, at September 30, 2006. The unused portion of home equity lines was \$4.4 million at such date. Our home equity loans are fully amortizing and have terms to maturity of up to 20 years. While home equity loans also are secured by the borrower's residence, we generally obtain a second mortgage position on these loans. Our lending policy provides that our home equity loans have loan-to-value ratios, when combined with any first mortgage, of 80% or less, although the preponderance of our home equity loans have combined loan-to-value ratios of 75% or less. We also offer home equity revolving lines of credit with interest tied to the Wall Street Journal prime rate. Generally, we have a second mortgage on the borrower's residence as collateral on our home equity lines. In addition, our home equity lines generally have loan-to-value ratios (combined with any loan secured by a first mortgage) of 75% or less. Our customers may apply for home equity lines as well as home equity loans at any banking office.

**CONSTRUCTION AND LAND ACQUISITION LENDING.** We have been an active originator of construction and land development loans for many years but have substantially increased our construction loan efforts in recent years as a growth area for us because they have shorter terms to maturity and they generally have floating or adjustable interest rates. We have focused our construction lending on making loans to developers and homebuilders in our primary market area to acquire, develop and build single-family residences or condominium projects. Our construction loans include, to a lesser extent, loans for the construction of multi-family residential or mixed-use properties. At September 30, 2006, our construction loans amounted to \$82.8 million, or 32.3% of our total loan portfolio. This amount includes \$36.3 million of undisbursed loans in process (of which \$6.6 million relates to participation interests we have sold). Our construction loan portfolio has grown appreciably since September 30, 2002, when construction loans amounted to \$17.0 million, or 8.9% of our total loan portfolio.

A substantial amount of our construction loans are construction and development loans to contractors and builders primarily to finance the construction of condominium projects, single-family homes and small to medium-sized residential subdivisions. Loans to finance the construction of

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condominium projects or single-family homes and subdivisions are generally offered to experienced builders in our primary market area with whom we have an established relationship. Residential construction and development loans are offered with terms of up to 36 months although typically the terms are 12 to 24 months. One or two six-month extensions may be provided for at our option and upon payment of a fee by the borrower. The maximum loan-to-value limit applicable to these loans is 75% of the appraised post construction value and do not require amortization of the principal during the term of the loan. We often establish interest reserves and obtain personal and/or corporate guarantees as additional security on our construction loans. Construction loan proceeds are disbursed periodically in increments as construction progresses and as inspection by our approved appraisers or loan inspectors warrants. Our construction loans are negotiated on an individual basis but typically have floating rates of interest based upon the Wall Street Journal prime rate. Additional fees may be charged as funds are disbursed. In addition to interest payments during the term of the construction loan, we typically require that payments to principal be made as units are completed and released. Generally such principal

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payments must be equal to 110% of the amount attributable to acquisition and development of the lot plus 100% of the amount attributable to construction of the individual home. We permit a pre-determined number of model homes to be constructed on an unsold or "speculative" basis. All other units must be pre-sold before we will disburse funds for construction. Our construction loans also include loans to acquire land and loans to develop the basic infrastructure, such as roads and sewers. The majority of our construction loans are secured by properties located in Philadelphia and Chester Counties, Pennsylvania. However, we also make construction loans in Bucks, Delaware and Montgomery Counties, Pennsylvania as well as the New Jersey suburbs of Philadelphia. In addition, we have sold participation interests in a number of our larger construction projects, generally retaining at least a 25% interest. Such sales do not provide for any recourse against the Bank.

Set forth below is a brief description of our five largest construction loans, all of which have performed in accordance with their terms.

Our largest construction and development loan is a \$20.0 million loan to a limited partnership sponsored by a Philadelphia-based regional developer. We sold participation interests totaling \$15.0 million to four other local financial institutions in connection with the closing of the loan in late 2004. We also received additional collateral from the borrower consisting of condominium units in another project with an estimated value of \$4.6 million at the time such collateral was pledged. The project involves the conversion of an existing building into a mixed-use building which will contain, when completed, approximately 200 loft condominiums above one floor of retail space. The project also involves the construction of both indoor and outdoor parking lots. The loan has a 36-month term with payments of interest only during the term of the loan and a floating interest at the Wall Street Journal prime plus 1% with a floor of 5.0%. As of November 2006, the developer had received agreements of sale covering 45 units and pre-sale (non-binding) reservations covering 3 units. The Bank's outstanding loan balance (with respect to its interest) at September 30, 2006 was approximately \$4.8 million with the total loan balance at such date amounting to approximately \$19.2 million. As of May 2006, the first phase of the project was completed which involved the initial 34 pre-sale units and building shell work. The developer elected to complete the remaining units in the existing building before they began conveying and occupying sites in order to limit the liability associated with construction site hazards and risks in

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occupying a building under construction, and to accelerate the overall project ahead of a potential market slowdown. During July 2006, we extended an additional loan of \$9.0 million for the second phase of the project. The new loan terms call for payments of interest only during the term of the loan and a floating interest at the Wall Street Journal prime plus 1% with a floor of 5.0%. The new loan will mature in 36 months from the date of the original loan. In late 2006, we sold participation interests related to the additional loan totaling \$5.1 million to three other local financial institutions in connection with the closing of the loan. The Bank's outstanding loan balance (with respect to its interest) at September 30, 2006 was approximately \$1.5 million with the total loan balance at such date amounting to approximately \$3.0 million.

In October 2005, we extended a \$5.0 million loan, also for the conversion of an existing building located in Philadelphia into condominiums. The limited partnership is operated by a Philadelphia-based construction company. The project involves the conversion of the existing building into 34 loft condominium units with outside parking. The loan has a 24 month term with interest only due during the term and a floating interest rate indexed to the Wall Street journal prime plus 1%. The loan has a floor of 5.0%. The loan provides for one six month extension upon the payment of a fee equal to .5% of the outstanding balance as of the date of the extension. The loan-to-value ratio at the date of origination was approximately 73%. We retained the entire interest in the loan. At the date hereof, the outstanding loan balance was approximately \$1.6 million. Construction of the project is proceeding on schedule and the contractor anticipates two sample units available for the spring 2007 selling season.

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In September 2005, we extended a \$3.0 million construction and development loan to a local developer to build a 17 townhouse project located in Philadelphia. The loan has a 24-month term with payments of interest only during the term of the loan and a floating interest rate at the Wall Street Journal prime rate plus 1% and with a floor of 7.25%. The loan to value ratio of the loan was approximately 68% at the date of origination without reference to the additional collateral we received. The additional collateral consists of a condo in Philadelphia and an office building in Sewell, New Jersey with estimated equity of \$540,000. In August 2006, we extended an additional \$1.5 million in order to facilitate successful completion of the project. At September 30, 2006, the outstanding balance of the loan was approximately \$4.1 million. As of October 2006, one unit has been sold and an additional 10 units are under agreement of sale.

In August 2005 we extended a \$5.0 million construction and land development loan to a local developer to convert an existing building into 17 loft condominium units located in Philadelphia. The loan has a 24-month term with payments of interest only during the term of the loan and a floating interest rate at the Wall Street Journal prime rate plus 1% and with a floor of 7.25%. The loan to value ratio of the loan was approximately 73% at the date of origination. At September 30, 2006, the outstanding balance of the Bank's loan was approximately \$3.9 million. As of October 2006, two units have been sold and an additional 10 units are under agreement of sale. Construction of the project is proceeding on schedule.

In September 2004 we extended a \$6.4 million construction and land development loan to a local developer to build an 18 townhouse project located in Philadelphia. Concurrently with closing the loan, we sold a 36.2% participation interest to another local financial institution, retaining the remaining 63.8%. The loan has a 24-month term with payments of interest only

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during the term of the loan and a floating interest rate at the Wall Street Journal prime rate plus 1% and with a floor of 5.00%. The loan to value ratio of the loan was approximately 76% at the date of origination without reference to the additional collateral we received. The additional collateral consists of two small commercial properties located in Upper Darby, Pennsylvania with an estimated value of \$578,000. At September 30, 2006 the outstanding balance of the Bank's portion of the loan was approximately \$1.6 million with the total loan balance outstanding at such date amounting to approximately \$2.5 million. The developer activated his six month extension clause to extend maturity until February 2007. As of October 2006, four units have been sold.

Construction financing is generally considered to involve a higher degree of credit risk than long-term financing on improved, owner-occupied real estate. Risk of loss on a construction loan depends largely upon the accuracy of the initial estimate of the property's value at completion of construction compared to the estimated costs, including interest, of construction and other assumptions. Additionally, if the estimate of value proves to be inaccurate, we may be confronted with a project, when completed, having a value less than the loan amount. We have attempted to minimize these risks by generally concentrating on residential construction loans in our market area to contractors with whom we have established relationships and by selling, with respect to larger construction and land development loans, participation interests. In the past, to the extent we have experienced any material difficulties, they have primarily related to loan participations we have purchased.

MULTI-FAMILY RESIDENTIAL AND COMMERCIAL REAL ESTATE LOANS. At September 30, 2006, our multi-family residential and commercial real estate loans amounted to \$16.4 million or 6.4% of our total loan portfolio. Although we continue to offer such loans and will originate such loans when it is favorable to us, multi-family residential loans have declined both in terms of the aggregate amount outstanding as well as a percentage of the loan portfolio since September 30, 2002. After declining since 2002, our commercial real estate loans increased slightly at September 30, 2005 to \$9.9 million and September 30, 2006 to \$11.3 million.

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Our commercial real estate and residential multi-family real estate loan portfolio consists primarily of loans secured by small office buildings, strip shopping centers, small apartment buildings and other properties used for commercial and multi-family purposes located in our market area. At September 30, 2006, the average commercial and multi-family real estate loan size was approximately \$216,000. The largest multi-family residential or commercial real estate loan at September 30, 2006 was \$1.2 million which was performing in accordance with its terms. Substantially all of the properties securing our multi-family residential and commercial real estate loans are located in our primary market area.

Although terms for commercial real estate and multi-family loans vary, our underwriting standards generally allow for terms up to 20 years with loan-to-value ratios of not more than 70%. Most of the loans are structured with balloon payments with amortization periods of up to 25 years. Interest rates are either fixed or adjustable, based upon designated market indices such as the Wall Street Journal prime rate plus a margin or, with respect to our multi-family residential loans, the Average Contract Interest Rate for previously occupied houses as reported by the Federal Housing Finance Board. In addition, fees of up to 2% are charged to the borrower at the origination of the loan. We obtain personal guarantees of the principals as additional collateral

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for commercial real estate and multi-family real estate loans.

Commercial real estate and multi-family real estate lending involves different risks than single-family residential lending. These risks include larger loans to individual borrowers and loan payments that are dependent upon the successful operation of the project or the borrower's business. These risks can be affected by supply and demand conditions in the project's market area of rental housing units, office and retail space and other commercial space. We attempt to minimize these risks by limiting loans to proven businesses, only considering properties with existing operating performance which can be analyzed, using conservative debt coverage ratios in our underwriting, and periodically monitoring the operation of the business or project and the physical condition of the property.

Various aspects of commercial and multi-family loan transactions are evaluated in an effort to mitigate the additional risk in these types of loans. In our underwriting procedures, consideration is given to the stability of the property's cash flow history, future operating projections, current and projected occupancy levels, location and physical condition. Generally, we impose a debt service ratio (the ratio of net cash flows from operations before the payment of debt service to debt service) of not less than 120%. We also evaluate the credit and financial condition of the borrower, and if applicable, the guarantor. Appraisal reports prepared by independent appraisers are reviewed by us prior to the closing of the loan. With respect to participations, we underwrite the loans as if we were the originating lender.

CONSUMER LENDING ACTIVITIES. We offer various types of consumer loans such as loans secured by deposit accounts and unsecured personal loans. Consumer loans are originated primarily through existing and walk-in customers and direct advertising. At September 30, 2006, \$1.2 million, or 0.5% of the total loan portfolio consisted of these types of loans.

Consumer loans generally have higher interest rates and shorter terms than residential loans. However, consumer loans have additional credit risk due to the type of collateral securing the loan or in some cases the absence of collateral.

COMMERCIAL BUSINESS LOANS. Our commercial business loans amounted to \$234,000 or 0.09% of the total loan portfolio at September 30, 2006.

Our commercial business loans typically are made to small to mid-sized businesses in our market area primarily to provide working capital. Small business loans may have adjustable or fixed rates of

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interest and generally have terms of three years or less but may go up to 15 years. Our commercial business loans generally are secured by real estate. In addition, we generally obtain personal guarantees from the principals of the borrower with respect to all commercial business loans.

LOAN APPROVAL PROCEDURES AND AUTHORITY. Our board of directors establishes Prudential Savings Bank's lending policies and procedures. Our various lending policies are reviewed at least annually by our management team and the board in order to propose modifications as a result of market conditions, regulatory changes and other factors. All modifications must be approved by our board of directors.

Home equity loans and lines of credit up to \$100,000 can be approved

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by one underwriter and either of two lending officers. Amounts in excess of the individual lending limit with respect to home equity loans and lines of credit must be approved by our two lending officers, and our President or Chief Financial Officer. All mortgage loans must be approved by either the executive committee of the board or the full board of directors of Prudential Savings Bank.

### ASSET QUALITY

GENERAL. One of our key objectives has been, and continues to be, maintaining a high level of asset quality. In addition to maintaining credit standards for new originations which we believe are sound, we are proactive in our loan monitoring, collection and workout processes in dealing with delinquent or problem loans. We also retain an independent, third party to undertake periodic reviews of the credit quality of a random sample of new loans and all of our major loans on an ongoing basis.

Reports listing all delinquent accounts are generated and reviewed by management on a monthly basis. These reports include information regarding all loans 30 days or more delinquent and all real estate owned and are provided to the board of directors. The procedures we take with respect to delinquencies vary depending on the nature of the loan, period and cause of delinquency and whether the borrower is habitually delinquent. When a borrower fails to make a required payment on a loan, we take a number of steps to have the borrower cure the delinquency and restore the loan to current status. We generally send the borrower a written notice of non-payment after the loan is first past due. Our guidelines provide that telephone, written correspondence and/or face-to-face contact will be attempted to ascertain the reasons for delinquency and the prospects of repayment. When contact is made with the borrower at any time prior to foreclosure, we will attempt to obtain full payment, work out a repayment schedule with the borrower to avoid foreclosure or, in some instances, accept a deed in lieu of foreclosure. In the event payment is not then received or the loan not otherwise satisfied, additional letters and telephone calls generally are made. If the loan is still not brought current or satisfied and it becomes necessary for us to take legal action, which typically occurs after a loan is 90 days or more delinquent, we will commence foreclosure proceedings against any real property that secures the loan. If a foreclosure action is instituted and the loan is not brought current, paid in full, or refinanced before foreclosure sale, the property securing the loan generally is sold at foreclosure and, if purchased by us, becomes real estate owned.

On loans where the collection of principal or interest payments is doubtful, the accrual of interest income ceases ("non-accrual" loans). On loans 90 days or more past due as to principal and interest payments, our policy, with certain limited exceptions with respect to single-family residential mortgage loans, is to discontinue accruing additional interest and reverse any interest currently accrued. On occasion, this action may be taken earlier if the financial condition of the borrower raises significant concern with regard to his/her ability to service the debt in accordance with the terms of the loan agreement. Interest income is not accrued on these loans until the borrower's financial condition and payment record demonstrate an ability to service the debt.

Real estate which is acquired as a result of foreclosure is classified as real estate owned until sold. Real estate owned is recorded at the lower of cost or fair value less estimated selling costs. Costs associated with acquiring and improving a foreclosed property are usually capitalized to the extent that

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the carrying value does not exceed fair value less estimated selling costs. Holding costs are charged to expense. Gains and losses on the sale of real estate owned are charged to operations, as incurred.

We account for our impaired loans under generally accepted accounting principles. An impaired loan generally is one for which it is probable, based on current information, that the lender will not collect all the amounts due under the contractual terms of the loan. Large groups of smaller balance, homogeneous loans are collectively evaluated for impairment. Loans collectively evaluated for impairment include smaller balance commercial real estate loans, residential real estate loans and consumer loans. These loans are evaluated as a group because they have similar characteristics and performance experience. Larger commercial real estate, construction and commercial business loans are individually evaluated for impairment. We had no impaired loans as of September 30, 2005 and 2006.

Federal regulations and our policies require that we utilize an internal asset classification system as a means of reporting problem and potential problem assets. We have incorporated an internal asset classification system, consistent with Federal banking regulations, as a part of our credit monitoring system. We currently classify problem and potential problem assets as "substandard," "doubtful" or "loss" assets. An asset is considered "substandard" if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. "Substandard" assets include those characterized by the "distinct possibility" that the insured institution will sustain "some loss" if the deficiencies are not corrected. Assets classified as "doubtful" have all of the weaknesses inherent in those classified "substandard" with the added characteristic that the weaknesses present make "collection or liquidation in full," on the basis of currently existing facts, conditions, and values, "highly questionable and improbable." Assets classified as "loss" are those considered "uncollectible" and of such little value that their continuance as assets without the establishment of a specific loss reserve is not warranted. Assets which do not currently expose the insured institution to sufficient risk to warrant classification in one of the aforementioned categories but possess weaknesses are required to be designated "special mention."

When an insured institution classifies one or more assets, or portions thereof, as "substandard" or "doubtful," it is required that a general valuation allowance for loan losses be established for loan losses in an amount deemed prudent by management. General valuation allowances represent loss allowances which have been established to recognize the inherent losses associated with lending activities, but which, unlike specific allowances, have not been allocated to particular problem assets. When an insured institution classifies one or more assets, or portions thereof, as "loss," it is required either to establish a specific allowance for losses equal to 100% of the amount of the asset so classified or to charge off such amount.

A savings institution's determination as to the classification of its assets and the amount of its valuation allowances is subject to review by Federal and state bank regulators which can order the establishment of additional general or specific loss allowances. The Federal banking agencies, have adopted an interagency policy statement on the allowance for loan and lease losses. The policy statement provides guidance for financial institutions on both the responsibilities of management for the assessment and establishment of allowances and guidance for banking agency examiners to use in determining the adequacy of general valuation guidelines. Generally, the policy statement recommends that institutions have effective systems and controls to identify, monitor and address asset quality problems; that management analyze all significant factors that affect the collectibility of the portfolio in a reasonable manner; and that management establish acceptable allowance evaluation processes that meet the



objectives set forth in the policy statement. In July 2001, the SEC issued Staff Accounting Bulletin ("SAB") No. 102, "Selected Loan Loss Allowance Methodology and Documentation Issues." The guidance contained in the SAB focuses on the documentation the SEC staff normally expects registrants to prepare and maintain in support of the allowance for loan and lease losses. Concurrent with the SEC's issuance of SAB No. 102, the federal banking agencies, represented by the Federal Financial Institutions Examination Council ("FFIEC"), issued an interagency policy statement entitled "Allowance for Loan and Lease Losses Methodologies and Documentation for Banks and Savings Institutions" (Policy Statement). The SAB and Policy Statement were the result of an agreement between the SEC and the federal banking agencies in March 1999 to provide guidance on allowance for loan and lease losses methodologies and supporting documentation. Our allowance for loan losses includes a portion which is allocated by type of loan, based primarily upon our periodic reviews of the risk elements within the various categories of loans, as well as an unallocated portion. The specific components relate to loans that are classified as either doubtful, substandard or special mention. The general components covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. The unallocated portion of the allowance is established upon consideration of various qualitative and quantitative factors with respect to the overall loan portfolio. Our management believes that, based on information currently available, its allowance for loan losses is maintained at a level which covers all known and inherent losses that are both probable and reasonably estimable at each reporting date. However, actual losses are dependent upon future events and, as such, further additions to the level of allowances for loan losses may become necessary.

We review and classify assets on a quarterly basis and the board of directors is provided with monthly reports on our classified assets. We classify assets in accordance with the management guidelines described above. At September 30, 2006, 2005 and 2004, we had no assets classified as "doubtful" or "loss", and \$151,000, \$600,000 and \$1.0 million, respectively, of assets classified as "substandard." In addition, as of September 30, 2006, 2005 and 2004, we did not have any loans designated "special mention."

DELINQUENT LOANS. The following table shows the delinquencies in our loan portfolio as of the dates indicated.

	September 30, 2006					
	30-89 Days Overdue		90 Or More Days Overdue		30-89 Days Over	
	Number Of Loans	Principal Balance	Number Of Loans	Principal Balance	Number Of Loans	Pr B
	(Dollars in Thousands)					
One- to four-family residential	15	\$1,502	4	\$ 151	19	\$
Multi-family residential	--	--	--	--	--	
Commercial real estate	--	--	--	--	--	
Construction and land development	--	--	--	--	1	
Commercial business	1	1	--	--	--	

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Consumer loans	--	--	--	--	3
	---	-----	---	-----	---
Total delinquent loans	16	\$1,503	4	\$ 151	23
	===	=====	===	=====	===
Delinquent loans to total net loans		0.68%		0.07%	
Delinquent loans to total loans		0.59%		0.06%	

NON-PERFORMING LOANS AND REAL ESTATE OWNED. The following table sets forth information regarding our non-performing loans and real estate owned. Our general policy is to cease accruing interest on loans, other than single-family residential loans, which are 90 days or more past due and to reverse all accrued interest. We had no loans on non-accrual status during the years ended September 30, 2006 and 2005.

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The following table shows the amounts of our non-performing assets (defined as non-accruing loans, accruing loans 90 days or more past due and real estate owned) at the dates indicated. We did not have troubled debt restructurings at any of the dates indicated.

	September 30,				
	2006	2005	2004	2003	2002
	(Dollars in Thousands)				
Non-accruing loans:					
One- to four-family residential	\$ --	\$ --	\$ --	\$ --	\$ --
Multi-family residential	--	--	--	--	--
Commercial real estate	--	--	--	--	448
Construction and land development	--	--	--	500	994
Commercial business	--	--	--	--	--
Consumer	--	--	--	--	--
	-----	-----	-----	-----	-----
Total non-accruing loans	--	--	--	500	1,442
	-----	-----	-----	-----	-----
Accruing loans 90 days or more past due:					
One- to four-family residential	151	240	478	386	259
Multi-family residential	--	--	--	--	--
Commercial real estate and land	--	--	--	--	--
Construction and land development	--	--	--	--	--
Commercial business	--	--	--	--	--
Consumer	--	--	1	4	26
	-----	-----	-----	-----	-----
Total accruing loans 90 days or more past due	151	240	479	390	285
	-----	-----	-----	-----	-----
Total non-performing loans (1)	151	240	479	890	1,727
	-----	-----	-----	-----	-----
Real estate owned, net (2)	--	360	548	626	43
	-----	-----	-----	-----	-----
Total non-performing assets	\$ 151	\$ 600	\$1,027	\$1,516	\$1,770
	=====	=====	=====	=====	=====
Troubled debt restructurings	--	--	--	--	--
Total non-performing loans as a					

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percentage of loans, net	0.07%	0.14%	0.32%	0.65%	0.95%
	=====	=====	=====	=====	=====
Total non-performing loans as a percentage of total assets	0.03%	0.05%	0.12%	0.22%	0.50%
	=====	=====	=====	=====	=====
Total non-performing assets as a percentage of total assets	0.03%	0.13%	0.25%	0.38%	0.51%
	=====	=====	=====	=====	=====

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- (1) Non-performing loans consist of non-accruing loans plus accruing loans 90 days or more past due.
- (2) Real estate owned balances are shown net of related loss allowances and consists solely of real property.

Interest income on impaired loans other than non-accrual loans is recognized on an accrual basis. Interest income on non-accrual loans is recognized only as collected. There was no such interest recognized for fiscal 2006 and 2005.

Property acquired by Prudential Savings Bank through foreclosure is initially recorded at the lower of cost, which is the lesser of the carrying value of the loan or fair value at the date of acquisition, or the fair value of the related assets at the date of foreclosure, less estimated costs to sell. Thereafter, if there is a further deterioration in value, we charge earnings for the diminution in value. Our policy is to obtain an appraisal on real estate subject to foreclosure proceedings prior to the time of foreclosure if the property is located outside our market area or consists of other than single-family residential property. We may obtain re-appraisals on a periodic basis on foreclosed properties. We also conduct inspections on foreclosed properties. As of September 30, 2006, the balance of real estate owned was \$-0-.

In the second quarter of fiscal 2006, the lone real estate owned property at September 30, 2005 was sold at a pre-tax gain of approximately \$106,000.

ALLOWANCE FOR LOAN LOSSES. The allowance for loan losses is established through a provision for loan losses. We maintain the allowance at a level believed, to the best of management's knowledge, to cover all known and inherent losses in the portfolio that are both probable and reasonable to estimate at each reporting date. Management reviews the allowance for loan losses on no less than a quarterly basis

in order to identify those inherent losses and to assess the overall collection probability for the loan portfolio. For each primary type of loan, we establish a loss factor reflecting our estimate of the known and inherent losses in such loan type using both a quantitative analysis as well as consideration of qualitative factors. Our evaluation process includes, among other things, an analysis of delinquency trends, non-performing loan trends, the level of charge-offs and recoveries, prior loss experience, total loans outstanding, the volume of loan originations, the type, size and geographic concentration of our loans, the value of collateral securing the loan, the borrower's ability to repay and repayment performance, the number of loans requiring heightened management oversight, local economic conditions and industry experience. In addition, each loan type is assigned a rating based on the assumed risk elements

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of such loan types. Such risk ratings are periodically reviewed by management and revised as deemed appropriate. The establishment of the allowance for loan losses is significantly affected by management judgment and uncertainties and there is a likelihood that different amounts would be reported under different conditions or assumptions. Various regulatory agencies, as an integral part of their examination process, periodically review our allowance for loan losses. Such agencies may require us to make additional provisions for estimated loan losses based upon judgments different from those of management. As of September 30, 2006, our allowance for loan losses was 0.24% of total loans receivable and 409.7% of non-performing loans. All of the amount of the allowance at each of the dates set forth in the tables on the following page consisted of general reserves.

We have reviewed the Interagency Policy Statement on the Allowance For Loan and Lease Losses (ALLL), issued December 13, 2006. The purpose of this policy statement is to issue guidance on important aspects of loan loss allowance practices. We believe that our methodology for the evaluation of our loan portfolio and the calculation of our ALLL is consistent with this statement.

In the five-year period ended September 30, 2006, our loan charge-offs have been relatively modest and two loans were responsible for the majority of such charge-offs.

We will continue to monitor and modify our allowances for loan losses as conditions dictate. No assurances can be given that our level of allowance for loan losses will cover all of the inherent losses on our loans or that future adjustments to the allowance for loan losses will not be necessary if economic and other conditions differ substantially from the economic and other conditions used by management to determine the current level of the allowance for loan losses.

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The following table shows changes in our allowance for loan losses during the periods presented.

	At Or For The Year Ended September 30,				
	2006	2005	2004	2003	2002
	(Dollars in Thousands)				
Total loans outstanding at end of period	\$256,140	\$201,438	\$173,442	\$152,503	\$191,442
Average loans outstanding	197,913	163,166	142,348	156,894	186,442
Allowance for loan losses, beginning of period	558	558	553	621	621
Provision for loan losses	60	--	50	180	--
Charge-offs:					
One- to four-family residential	--	--	--	--	--
Multi-family	--	--	--	--	--
Commercial real estate	--	--	50	172	--
Construction and land development	--	--	28	50	--
Commercial business	--	--	--	--	--
Consumer	--	--	--	51	--



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GENERAL. We invest in securities in accordance with policies approved by our board of directors. The investment policy designates our President, our Chief Financial Officer and our Treasurer as the Investment Committee, which committee is authorized by the board to make the Bank's investments consistent with the investment policy. The board of directors of Prudential Savings Bank reviews all investment activity on a monthly basis.

Our investment policy is designed primarily to manage the interest rate sensitivity of our assets and liabilities, to generate a favorable return without incurring undue interest rate and credit risk, to complement our lending activities and to provide and maintain liquidity. In recent periods, we substantially increased our investment and mortgage-backed securities portfolio due to concerns over the interest risk inherent in investing in long-term, fixed-rate residential mortgage loans in the low interest environment that has existed in recent years.

At September 30, 2006, our investment and mortgage-backed securities amounted to \$225.8 million or 47.8% of total assets at such date. The largest component of our securities portfolio in recent periods has been U.S. Government and agency obligations, which amounted to \$132.1 million or 58.5% of the securities portfolio at September 30, 2006. In addition, we invest in mortgage-backed securities and to a significantly lesser degree, municipal securities and other securities. Included in our investment securities available for sale is a \$34.1 million investment in a mutual fund that invests primarily in adjustable-rate mortgages and floating-rate securities. At September 30, 2006, we had unrecognized loss on this investment of approximately \$930,000 which reduced our total equity accordingly.

Approximately \$48.7 million of U.S. Government and agency securities at September 30, 2006 were "step-up" securities. These securities require the issuer to pay increased interest rates in the future according to pre-determined schedules and formulas. Our portfolio currently contains securities that call for various interest rate increases at various repricing intervals. The repricing periods range from monthly to every five years with interest rate adjustments ranging from 0.10% to 2.0%. In addition, these securities are callable at the option of the issuers. Although designed to protect the investor in a rising rate environment, the rate increases on these securities may not keep pace with rising interest rates in a rapidly rising interest rate environment. Also, because of the call feature, the securities may be called by the issuer at a time when we are not able to reinvest the proceeds of the called security at a rate comparable to that which we were earning on the security at the time it was called.

Pursuant to Statement of Financial Accounting Standards ("SFAS") No. 115, our securities are classified as available for sale, held to maturity, or trading, at the time of acquisition. Securities classified as held to maturity must be purchased with the intent and ability to hold that security until its final maturity, and can be sold prior to maturity only under rare circumstances. Held to maturity securities are accounted for based upon the amortized cost of the security. Available for sale securities can be sold at any time based upon needs or market conditions. Available for sale securities are accounted for at fair value, with unrealized gains and losses on these securities, net of income tax provisions, reflected in retained earnings as accumulated other comprehensive income. At September 30, 2006, we had \$132.1 million of investment securities classified as held to maturity, \$38.7 million of investment securities classified as available for sale, \$50.4 million of mortgage-backed securities classified as held to maturity, \$4.6 million of mortgage-backed securities classified as available for sale, and no securities classified as trading account.

We do not purchase mortgage-backed derivative instruments nor do we purchase corporate obligations which are not rated investment grade or better.

Our mortgage-backed securities consist primarily of mortgage pass-through certificates issued by the Government National Mortgage Association ("GNMA" or "Ginnie Mae"), Fannie Mae ("FNMA") or Freddie Mac ("FHLMC"). We have not invested in collateralized mortgage obligations ("CMOs") issued by such agencies. At September 30, 2006, all of our mortgage-backed securities were issued by the GNMA, FNMA or FHLMC.

Investments in mortgage-backed securities involve a risk that actual prepayments will be greater than estimated prepayments over the life of the security, which may require adjustments to the amortization of any premium or accretion of any discount relating to such instruments thereby changing the net yield on such securities. There is also reinvestment risk associated with the cash flows from such securities or in the event such securities are redeemed by the issuer. In addition, the market value of such securities may be adversely affected by changes in interest rates.

Ginnie Mae is a government agency within the Department of Housing and Urban Development which is intended to help finance government-assisted housing programs. Ginnie Mae securities are backed by loans insured by the Federal Housing Administration, or guaranteed by the Veterans Administration. The timely payment of principal and interest on Ginnie Mae securities is guaranteed by Ginnie Mae and backed by the full faith and credit of the U.S. Government. Freddie Mac is a private corporation chartered by the U.S. Government. Freddie Mac issues participation certificates backed principally by conventional mortgage loans. Freddie Mac guarantees the timely payment of interest and the ultimate return of principal on participation certificates. Fannie Mae is a private corporation chartered by the U.S. Congress with a mandate to establish a secondary market for mortgage loans. Fannie Mae guarantees the timely payment of principal and interest on Fannie Mae securities. Freddie Mac and Fannie Mae securities are not backed by the full faith and credit of the U.S. Government, but because Freddie Mac and Fannie Mae are U.S. Government-sponsored enterprises, these securities are considered to be among the highest quality investments with minimal credit risks.

The following table sets forth certain information relating to our investment and mortgage-backed securities portfolios at the dates indicated.

	September 30,					
	2006		2005		2004	
	Amortized Cost	Market Value	Amortized Cost	Market Value	Amortized Cost	Market Value
	(In Thousands)					
Mortgage-backed securities	\$ 54,894	\$ 54,142	\$ 66,828	\$ 67,124	\$ 80,932	\$ 82,074
U.S. Government and agency obligations	132,198	129,675	129,954	128,163	116,395	116,122
Municipal obligations	2,884	2,853	2,884	2,847	2,409	2,380
ARM mutual fund	34,982	34,052	34,982	34,123	34,982	34,544
Total	224,958	220,722	234,648	232,257	234,718	235,120

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FHLB stock	2,217	2,217	1,811	1,811	2,074	2,074
FHLMC stock	26	1,754	26	1,493	26	1,725
FNMA stock	1	7	1	5	1	8
	-----	-----	-----	-----	-----	-----
Total mortgage backed and investment securities	\$227,202	\$224,700	\$236,486	\$235,566	\$236,819	\$238,927
	=====	=====	=====	=====	=====	=====

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The following tables set forth the amount of investment and mortgage-backed securities which mature during each of the periods indicated and the weighted average yields for each range of maturities at September 30, 2006. Tax-exempt yields have not been adjusted to a tax-equivalent basis.

	Amounts At September 30, 2006 Which					
	One Year Or Less	Weighted Average Yield	Over One Year Through Five Years	Weighted Average Yield	Over Five Through Ten Years	Weighted Average Yield
	-----	-----	-----	-----	-----	-----
	(Dollars in Thousands)					
Bonds and other debt securities:						
U.S. Government and agency obligations	\$13,085	4.28%	\$33,084	4.10%	\$38,102	5.00%
Municipal obligations	--	--	--	--	2,884	3.00%
Mortgage-backed securities	--	--	1,920	4.50%	26	6.00%
	-----	-----	-----	-----	-----	-----
Total	\$13,085	4.28%	\$35,004	4.12%	\$41,012	4.00%
	=====	=====	=====	=====	=====	=====

The following table sets forth the composition of our mortgage-backed securities portfolio at each of the dates indicated all of which were classified as held to maturity in fiscal 2005 and 2004 while a portion was classified as available-for-sale in fiscal 2006. The securities all bear fixed rates of interest.

	September 30,		
	2006	2005	2004
	-----	-----	-----
	(In Thousands)		
GNMA	\$46,991	\$62,449	\$79,626
FHLMC	1,920	2,541	818
FNMA	5,983	1,838	488
	-----	-----	-----
Total mortgage-backed securities	\$54,894	\$66,828	\$80,932
	=====	=====	=====

Information regarding the contractual maturities and weighted average yield of our mortgage-backed securities portfolio at September 30, 2006 is presented below. Due to repayments of the underlying loans, the actual



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maturities of mortgage-backed securities generally are substantially less than the scheduled maturities.

	Amounts At September 30, 2006 Which Mature In				
	One Year Or Less	Weighted Average Yield	Over One Through Five Years	Weighted Average Yield	Over Five Years
(Dollars in Thousands)					
GNMA	\$--	--%	\$ --	--%	\$46,991
FHLMC	--	--	1,920	4.50	--
FNMA	--	--	--	--	5,983
	---	---	-----	-----	-----
Total mortgage-backed securities	\$--	--%	\$1,920	4.50%	\$52,974
	===	===	=====	=====	=====

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The following table sets forth the purchases, and principal repayments of our mortgage-backed securities during the periods indicated.

	At Or For The Year Ended September 30,		
	2006	2005	2004
(Dollars in Thousands)			
Mortgage-backed securities at beginning of period	\$ 66,828	\$ 80,932	\$ 82,556
Purchases	4,610	4,481	21,771
Repayments	(12,011)	(18,615)	(23,422)
Sales	(4,564)	--	--
Amortizations of premiums, net	31	30	27
	-----	-----	-----
Mortgage-backed securities at end of period	\$ 54,894	\$ 66,828	\$ 80,932
	=====	=====	=====
Weighted average yield at end of period	5.09%	5.16%	5.24%
	=====	=====	=====

### SOURCES OF FUNDS

GENERAL. Deposits, loan repayments and prepayments, proceeds from sales of loans, cash flows generated from operations and FHLB advances are the primary sources of our funds for use in lending, investing and for other general purposes.

DEPOSITS. We offer a variety of deposit accounts with a range of interest rates and terms. Our deposits consist of checking, both interest-bearing and non-interest-bearing, money market, savings and certificate of deposit accounts. At September 30, 2006, 50.6% of the funds deposited with Prudential Savings Bank were in core deposits, which are deposits other than

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certificates of deposit.

The flow of deposits is influenced significantly by general economic conditions, changes in money market rates, prevailing interest rates and competition. Our deposits are obtained predominantly from the areas where its branch offices are located. We have historically relied primarily on customer service and long-standing relationships with customers to attract and retain these deposits; however, market interest rates and rates offered by competing financial institutions significantly affect our ability to attract and retain deposits. The interest rates offered on our deposits are competitive in the market place and have increased over the past year as market rates have increased.

Prudential Savings Bank uses traditional means of advertising its deposit products, including broadcast and print media and generally does not solicit deposits from outside its market area.

We do not actively solicit certificate accounts of \$100,000 and above, known as "jumbo CDs," or use brokers to obtain deposits. At September 30, 2006, our jumbo CDs amounted to \$44.9 million, of which \$32.6 million are scheduled to mature within twelve months. At September 30, 2006, the weighted average remaining maturity of our certificate of deposit accounts was 11.8 months.

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The following table shows the distribution of, and certain other information relating to, our deposits by type of deposit, as of the dates indicated.

	September 30,					
	2006		2005		2004	
	Amount	%	Amount	%	Amount	%
(Dollars in Thousands)						
<b>Certificate accounts:</b>						
0.00% - 1.99%	\$ --	--%	\$ 618	0.18%	\$ 1,022	0.29%
2.00% - 2.99%	617	0.18	45,973	13.66	91,393	26.18
3.00% - 3.99%	30,933	8.91	52,903	15.72	23,165	6.63
4.00% - 4.99%	70,410	20.27	30,212	8.98	20,308	5.82
5.00% - 5.99%	69,642	20.05	14,611	4.35	15,062	4.31
6.00% - 6.99%	--	--	--	--	--	--
Total certificate accounts	171,602	49.41	144,317	42.89	150,950	43.23
<b>Transaction accounts:</b>						
Savings	76,989	22.17	87,709	26.07	94,868	27.17
Checking:						
Interest-bearing	29,675	8.55	41,094	12.21	51,948	14.88
Noninterest-bearing	4,528	1.30	3,441	1.02	2,232	0.64
Money market	64,498	18.57	59,907	17.81	49,161	14.08
Total transaction accounts	175,690	50.59	192,151	57.11	198,209	56.77
Total deposits	\$347,292	100.00%	\$336,468	100.00%	\$349,159	100.00%

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The following table shows the average balance of each type of deposit and the average rate paid on each type of deposit for the periods indicated.

	Year Ended September 30,					
	2006			2005		
	Average Balance	Interest Expense	Average Rate Paid	Average Balance	Interest Expense	Average Rate Paid
	(Dollars in Thousands)					
Savings accounts	\$ 81,472	\$ 2,458	3.02%	\$ 91,821	\$1,728	1.88
Interest-bearing checking and money market accounts	98,112	3,081	3.14	101,146	2,273	2.25
Certificate accounts	156,869	5,304	3.38	144,445	4,521	3.13
<b>Total interest-bearing deposits</b>	<b>336,453</b>	<b>\$10,843</b>	<b>3.22</b>	<b>337,412</b>	<b>\$8,522</b>	<b>2.53</b>
Non-interest-bearing checking	3,789			10,066		
<b>Total deposits</b>	<b>\$340,242</b>		<b>3.19%</b>	<b>\$347,478</b>		<b>2.45</b>

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The following table shows our savings flows during the periods indicated.

	Year Ended September 30,		
	2006	2005	2004
	(In Thousands)		
Total deposits	\$ 488,409	\$ 504,735	\$ 411,005
Total withdrawals	(485,532)	(524,140)	(409,093)
Interest credited	7,948	6,714	6,470
<b>Total increase (decrease) in deposits</b>	<b>\$ 10,825</b>	<b>\$ (12,691)</b>	<b>\$ 8,382</b>

The following table presents, by various interest rate categories and maturities, the amount of certificates of deposit at September 30, 2006.

Certificates Of Deposit	Balance At September 30, 2006				
	Maturing In The 12 Months Ending September 30,				
	2007	2008	2009	Thereafter	Total
	(In Thousands)				

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Less than 2.00%	\$ --	\$ --	\$ --	\$ --	\$ --
2.00% - 2.99%	617	--	--	--	617
3.00% - 3.99%	20,542	7,078	3,313	--	30,933
4.00% - 4.99%	49,408	14,094	1,585	5,323	70,410
5.00% - 5.99%	53,832	6,127	--	9,683	69,642
	-----	-----	-----	-----	-----
Total certificate accounts	\$124,399	\$27,299	\$4,898	\$15,006	\$171,602
	=====	=====	=====	=====	=====

The following tables show the maturities of our certificates of deposit of \$100,000 or more at September 30, 2006, by time remaining to maturity.

Quarter Ending:	Amount	Weighted Average Rate
-----	-----	-----
	(Dollars in Thousands)	
December 31, 2006	\$ 7,170	4.54%
March 31, 2007	13,679	5.04
June 30, 2007	3,088	4.74
September 30, 2007	8,635	4.96
After September 30, 2007	12,346	4.41
	-----	-----
Total certificates of deposit with balances of \$100,000 or more	\$44,918	4.75%
	=====	=====

**BORROWINGS.** We utilize advances from the Federal Home Loan Bank of Pittsburgh as an alternative to retail deposits to fund our operations as part of our operating strategy. These FHLB advances are collateralized primarily by certain of our mortgage loans and mortgage-backed securities and secondarily by our investment in capital stock of the Federal Home Loan Bank of Pittsburgh. FHLB advances are made pursuant to several different credit programs, each of which has its own interest rate and range of maturities. The maximum amount that the Federal Home Loan Bank of Pittsburgh will advance to member institutions, including Prudential Savings Bank, fluctuates from time to time in accordance with the policies of the Federal Home Loan Bank. At September 30, 2006, we had \$31.8 million in outstanding FHLB advances and \$128.0 million of additional FHLB advances available. At such date, maturities range from one month to four years. We have not utilized any other types of borrowings such as securities sold under agreements to repurchase. The increase in borrowings during fiscal 2006 was to meet increased loan demand.

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The following table shows certain information regarding our borrowings at or for the dates indicated:

	At Or For The Year Ended September 30,		
	-----	-----	-----
	2006	2005	2004
	-----	-----	-----
	(Dollars in Thousands)		
FHLB advances:			
Average balance outstanding	\$19,628	\$13,841	\$13,880
Maximum amount outstanding at any month-end during the period	\$31,784	\$13,859	\$13,897

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Balance outstanding at end of period	\$31,784	\$13,823	\$13,862
Average interest rate during the period	5.564%	3.574%	3.574%
Weighted average interest rate at end of period	5.487%	5.526%	5.517%

We have six FHLB advances made under a low-income housing program in which we participate. Four of the FHLB advances amortize over the period to maturity. Three of these advances are at an interest rate of 3.0% and one is at 2.0%. The other two FHLB advances bear a zero percent interest rate. The total of these six FHLB advances is \$784,000. At September 30, 2006, repayments of \$41,000 are due within one year as part of the program. Advances from the FHLB which are not part of the low-income housing program total \$31.0 million, with interest rates ranging from 5.45% to 5.98% and maturities ranging from October 2006 to September 2010.

### SUBSIDIARIES

The Company has only one direct subsidiary: Prudential Savings Bank. The Bank's sole subsidiary as of September 30, 2006 was PSB Delaware, Inc. ("PSB"), a Delaware-chartered company established to hold certain investments of the Bank. As of September 30, 2006, PSB has assets of \$63.5 million primarily consisting of mortgage backed securities. We may consider the establishment of one or more additional subsidiaries in the future.

### EMPLOYEES

At September 30, 2006, we had 68 full-time employees, and six part-time employees. None of such employees are represented by a collective bargaining group, and we believe that our relationship with our employees is good.

### REGULATION

Set forth below is a brief description of certain laws relating to the regulation of Prudential Bancorp, Prudential Mutual Holding Company and Prudential Savings Bank. This description does not purport to be complete and is qualified in its entirety by reference to applicable laws and regulations.

### GENERAL

Prudential Savings Bank as a Pennsylvania chartered savings bank with deposits insured by the Deposit Insurance Fund administered by the Federal Deposit Insurance Corporation, is subject to extensive regulation and examination by the Pennsylvania Department of Banking and by the Federal Deposit Insurance Corporation. The federal and state laws and regulations applicable to banks regulate, among other things, the scope of their business, their investments, the reserves required to be kept against deposits, the timing of the availability of deposited funds and the nature and amount of and collateral for

certain loans. This regulatory structure also gives the federal and state banking agencies extensive discretion in connection with their supervisory and enforcement activities and examination policies, including policies with respect to the classification of assets and the establishment of adequate loan loss reserves for regulatory purposes. The laws and regulations governing Prudential Savings Bank generally have been promulgated to protect depositors and not for the purpose of protecting shareholders.

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Federal law provides the federal banking regulators, including the Federal Deposit Insurance Corporation and the Federal Reserve Board, with substantial enforcement powers. This enforcement authority includes, among other things, the ability to assess civil money penalties, to issue cease-and-desist or removal orders, and to initiate injunctive actions against banking organizations and institution-affiliated parties, as defined. In general, these enforcement actions may be initiated for violations of laws and regulations and unsafe or unsound practices. Other actions or inactions may provide the basis for enforcement action, including misleading or untimely reports filed with regulatory authorities. Any change in such regulation, whether by the Pennsylvania Department of Banking, the Federal Deposit Insurance Corporation, the Federal Reserve Board or the United States Congress, could have a material impact on us and our operations.

Prudential Bancorp and Prudential Mutual Holding Company are registered as bank holding companies under the Bank Holding Company Act and are subject to regulation and supervision by the Federal Reserve Board and by the Pennsylvania Department of Banking. Prudential Bancorp and Prudential Mutual Holding Company file annually a report of their operations with, and are subject to examination by, the Federal Reserve Board and the Pennsylvania Department of Banking. This regulation and oversight is generally intended to ensure that Prudential Bancorp and Prudential Mutual Holding Company limit their activities to those allowed by law and that they operate in a safe and sound manner without endangering the financial health of Prudential Savings Bank.

In connection with the reorganization completed in March 2005, Prudential Bancorp registered its common stock with the SEC under the Securities Exchange Act of 1934. Prudential Bancorp is subject to the proxy and tender offer rules, insider trading reporting requirements and restrictions, and certain other requirements under the Securities Exchange Act of 1934. Prudential Bancorp's common stock is listed on the Nasdaq Global Market under the symbol "PBIP." The Nasdaq Stock Market listing requirements impose additional requirements on us, including, among other things, rules relating to corporate governance and the composition and independence of our board of directors and various committees of the board, such as the audit committee.

### REGULATION OF PRUDENTIAL BANCORP AND PRUDENTIAL MUTUAL HOLDING COMPANY

**BANK HOLDING COMPANY ACT ACTIVITIES AND OTHER LIMITATIONS.** Under the Bank Holding Company Act, Prudential Bancorp and Prudential Mutual Holding Company must obtain the prior approval of the Federal Reserve Board before they may acquire control of another bank or bank holding company, merge or consolidate with another bank holding company, acquire all or substantially all of the assets of another bank or bank holding company, or acquire direct or indirect ownership or control of any voting shares of any bank or bank holding company if, after such acquisition, Prudential Bancorp and Prudential Mutual Holding Company would directly or indirectly own or control more than 5% of such shares.

Federal statutes impose restrictions on the ability of a bank holding company and its nonbank subsidiaries to obtain extensions of credit from its subsidiary bank, on the subsidiary bank's investments in the stock or securities of the holding company, and on the subsidiary bank's taking of the holding company's stock or securities as collateral for loans to any borrower. A bank holding company and its

subsidiaries are also prevented from engaging in certain tie-in arrangements in

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connection with any extension of credit, lease or sale of property, or furnishing of services by the subsidiary bank.

A bank holding company is required to serve as a source of financial and managerial strength to its subsidiary banks and may not conduct its operations in an unsafe or unsound manner. In addition, it is the policy of the Federal Reserve Board that a bank holding company should stand ready to use available resources to provide adequate capital to its subsidiary banks during periods of financial stress or adversity and should maintain the financial flexibility and capital-raising capacity to obtain additional resources for assisting its subsidiary banks. A bank holding company's failure to meet its obligations to serve as a source of strength to its subsidiary banks will generally be considered by the Federal Reserve Board to be an unsafe and unsound banking practice or a violation of the Federal Reserve Board regulations, or both.

NON-BANKING ACTIVITIES. The business activities of Prudential Bancorp and Prudential Mutual Holding Company, as bank holding companies, are restricted by the Bank Holding Company Act. Under the Bank Holding Company Act and the Federal Reserve Board's bank holding company regulations, bank holding companies may only engage in, or acquire or control voting securities or assets of a company engaged in,

- o banking or managing or controlling banks and other subsidiaries authorized under the Bank Holding Company Act; and
- o any Bank Holding Company Act activity the Federal Reserve Board has determined to be so closely related that it is incidental to banking or managing or controlling banks.

The Federal Reserve Board has determined by regulation that certain activities are closely related to banking including operating a mortgage company, finance company, credit card company, factoring company, trust company or savings association; performing certain data processing operations; providing limited securities brokerage services; acting as an investment or financial advisor; acting as an insurance agent for certain types of credit-related insurance; leasing personal property on a full-payout, non-operating basis; providing tax planning and preparation services; operating a collection agency; and providing certain courier services. However, as discussed below, certain other activities are permissible for a bank holding company that becomes a financial holding company.

FINANCIAL MODERNIZATION. The Gramm-Leach-Bliley Act permits greater affiliation among banks, securities firms, insurance companies, and other companies under a new type of financial services company known as a "financial holding company." A financial holding company essentially is a bank holding company with significantly expanded powers. Financial holding companies are authorized by statute to engage in a number of financial activities previously impermissible for bank holding companies, including securities underwriting, dealing and market making; sponsoring mutual funds and investment companies; insurance underwriting and agency; and merchant banking activities. The Gramm-Leach-Bliley Act also permits the Federal Reserve Board and the Treasury Department to authorize additional activities for financial holding companies if they are "financial in nature" or "incidental" to financial activities. A bank holding company may become a financial holding company if each of its subsidiary banks is well capitalized, well managed, and has at least a "satisfactory" Community Reinvestment Act rating. A financial holding company must provide notice to the Federal Reserve Board within 30 days after commencing activities previously determined by statute or by the Federal Reserve Board and Department of the Treasury to be permissible. Prudential Bancorp and Prudential Mutual Holding Company have not submitted notices to the Federal Reserve Board of their intent to be deemed financial holding companies. However, they are not precluded

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from submitting a notice in the future should they wish to engage in activities only permitted to financial holding companies.

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REGULATORY CAPITAL REQUIREMENTS. The Federal Reserve Board has adopted capital adequacy guidelines pursuant to which it assesses the adequacy of capital in examining and supervising a bank holding company and in analyzing applications to it under the Bank Holding Company Act. The Federal Reserve Board's capital adequacy guidelines for Prudential Bancorp, on a consolidated basis, are similar to those imposed on Prudential Savings Bank by the Federal Deposit Insurance Corporation. See "-Regulation of Prudential Savings Bank - Regulatory Capital Requirements."

RESTRICTIONS ON DIVIDENDS. Prudential Bancorp's ability to declare and pay dividends may depend in part on dividends received from Prudential Savings Bank. The Pennsylvania Banking Code regulates the distribution of dividends by savings banks and states, in part, that dividends may be declared and paid out of accumulated net earnings, provided that the bank continues to meet its surplus requirements. In addition, dividends may not be declared or paid if Prudential Savings Bank is in default in payment of any assessment due the Federal Deposit Insurance Corporation.

A Federal Reserve Board policy statement on the payment of cash dividends states that a bank holding company should pay cash dividends only to the extent that the holding company's net income for the past year is sufficient to cover both the cash dividends and a rate of earnings retention that is consistent with the holding company's capital needs, asset quality and overall financial condition. The Federal Reserve Board also indicated that it would be inappropriate for a company experiencing serious financial problems to borrow funds to pay dividends. Furthermore, under the federal prompt corrective action regulations, the Federal Reserve Board may prohibit a bank holding company from paying any dividends if the holding company's bank subsidiary is classified as "undercapitalized." See "-Regulation of Prudential Savings Bank - Prompt Corrective Action," below.

SARBANES-OXLEY ACT OF 2002. On July 30, 2002, President George W. Bush signed into law the Sarbanes-Oxley Act of 2002, which generally establishes a comprehensive framework to modernize and reform the oversight of public company auditing, improve the quality and transparency of financial reporting by those companies and strengthen the independence of auditors. Among other things, the new legislation (i) created a public company accounting oversight board which is empowered to set auditing, quality control and ethics standards, to inspect registered public accounting firms, to conduct investigations and to take disciplinary actions, subject to SEC oversight and review; (ii) strengthened auditor independence from corporate management by, among other things, limiting the scope of consulting services that auditors can offer their public company audit clients; (iii) heightened the responsibility of public company directors and senior managers for the quality of the financial reporting and disclosure made by their companies; (iv) adopted a number of provisions to deter wrongdoing by corporate management; (v) imposed a number of new corporate disclosure requirements; (vi) adopted provisions which generally seek to limit and expose to public view possible conflicts of interest affecting securities analysts; and (vii) imposed a range of new criminal penalties for fraud and other wrongful acts, as well as extended the period during which certain types of lawsuits can be brought against a company or its insiders.

On August 9, 2006, the SEC issued proposed rules for smaller public companies, such as Prudential Bancorp, further extending the dates for their



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compliance with the internal control requirements mandated by Section 404 of the Sarbanes-Oxley Act of 2002. Pursuant to the proposal, a non-accelerated filer would not be required to provide management's report on internal control over financial reporting until it files an annual report for a fiscal year ending on or after December 15, 2007. If, however, the SEC has not issued additional guidance for management on how to complete its assessment of internal control over financial reporting in time to be of assistance in connection with annual reports filed for fiscal years ending on or after December 15, 2007, this deadline could be further postponed. Under the proposal, the auditor's attestation report on internal control over financial reporting would not be required until a non-accelerated filer files an annual report for a fiscal year ending on or

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after December 15, 2008. If revisions to Auditing Standard No. 2 have not been finalized in time to be of assistance in connection with annual reports filed for fiscal years ending on or after December 15, 2008, this deadline could also be further postponed.

RESTRICTIONS APPLICABLE TO MUTUAL HOLDING COMPANIES. While regulations governing Pennsylvania-chartered mutual holding companies have not been adopted, under authority of Section 115.1 of the Pennsylvania Banking Code of 1965, as amended, and a policy statement issued by the Pennsylvania Department of Banking, the Department approved the reorganization of Prudential Saving Bank to the mutual holding company form of organization.

Pursuant to Pennsylvania law, a mutual holding company may engage only in the following activities:

- o investing in the stock of one or more financial institution subsidiaries;
- o acquiring one or more additional financial institution subsidiaries into a subsidiary of the holding company;
- o merging with or acquiring another holding company, one of whose subsidiaries is a financial institution subsidiary;
- o investing in a corporation the capital stock of which is available for purchase by a savings bank under federal law or under the Pennsylvania Banking Code;
- o engaging in such activities as are permitted, by statute or regulation, to a holding company of a federally chartered insured mutual institution under federal law; and
- o engaging in such other activities as may be permitted by the Pennsylvania Department of Banking.

If a mutual holding company acquires or merges with another holding company, the holding company acquired or the holding company resulting from such merger or acquisition may only invest in assets and engage in activities listed above, and has a period of two years to cease any non-conforming activities and divest of any non-conforming investments.

The mutual holding company will be subject to such regulations as the Pennsylvania Department of Banking may prescribe. No mutual holding company regulations have been issued to date by the Department.

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### REGULATION OF PRUDENTIAL SAVINGS BANK

PENNSYLVANIA SAVINGS BANK LAW. The Pennsylvania Banking Code contains detailed provisions governing the organization, location of offices, rights and responsibilities of directors, officers, and employees, as well as corporate powers, savings and investment operations and other aspects of Prudential Savings Bank and its affairs. The code delegates extensive rule-making power and administrative discretion to the Pennsylvania Department of Banking so that the supervision and regulation of state-chartered savings banks may be flexible and readily responsive to changes in economic conditions and in savings and lending practices.

The Pennsylvania Banking Code also provides that state-chartered savings banks may engage in any activity permissible for a federal savings association, subject to regulation by the Pennsylvania

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Department of Banking. The Federal Deposit Insurance Act, however, prohibits Prudential Savings Bank from making new investments, loans, or becoming involved in activities as principal and equity investments which are not permitted for national banks unless:

- o the Federal Deposit Insurance Corporation determines the activity or investment does not pose a significant risk of loss to the Deposit Insurance Fund; and
- o Prudential Savings Bank meets all applicable capital requirements.

Accordingly, the additional operating authority provided to Prudential Savings Bank by the Pennsylvania Banking Code is significantly restricted by the Federal Deposit Insurance Act.

INSURANCE OF ACCOUNTS. The deposits of Prudential Savings Bank are insured to the maximum extent permitted by the Deposit Insurance Fund, which is administered by the Federal Deposit Insurance Corporation, and are backed by the full faith and credit of the U.S. Government. As insurer, the Federal Deposit Insurance Corporation is authorized to conduct examinations of, and to require reporting by, insured institutions. It also may prohibit any insured institution from engaging in any activity the Federal Deposit Insurance Corporation determines by regulation or order to pose a serious threat to the Federal Deposit Insurance Corporation. The Federal Deposit Insurance Corporation also has the authority to initiate enforcement actions against savings institutions.

Each Federal Deposit Insurance Corporation insured institutions is assigned to one of three capital groups which are based solely on the level of an institution's capital - "well capitalized," "adequately capitalized" and "undercapitalized" - which are defined in the same manner as the regulations establishing the prompt corrective action system discussed below. These three groups are then divided into three subgroups which reflect varying levels of supervisory concern, from those which are considered to be healthy to those which are considered to be of substantial supervisory concern. The matrix so created results in nine assessment risk classifications, with rates during the last six months of 2005 ranging from zero for well capitalized, healthy institutions, such as Prudential Savings Bank, to 27 basis points for undercapitalized institutions with substantial supervisory concerns. Prudential Savings Bank currently is considered well capitalized and has a zero assessment

rate.

In addition, all institutions with deposits insured by the Federal Deposit Insurance Corporation are required to pay assessments to fund interest payments on bonds issued by the Financing Corporation, a mixed-ownership government corporation established to recapitalize the predecessor to the Savings Association Insurance Fund. The assessment rate for the fourth quarter of 2006 was .0124% of insured deposits and is adjusted quarterly. These assessments will continue until the Financing Corporation bonds mature in 2019.

The Federal Deposit Insurance Corporation may terminate the deposit insurance of any insured depository institution, including Prudential Savings Bank, if it determines after a hearing that the institution has engaged or is engaging in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, order or any condition imposed by an agreement with the Federal Deposit Insurance Corporation. It also may suspend deposit insurance temporarily during the hearing process for the permanent termination of insurance, if the institution has no tangible capital. If insurance of accounts is terminated, the accounts at the institution at the time of the termination, less subsequent withdrawals, shall continue to be insured for a period of six months to two years, as determined by the Federal Deposit Insurance Corporation. Management is aware of no existing circumstances which would result in termination of Prudential Savings Bank's deposit insurance.

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DEPOSIT INSURANCE REFORM. On February 8, 2006, President George W. Bush signed into law legislation that merged the Bank Insurance Fund and the Savings Association Insurance Fund to form the Deposit Insurance Fund, eliminated any disparities in bank and thrift risk-based premium assessments, reduced the administrative burden of maintaining and operating two separate funds and established certain new insurance coverage limits and a mechanism for possible periodic increases. The legislation also gave the Federal Deposit Insurance Corporation greater discretion to identify the relative risks all institutions present to the Deposit Insurance Fund and set risk-based premiums.

Major provisions in the legislation include:

- o merging the Savings Association Insurance Fund and Bank Insurance Fund, which became effective March 31, 2006;
- o maintaining basic deposit and municipal account insurance coverage at \$100,000 but providing for a new basic insurance coverage for retirement accounts of \$250,000. Insurance coverage for basic deposit and retirement accounts could be increased for inflation every five years in \$10,000 increments beginning in 2011;
- o providing the Federal Deposit Insurance Corporation with the ability to set the designated reserve ratio within a range of between 1.15% and 1.50%, rather than maintaining 1.25% at all times regardless of prevailing economic conditions;
- o providing a one-time assessment credit of \$4.7 billion to banks and savings associations in existence on December 31, 1996, which may be used to offset future premiums with certain limitations; and

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- o requiring the payment of dividends of 100% of the amount that the insurance fund exceeds 1.5% of the estimated insured deposits and the payment of 50% of the amount that the insurance fund exceeds 1.35% of the estimated insured deposits (when the reserve is greater than 1.35% but no more than 1.5%).

Pursuant to the Reform Act, the Federal Deposit Insurance Corporation has determined to maintain the designated reserve ratio at its current 1.25%, which will be reviewed annually. The Federal Deposit Insurance Corporation has also adopted a new risk-based premium system that provides for quarterly assessments based on an insured institution's ranking in one of four risk categories based upon supervisory and capital evaluations. Beginning in 2007, well-capitalized institutions (generally those with CAMELS composite ratings of 1 or 2) will be grouped in Risk Category I and will be assessed for deposit insurance at an annual rate of between five and seven basis points. The assessment rate for an individual institution is determined according to a formula based on a weighted average of the institution's individual CAMEL component ratings plus either five financial ratios or, in the case of an institution with assets of \$10.0 billion or more, the average ratings of its long-term debt. Institutions in Risk Categories II, III and IV will be assessed at annual rates of 10, 28 and 43 basis points, respectively. Prudential Savings Bank anticipates that it will be able to offset its deposit insurance premium for 2007 with the special assessment credit.

REGULATORY CAPITAL REQUIREMENTS. The Federal Deposit Insurance Corporation has promulgated capital adequacy requirements for state-chartered banks that, like Prudential Savings Bank, are not members of the Federal Reserve Board System. The capital regulations establish a minimum 3% Tier 1 leverage capital requirement for the most highly rated state-chartered, non-member banks, with an additional cushion of at least 100 to 200 basis points for all other state-chartered, non-member banks, which effectively increases the minimum Tier 1 leverage ratio for such other banks to 4% to 5% or more. Under the Federal Deposit Insurance Corporation's regulations, the highest-rated banks are those that the Federal Deposit Insurance Corporation determines are not anticipating or experiencing significant growth and have well diversified risk, including no undue interest rate risk exposure, excellent asset quality, high

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liquidity, good earnings and, in general, which are considered a strong banking organization, rated composite 1 under the Uniform Financial Institutions Rating System. Tier 1, or leverage capital, is defined as the sum of common shareholders' equity, including retained earnings, noncumulative perpetual preferred stock and related surplus, and minority interests in consolidated subsidiaries, minus all intangible assets other than certain purchased mortgage servicing rights and purchased credit card relationships.

The Federal Deposit Insurance Corporation's regulations also require that state-chartered, non-member banks meet a risk-based capital standard. The risk-based capital standard requires the maintenance of total capital, defined as Tier 1 capital and supplementary (Tier 2) capital, to risk weighted assets of 8%. In determining the amount of risk-weighted assets, all assets, plus certain off balance sheet assets, are multiplied by a risk-weight of 0% to 100%, based on the risks the Federal Deposit Insurance Corporation believes are inherent in the type of asset or item. The components of Tier 1 capital for the risk-based standards are the same as those for the leverage capital requirement. The components of supplementary (Tier 2) capital include cumulative perpetual preferred stock, mandatory subordinated debt, perpetual subordinated debt, intermediate-term preferred stock, up to 45% of unrealized gains on equity

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securities and a portion of a bank's allowance for loan losses. Allowance for loan losses includable in supplementary capital is limited to a maximum of 1.25% of risk-weighted assets. Overall, the amount of supplementary capital that may be included in total capital is limited to 100% of Tier 1 capital.

A bank that has less than the minimum leverage capital requirement is subject to various capital plan and activities restriction requirements. The Federal Deposit Insurance Corporation's regulations also provide that any insured depository institution with a ratio of Tier 1 capital to total assets that is less than 2.0% is deemed to be operating in an unsafe or unsound condition pursuant to Section 8(a) of the Federal Deposit Insurance Act and could be subject to potential termination of deposit insurance.

Prudential Savings Bank is also subject to minimum capital requirements imposed by the Pennsylvania Department of Banking on Pennsylvania chartered depository institutions. Under the Pennsylvania Department of Banking's capital regulations, a Pennsylvania bank or savings association must maintain a minimum leverage ratio of Tier 1 capital, as defined under the Federal Deposit Insurance Corporation's capital regulations, to total assets of 4%. In addition, the Pennsylvania Department of Banking has the supervisory discretion to require a higher leverage ratio for any institution or association based on inadequate or substandard performance in any of a number of areas. The Pennsylvania Department of Banking incorporates the same Federal Deposit Insurance Corporation risk-based capital requirements in its regulations.

At September 30, 2006, Prudential Savings Bank exceeded all of its regulatory capital requirements, with leverage and total risk-based capital ratios of 14.74% and 31.56%, respectively.

PROMPT CORRECTION ACTION. The following table shows the amount of capital associated with the different capital categories set forth in the prompt correction action regulations.

Capital Category	Total Risk-Based Capital	Tier 1 Risk-Based Capital	Tier 1 Leverage Capital
Well capitalized	10% or more	6% or more	5% or more
Adequately capitalized	8% or more	4% or more	4% or more
Undercapitalized	Less than 8%	Less than 4%	Less than 4%
Significantly undercapitalized	Less than 6%	Less than 3%	Less than 3%

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In addition, an institution is "critically undercapitalized" if it has a ratio of tangible equity to total assets that is equal to or less than 2.0%. Under specified circumstances, a federal banking agency may reclassify a well capitalized institution as adequately capitalized and may require an adequately capitalized institution or an undercapitalized institution to comply with supervisory actions as if it were in the next lower category, except that the Federal Deposit Insurance Corporation may not reclassify a significantly undercapitalized institution as critically undercapitalized.

An institution generally must file a written capital restoration plan which meets specified requirements within 45 days of the date that the institution receives notice or is deemed to have notice that it is

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undercapitalized, significantly undercapitalized or critically undercapitalized. A federal banking agency must provide the institution with written notice of approval or disapproval within 60 days after receiving a capital restoration plan, subject to extensions by the agency. An institution which is required to submit a capital restoration plan must concurrently submit a performance guaranty by each company that controls the institution. In addition, undercapitalized institutions are subject to various regulatory restrictions, and the appropriate federal banking agency also may take any number of discretionary supervisory actions.

At September 30, 2006, Prudential Savings Bank was deemed a well capitalized institution for purposes of the above regulations and as such is not subject to the above mentioned restrictions.

The table below sets forth the Company and the Bank's capital position relative to its regulatory capital requirements at September 30, 2006.

	Actual		Required For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions		Excess Over Well-Capital Provision	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
	-----	-----	-----	-----	-----	-----	-----	-----
(Dollars in Thousands)								
Total risk-based capital								
Company	\$87,894	39.68%	\$17,722	8.00%	N/A	N/A	N/A	
Bank	69,917	31.56	17,722	8.00	\$22,153	10.00%	\$47,764	2
Tier 1 risk-based capital								
Company	86,914	39.23	8,861	4.00	N/A	N/A	N/A	
Bank	68,937	31.12	8,861	4.00	13,292	6.00	55,645	3
Tier 1 leverage capital								
Company	86,914	18.64	18,646	4.00	N/A	N/A	N/A	
Bank	68,937	14.74	18,703	4.00	23,379	5.00	45,558	

**AFFILIATE TRANSACTION RESTRICTIONS.** Federal laws strictly limit the ability of banks to engage in transactions with their affiliates, including their bank holding companies. Such transactions between a subsidiary bank and its parent company or the nonbank subsidiaries of the bank holding company are limited to 10% of a bank subsidiary's capital and surplus and, with respect to such parent company and all such nonbank subsidiaries, to an aggregate of 20% of the bank subsidiary's capital and surplus. Further, loans and extensions of credit generally are required to be secured by eligible collateral in specified amounts. Federal law also requires that all transactions between a bank and its affiliates be on terms as favorable to the bank as transactions with non-affiliates.

**FEDERAL HOME LOAN BANK SYSTEM.** Prudential Savings Bank is a member of the Federal Home Loan Bank of Pittsburgh, which is one of 12 regional Federal Home Loan Banks. Each Federal Home Loan Bank serves as a reserve or central bank for its members within its assigned region. It is funded primarily from funds deposited by member institutions and proceeds from the sale of consolidated obligations of the Federal Home Loan Bank System. It makes loans to members (i.e., advances) in

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accordance with policies and procedures established by the board of directors of the Federal Home Loan Bank. At September 30, 2006, Prudential Savings Bank had \$31.8 million in FHLB advances.

As a member, Prudential Savings Bank is required to purchase and maintain stock in the Federal Home Loan Bank of Pittsburgh in an amount equal to the greater of 1% of its aggregate unpaid residential mortgage loans, home purchase contracts or similar obligations at the beginning of each year or 5% of its outstanding advances from the Federal Home Loan Bank. At September 30, 2006, Prudential Savings Bank had \$2.2 million in stock of the Federal Home Loan Bank of Pittsburgh which was in compliance with this requirement.

FEDERAL RESERVE BOARD SYSTEM. The Federal Reserve Board requires all depository institutions to maintain non-interest bearing reserves at specified levels against their transaction accounts, which are primarily checking and NOW accounts, and non-personal time deposits. The balances maintained to meet the reserve requirements imposed by the Federal Reserve Board may be used to satisfy the liquidity requirements that are imposed by the Pennsylvania Department of Banking. At September 30, 2006, Prudential Savings Bank was in compliance with these reserve requirements.

### DIVIDEND WAIVERS BY PRUDENTIAL MUTUAL HOLDING COMPANY

It has been the policy of a number of mutual holding companies to waive the receipt of dividends declared by their subsidiary companies. In connection with its approval of the reorganization, however, the Federal Reserve Board imposed certain conditions on the waiver by Prudential Mutual Holding Company of dividends paid on the common stock by Prudential Bancorp. In particular, the Federal Reserve Board requires that Prudential Mutual Holding Company obtain the prior approval of the Federal Reserve Board before Prudential Mutual Holding Company may waive any dividends from Prudential Bancorp. As of the date hereof, we are not aware that the Federal Reserve Board has given its approval to any waiver of dividends by any mutual holding company that has requested such approval.

The Federal Reserve Board approval of the reorganization also required that the amount of any dividends waived by Prudential Mutual Holding Company will not be available for payment to the public stockholders of Prudential Bancorp (i.e., shareholders except for Prudential Mutual Holding Company) and that such amounts will be excluded from Prudential Bancorp's capital for purposes of calculating dividends payable to the public shareholders. Moreover, Prudential Savings Bank would be required to maintain the cumulative amount of dividends waived by Prudential Mutual Holding Company in a restricted capital account that would be added to the liquidation account established in the reorganization. This amount would not be available for distribution to public stockholders. The restricted capital account and liquidation account amounts would not be reflected in Prudential Savings Bank's financial statements, but would be considered as a notational or memorandum account of Prudential Savings Bank. These accounts would be maintained in accordance with the laws, rules, regulations and policies of the Pennsylvania Banking Department and the plan of reorganization. The plan of reorganization also provides that if Prudential Mutual Holding Company converts to stock form in the future (commonly referred to as a second step reorganization), any waived dividends would reduce the percentage of the converted company's shares of common stock issued to public shareholders in connection with any such transaction.

Prudential Mutual Holding Company does not expect to seek the prior approval of the Federal Reserve Board to waive dividends declared by Prudential Bancorp. If Prudential Mutual Holding Company decides that it is in its best

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interest to waive a particular dividend to be paid by Prudential Bancorp and the Federal Reserve Board approves such waiver, then Prudential Bancorp would pay such dividend only to its public shareholders. The amount of the dividend waived by Prudential Mutual Holding Company would be treated in the manner described above. Prudential Mutual Holding

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Company's decision as to whether or not to waive a particular dividend will depend on a number of factors, including Prudential Mutual Holding Company's capital needs, the investment alternatives available to Prudential Mutual Holding Company as compared to those available to Prudential Bancorp, and the possibility of regulatory approvals.

### TAXATION

#### FEDERAL TAXATION

GENERAL. Prudential Bancorp, Prudential Mutual Holding Company and Prudential Savings Bank are subject to federal income taxation in the same general manner as other corporations with some exceptions listed below. The following discussion of federal, state and local income taxation is only intended to summarize certain pertinent income tax matters and is not a comprehensive description of the applicable tax rules. Prudential Savings Bank's federal and state income tax returns for taxable years through September 30, 2002 have been closed for purposes of examination by the Internal Revenue Service or the Pennsylvania Department of Revenue.

Prudential Bancorp files a consolidated federal income tax return with Prudential Savings Bank and its subsidiary, PSB Delaware, Inc. Accordingly, any cash distributions made by Prudential Bancorp to its shareholders will be treated as cash dividends and not as a non-taxable return of capital to shareholders for federal and state tax purposes.

METHOD OF ACCOUNTING. For federal income tax purposes, Prudential Bancorp and Prudential Savings Bank report income and expenses on the accrual method of accounting and file their federal income tax return on a calendar year basis.

BAD DEBT RESERVES. The Small Business Job Protection Act of 1996 eliminated the use of the reserve method of accounting for bad debt reserves by savings associations, effective for taxable years beginning after 1995. Prior to that time, Prudential Savings Bank was permitted to establish a reserve for bad debts and to make additions to the reserve. These additions could, within specified formula limits, be deducted in arriving at taxable income. As a result of the Small Business Job Protection Act of 1996, savings associations must use the specific charge-off method in computing their bad debt deduction beginning with their 1996 federal tax return. In addition, federal legislation required the recapture over a six year period of the excess of tax bad debt reserves at December 31, 1995 over those established as of December 31, 1987.

TAXABLE DISTRIBUTIONS AND RECAPTURE. Prior to the Small Business Job Protection Act of 1996, bad debt reserves created prior to January 1, 1988 were subject to recapture into taxable income if Prudential Savings Bank failed to meet certain thrift asset and definitional tests. New federal legislation eliminated these savings association related recapture rules. However, under current law, pre-1988 reserves remain subject to recapture should Prudential Savings Bank make certain non-dividend distributions or cease to maintain a bank charter.



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At September 30, 2006, the total federal pre-1988 reserve was approximately \$6.6 million. The reserve reflects the cumulative effects of federal tax deductions by Prudential Savings Bank for which no federal income tax provisions have been made.

ALTERNATIVE MINIMUM TAX. The Internal Revenue Code imposes an alternative minimum tax at a rate of 20% on a base of regular taxable income plus certain tax preferences. The alternative minimum tax is payable to the extent such alternative minimum tax income is in excess of the regular income tax. Net operating losses, of which Prudential Savings Bank has none, can offset no more than 90% of alternative minimum taxable income. Certain payments of alternative minimum tax may be used as

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credits against regular tax liabilities in future years. Prudential Savings Bank has not been subject to the alternative minimum tax.

NET OPERATING LOSS CARRYOVERS. For net operating losses in tax years beginning before August 6, 1997, Prudential Savings Bank may carry back net operating losses to the three years preceding the loss year and then forward to fifteen years following the loss years. For net operating losses in years beginning after August 5, 1997, net operating losses can be carried back to the two years preceding the loss year and forward to the 20 years following the loss year. At September 30, 2006, Prudential Savings Bank had no net operating loss carry forwards for federal income tax purposes.

CORPORATE DIVIDENDS RECEIVED DEDUCTION. Prudential Bancorp may exclude from its income 100% of dividends received from Prudential Savings Bank as a member of the same affiliated group of corporations. The corporate dividends received deduction is 80% in the case of dividends received from corporations which a corporate recipient owns less than 80%, but at least 20% of the distribution corporation. Corporations which own less than 20% of the stock of a corporation distributing a dividend may deduct only 70% of dividends received.

### STATE AND LOCAL TAXATION

PENNSYLVANIA TAXATION. Prudential Bancorp is subject to the Pennsylvania Corporate Net Income Tax, Capital Stock and Franchise Tax. The Corporation Net Income Tax rate for 2006 is 9.99% and is imposed on unconsolidated taxable income for federal purposes with certain adjustments. In general, the Capital Stock and Franchise Tax is a property tax imposed on a corporation's capital stock value at a statutorily defined rate, such value being determined in accordance with a fixed formula based upon average net income and net worth.

Prudential Savings Bank is subject to tax under the Pennsylvania Mutual Thrift Institutions Tax Act, as amended to include thrift institutions having capital stock. Pursuant to the Mutual Thrift Institutions Tax, the tax rate is 11.50%. The Mutual Thrift Institutions Tax exempts Prudential Savings Bank from other taxes imposed by the Commonwealth of Pennsylvania for state income tax purposes and from all local taxation imposed by political subdivisions, except taxes on real estate and real estate transfers. The Mutual Thrift Institutions Tax is a tax upon net earnings, determined in accordance with generally accepted accounting principles with certain adjustments. The Mutual Thrift Institutions Tax, in computing income according to generally accepted accounting principles, allows for the deduction of interest earned on state and federal obligations, while disallowing a percentage of a thrift's

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interest expense deduction in the proportion of interest income on those securities to the overall interest income of Prudential Savings Bank. Net operating losses, if any, thereafter can be carried forward three years for Mutual Thrift Institutions Tax purposes.

### ITEM 1A. RISK FACTORS.

IN ANALYZING WHETHER TO MAKE OR TO CONTINUE AN INVESTMENT IN OUR SECURITIES, INVESTORS SHOULD CONSIDER, AMONG OTHER FACTORS, THE FOLLOWING RISK FACTORS.

#### OUR PORTFOLIO OF LOANS WITH A HIGHER RISK OF LOSS IS INCREASING

In recent years, we have increased our originations or purchases of construction and land development loans. These loans have a higher risk of default and loss than single-family residential mortgage loans. Construction and land development loans have increased from \$17.0 million or 8.9% of our total loan portfolio at September 30, 2002 to \$82.8 million or 32.3% of the total loan portfolio at September 30, 2006. At the same time, both the dollar amount and the percentage of the loan portfolio

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comprised of single-family residential mortgage loans has decreased. Single-family residential mortgage loans held by Prudential Savings Bank have decreased from \$158.9 million or 83.1% of our total loan portfolio at September 30, 2002 to \$155.5 million or 60.7% at September 30, 2006. Construction and land development loans generally have a higher risk of loss than single-family residential mortgage loans. The risk of loss on construction and land development loans depends largely upon the accuracy of the initial estimate of the property's value at completion of construction compared to the estimated cost, including interest, of construction and other assumptions. Furthermore, if the estimates of value prove to be inaccurate, we can be confronted with projects, when completed, having values less than the loan amounts. In addition, such loans have significantly higher average loan balances compared to single-family residential mortgage loans. Consequently, an adverse development with respect to one loan or credit relationship could expose us to a significantly greater risk of loss compared to an adverse development with respect to a single-family residential mortgage loan. We may also be required to increase our allowance for loan losses both due to actual losses or the increase in the estimated loss inherent in our portfolio which would reduce our net income. We have also originated or committed to originate substantially larger construction loans in recent periods and our portfolio of such loans is not seasoned.

#### OUR LOANS ARE CONCENTRATED TO BORROWERS IN OUR MARKET AREA

At September 30, 2006, the preponderance of our total loans were to individuals and/or secured by properties located in our primary market area of the Philadelphia metropolitan area. We have relatively few loans outside of our market. As a result, we may have a greater risk of loan defaults and losses in the event of an economic downturn in our market area.

#### OUR RESULTS OF OPERATIONS ARE SIGNIFICANTLY DEPENDENT ON ECONOMIC CONDITIONS AND RELATED UNCERTAINTIES.

Commercial banking is affected, directly and indirectly, by domestic and international economic and political conditions and by governmental monetary and fiscal policies. Conditions such as inflation, recession, unemployment,

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volatile interest rates, real estate values, government monetary policy, international conflicts, the actions of terrorists and other factors beyond our control may adversely affect our results of operations. Changes in interest rates, in particular, could adversely affect our net interest income and have a number of other adverse effects on our operations, as discussed in the immediately succeeding risk factor. Adverse economic conditions also could result in an increase in loan delinquencies, foreclosures and nonperforming assets and a decrease in the value of the property or other collateral which secures our loans, all of which could adversely affect our results of operations. We are particularly sensitive to changes in economic conditions and related uncertainties in Eastern Pennsylvania because we derive substantially all of our loans, deposits and other business from this area. Accordingly, we remain subject to the risks associated with prolonged declines in national or local economies.

CHANGES IN INTEREST RATES COULD HAVE A MATERIAL ADVERSE EFFECT ON OUR OPERATIONS.

The operations of financial institutions such as ours 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 and our ability to realize gains from the sale of such assets; our ability to obtain and retain deposits in competition with other available

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investment alternatives; the ability of our borrowers to repay adjustable or variable rate loans; and the fair value of the derivatives carried on our balance sheet, derivative hedge effectiveness testing and the amount of ineffectiveness recognized in our earnings. 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. Although we believe that the estimated maturities of our interest-earning assets currently are well balanced in relation to the estimated maturities of our interest-bearing liabilities (which involves various estimates as to how changes in the general level of interest rates will impact these assets and liabilities), there can be no assurance that our profitability would not be adversely affected during any period of changes in interest rates.

WE ARE SUBJECT TO EXTENSIVE REGULATION WHICH COULD ADVERSELY AFFECT OUR BUSINESS AND OPERATIONS.

We and our subsidiaries are subject to extensive federal and state governmental supervision and regulation, which are intended primarily for the protection of depositors. In addition, we and our subsidiaries are subject to changes in federal and state laws, as well as changes in regulations, governmental policies and accounting principles. The effects of any such potential changes cannot be predicted but could adversely affect the business and operations of us and our subsidiaries in the future.

WE FACE STRONG COMPETITION WHICH MAY ADVERSELY AFFECT OUR PROFITABILITY.

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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 commercial 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 you 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 far greater resources than we have to invest in technology.

WE AND OUR BANKING SUBSIDIARY ARE SUBJECT TO CAPITAL AND OTHER REQUIREMENTS WHICH RESTRICT OUR ABILITY TO PAY DIVIDENDS.

Our ability to pay dividends to our shareholders may depend upon the dividends we receive from Prudential Savings Bank. Dividends paid by the Bank are subject to restrictions under Pennsylvania and federal laws and regulations. In addition, Prudential Savings Bank must maintain certain capital levels, which may restrict the ability of the Bank to pay dividends to us and our ability to pay dividends to our shareholders.

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HOLDERS OF OUR COMMON STOCK HAVE NO PREEMPTIVE RIGHTS AND ARE SUBJECT TO POTENTIAL DILUTION.

Our articles of incorporation do not provide any shareholder with a preemptive right to subscribe for additional shares of common stock upon any increase thereof. Thus, upon the issuance of any additional shares of common stock or other voting securities of Prudential Bancorp or securities convertible into common stock or other voting securities, shareholders may be unable to maintain their pro rata voting or ownership interest in us.

ITEM 1B.UNRESOLVED STAFF COMMENTS.

Not applicable.

ITEM 2. PROPERTIES

We currently conduct business from our main office and five banking offices. The following table sets forth the net book value of the land, building and leasehold improvements and certain other information with respect to the our offices at September 30, 2006. All the offices are owned by us.

Date Of	Net Book
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Description/Address	Leased/Owned	Lease Expiration	Value Of Property	Amount Of Deposits
			(In Thousands)	
Main Office 1834 Oregon Avenue Philadelphia, PA 19145-4725	Owned	N/A	\$574	\$185,695
Snyder Branch 2101 South 19th Street Philadelphia, PA 19145-3709	Owned	N/A	6	24,784
Center City Branch 112 South 19th Street Philadelphia, PA 19103-4667	Owned	N/A	18	25,945
Broad Street Branch 1722 South Broad Street Philadelphia, PA 19145-2388	Owned	N/A	244	48,049
Pennsport Branch 238A Moore Street Philadelphia, PA 19148-1925	Owned	N/A	66	37,266
Drexel Hill Branch 601 Morgan Avenue Drexel Hill, PA 19026-3105	Owned	N/A	96	25,553

The Company has filed an application with the Pennsylvania Department of Banking and the Federal Deposit Insurance Corporation for approval to establish a new branch office in the Old City section of Philadelphia. The new branch is anticipated to commence operations in the Spring of 2007.

ITEM 3. LEGAL PROCEEDINGS

On October 4, 2006, Stilwell Value Partners I, L.P. ("Stilwell") filed suit in the United States District Court for the Eastern District of Pennsylvania against Prudential Mutual Holding Company (the "MHC"), Prudential Bancorp, Inc. of Pennsylvania (the "Company") and each of the directors of the MHC and the Company individually seeking equitable relief including (i) enjoining the Company and the directors from allowing the MHC to participate in any shareholder vote to consider the adoption of proposed stock option and stock recognition and retention plans (collectively, the "Stock Plans") and (ii) enjoining MHC from participating in any shareholder vote to approve the Stock Plans. In the event that the MHC and the Company are not enjoined, Stilwell is seeking damages, the amount to be determined at trial.

Stilwell alleges that the Company's prospectus used to solicit offers to purchase shares of the Company's common stock in connection with the mutual holding reorganization of Prudential Savings Bank "promised" that the Stock Plans would be submitted only for consideration by the Company's public shareholders and not the MHC which controls a majority of the Company's issued and outstanding shares of common stock and that Stilwell relied on such promise in determining to invest in the common stock of the Company. Stilwell also alleges the individual directors have violated their fiduciary duties to Stilwell by delaying the consideration of the Stock Plans until such time that MHC can vote its shares on the Stock Plans assuring their approval by

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shareholders. The Company believes Stilwell's allegations are without merit and intends to vigorously defend the case. On November 20, 2006, the Company, the MHC and the director defendants filed a motion to dismiss the complaint, asserting, among other things, that the prospectus contained no "promise," implied or otherwise, that the MHC would never vote on the adoption of the Stock Plans and that the breach of fiduciary duty claim, with respect to the timing of any such vote, is legally insufficient.

Since the case is in its early stages and discovery has not commenced, no prediction can be made as to the outcome thereof.

Other than the above referenced litigation, the Company is involved in various legal proceedings occurring in the ordinary course of business. Management of the Company, based on discussions with litigation counsel, believes that such proceedings will not have a material adverse effect on the financial condition or operations of the Company. There can be no assurance that any of the outstanding legal proceedings to which the Company is a party will not be decided adversely to the Company's interests and have a material adverse effect on the financial condition and operations of the Company.

#### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Not applicable.

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## PART II

#### ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

(a) Our common stock is traded on the NASDAQ Global Market (NASDAQ) under the symbol "PBIP". At December 14, 2006, there were approximately 321 registered shareholders of record, not including the number of persons or entities whose stock is held in nominee or "street" name through various brokerage firms and banks. The following table shows the quarterly high and low trading prices of our stock and the amount of cash dividends declared per share for fiscal 2006 and the last three fiscal 2005 quarters. Our common stock commenced trading on Nasdaq on March 30, 2005.

Quarter ended:	Stock Price		Cash
	High	Low	Dividends Per Share
September 30, 2006...	\$13.45	\$13.10	\$0.04
June 30, 2006.....	14.02	12.82	0.04
March 31, 2006.....	13.96	11.70	0.04
December 31, 2005...	11.98	10.70	0.04
September 30, 2005...	\$12.90	\$10.70	\$0.04
June 30, 2005.....	11.05	8.50	0.04
March 31, 2005.....	10.05	9.55	--

(b) Not applicable

(c) The following table presents the repurchasing activity of the stock repurchase program during the fourth quarter of fiscal 2006:

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Period -----	Total Number Of Shares Purchased	Average Price Paid Per Share	Total Number Of Shares Purchased As Part Of Publicly Announced Plans Or Programs -----
Month #1 July 1, 2006 - July 31, 2006.....	26,830	\$13.24	26,830
Month #2 August 1, 2006 - August 31, 2006.....	95,000	13.30	95,000
Month #3 September 1, 2006 - September 30, 2006...	50,000	13.30	50,000
	-----	-----	-----
Total.....	171,830	\$13.29	171,830
	=====	=====	=====

Notes to the table.

- (1) On April 6, 2006, the Company announced its second stock repurchase program to repurchase 269,000 shares or approximately 5% of the Company's outstanding common stock held by shareholders other than Prudential Mutual Holding Company, such program to commence upon completion of the first program (which was completed in May 2006). The second stock repurchase program was completed during November 2006.

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ITEM 6. SELECTED FINANCIAL DATA

Set forth below is selected financial and other data of Prudential Bancorp. Prior to March 29, 2005, the date we completed the reorganization, such data only reflects information with respect to Prudential Savings Bank.

	At September 30,				
	2006	2005	2004	2003	2002
	(Dollars in Thousands)				
SELECTED FINANCIAL AND OTHER DATA:					
Total assets	\$472,381	\$446,592	\$406,638	\$395,825	\$344,8
Cash and cash equivalents	13,428	26,815	10,061	24,108	29,0
Investment securities:					
Held-to-maturity	132,084	129,840	114,806	98,991	23,9
Available-for-sale	38,747	38,584	40,287	43,175	36,2
Mortgage-backed securities:					
Held-to-maturity	50,360	66,828	80,932	82,556	66,1
Available-for-sale	4,615	--	--	--	
Loans receivable, net	219,418	175,091	151,565	137,926	181,9
Deposits	347,292	336,468	349,159	340,777	292,3
FHLB advances	31,784	13,823	13,862	13,900	13,9
Total equity, substantially restricted	87,448	90,825	39,099	36,548	34,3

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	Year Ended September 30,				
	2006	2005	2004	2003	2002
	(Dollars in Thousands)				
<b>SELECTED OPERATING DATA:</b>					
Total interest income	\$ 24,542	\$ 21,077	\$ 19,513	\$ 18,813	\$ 19,2
Total interest expense	11,935	9,297	9,002	9,707	10,3
Net interest income	12,607	11,780	10,511	9,106	8,8
Provision for loan losses	60	--	50	180	1
Net interest income after provision for loan losses	12,547	11,780	10,461	8,926	8,7
Total non-interest income	938	567	581	742	6
Total non-interest expense	7,875	7,069	7,323	6,047	5,4
Income before income taxes	5,610	5,278	3,719	3,621	3,8
Income taxes	1,773	1,886	1,246	1,253	1,3
Net income	\$ 3,837	\$ 3,392	\$ 2,473	\$ 2,368	\$ 2,4
Basic Earnings per share (1)	0.32	0.15	--	--	
Diluted earnings per share (1)	0.32	0.15	--	--	
<b>SELECTED OPERATING RATIOS(2):</b>					
Average yield on interest-earning assets	5.58%	5.03%	4.97%	5.18%	6.
Average rate on interest-bearing liabilities	3.34	2.64	2.48	2.91	3.
Average interest rate spread(3)	2.24	2.39	2.49	2.27	2.
Net interest margin(3)	2.87	2.81	2.68	2.51	2.
Average interest-earning assets to average interest-bearing liabilities	122.94	118.81	108.13	108.67	108.
Net interest income after provision for loan losses to non-interest expense	159.33	166.64	142.85	147.61	160.
Total non-interest expense to average assets	1.73	1.64	1.80	1.61	1.
Efficiency ratio(4)	58.14	57.25	66.02	61.40	57.
Return on average assets	0.84	0.79	0.61	0.63	0.
Return on average equity	4.26	5.14	6.50	6.64	7.
Average equity to average assets	19.82	15.30	9.36	9.52	10.

(FOOTNOTES ON NEXT PAGE)

At Or For The Year Ended September 30,				
2006	2005	2004	2003	2002



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### ASSET QUALITY RATIOS(5):

Non-performing loans as a percent of total loans receivable(6)	0.07%	0.14%	0.32%	0.65%	0.95%
Non-performing assets as a percent of total assets(6)	0.03	0.13	0.25	0.38	0.51
Allowance for loan losses as a percent of non-performing loans	409.66	233.47	116.49	62.13	35.96
Net charge-offs to average loans receivable	--	--	0.03	0.16	0.14

### CAPITAL RATIOS(5):

Tier 1 leverage ratio					
Company	18.64%	20.98%	N/A	N/A	N/A
Bank	14.74	14.55	9.39%	9.03%	9.69%
Tier 1 risk-based capital ratio					
Company	39.23%	48.54%	N/A	N/A	N/A
Bank	31.12	34.71	24.50	21.95	20.29
Total risk-based capital ratio					
Company	39.68%	48.98%	N/A	N/A	N/A
Bank	31.56	35.16	25.22	22.29	20.66

-----

- (1) Due to the timing of the Bank's reorganization into the mutual holding company form and the completion of the Company's initial public offering on March 29, 2005, earnings per share for the year ended September 30, 2005 is for the six month period ended September 30, 2005. There were no shares of common stock of the Company outstanding during the pre 2005 periods.
- (2) With the exception of end of period ratios, all ratios are based on average monthly balances during the indicated periods.
- (3) Average interest rate spread represents the difference between the average yield on interest-earning assets and the average rate paid on interest-bearing liabilities, and net interest margin represents net interest income as a percentage of average interest-earning assets.
- (4) The efficiency ratio represents the ratio of non-interest expense divided by the sum of net interest income and non-interest income.
- (5) Asset quality ratios and capital ratios are end of period ratios, except for net charge-offs to average loans receivable. The Bank converted to a Pennsylvania-chartered savings bank in August 2004 and thus became subject to the Federal Deposit Insurance Corporation regulatory capital regulations. Prior thereto, the Bank was a Pennsylvania-chartered savings association subject to regulations by the Office of Thrift Supervision. Under Federal Deposit Insurance Corporation regulations, capital ratios for the Bank are based on average assets rather than assets, as adjusted, at the relevant date as required by the regulations of the Office of Thrift Supervision. Since the Company did not have any capital stock outstanding prior to March 29, 2005, no capital ratios are presented for the pre 2005 periods.
- (6) Non-performing assets consist of non-performing loans and real estate owned. Non-performing loans consist of all loans 90 days or more past due and loans in excess of 90 days delinquent and still accruing interest. It is our policy to cease accruing interest on all loans, other than single-family residential mortgage loans, 90 days or more past due. Real estate owned consists of real estate acquired through foreclosure and real estate acquired by acceptance of a deed-in-lieu of foreclosure.

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### ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

#### OVERVIEW

We are a community oriented savings bank headquartered in Philadelphia, Pennsylvania. We operate six banking offices in Philadelphia and Delaware Counties. Our primary business consists of attracting deposits from the general public and using those funds together with funds we borrow to originate loans to our customers and invest primarily in U.S. Government and agency securities and mortgage-backed securities. At September 30, 2006, we had total assets of \$472.4 million, including \$219.4 million in net loans and \$225.8 million of investment and mortgage-backed securities, total deposits of \$347.3 million and total equity of \$87.4 million.

This Management's Discussion and Analysis section is intended to assist in understanding the financial condition and results of operations of Prudential Bancorp. The results of operations of Prudential Bancorp are primarily dependent on the results of the Bank. The information contained in this section should be read in conjunction with our financial statements and the accompanying notes to the consolidated financial statements and other sections contained in Item 8 of this Form 10-K.

#### FORWARD-LOOKING STATEMENTS.

In addition to historical information, this Annual Report on Form 10-K includes certain "forward-looking statements" based on management's current expectations. The Company's actual results could differ materially, as such term is defined in the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended, from management's expectations. Such forward-looking statements include statements regarding management's current intentions, beliefs or expectations as well as the assumptions on which such statements are based. These forward-looking statements are subject to significant business, economic and competitive uncertainties and contingencies, many of which are not subject to the Company's control. You are cautioned that any such forward-looking statements are not guarantees of future performance and involve risks and uncertainties, and that actual results may differ materially from those contemplated by such forward-looking statements. Factors that could cause future results to vary from current management expectations include, but are not limited to, general economic conditions, legislative and regulatory changes, monetary and fiscal policies of the federal government, changes in tax policies, rates and regulations of federal, state and local tax authorities, changes in interest rates, deposit flows, the cost of funds, demand for loan products, demand for financial services, competition, changes in the quality or composition of the Company's loan and investment securities portfolios, changes in accounting principles, policies or guidelines and other economic, competitive, governmental and technological factors affecting the Company's operations, markets, products, services and fees.

The Company undertakes no obligation to update or revise any forward-looking statements to reflect changed assumptions, the occurrence of unanticipated events or changes to future operating results that occur subsequent to the date such forward-looking statements are made.

#### CRITICAL ACCOUNTING POLICIES

In reviewing and understanding financial information for Prudential Bancorp, you are encouraged to read and understand the significant accounting policies used in preparing our financial statements. These policies are

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described in Note 2 of the notes to our financial statements included in Item 8 hereof. The accounting and financial reporting policies of Prudential Bancorp conform to accounting principles generally accepted in the United States of America and to general practices within the banking industry. Accordingly, the financial statements require certain estimates, judgments and assumptions, which are

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believed to be reasonable, based upon the information available. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the periods presented. The following accounting policies comprise those that management believes are the most critical to aid in fully understanding and evaluating our reported financial results. These policies require numerous estimates or economic assumptions that may prove inaccurate or may be subject to variations which may significantly affect our reported results and financial condition for the period or in future periods.

**ALLOWANCE FOR LOAN LOSSES.** The allowance for loan losses is established through a provision for loan losses charged to expense. Loans are charged against the allowance for loan losses when management believes that the collectibility of the principal is unlikely. Subsequent recoveries are added to the allowance. The allowance is an amount that management believes will cover known and inherent losses in the loan portfolio, based on evaluations of the collectibility of loans. The evaluations take into consideration such factors as changes in the types and amount of loans in the loan portfolio, historical loss experience, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral, estimated losses relating to specifically identified loans, and current economic conditions. This evaluation is inherently subjective as it requires material estimates including, among others, exposure at default, the amount and timing of expected future cash flows on impacted loans, value of collateral, estimated losses on our commercial, construction and residential loan portfolios and general amounts for historical loss experience. All of these estimates may be susceptible to significant change.

While management uses the best information available to make loan loss allowance evaluations, adjustments to the allowance may be necessary based on changes in economic and other conditions or changes in accounting guidance. Historically, our estimates of the allowance for loan loss have not required significant adjustments from management's initial estimates. In addition, the Pennsylvania Department of Banking and the Federal Deposit Insurance Corporation, as an integral part of their examination processes, periodically review our allowance for loan losses. The Pennsylvania Department of Banking and the Federal Deposit Insurance Corporation may require the recognition of adjustments to the allowance for loan losses based on their judgment of information available to them at the time of their examinations. To the extent that actual outcomes differ from management's estimates, additional provisions to the allowance for loan losses may be required that would adversely impact earnings in future periods.

**INCOME TAXES.** We make estimates and judgments to calculate some of our tax liabilities and determine the recoverability of some of our deferred tax assets, which arise from temporary differences between the tax and financial statement recognition of revenues and expenses. We also estimate a reserve for deferred tax assets if, based on the available evidence, it is more likely than not that some portion or all of the recorded deferred tax assets will not be realized in future periods. These estimates and judgments are inherently

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subjective. In the past, our estimates and judgments to calculate our deferred tax accounts have not required significant revision to our initial estimates.

In evaluating our ability to recover deferred tax assets, we consider all available positive and negative evidence, including our past operating results, recent cumulative losses and our forecast of future taxable income. In determining future taxable income, we make assumptions for the amount of taxable income, the reversal of temporary differences and the implementation of feasible and prudent tax planning strategies. These assumptions require us to make judgments about our future taxable income and are consistent with the plans and estimates we use to manage our business. Any reduction in estimated future taxable income may require us to record an additional valuation allowance against our deferred tax assets. An increase in the valuation allowance would result in additional income tax expense in the period and could have a significant impact on our future earnings.

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### RECENT ACCOUNTING PRONOUNCEMENTS

In March 2006, the FASB issued SFAS No. 156, ACCOUNTING FOR SERVICING OF FINANCIAL ASSETS- AN AMENDMENT OF FASB STATEMENT NO. 140 ("SFAS No. 140" and "SFAS No. 156"). SFAS No. 140 establishes, among other things, the accounting for all separately recognized servicing assets and servicing liabilities. SFAS No. 156 amends SFAS No. 140 to require that all separately recognized servicing assets and servicing liabilities be initially measured at fair value, if practicable. SFAS No. 156 permits, but does not require, the subsequent measurement of separately recognized servicing assets and servicing liabilities at fair value. Under SFAS No. 156, an entity can elect subsequent fair value measurement to account for its separately recognized servicing assets and servicing liabilities. Adoption of SFAS No. 156 is required as of the beginning of the first fiscal year that begins after September 15, 2006. Upon adoption, the Company will apply the requirements for recognition and initial measurement of servicing assets and servicing liabilities prospectively to all transactions. The Company will adopt SFAS No. 156 for the fiscal year beginning October 1, 2006 and currently has not determined if it will adopt SFAS No. 156 using the fair value election. The Company does not anticipate any material impact to its financial condition or results of operations as a result of the adoption of SFAS No. 156.

On July 13, 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"), which is effective for fiscal years beginning after December 15, 2006. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in the financial statements in accordance with FASB Statement No. 109, "Accounting for Income Taxes." This Interpretation prescribes a comprehensive model for how a company should recognize, measure, present and disclose in its financial statements uncertain tax positions that the company has taken or expects to take on a tax return. The Company is currently assessing the impact of FIN 48 on its financial statements.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurement." SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. This Statement does not require any new fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The Company is currently assessing the impact of SFAS No. 157 on its financial statements.

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In September 2006, the Financial Accounting Standards Board ("FASB") issued SFAS No. 158, "Employer's Accounting for Defined Benefit Pension and Other Postretirement Plans--an amendment of FASB Statements No. 87, 88, 106, and 132(R)." SFAS No. 158 requires an employer to recognize in its statement of financial position an asset for a plan's overfunded status or a liability for a plan's underfunded status, measure a plan's assets and its obligations that determine its funded status as of the end of the employer's fiscal year, and recognize changes in the funded status of a defined benefit postretirement plan in the year in which the changes occur. Those changes will be reported in comprehensive income and as a separate component of stockholders' equity. SFAS No. 158 is effective for publicly held companies for fiscal years ending after December 15, 2006. The Bank participates in a multi-employer defined benefit plan. We do not anticipate that the implementation of SFAS No. 158 will have any impact on our financial position, results of operations and cash flows because it is not applicable to multi-employer defined benefit plans.

In February 2006, the FASB issued SFAS No. 155, "Accounting For Certain Hybrid Financial Instruments." This statement amends FASB Statements No. 133, "Accounting For Derivative Instruments and Hedging Activities, and FASB SFAS No. 140, "Accounting For Transfers and Servicing of Financial Assets and Extinguishment of Liabilities". FAS 155 permits fair value re-measurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, clarifies which interest-only strips and principal-only strips are not subject to the

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requirements of Statement 133, establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation, clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives, and amends Statement 140 to eliminate the prohibition on a qualifying special purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. FAS 155 is effective for all financial instruments acquired or issued after the beginning of an entities first fiscal year that begins after September 15, 2006. The adoption of the statement did not have a material effect on the financial statements.

In September 2006, the Securities and Exchange Commission ("SEC") issued SAB No. 108 expressing the SEC staff's views regarding the process of quantifying financial statement misstatements and the build up of improper amounts on the balance sheet. SAB 108 requires that registrants quantify errors using both a balance sheet and income statement approach and evaluate whether either approach results in a misstated amount that, when all relevant quantitative and qualitative factors are considered, is material. The built up misstatements, while not considered material in the individual years in which the misstatements were built up, may be considered material in a subsequent year if a company were to correct those misstatements through current period earnings. Initial application of SAB No. 108 allows registrants to elect not to restate prior periods but to reflect the initial application in their annual financial statements covering the first fiscal year ending after November 15, 2006. The cumulative effect of the initial application should be reported in the carrying amounts of assets and liabilities as of the beginning of that fiscal year and the offsetting adjustment, net of tax, should be made to the opening balance of retained earnings for that year.

The Company implemented SAB 108 on October 1, 2006 which resulted in an increase to Mortgage-backed securities held to maturity of approximately

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\$320,000, an increase in deferred income tax liability of approximately \$142,000 and a cumulative adjustment to increase beginning Retained Earnings of approximately \$178,000. The adjustment relates to two separate accounting entries. The first entry pertains to the method of accounting that was utilized in past years for the recognition of investment income on Mortgage-backed securities. Prior to 2006, the Company used the straight line method over the contractual life of the securities rather than using the effective yield method prescribed by SFAS No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases. The impact of this entry was the correction of an understatement of Mortgage-backed securities by approximately \$320,000 and deferred income tax liability of \$102,000. The second entry relates to a write off of a deferred tax asset of approximately \$40,000 that was incorrectly accounted for in prior periods.

In prior periods, management performed a quantitative and qualitative analysis of the differences between these two methods of accounting and concluded that there was not a material impact on any past individual quarter or annual reporting periods.

DERIVATIVE FINANCIAL INSTRUMENTS, CONTRACTUAL OBLIGATIONS AND OTHER COMMITMENTS. A derivative financial instrument includes futures, forwards, interest rate swaps, option contracts, and other financial instruments with similar characteristics. We have not used derivative financial instruments in the past and do not currently have any intent to do so in the future.

While we have not used derivative financial instruments, we are a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of our customers. These financial instruments include commitments to extend credit and the unused portions of lines of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated statements of financial condition. Commitments to extend

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credit generally have fixed expiration dates and may require additional collateral from the borrower if deemed necessary. Commitments to extend credit are not recorded as an asset or liability by us until the instrument is exercised.

The following tables summarize our outstanding commitments to originate loans and to advance additional amounts pursuant to outstanding letters of credit, lines of credit and under our construction loans at the dates indicated.

### COMMITMENTS

The following tables summarize our outstanding commitments to originate loans and to advance additional amounts pursuant to outstanding letters of credit, lines of credit and undisbursed construction loans at September 30, 2006.

Total Amounts	Amount Of Commitment Expiration - Per Period			
	To	1-3	4-5	After 5

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	Committed	1 Year	Years	Years	Years
	-----	-----	-----	-----	-----
	(In Thousands)				
Letters of credit	\$ 110	\$ 110	\$ --	\$--	\$ --
Lines of credit	6,706	--	--	--	6,706
Undisbursed portions of loans in process	36,258 (1)	15,388	20,870	--	--
Commitments to originate loans	4,933	4,933	--	--	--
	-----	-----	-----	-----	-----
Total commitments	\$48,007	\$20,431	\$20,870	\$--	\$6,706
	=====	=====	=====	====	=====

(1) Includes participation interests sold to other financial institutions totaling \$6.6 million; Prudential Savings Bank will fund such amount and be reimbursed by the participants.

CONTRACTUAL CASH OBLIGATIONS

The following table summarizes our contractual cash obligations at September 30, 2006.

	Payments Due By Period				
	TOTAL	TO 1 YEAR	1-3 YEARS	4-5 YEARS	AFTER 5 YEARS
	-----	-----	-----	-----	-----
	(In Thousands)				
Certificates of deposit	\$171,602	\$124,399	\$32,197	\$15,006	\$ --
FHLB advances (1)	31,784	18,041	84	13,088	571
Other borrowed money	--	--	--	--	--
	-----	-----	-----	-----	-----
Total long-term debt	203,386	142,440	32,281	28,094	571
Operating lease obligations	166	61	105	--	--
	-----	-----	-----	-----	-----
Total contractual obligations	\$203,552	\$142,501	\$32,386	\$28,094	\$571
	=====	=====	=====	=====	=====

(1) Does not include approximately \$760,000 in interest expense due annually on FHLB advances through the year 2010.

AVERAGE BALANCES, NET INTEREST INCOME, AND YIELDS EARNED AND RATES PAID. The following table shows for the periods indicated the total dollar amount of interest from average interest-earning assets and the resulting yields, as well as the interest expense on average interest-bearing liabilities, expressed both in dollars and rates, and the net interest margin. Tax-exempt income and yields have not been adjusted to a tax-equivalent basis. All average balances are based on monthly balances. Management does not believe that the monthly averages differ significantly from what the daily averages would be.

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	Year Ended September				
	2006			2005	
	Average Balance	Interest	Average Yield/ Rate(1)	Average Balance	Interest
	(Dollars in Thousand)				
Interest-earning assets:					
Investment securities	\$173,713	\$ 8,019	4.62%	\$157,648	\$ 6,758
Mortgage-backed securities	60,750	3,147	5.18	72,771	3,783
Loans receivable(1)	197,913	13,077	6.61	163,166	9,885
Other interest-earning assets	7,307	299	4.09	25,512	651
Total interest-earning assets	439,683	24,542	5.58%	419,097	21,077
Non-interest-earning assets	14,786			12,073	
Total assets	\$454,469			\$431,170	
Interest-bearing liabilities:					
Savings accounts	\$ 81,472	2,449	3.01%	\$ 91,821	1,719
Checking and money market accounts	98,112	3,081	3.14	101,146	2,273
Certificate accounts	156,869	5,304	3.38	144,445	4,520
Total deposits	336,453	10,834	3.22	337,412	8,512
FHLB advances	19,628	1,092	5.56	13,842	775
Real estate tax escrow accounts	1,552	9	0.58	1,490	10
Other interest-bearing liabilities	--	--	--	--	--
Total interest-bearing liabilities	357,633	11,935	3.34%	352,744	9,297
Non-interest-bearing liabilities	6,762			12,459	
Total liabilities	364,395			365,203	
Stockholders' Equity	90,074			65,967	
Total liabilities and Stockholders' Equity	\$454,469			\$431,170	
Net interest-earning assets	\$ 82,050			\$ 66,354	
Net interest income; interest rate spread		\$12,607	2.24%		\$11,780
Net interest margin(2)			2.87%		
Average interest-earning assets to average interest-bearing liabilities			122.94%		

(1) Includes nonaccrual loans during the respective periods. Calculated net of deferred fees and discounts, loans in process and allowance for loan losses.

(2) Equals net interest income divided by average interest-earning assets.



RATE/VOLUME ANALYSIS. The following table shows the extent to which changes in interest rates and changes in volume of interest-earning assets and interest-bearing liabilities affected our interest income and expense during the periods indicated. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to (1) changes in rate, which is the change in rate multiplied by prior year volume, and (2) changes in volume, which is the change in volume multiplied by prior year rate. The combined effect of changes in both rate and volume has been allocated proportionately to the change due to rate and the change due to volume.

	2006 vs. 2005					
	Increase (Decrease) Due To			Total Increase (Decrease)	Increase (D	
	Rate	Volume	Rate/ Volume		Rate	Vol
	(In Thousands)					
Interest income:						
Investment securities	\$ 519	\$ 689	\$ 53	\$ 1,261	\$ 214	\$
Mortgage-backed securities	(13)	(625)	2	(636)	(85)	(
Loans receivable, net	896	2,105	191	3,192	40	1,
Other interest-earning assets	393	(465)	(280)	(352)	130	
Total interest-earning assets	1,795	1,704	(34)	3,465	299	1,
Interest expense:						
Savings accounts	1,041	(194)	(117)	730	109	
Checking accounts (interest-bearing and non-interest bearing)	903	(68)	(27)	808	303	
Certificate accounts	364	389	31	784	211	(
Total deposits	2,308	127	(113)	2,322	623	(
FHLB advances	(5)	324	(2)	317	(1)	
Other interest-bearing liabilities	(1)	--	--	(1)	(3)	
Total interest-bearing liabilities	2,302	451	(115)	2,638	619	(
Increase (decrease) in net interest income	\$ (507)	\$ 1,253	\$ 81	\$ 827	\$ (320)	\$ 1,

#### COMPARISON OF FINANCIAL CONDITION AT SEPTEMBER 30, 2006 AND SEPTEMBER 30, 2005

The Company's total assets increased by \$25.8 million or 5.8% to \$472.4 million at September 30, 2006 from September 30, 2005 primarily due to continued growth of the loan portfolio. The Company's net loan portfolio experienced a \$44.3 million or 25.3% increase to \$219.4 million at September 30, 2006 as management continued its emphasis on growing the Company's loan portfolio. The majority of the growth was concentrated in the single-family construction and residential mortgage loan portfolios. Partially offsetting such

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increase were decreases in cash and cash equivalents as well as mortgage-backed securities. The \$13.4 million decrease in cash and cash equivalents to \$13.4 million at September 30, 2006 reflected the systematic investment of funds received in the subscription offering in loans and other higher yielding investments while the \$11.9 million decline in the mortgage-backed securities portfolios reflected the Company's determination to re-invest proceeds from maturing securities into loans.

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Total liabilities increased by \$29.2 million or 8.2% to \$384.9 million at September 30, 2006 from September 30, 2005 reflecting increased Federal Home Loan Bank borrowings ("FHLB") and deposits in order to assist funding loan demand. Advances from the FHLB increased \$18.0 million to \$31.8 million at September 30, 2006 from \$13.8 million at September 30, 2005. At September 30, 2006, total deposits increased \$10.8 million or 3.2% to \$347.3 million from \$336.5 million as of September 30, 2005. The increase was due to a \$27.3 million increase in certificates of deposit, partially offset by a \$16.5 million decrease in core deposits. The increase in certificates resulted primarily from implementation of a more aggressive deposit pricing strategy combined with increased customer demand for attractive short-term investments in the rising interest rate market experienced throughout fiscal 2006.

Stockholders' equity decreased by \$3.4 million to \$87.4 million at September 30, 2006 as compared to \$90.8 million at September 30, 2005 in large part due to the repurchase during fiscal 2006 of 433,130 shares of common stock at a total cost of \$5.8 million combined with the payment of \$1.9 million in dividends, offset in part by \$3.8 million in net income for the year ended September 30, 2006.

The Company previously announced in April 2006 that the Board had approved the commencement of its second stock repurchase program of up to an additional 269,000 shares or approximately 5% of the Company's outstanding common stock held by other than Prudential Mutual Holding Company. The Company's second repurchase program commenced in May 2006 upon completion of its first repurchase program covering 277,000 shares. The average cost per share of the 499,430 shares which had been repurchased during fiscal 2006 and 2005 was \$12.86 per share.

### COMPARISON OF OPERATING RESULTS FOR THE YEAR ENDED SEPTEMBER 30, 2006 AND SEPTEMBER 30, 2005

GENERAL. We had net income of \$3.8 million for the year ended September 30, 2006 as compared to \$3.4 million for the prior fiscal year. The results for the year ended September 30, 2006 as compared to the year ended September 30, 2005 reflected primarily the effects of an \$827,000 increase in net interest income combined with a \$370,000 increase in non-interest income offset by a \$806,000 increase in non-interest expenses. The increase in net interest income reflected in large part the increase in the average net interest-earning assets for the year ended September 30, 2006 compared to the year ended September 30, 2005, as the stock reorganization only reflected half of the 2005 fiscal year. Our non-interest expenses increased due primarily to additional expenses incurred from operating as a public company for a full year.

INTEREST INCOME. Our total interest income was \$24.5 million for the year ended September 30, 2006 compared to \$21.1 million for the year ended September 30, 2005, an increase of \$3.5 million or 16.4%. The higher amount of interest income in fiscal 2006 primarily reflected the effects of increases in the average balances of interest-earning assets and to a lesser extent the

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increase in the net interest margin. The primary reason for the increase in interest income was a \$3.2 million increase in interest income and fees earned on our loan portfolio for the year ended September 30, 2006 compared to the year ended September 30, 2005 and a \$908,000 increase in interest and dividends earned on our investment securities portfolio, partially offset by a \$636,000 decrease in interest on mortgage-backed securities for fiscal 2006 as compared to 2005. The primary reason for the increase in interest income on our loan portfolio was the 21.3% increase in the average balance of such assets for the year ended September 30, 2006 compared to the year ended September 30, 2005. Likewise, the average yield earned on the loan portfolio increased 55 basis points to 6.61% for fiscal 2006 compared to fiscal 2005.

**INTEREST EXPENSE.** Our interest expense increased during the year ended September 30, 2006 compared to the year ended September 30, 2005, reflecting the current rising interest rate environment. Total interest expense amounted to \$11.9 million during the year ended September 30, 2006 compared to \$9.3 million for the year ended September 30, 2005, an increase of \$2.6 million or 28.4%. The primary

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reason for the increase in interest expense was a 70 basis point increase in the average rate paid on deposits to 3.22% for the year ended September 30, 2006 compared to the year ended September 30, 2005. As a result, interest expense on total deposits was \$10.8 million in the year ended September 30, 2006 compared to \$8.5 million in fiscal 2005. Interest expense on FHLB advances increased by \$317,000 due to an increase in the average balance of \$5.8 million for fiscal 2006 compared to fiscal 2005.

**PROVISION FOR LOAN LOSSES.** We have identified the evaluation of the allowance for loan losses as a critical accounting policy where amounts are sensitive to material variation. This policy is significantly affected by our judgment and uncertainties and there is a likelihood that materially different amounts would be reported under different, but reasonably plausible, conditions or assumptions. Our activity in the provision for loan losses, which consists of charges or recoveries to operating results, is undertaken in order to maintain a level of total allowance for losses that management believes covers all known and inherent losses that are both probable and reasonably estimable at each reporting date. Our evaluation process includes, among other things, an analysis of delinquency trends, non-performing loan trends, the level of charge-offs and recoveries, prior loss experience, total loans outstanding, the volume of loan originations, the type, size and geographic concentration of our loans, the value of collateral securing the loan, the borrower's ability to repay and repayment performance, the number of loans requiring heightened management oversight, local economic conditions and industry experience. In recent periods, in establishing the allowance for loan losses we have given particular consideration to the growth in our construction and land development loan portfolio. For each primary type of loan, we establish a loss factor reflecting our estimate of the known and inherent losses in each loan type using the quantitative analysis as well as consideration of the qualitative factors. Such risk ratings are periodically reviewed by management and revised as deemed appropriate. The establishment of the allowance for loan losses is significantly affected by management judgment and uncertainties and there is a likelihood that different amounts would be reported under different conditions or assumptions. Various regulatory agencies, as an integral part of their examination process, periodically review our allowance for loan losses. Such agencies may require us to make additional provisions for estimated loan losses based upon judgments different from those of management. Furthermore, the amount of the allowance for loan losses is only an estimate and actual losses may vary from this estimate.

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We established an additional provision for loan losses for the year ended September 30, 2006 of \$60,000. No provision was made during fiscal 2005. We did not have any charge-offs in our allowance for loan losses for the year ended September 30, 2006 or 2005. Historically, we have experienced a modest level of charge-offs. The provision was established due to continued growth in the loan portfolio, primarily with regard to increases in construction and land development loans. Our allowance for loan losses amounted to \$618,000, or 0.24% of total loans outstanding at September 30, 2006 compared to \$558,000 or 0.28% of total loans outstanding at September 30, 2005.

**NON-INTEREST INCOME.** Our non-interest income is comprised of fees and other service charges on customer accounts, and other operating income. Our total non-interest income amounted to \$938,000 for the year ended September 30, 2006 compared to \$567,000 for the year ended September 30, 2005, a \$370,000 or 65.3% increase. The primary reason for the increase in non-interest income in the 2006 period compared to the 2005 period was income from Bank Owned Life Insurance (BOLI) of \$166,000 in 2006 which was not applicable in the 2005 fiscal year. The BOLI, purchased during fiscal 2006, provides an attractive tax-exempt return to the Company and is being used by the Company to fund various employee benefit plans. Also contributing the increase was gain on sale of a real estate owned property of \$106,000, increased ATM fees of \$73,000, and gain on sale of mortgage-backed securities of \$48,000.

**NON-INTEREST EXPENSE.** Non-interest expense is comprised primarily of salaries and employee benefits expense, net occupancy and depreciation costs, data processing costs, professional service fees, directors compensation and various other operating expenses. Our total non-interest expense amounted to

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\$7.9 million for the year ended September 30, 2006, a \$806,000 or 11.4% increase from \$7.1 million of non-interest expense for the year ended September 30, 2005. The increase reflected increased employee and director compensation and benefit expense of \$428,000 due primarily to an increase in retirement plan expenses and normal merit pay rate increases combined with an increase in professional services expense of \$247,000 reflecting the additional expenses incurred due to operating as a public company, as we were only operating as a public company for approximately half of the 2005 fiscal year.

**INCOME TAX EXPENSE.** Our income tax expense for the year ended September 30, 2006 amounted to \$1.8 million with an effective income tax rate of 31.6% compared to income tax expense of \$1.9 million with an effective income tax rate of 35.7% for the year ended September 30, 2005. This decrease in the effective tax rate reflected the implementation of various tax strategies as well as the recognition of certain tax benefits as a result of the adjustment of a valuation allowance during the first fiscal quarter of 2006.

### COMPARISON OF OPERATING RESULTS FOR THE YEAR ENDED SEPTEMBER 30, 2005 AND SEPTEMBER 30, 2004

**GENERAL.** We had net income of \$3.4 million for the year ended September 30, 2005 as compared to \$2.5 million for the prior fiscal year. The results for the year ended September 30, 2005 as compared to the year ended September 30, 2004 reflected primarily the effects of a \$1.3 million increase in net interest income combined with a \$50,000 decrease in the provision for loan losses and a \$253,000 decrease in non-interest expenses. The increase in net interest income reflected in large part the increase in the net interest margin by 13 basis points to 2.81% for the year ended September 30, 2005 compared to

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2.68% for the year ended September 30, 2004. Although the weighted average yield on our interest-earning assets increased by 6 basis points, the average rate paid on our interest-bearing liabilities increased to a greater degree, increasing 16 basis points. We have continued to maintain our rates on our checking and savings accounts above those of many of our competitors for competitive reasons based on the demographics and composition of our customer base, although we may not do so in the future. The increase in the net interest margin reflected the effects of the infusion of the net proceeds of the Company's initial public offering in March 2005 which offset the decline in our interest rate spread. Our non-interest expenses decreased due primarily to an aggregate \$236,000 decrease in salaries and employee benefit expense and a \$134,000 decrease in litigation expense. However, partially offsetting the increase in net interest income and the decline in non-interest expense was the decline in non-interest income. We experienced a \$14,000 decline in our non-interest income to \$567,000 for the year ended September 30, 2005 as compared to fiscal 2004 primarily due to a \$17,000 decrease in fees and other service charges, offset in part by a \$4,000 increase in other non-interest income. The decline in fees and other service charges reflected a reduced volume of fee-based transactions, in particular, mortgage loan prepayment fees.

**INTEREST INCOME.** Our total interest income was \$21.1 million for the year ended September 30, 2005 compared to \$19.5 million for the year ended September 30, 2004, an increase of \$1.6 million or 8.0%. The higher amount of interest income in fiscal 2005 primarily reflected the effects of increases in the average balances of interest-earning assets and to a lesser extent the increase in the net interest margin. The primary reason for the increase in interest income was a \$1.3 million increase in interest and fees income earned on our loan portfolio for the year ended September 30, 2005 compared to the year ended September 30, 2004 and a \$956,000 increase in interest and dividends earned on our investment securities portfolio, partially offset by a \$692,000 decrease in interest on mortgage-backed securities for fiscal 2005 as compared to 2004. The primary reason for the increase in interest income on our loan portfolio was the 14.6% increase in the average balance of such assets for the year ended September 30, 2005 compared to the year ended September 30, 2004. Likewise, the average yield earned on the loan portfolio increased 3 basis points to 6.06% for fiscal 2005 compared to fiscal 2004.

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**INTEREST EXPENSE.** Our interest expense increased during the year ended September 30, 2005 compared to the year ended September 30, 2004, reflecting the rising interest rate environment during fiscal 2005. Total interest expense amounted to \$9.3 million during the year ended September 30, 2005 compared to \$9.0 million for the year ended September 30, 2004, an increase of \$295,000 or 3.3%. The primary reason for the increase in interest expense was a 16 basis point increase in the average rate paid on deposits to 2.52% for the year ended September 30, 2005 compared to the year ended September 30, 2004 which more than offset the 2.9% decrease in the average balance of deposits in the period. As a result, interest expense on total deposits was \$8.5 million in the year ended September 30, 2005 compared to \$8.2 million in fiscal 2004. Interest expense on FHLB advances remained essentially the same during both periods as the average balance and rate paid were relatively unchanged.

**PROVISION FOR LOAN LOSSES.** We did not establish a provision for loan losses for the year ended September 30, 2005 compared to a provision of \$50,000 for the year ended September 30, 2004. We did not have any charge-offs in our allowance for loan losses for the year ended September 30, 2005 compared to \$45,000 in charge-offs, net of recoveries, for fiscal 2004. Historically, we have experienced a modest level of charge-offs. All of the charge-offs in the

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year ended September 30, 2004 related to two lending relationships, both of which consisted of participation interests in commercial real estate loans. One loan was secured by a golf course and golf house while the other was secured by a storage facility. Our allowance for loan losses amounted to \$558,000, or 0.28% of total loans outstanding at September 30, 2005.

**NON-INTEREST INCOME.** Our non-interest income is comprised of fees and other service charges on customer accounts, and other operating income. Our total non-interest income amounted to \$567,000 for the year ended September 30, 2005 compared to \$581,000 for the year ended September 30, 2004, a \$14,000 or 2.3% decrease. The primary reason for the decrease in non-interest income in the 2005 period compared to the 2004 period was a \$17,000 decrease in fees and other service charges due to a reduced volume of fee generating transactions, in particular, mortgage loan prepayment fees (as mortgage refinancing activity declined) and late charges. Such declines were offset in part due to a \$4,000 increase in other non-interest income which consists of miscellaneous operating income.

**NON-INTEREST EXPENSE.** Non-interest expense is comprised primarily of salaries and employee benefits expense, net occupancy and depreciation costs, data processing costs, professional service fees, directors compensation and various other operating expenses. Our total non-interest expense amounted to \$7.1 million for the year ended September 30, 2005, a \$253,000 or 3.5% decrease from \$7.3 million of non-interest expense for the year ended September 30, 2004. The decrease was due primarily to an aggregate \$236,000 decrease in salary and employee benefits expense and a \$134,000 decrease in litigation expense. The increase in professional service expense of \$193,000 was due primarily to our reorganization completed during the fiscal year and additional expenses related to being a public company. In addition, director compensation expense increased \$77,000 due in large part to a one-time expense incurred during the mutual holding company reorganization resulting from the payment of \$38,250 to a director in connection with the termination of a supplemental retirement plan. In addition, due to the increased time commitments, responsibilities and obligations imposed on the directorate as a result of the Bank being part of a public company, the annual retainer and committee fees for service on the Bank's Board increased. Excluding the one-time expense related to the benefit settlement, director compensation expense amounted to \$219,000 for fiscal 2005 as compared to \$181,000 for fiscal 2004.

**INCOME TAX EXPENSE.** Our income tax expense was \$1.9 million for fiscal year 2005 and \$1.2 million for fiscal year 2004. Our effective tax rate was 35.7% for the year ended September 30, 2005 compared to 33.5% for the year ended September 30, 2004 reflected in large part the increase in the Company's net income before taxes.

### LIQUIDITY AND CAPITAL RESOURCES

Our primary sources of funds are from deposits, scheduled principal and interest payments on loans, loan prepayments and the maturity of loans, mortgage-backed securities and other investments, and other funds provided from operations. While scheduled payments from the amortization of loans and mortgage-backed securities and maturing investment securities are relatively predictable sources of funds, deposit flows and loan prepayments can be greatly influenced by general interest rates, economic conditions and competition. We also maintain excess funds in short-term, interest-bearing assets that provide additional liquidity. At September 30, 2006, our cash and cash equivalents amounted to \$13.4 million. In addition, our available for sale investment and

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mortgage-backed securities amounted to an aggregate of \$43.4 million at September 30, 2006.

We use our liquidity to fund existing and future loan commitments, to fund maturing certificates of deposit and demand deposit withdrawals, to invest in other interest-earning assets, and to meet operating expenses. At September 30, 2006, we had certificates of deposit maturing within the next 12 months amounting to \$124.4 million. Based upon historical experience, we anticipate that a significant portion of the maturing certificates of deposit will be redeposited with us.

In addition to cash flow from loan and securities payments and prepayments as well as from sales of available for sale securities, we have significant borrowing capacity available to fund liquidity needs should the need arise. Our borrowings consist solely of advances from the Federal Home Loan Bank of Pittsburgh, of which we are a member. Under terms of the collateral agreement with the Federal Home Loan Bank, we pledge residential mortgage loans and mortgage-backed securities as well as our stock in the Federal Home Loan Bank as collateral for such advances. At September 30, 2006, we had \$31.8 million in outstanding FHLB advances and we had \$128.0 million in additional FHLB advances available to us.

We anticipate that we will continue to have sufficient funds and alternative funding sources to meet our current commitments.

### IMPACT OF INFLATION AND CHANGING PRICES

The consolidated financial statements, accompanying notes, and related financial data of Prudential Bancorp presented in Item 8. Financial Statements and Supplementary Data in Part II of this Annual Report on Form 10-K have been prepared in accordance with generally accepted accounting principles, which require the measurement of financial position and operating results in terms of historical dollars without considering the changes in purchasing power of money over time due to inflation. The impact of inflation is reflected in the increased cost of operations. Most of our assets and liabilities are monetary in nature; therefore, the impact of interest rates has a greater impact on its performance than the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or to the same extent as the prices of goods and services.

### ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

**HOW WE MANAGE MARKET RISK.** Market risk is the risk of loss from adverse changes in market prices and rates. Our market risk arises primarily from the interest rate risk which is inherent in our lending, investment and deposit gathering activities. To that end, management actively monitors and manages interest rate risk exposure. In addition to market risk, our primary risk is credit risk on our loan portfolio. We attempt to manage credit risk through our loan underwriting and oversight policies.

The principal objective of our interest rate risk management function is to evaluate the interest rate risk embedded in certain balance sheet accounts, determine the level of risk appropriate given our business strategy, operating environment, capital and liquidity requirements and performance objectives, and manage the risk consistent with approved guidelines. We seek to manage our exposure to risks from changes in interest rates while at the same time trying to improve our net interest spread. We monitor interest rate risk as

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such risk relates to our operating strategies. We have established an Asset/Liability Committee which is comprised of our President and Chief Executive Officer, Chief Financial Officer, Chief Lending Officer, Treasurer and Controller. The Asset/Liability Committee meets on a regular basis and is responsible for reviewing our asset/liability policies and interest rate risk position. Both the extent and direction of shifts in interest rates are uncertainties that could have a negative impact on future earnings.

In recent years, we primarily have utilized the following strategies in our efforts to manage interest rate risk:

- o we have increased our originations of shorter term loans and/or loans with adjustable rates of interest, particularly construction and land development loans;
- o we have invested in securities with "step-up" rate features providing for increased interest rates prior to maturity according to a pre-determined schedule and formula; and
- o we have maintained moderate levels of short-term liquid assets.

However, notwithstanding the foregoing strategies, we remain subject to a significant level of interest rate risk in a rising rate environment due to the high proportion of our loan portfolio that consists of fixed-rate loans as well as our decision to invest a significant amount of our assets in long-term, fixed-rate investment and mortgage-backed securities designated as held to maturity. In addition, our interest rate spread and margin have been adversely affected due to the tightening of the yield curve. Likewise, our unwillingness to originate long-term, fixed-rate residential mortgage loans at low rates has resulted in borrowers in many cases refinancing loans elsewhere, requiring us to reinvest the resulting proceeds from the loan payoffs at low current market rates of interest. Thus, both of these strategies have increased our interest rate risk.

**GAP ANALYSIS.** The matching of assets and liabilities may be analyzed by examining the extent to which such assets and liabilities are "interest rate sensitive" and by monitoring the Bank's interest rate sensitivity "gap." An asset and liability is said to be interest rate sensitive within a specific time period if it will mature or reprice within that time period. The interest rate sensitivity gap is defined as the difference between the amount of interest-earning assets maturing or repricing within a specific time period and the amount of interest-bearing liabilities maturing or repricing within that same time period. A gap is considered positive when the amount of interest rate sensitive assets exceeds the amount of interest rate sensitive liabilities. A gap is considered negative when the amount of interest rate sensitive liabilities exceeds the amount of interest rate sensitive assets. During a period of rising interest rates, a negative gap would tend to affect adversely net interest income while a positive gap would tend to result in an increase in net interest income. Conversely, during a period of falling interest rates, a negative gap would tend to result in an increase in net interest income while a positive gap would tend to affect adversely net interest income.

The table on the next page sets forth the amounts of our interest-earning assets and interest-bearing liabilities outstanding at September 30, 2006, which we expect, based upon certain assumptions, to reprice or mature in each of the future time periods shown (the "GAP Table"). Except as stated below, the amounts of assets and liabilities shown which reprice or mature during a particular period were



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determined in accordance with the earlier of term to repricing or the contractual maturity of the asset or liability. The table sets forth an approximation of the projected repricing of assets and liabilities at September 30, 2006, on the basis of contractual maturities, anticipated prepayments, and scheduled rate adjustments within a three-month period and subsequent selected time intervals. The loan amounts in the table reflect principal balances expected to be redeployed and/or repriced as a result of contractual amortization and anticipated prepayments of adjustable-rate loans and fixed-rate loans, and as a result of contractual rate adjustments on adjustable-rate loans. Annual prepayment rates for adjustable-rate and fixed-rate single-family and multi-family residential and commercial mortgage loans are assumed to range from 7.9% to 25.2%. The annual prepayment rate for mortgage-backed securities is assumed to range from 7.0% to 20.6%. Money market deposit accounts, savings accounts and interest-bearing checking accounts are assumed to have annual rates of withdrawal, or "decay rates," based on information from the Federal Deposit Insurance Corporation. For savings accounts and checking accounts, the decay rates are 60% in one to three years, 20% in three to five years and 20% in five to 10 years. For money market accounts, the decay rates are 50% in three to 12 months and 50% in 13 to 36 months.

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	3 Months Or Less	More Than 3 Months To 1 Year	More Than 1 Year To 3 Years	More Than 3 Years To 5 Years	More Than 5 Years	Tot
(Dollars in Thousands)						
<b>Interest-earning assets(1):</b>						
Investment securities	\$ 20,234	\$ 24,964	\$ 22,087	\$ 18,090	\$ 84,717	\$
Mortgage-backed securities	1,541	4,167	6,414	10,031	32,741	
Loans receivable(2)	61,473	25,730	43,390	29,214	60,229	
Other interest-earning assets(3)	9,902	--	--	--	--	
	-----	-----	-----	-----	-----	-----
Total interest-earning assets	\$ 93,150	\$ 54,861	\$ 71,891	\$ 57,335	\$177,687	\$
	=====	=====	=====	=====	=====	=====
<b>Interest-bearing liabilities:</b>						
Savings accounts	\$ 772	\$ 116	\$ 45,592	\$ 15,197	\$ 15,197	\$
Checking accounts/money market	--	32,249	49,217	5,657	5,657	
Certificate accounts	32,055	92,344	32,197	15,006	--	
FHLB advances	18,000	--	--	13,000	784	
Real estate tax escrow accounts	--	--	--	--	1,230	
	-----	-----	-----	-----	-----	-----
Total interest-bearing liabilities	\$ 50,827	\$124,709	\$127,006	\$ 48,860	\$ 22,868	\$
	=====	=====	=====	=====	=====	=====
Interest-earning assets less interest-bearing liabilities	\$ 42,323	\$ (69,848)	\$ (55,115)	\$ 8,475	\$154,819	\$
	=====	=====	=====	=====	=====	=====
Cumulative interest-rate sensitivity gap(4)	\$ 42,323	\$ (27,525)	\$ (82,640)	\$ (74,165)	\$ 80,654	\$
	=====	=====	=====	=====	=====	=====

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Cumulative interest-rate gap as a percentage of total assets at September 30, 2006	8.96%	(5.83)%	(17.49)%	(15.70)%	17.07%
	=====	=====	=====	=====	=====
Cumulative interest-earning assets as a percentage of cumulative interest-bearing liabilities at September 30, 2006	183.27%	84.32%	72.68%	78.89%	121.55%
	=====	=====	=====	=====	=====

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- (1) Interest-earning assets are included in the period in which the balances are expected to be redeployed and/or repriced as a result of anticipated prepayments, scheduled rate adjustments and contractual maturities.
- (2) For purposes of the gap analysis, loans receivable includes non-performing loans gross of the allowance for loan losses, undisbursed loan funds, unamortized discounts and deferred loan fees.
- (3) Includes FHLB stock.
- (4) Interest-rate sensitivity gap represents the difference between net interest-earning assets and interest-bearing liabilities.

Certain shortcomings are inherent in the method of analysis presented in the foregoing table. For example, although certain assets and liabilities may have similar maturities or periods to repricing, they may react in different degrees to changes in market interest rates. Also, the interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types may lag behind changes in market rates. Additionally, certain assets, such as adjustable-rate loans, have features which restrict changes in interest rates both on a short-term basis and over the life of the asset. Further, in the event of a change in interest rates, prepayment and early withdrawal levels would likely deviate significantly from those assumed in calculating the table. Finally, the ability of many borrowers to service their adjustable-rate loans may decrease in the event of an interest rate increase.

NET PORTFOLIO VALUE ANALYSIS. Our interest rate sensitivity also is monitored by management through the use of a model which generates estimates of the changes in our net portfolio value ("NPV") over a range of interest rate scenarios. NPV is the present value of expected cash flows from assets,

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liabilities and off-balance sheet contracts. The NPV ratio, under any interest rate scenario, is defined as the NPV in that scenario divided by the market value of assets in the same scenario. The following table sets forth our NPV as of September 30, 2006 and reflects the changes to NPV as a result of immediate and sustained changes in interest rates as indicated.

Change In Interest Rates In Basis Points (Rate Shock)	Net Portfolio Value			NPV As % Of Portfolio Value Of Assets	
-----	Amount	\$ Change	% Change	NPV Ratio	Change
-----	-----	-----	-----	-----	-----

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(Dollars in Thousands)					
300bp	\$ 61,093	\$(33,398)	(35.35)%	14.61%	(5.67)%
200	71,385	(23,106)	(24.45)	16.48	(3.80)
100	82,668	(11,823)	(12.51)	18.40	(1.88)
Static	94,491	--	--	20.28	--
(100)	100,191	5,700	6.03	21.01	0.73
(200)	97,849	3,358	3.55	20.40	0.12
(300)	95,322	831	0.88	19.75	(0.53)

As is the case with the GAP Table, certain shortcomings are inherent in the methodology used in the above interest rate risk measurements. Modeling changes in NPV require the making of certain assumptions which may or may not reflect the manner in which actual yields and costs respond to changes in market interest rates. In this regard, the models presented assume that the composition of our interest sensitive assets and liabilities existing at the beginning of a period remains constant over the period being measured and also assumes that a particular change in interest rates is reflected uniformly across the yield curve regardless of the duration to maturity or repricing of specific assets and liabilities. Accordingly, although the NPV model provides an indication of interest rate risk exposure at a particular point in time, such model is not intended to and does not provide a precise forecast of the effect of changes in market interest rates on net interest income and will differ from actual results.

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### ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

#### REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders' of  
Prudential Bancorp, Inc. of Pennsylvania and subsidiary  
Philadelphia, Pennsylvania

We have audited the accompanying consolidated statements of financial condition of Prudential Bancorp, Inc. of Pennsylvania and subsidiary (the "Company") as of September 30, 2006 and 2005, and the related consolidated statements of income, stockholders' equity and comprehensive income, and cash flows for each of the three years in the period ended September 30, 2006. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, such consolidated financial statements present fairly, in all

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material respects, the financial position of Prudential Bancorp, Inc. of Pennsylvania and subsidiary as of September 30, 2006 and 2005, and the results of their operations and their cash flows for each of the three years in the period ended September 30, 2006, in conformity with accounting principles generally accepted in the United States of America.

/s/ Deloitte & Touche LLP

Philadelphia, Pennsylvania  
December 20, 2006

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### PRUDENTIAL BANCORP, INC. OF PENNSYLVANIA AND SUBSIDIARY

#### CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

	Se
	2006
	-----
<b>ASSETS</b>	
Cash and amounts due from depository institutions	\$ 5,742,
Interest-bearing deposits	7,685,
	-----
Total cash and cash equivalents	13,427,
Investment securities held to maturity (estimated fair value-- September 30, 2006, \$129,593,126; September 30, 2005, \$128,046,676)	132,083,
Investment securities available for sale (amortized cost-- September 30, 2006, \$38,007,246; September 30, 2005, \$38,007,143)	38,747,
Mortgage-backed securities held to maturity (estimated fair value-- September 30, 2006, \$49,526,374; September 30, 2005, \$67,123,459)	50,359,
Mortgage-backed securities available for sale (amortized cost-- September 30, 2006, \$4,534,743)	4,615,
Loans receivable--net of allowance for loan losses (September 30, 2006, \$617,956; September 30, 2005, \$557,956)	219,417,
Accrued interest receivable:	
Loans receivable	1,251,
Mortgage-backed securities	236,
Investment securities	1,707,
Real estate owned	
Federal Home Loan Bank stock--at cost	2,217,
Office properties and equipment--net	1,721,
Prepaid expenses and other assets	6,596,
Deferred income taxes, net	
	-----
<b>TOTAL ASSETS</b>	<b>\$472,381,</b>
	=====
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>	
<b>LIABILITIES:</b>	
Deposits:	
Noninterest-bearing	\$ 6,035,
Interest-bearing	341,256,

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Total deposits	347,292,
Advances from Federal Home Loan Bank	31,783,
Accrued interest payable	2,892,
Advances from borrowers for taxes and insurance	1,230,
Accounts payable and accrued expenses	1,117,
Accrued dividend payable	464,
Deferred income taxes, net	153,
<b>Total liabilities</b>	<b>384,933,</b>
-----	
COMMITMENTS AND CONTINGENCIES (Note 13)	
STOCKHOLDERS' EQUITY:	
Preferred stock, \$.01par value, 10,000,000 shares authorized; none issued	
Common stock, \$.01 par value, 40,000,000 shares authorized; issued 12,563,750; outstanding - 12,064,320 at September 30, 2006: 12,497,450 at September 30, 2005	125,
Additional paid-in capital	54,798,
Unearned ESOP shares	(4,126,
Treasury stock, at cost: 499,430 shares at September 30, 2006; 66,300 shares at September 30, 2005	(6,422,
Retained earnings	42,538,
Accumulated other comprehensive income	534,
<b>Total stockholders' equity</b>	<b>87,447,</b>
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$472,381,</b>
	=====

See notes to consolidated financial statements.

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PRUDENTIAL BANCORP, INC. OF PENNSYLVANIA AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF INCOME

	Years Ended September 30,		
	2006	2005	2004
	-----	-----	-----
INTEREST INCOME:			
Interest and fees on loans	\$13,077,080	\$ 9,884,634	\$ 8,583,749
Interest on mortgage-backed securities	3,146,953	3,782,535	4,474,936
Interest and dividends on investments	8,318,281	7,410,044	6,454,327
<b>Total interest income</b>	<b>24,542,314</b>	<b>21,077,213</b>	<b>19,513,012</b>
INTEREST EXPENSE:			
Interest on deposits	10,843,080	8,522,472	8,204,756
Interest on borrowings	1,091,896	774,677	797,208
<b>Total interest expense</b>	<b>11,934,976</b>	<b>9,297,149</b>	<b>9,001,964</b>
	-----	-----	-----

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NET INTEREST INCOME	12,607,338	11,780,064	10,511,048
PROVISION FOR LOAN LOSSES	60,000	--	50,000
	-----	-----	-----
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	12,547,338	11,780,064	10,461,048
	-----	-----	-----
NON-INTEREST INCOME:			
Fees and other service charges	549,369	470,386	487,612
Gain on sale of real estate owned	105,673	--	--
Gain on sale of mortgage-backed securities	47,632	--	--
Other	235,045	97,034	93,385
	-----	-----	-----
Total non-interest income	937,719	567,420	580,997
	-----	-----	-----
NON-INTEREST EXPENSES:			
Salaries and employee benefits	4,465,450	4,060,405	4,296,623
Data processing	468,411	476,708	423,513
Professional services	600,187	353,514	160,210
Office occupancy	327,646	305,853	305,025
Depreciation	242,452	261,055	270,462
Payroll taxes	256,188	235,777	221,103
Director compensation	259,925	257,398	180,552
Litigation expense	--	120,000	254,013
Other	1,254,819	998,768	1,211,130
	-----	-----	-----
Total non-interest expenses	7,875,078	7,069,478	7,322,631
	-----	-----	-----
INCOME BEFORE INCOME TAXES	5,609,979	5,278,006	3,719,414
	-----	-----	-----
INCOME TAXES:			
Current	1,646,330	1,734,209	957,224
Deferred	126,744	152,222	289,227
	-----	-----	-----
Total	1,773,074	1,886,431	1,246,451
	-----	-----	-----
NET INCOME	\$ 3,836,905	\$ 3,391,575	\$ 2,472,963
	=====	=====	=====
BASIC EARNINGS PER SHARE (1) (2)	\$ 0.32	\$ 0.15	N/A
DILUTED EARNINGS PER SHARE (1) (2)	\$ 0.32	\$ 0.15	N/A

-----  
(1) No shares of common stock were outstanding for the 2004 period.

(2) Due to the timing of the Bank's reorganization into the mutual holding company form and the completion of the Company's initial public offering on March 29, 2005, earnings per share information for 2005 are for the period March 30, 2005 through September 30, 2005.

See notes to consolidated financial statements.

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	Common Stock	AdditinalL Paid-In Capital	Unearned ESOP Shares	Treasury Stock
	-----	-----	-----	-----
BALANCE, SEPTEMBER 30, 2003	\$ --	\$ --	\$ --	\$ --
Comprehensive income:				
Net income				
Net unrealized holding gain on available for sale securities arising during the period, net of income tax expense of \$41,712				
Comprehensive income				
BALANCE, SEPTEMBER 30, 2004	--	--	--	--
Comprehensive income:				
Net income				
Net unrealized holding loss on available for sale securities arising during the period, net of income tax benefit of \$245,847				
Comprehensive income				
Capitalization of mutual holding company				
Cash dividends				
Issuance of common stock	125,638	54,724,693		
Treasury stock purchased				(654,415)
Purchase of ESOP shares			(4,461,166)	
ESOP shares committed to be released		9,067	111,555	
BALANCE, SEPTEMBER 30, 2005	\$125,638	\$54,733,760	\$ (4,349,611)	\$ (654,415)
Comprehensive income:				
Net income				
Net unrealized holding gain on available for sale securities arising during the period, net of income tax expense of \$84,271				
Comprehensive income				
Cash dividends				
Treasury stock purchased				(5,768,063)

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ESOP shares committed to be released		64,361	223,110	
BALANCE, SEPTEMBER 30, 2006	\$125,638	\$54,798,121	\$ (4,126,501)	\$ (6,422,478)
	=====	=====	=====	=====
		Retained	Accumulated Other	Total
		Earnings	Comprehensive	Stockholders'
		S	Income (Loss)	Equity
				Compreh
				Inc
		-----	-----	-----
BALANCE, SEPTEMBER 30, 2003	\$35,793,735	\$ 754,373	\$36,548,108	
Comprehensive income:				
Net income	2,472,963		2,472,963	2,47
Net unrealized holding gain on available for sale securities arising during the period, net of income tax expense of \$41,712		77,466	77,466	7
Comprehensive income				\$2,55
	-----	-----	-----	=====
BALANCE, SEPTEMBER 30, 2004	38,266,698	831,839	39,098,537	
Comprehensive income:				
Net income	3,391,575		3,391,575	3,39
Net unrealized holding loss on available for sale securities arising during the period, net of income tax benefit of \$245,847		(456,574)	(456,574)	(45
Comprehensive income				\$2,93
				=====
Capitalization of mutual holding company	(100,000)		(100,000)	
Cash dividends	(963,612)		(963,612)	
Issuance of common stock			54,850,331	
Treasury stock purchased			(654,415)	
Purchase of ESOP shares			(4,461,166)	
ESOP shares committed to be released			120,622	
	-----	-----	-----	
BALANCE, SEPTEMBER 30, 2005	\$40,594,661	\$ 375,265	\$90,825,298	
	=====	=====	=====	
Comprehensive income:				
Net income	3,836,905		3,836,905	3,83
Net unrealized holding gain on available for sale securities arising during the period, net of income tax expense of \$84,271		158,805	158,805	15
Comprehensive income				\$3,99
				=====
Cash dividends	(1,892,776)		(1,892,776)	
Treasury stock purchased			(5,768,063)	
ESOP shares committed to be released			287,471	
	-----	-----	-----	
BALANCE, SEPTEMBER 30, 2006	\$42,538,790	\$534,070	\$87,447,640	
	=====	=====	=====	



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See notes to consolidated financial statements.

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## PRUDENTIAL BANCORP, INC. OF PENNSYLVANIA AND SUBSIDIARY

### STATEMENTS OF CASH FLOWS

	Years Ended Se	
	2006	2005
<b>OPERATING ACTIVITIES:</b>		
Net income	\$ 3,836,905	\$ 3,391,
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	60,000	
Depreciation	242,252	261,
Net gain on sale of real estate owned	(105,673)	
Net gain on sale of mortgage-backed securities held to maturity	(47,632)	
Net accretion of premiums/discounts	(48,821)	(66,
Income from bank owned life insurance	(165,594)	
Amortization of deferred loan fees	(333,651)	(254,
Amortization of ESOP	287,471	120,
Deferred income tax expense	126,744	152,
Changes in assets and liabilities which (used) provided cash:		
Accounts payable and accrued expenses	(837,837)	335,
Accrued interest payable	967,436	73,
Prepaid expenses and other assets	(3,772,664)	(801,
Accrued interest receivable	(395,413)	(152,
Net cash (used in) provided by operating activities	(186,477)	3,060,
<b>INVESTING ACTIVITIES:</b>		
Purchase of investment securities held to maturity	(6,226,562)	(46,265,
Purchase of investment securities available for sale	--	
Purchase of mortgage-backed securities held to maturity	--	(4,481,
Purchase of mortgage-backed available for sale	(4,610,148)	
Principal collected on loans	47,942,831	53,454,
Principal payments received on mortgage-backed securities:		
Held-to-maturity	11,933,713	18,615,
Available for sale	76,540	
Loans originated or acquired	(91,995,723)	(76,727,
Proceeds from call/maturity or sale of investment securities:		
Held to maturity	4,000,000	31,268,
Available for sale	--	1,000,
Proceeds from sale of mortgage-backed securities	4,611,571	
Purchase of Federal Home Loan Bank stock	(405,600)	(183,
Proceeds from redemption of Federal Home Loan Bank stock	--	446,
Proceeds from sale of real estate owned	465,957	187,
Purchases of equipment	(216,791)	(128,
Net cash used in investing activities	(34,424,212)	(22,813,
<b>FINANCING ACTIVITIES:</b>		

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Net (decrease) increase in demand deposits, NOW accounts, and savings accounts	(16,460,437)	(6,058,
Net increase (decrease) in certificates of deposit	27,285,088	(6,632,
Net borrowing (repayment) with Federal Home Loan Bank	17,960,340	(38,
Increase in advances from borrowers for taxes and insurance	116,381	83,
Proceeds from the issuance of stock	--	54,850,
Capitalization of mutual holding company	--	(100,
Cash dividend paid	(1,910,101)	(481,
Purchase stock for ESOP	--	(4,461,
Purchase of treasury stock	(5,768,063)	(654,
	-----	-----
Net cash provided by financing activities	21,223,208	36,507,
	-----	-----
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(13,387,481)	16,754,
CASH AND CASH EQUIVALENTS--Beginning of year	26,815,017	10,060,
	-----	-----
CASH AND CASH EQUIVALENTS--End of year	\$ 13,427,536	\$ 26,815,
	=====	=====
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Interest paid on deposits and advances from Federal Home Loan Bank	\$ 10,967,658	\$ 9,223,
	=====	=====
Income taxes paid	\$ 1,616,000	\$ 1,680,
	=====	=====

See notes to consolidated financial statements.

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PRUDENTIAL BANCORP, INC. OF PENNSYLVANIA AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE YEARS ENDED SEPTEMBER 30, 2006, 2005 AND 2004

### 1. NATURE OF OPERATIONS AND BASIS OF PRESENTATION

Prudential Bancorp, Inc. of Pennsylvania (the "Company") is a Pennsylvania corporation, which was organized to be the mid-tier holding company for Prudential Savings Bank (the "Bank"), which is a Pennsylvania-chartered, FDIC-insured savings bank with six full service branches in the Philadelphia area. The Company was organized in conjunction with the Bank's reorganization from a mutual savings bank to the mutual holding company structure in March 2005. Financial statements prior to the reorganization were the financial statements of the Bank. The Bank is principally in the business of attracting deposits from its community through its branch offices and investing those deposits, together with funds from borrowings and operations, primarily in single-family residential loans. The Bank's sole subsidiary as of September 30, 2006 was PSB Delaware, Inc. ("PSB"), a Delaware-chartered company established to hold certain investments of the Bank. As of September 30, 2006, PSB has assets of \$63.5 million primarily consisting of mortgage backed securities.

Prudential Mutual Holding Company, a Pennsylvania corporation, is the mutual holding company parent of the Company. As of September 30, 2006, Prudential Mutual Holding Company owns 57.3% (6,910,062 shares) of the

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Company's outstanding common stock and must always own at least a majority of the voting stock of the Company. In addition to the shares of the Company, Prudential Mutual Holding Company was capitalized with \$100,000 in cash from the Bank in connection with the completion of the reorganization. The consolidated financial statements of the Company include the accounts of the Company and the Bank. All significant intercompany balances and transactions have been eliminated.

Prior to the reorganization described above, the Board of Directors approved a plan of charter conversion in May 2004 pursuant to which the Bank would convert its charter from a Pennsylvania-chartered mutual savings and loan association to a Pennsylvania-chartered mutual savings bank. Such conversion was subject to receipt of both member and regulatory approval. The members of the Bank approved the plan of conversion at a special meeting held on July 20, 2004 and the Pennsylvania Department of Banking approved the Bank's application to convert its charter on July 21, 2004. The conversion to a Pennsylvania-chartered mutual savings bank was completed on August 20, 2004. As a result of the charter conversion, the Bank's primary federal banking regulator changed from the Office of Thrift Supervision to the Federal Deposit Insurance Corporation. The Pennsylvania Department of Banking remains as the Bank's state banking regulator.

### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**CONSOLIDATION** -The accompanying consolidated financial statements include the accounts of the Company and the Bank. All significant intercompany accounts and transactions have been eliminated in consolidation.

**USE OF ESTIMATES IN THE PREPARATION OF FINANCIAL STATEMENTS**--The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts

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of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. The most significant estimates and assumptions in the Company's financial statements are recorded in the allowance for loan losses and deferred income taxes. Actual results could differ from those estimates.

**CASH AND CASH EQUIVALENTS**--For purposes of reporting cash flows, cash and cash equivalents include cash and amounts due from depository institutions and interest-bearing deposits (maturing within 90 days).

**INVESTMENT SECURITIES AND MORTGAGE-BACKED SECURITIES**--The Bank classifies and accounts for debt and equity securities as follows:

**HELD TO MATURITY**--Debt securities that management has the positive intent and ability to hold until maturity are classified as held to maturity and are carried at their remaining unpaid principal balance, net of unamortized premiums or unaccreted discounts. Premiums are amortized and discounts are accreted using the interest method over the estimated remaining term of the underlying security.

**AVAILABLE FOR SALE**--Debt and equity securities that will be held for indefinite periods of time, including securities that may be sold in

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response to changes in market interest or prepayment rates, needs for liquidity, and changes in the availability of and the yield of alternative investments, are classified as available for sale. These assets are carried at fair value. Fair value is determined using published and brokers' quotes as of the close of business at the period-ends presented. Unrealized gains and losses are excluded from earnings and are reported net of tax as a separate component of stockholders' equity until realized. Realized gains or losses on the sale of investment and mortgage-backed securities are reported in earnings as of the trade date and determined using the adjusted cost of the specific security sold.

LOANS RECEIVABLE--Mortgage loans consist of loans secured primarily by first liens on 1-4 family residential properties and are stated at their unpaid principal balances net of unamortized net fees/costs. Other loans consist of residential construction loans, consumer loans, commercial real estate loans, commercial business loans, and loans secured by savings accounts which are likewise stated at their unpaid principal balances net of unamortized net fees/costs. Generally, the intent of management is to hold loans originated and purchased to maturity. The Bank defers all loan fees, net of certain direct loan origination costs. The balance is accreted into interest income as a yield adjustment over the life of the loan using the interest method.

ALLOWANCE FOR LOAN LOSSES--The allowance for loan losses is increased by charges to income and decreased by charge-offs (net of recoveries). Management's periodic evaluation of the adequacy of the allowance is based on the Bank's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect a borrower's ability to repay, the estimated value of any underlying collateral and current economic conditions.

The allowance consists of specific and general components. The specific component relates to loans that are classified as either doubtful, substandard or special mention. The general component covers nonclassified loans and is based on historical loss experience adjusted for qualitative factors.

A loan is considered to be impaired when, based upon current information and events, it is probable that the Bank will be unable to collect all amounts due according to the contractual terms of the loan. The Bank measures impaired loans based on the present value of expected future cash flows

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discounted at the loan's effective interest rate, or the loan's observable market price, or the fair value of the collateral if the loan is collateral-dependent. Impairment losses are included in the provision for loan losses.

MORTGAGE SERVICING RIGHTS--The Bank originates mortgage loans held for investment and held for sale. At origination, the mortgage loan is identified as either held for sale or for investment. Mortgage loans held for sale are carried at the lower of cost or the value of forward committed contracts (which approximates market), determined on a net aggregate basis. The Bank had no loans classified as held for sale at September 30, 2006 and 2005.

The Bank assesses the retained interest in the servicing asset or liability

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associated with the sold loans based on the relative fair values. The servicing asset or liability is amortized in proportion to and over the period during which estimated net servicing income or net servicing loss, as appropriate, will be received. Assessment of the fair value of the retained interest is performed on a continual basis. At September 30, 2006 and 2005, mortgage servicing rights of \$28,689 and \$35,230, respectively, were included in other assets. No valuation allowance was deemed necessary at the periods presented.

Amortization of the servicing asset totaled \$6,541, \$7,508, and \$8,979 for the years ended September 2006, 2005 and 2004, respectively.

UNAMORTIZED PREMIUMS AND DISCOUNTS--Unamortized premiums and discounts on loans receivable, mortgage-backed securities, and investment securities are amortized over the estimated average lives of the loans, certificates or securities purchased using a method which approximates the interest method.

REAL ESTATE OWNED--Real estate acquired through, or in lieu of, loan foreclosure is initially recorded at the lower of book value or the estimated fair value at the date of acquisition, less estimated selling costs, establishing a new cost basis. Revenues and expenses from operations are included in other expense. Additions to the valuation allowance are included in other expense. Costs related to the development and improvement of real estate owned properties are capitalized and those relating to holding the properties are charged to expense. After foreclosure, valuations are periodically performed by management and an allowance for losses is established, if necessary, by a charge to operations if the carrying value of a property exceeds its estimated fair value minus estimated costs to sell.

FHLB STOCK - FHLB stock is classified as a restricted equity security because ownership is restricted and there is not an established market for its resale. FHLB stock is carried at cost and is evaluated for impairment.

OFFICE PROPERTIES AND EQUIPMENT--Land is carried at cost. Office properties and equipment are recorded at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the expected useful lives of the assets. The costs of maintenance and repairs are expensed as they are incurred, and renewals and betterments are capitalized and depreciated over their useful lives.

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CASH SURRENDER VALUE OF LIFE INSURANCE--The Bank funds the premiums for insurance policies on the lives of certain directors of the Bank. The cash surrender value of the insurance policies, up to the total amount of premiums paid, is recorded as an asset in the statements of financial condition and included in other assets. In fiscal 2006, the Company purchased \$5.0 million of bank owned life insurance ("BOLI"). The BOLI provides an attractive tax-exempt return to the Company and is being used by the Company to fund various employee benefit plans. The BOLI is included in other assets at its cash surrender value.

DIVIDEND PAYABLE - On September 20, 2006, the Company's Board of Directors declared a quarterly cash dividend of \$.04 per share on the common stock of the Company payable on October 31, 2006 to the shareholders of record at the close of business on October 13, 2006. The Company had 12,064,320 shares outstanding at the time of the dividend declaration resulting in a payable of \$464,481 at September 30, 2006. A portion of the cash dividend

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was payable to Prudential Mutual Holding Company on its shares of the Company's common stock and totaled \$276,402.

EMPLOYEE STOCK OWNERSHIP PLAN - In fiscal year 2005, the Bank established an employee stock ownership plan ("ESOP") for substantially all of its full-time employees. The ESOP purchased 452,295 shares of the Company's common stock on the open market for approximately \$4.5 million. The Bank accounts for its ESOP in accordance with Statement of Position ("SOP") 93-6, EMPLOYERS' ACCOUNTING FOR EMPLOYEE STOCK OWNERSHIP PLANS. Shares of the Company's common stock purchased by the ESOP are held in a suspense account until released for allocation to participants. Shares released will be allocated to each eligible participant based on the ratio of each such participant's compensation, as defined in the ESOP, to the total compensation of all eligible plan participants. As the unearned shares are released from suspense, the Company recognizes compensation expense equal to the fair value of the ESOP shares during the periods in which they become committed to be released. To the extent that the fair value of the ESOP shares released differs from the cost of such shares, the difference is recorded to equity as additional paid-in capital. As of September 30, 2006 the Company had allocated a total of 16,965 shares from the suspense account to participants and committed to release an additional 16,965 shares. For the year ended September 30, 2006, the Company recognized \$287,471 in compensation expense related to the ESOP.

TREASURY STOCK - Stock held in treasury by the Company is accounted for using the cost method, which treats stock held in treasury as a reduction to total stockholders' equity. In April 2006, the Company announced the commencement of its second stock repurchase program of up to an additional 269,000 shares or approximately 5% of the Company's outstanding common stock held by other than Prudential Mutual Holding Company. The Company's second repurchase program commenced upon completion of its first repurchase program covering 277,000 shares. The average cost per share of the 499,430 shares which had been repurchased was \$13.32 and \$9.87 per share during fiscal 2006 and 2005, respectively. The repurchased shares are available for general corporate purposes.

COMPREHENSIVE INCOME--The Company presents in the statement of comprehensive income those amounts from transactions and other events which currently are excluded from the statement of income and are recorded directly to stockholders' equity. For the years ended September 30, 2006, 2005 and 2004, the only components of comprehensive income were net income and unrealized holding gains and losses, net of income tax expense and benefit, on available for sale securities. Comprehensive income totaled \$3,995,710, \$2,935,001 and \$2,550,429 for the years ended September 30, 2006, 2005 and 2004, respectively.

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LOAN ORIGINATION AND COMMITMENT FEES--The Bank defers loan origination and commitment fees, net of certain direct loan origination costs. The balance is accreted into income as a yield adjustment over the life of the loan using the level-yield method.

INTEREST ON LOANS--The Bank recognizes interest on loans on the accrual basis. Income recognition is generally discontinued when a loan becomes 90 days or more delinquent. Any interest previously accrued is deducted from interest income. Such interest ultimately collected is credited to income when collection of principal and interest is no longer in doubt.

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INCOME TAXES--Deferred income taxes are recognized for the tax consequences of "temporary differences" by applying enacted statutory tax rates applicable to future years to differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities. The effect on deferred taxes of a change in tax rates is recognized in income in the period that includes the enactment date.

ACCOUNTING FOR DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES--The Company adopted the provisions of Statement of Financial Accounting Standards ("SFAS") No. 133, ACCOUNTING FOR DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES, as amended by SFAS Nos. 137 and 138, and as interpreted by the FASB and the Derivatives Implementation Group through "Statement 133 Implementation Issues," as of October 1, 2000. Currently, the Company has no instruments with embedded derivatives. The Company currently does not employ hedging activities that require designation as either fair value or cash flow hedges, or hedges of a net investment in a foreign operation.

TRANSFERS AND SERVICING OF FINANCIAL ASSETS AND EXTINGUISHMENTS OF LIABILITIES--The Company accounts for transfers and servicing of financial assets in accordance with SFAS No. 140, ACCOUNTING FOR TRANSFERS AND SERVICING OF FINANCIAL ASSETS AND EXTINGUISHMENTS OF LIABILITIES (a replacement of SFAS No. 125). This statement revises the standards for accounting for securitizations and other transfers of financial assets and collateral and requires certain disclosures, but it carries over most of the provisions of SFAS No. 125 without reconsideration. The statement requires an entity to recognize the financial and servicing assets it controls and the liabilities it has incurred, derecognize financial assets when control has been surrendered, and derecognize liabilities when extinguished. It requires that servicing assets and other retained interests in the transferred assets be measured by allocating the previous carrying amount between the asset sold, if any, and retained interests, if any, based on their relative fair values at the date of transfer.

### RECENT ACCOUNTING PRONOUNCEMENTS

In March 2006, the FASB issued SFAS No. 156, ACCOUNTING FOR SERVICING OF FINANCIAL ASSETS- AN AMENDMENT OF FASB STATEMENT NO. 140 ("SFAS No. 140" and "SFAS No. 156"). SFAS No. 140 establishes, among other things, the accounting for all separately recognized servicing assets and servicing liabilities. SFAS No. 156 amends SFAS No. 140 to require that all separately recognized servicing assets and servicing liabilities be initially measured at fair value, if practicable. SFAS No. 156 permits, but does not require, the subsequent measurement of separately recognized servicing assets and servicing liabilities at fair value. Under SFAS No. 156, an entity can elect subsequent fair value measurement to account for its separately recognized servicing assets and servicing liabilities. Adoption of SFAS No. 156 is required as of the beginning of the first fiscal year that begins after September 15, 2006. Upon adoption, the Company will apply the requirements for recognition and initial measurement of servicing assets and servicing liabilities prospectively to all transactions. The Company will adopt SFAS No. 156 for the fiscal year beginning October 1, 2006 and currently has not determined if it will adopt SFAS No. 156 using the fair value election. The Company does not

anticipate any material impact to its financial condition or results of operations as a result of the adoption of SFAS No. 156.

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On July 13, 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"), which is effective for fiscal years beginning after December 15, 2006. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in the financial statements in accordance with FASB Statement No. 109, "Accounting for Income Taxes." This Interpretation prescribes a comprehensive model for how a company should recognize, measure, present and disclose in its financial statements uncertain tax positions that the company has taken or expects to take on a tax return. The Company is currently assessing the impact of FIN 48 on its financial statements.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurement." SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. This Statement does not require any new fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The Company is currently assessing the impact of SFAS No. 157 on its financial statements.

In September 2006, the Financial Accounting Standards Board ("FASB") issued SFAS No. 158, "Employer's Accounting for Defined Benefit Pension and Other Postretirement Plans--an amendment of FASB Statements No. 87, 88, 106, and 132(R)." SFAS No. 158 requires an employer to recognize in its statement of financial position an asset for a plan's overfunded status or a liability for a plan's underfunded status, measure a plan's assets and its obligations that determine its funded status as of the end of the employer's fiscal year, and recognize changes in the funded status of a defined benefit postretirement plan in the year in which the changes occur. Those changes will be reported in comprehensive income and as a separate component of stockholders' equity. SFAS No. 158 is effective for publicly held companies for fiscal years ending after December 15, 2006. The Bank participates in a multi-employer defined benefit plan. We do not anticipate that the implementation of SFAS No. 158 will have any impact on our financial position, results of operations and cash flows because it is not applicable to multi-employer defined benefit plans.

In February 2006, the FASB issued SFAS No. 155, "Accounting For Certain Hybrid Financial Instruments." This statement amends FASB Statements No. 133, "Accounting For Derivative Instruments and Hedging Activities, and FASB SFAS No. 140, "Accounting For Transfers and Servicing of Financial Assets and Extinguishment of Liabilities". FAS 155 permits fair value re-measurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, clarifies which interest-only strips and principal-only strips are not subject to the requirements of Statement 133, establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation, clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives, and amends Statement 140 to eliminate the prohibition on a qualifying special purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. FAS 155 is effective for all financial instruments acquired or issued after the beginning of an entities first fiscal year that begins after September 15, 2006. The adoption of the statement did not have a material effect on the financial statements.

In September 2006, the Securities and Exchange Commission ("SEC") issued SAB No. 108 expressing the SEC staff's views regarding the process of quantifying financial statement misstatements and the build up of improper amounts on the balance sheet. SAB 108 requires that



registrants quantify errors using both a balance sheet and income statement approach and evaluate whether either approach results in a misstated amount that, when all relevant quantitative and qualitative factors are considered, is material. The built up misstatements, while not considered material in the individual years in which the misstatements were built up, may be considered material in a subsequent year if a company were to correct those misstatements through current period earnings. Initial application of SAB No. 108 allows registrants to elect not to restate prior periods but to reflect the initial application in their annual financial statements covering the first fiscal year ending after November 15, 2006. The cumulative effect of the initial application should be reported in the carrying amounts of assets and liabilities as of the beginning of that fiscal year and the offsetting adjustment, net of tax, should be made to the opening balance of retained earnings for that year.

The Company implemented SAB 108 on October 1, 2006 which resulted in an increase to Mortgage-backed securities held to maturity of approximately \$320,000, an increase in deferred income tax liability of approximately \$142,000 and a cumulative adjustment to increase beginning Retained Earnings of approximately \$178,000. The adjustment relates to two separate accounting entries. The first entry pertains to the method of accounting that was utilized in past years for the recognition of investment income on Mortgage-backed securities. Prior to 2006, the Company used the straight line method over the contractual life of the securities rather than using the effective yield method prescribed by SFAS No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases. The impact of this entry was the correction of an understatement of Mortgage-backed securities by approximately \$320,000 and deferred income tax liability of \$102,000. The second entry relates to a write off of a deferred tax asset of approximately \$40,000 that was incorrectly accounted for in prior periods.

In prior periods, management performed a quantitative and qualitative analysis of the differences between these two methods of accounting and concluded that there was not a material impact on any past individual quarter or annual reporting periods.

RECLASSIFICATIONS--Certain reclassifications have been made to the 2005 and 2004 financial statements to conform to the 2006 presentation. Such reclassifications had no impact on reported net income.

### 3. EARNINGS PER SHARE

Basic earnings per common share is computed based on the weighted average number of shares outstanding. Diluted earnings per share is computed based on the weighted average number of shares outstanding and common share equivalents ("CSEs") that would arise from the exercise of dilutive securities. As of September 30, 2006, the Company did not issue and does not have outstanding any CSEs. Due to the timing of the Bank's reorganization into the mutual holding company form and the completion of the Company's initial public offering on March 29, 2005, earnings per share

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for 2005 is for the period March 30, 2005 through September 30, 2005.  
The calculated basic and diluted earnings per share are as follows:

	For The Year Ended September 30, 2006		For The Period March 3 2005 To September 30, 2	
	Basic	Diluted	Basic	Diluted
Net income	\$ 3,836,905	\$ 3,836,905	\$ 1,800,242	\$ 1,800,2
Weighted average shares outstanding used in basic earnings per share computation	11,919,101	11,919,101	12,076,315	12,076,3
Effect of CSEs	--	--	--	
Adjusted weighted average shares used in diluted earnings per share computation	11,919,101	11,919,101	12,076,315	12,076,3
Earnings per share - basic and diluted	\$ 0.32	\$ 0.32	\$ 0.15	\$ 0.

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#### 4. INVESTMENT SECURITIES

The amortized cost and fair value of securities, with gross unrealized gains and losses, are as follows:

	September 30, 2006			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Est F V
Securities Held to Maturity:				
Debt securities - U.S. Treasury securities and securities of U.S. Government agencies	\$129,199,382	\$ --	\$ (2,458,930)	\$126
Debt securities - Municipal bonds	2,884,501	6,574	(38,401)	2
Total securities held to maturity	\$132,083,883	\$ 6,574	\$ (2,497,331)	\$129
Securities Available for Sale:				
Debt securities - U.S. Treasury securities and securities of U.S. Government agencies	\$ 2,998,800	\$ --	\$ (64,425)	\$ 2
FNMA stock	84	6,625	--	
Mutual fund	34,982,453	--	(930,081)	34
FHLMC preferred stock	25,909	1,727,724	--	1
Total securities available for sale	\$ 38,007,246	\$1,734,349	\$ (994,506)	\$ 38

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SEPTEMBER 30, 2005

	AMORTIZED COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	EST F V
Securities Held to Maturity:				
Debt securities - U.S. Treasury securities and securities of U.S. Government agencies	\$126,955,087	\$ 8,640	\$ (1,764,472)	\$125
Debt securities - Municipal bonds	2,884,425	6,889	(43,893)	2
Total securities held to maturity	\$129,839,512	\$ 15,529	\$ (1,808,365)	\$128
Securities Available for Sale:				
Debt securities - U.S. Treasury securities and securities of U.S. Government agencies	\$ 2,998,697	\$ --	\$ (34,946)	\$ 2
FNMA stock	84	5,294	--	34
Mutual fund	34,982,453	--	(859,797)	34
FHLMC preferred stock	25,909	1,466,780	--	1
Total securities available for sale	\$ 38,007,143	\$1,472,074	\$ (894,743)	\$ 38

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There were no sales of investment securities during the years ended September 30, 2006 or September 30, 2005. During the year ended September 30, 2004, the Bank sold \$5,837 of available for sale securities, which yielded no gain or loss.

The following table shows the gross unrealized losses and related estimated fair values of the Company's investment securities, aggregated by investment category and length of time that individual securities have been in a continuous loss position at September 30, 2006:

	Less Than 12 Months		More Than 12 Months	
	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value
Securities held to maturity:				
U.S. Treasury and Government agencies	\$76,277	\$8,919,209	\$2,382,653	\$114,821,242
Municipal bonds	--	--	38,401	1,601,100
Total securities held to maturity	76,277	8,919,209	2,421,054	116,422,342
Securities available for sale:				
U.S. Treasury and Government agencies	--	--	64,425	2,934,375
Mutual fund	--	--	930,081	34,052,372
Total securities available for sale	--	--	994,506	36,986,747

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Total	\$76,277	\$8,919,209	\$3,415,560	\$153,409,089
	=====	=====	=====	=====

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The following table shows the gross unrealized losses and related estimated fair values of the Company's investment securities, aggregated by investment category and length of time that individual securities have been in a continuous loss position at September 30, 2005:

	Less Than 12 Months		More Than 12 Months	
	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value
Securities held to maturity:				
U.S. Treasury and Government agencies	\$584,260	\$78,824,578	\$1,180,212	\$42,368,882
Municipal bonds	4,750	470,250	39,143	1,125,283
Total securities held to maturity	589,010	79,294,828	1,219,355	43,494,165
Securities available for sale:				
U.S. Treasury and Government agencies	34,946	2,963,750	--	--
Mutual fund	--	--	859,797	34,122,656
Total securities available for sale	34,946	2,963,750	859,797	34,122,656
Total	\$623,956	\$82,258,578	\$2,079,152	\$77,616,821
	=====	=====	=====	=====

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. For all securities that are in an unrealized loss position for an extended period of time and for all securities whose fair value is significantly below amortized cost, the Company performs an evaluation of the specific events attributable to the market decline of the security. The Company considers the length of time and extent to which the security's market value has been below cost as well as the general market conditions, industry characteristics, and the fundamental operating results of the issuer to determine if the decline is other-than-temporary. The Company also considers as part of the evaluation its intent and ability to hold the security until its market value has recovered to a level at least equal to the amortized cost. When the Company determines that a security's unrealized loss is other-than-temporary, a realized loss is recognized in the period in which the decline in value is determined to be other-than-temporary. The write-downs are measured based on public market prices of the security at the time the Company determines the decline in value was other-than-temporary.

At September 30, 2006, securities in a gross unrealized loss position for twelve months or longer consist of 122 securities having an aggregate depreciation of 2.2% from the Company's amortized cost basis. Securities in a gross unrealized loss position for less than twelve months consist of 9

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securities having an aggregate depreciation of 0.8% from the Company's amortized cost basis. The unrealized losses disclosed above are primarily related to movement in market interest rates. Although the fair value will fluctuate as the market interest rates move, the majority of the Company's investment portfolio consists of low-risk securities from U.S. government agencies or government sponsored enterprises. If held to maturity, the contractual principal and interest payments of such securities are expected to be received in full. As such, no loss in value is expected over the lives of the securities. Although not all of the securities are classified as held to maturity, the Company has the ability to hold these securities until they mature and does not intend to sell the securities at a loss. The Company also has a significant investment in a mutual fund that invests in short-term adjustable-rate mortgage-backed securities. Management believes that the estimated fair

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value of the mutual fund is also primarily dependent upon the movement in market interest rates. Although the investment in the mutual fund is classified as available for sale, the Company has the intent and ability to hold the mutual fund until the fair value increases and does not intend to sell it at a loss. Based on the above, management believes that the unrealized losses are temporary. The determination of whether a decline in market value is temporary is necessarily a matter of subjective judgment. The timing and amount of any realized losses reported in the Company's financial statements could vary if conclusions other than those made by management were to determine whether an other-than-temporary impairment exists.

The amortized cost and estimated fair value of debt securities, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	September 30, 2006			
	Held To Maturity		Available For Sale	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due within one year	\$ 13,084,653	\$ 13,033,970	\$ --	\$ --
Due after one through five years	33,084,146	32,601,588	--	--
Due after five through ten years	39,986,258	39,355,977	1,000,000	984,375
Due after ten years	45,928,826	44,601,591	1,998,800	1,950,000
<b>Total</b>	<b>\$132,083,883</b>	<b>\$129,593,126</b>	<b>\$2,998,800</b>	<b>\$2,934,375</b>

	September 30, 2005			
	Held To Maturity		Available For Sale	

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	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due within one year	\$ 4,000,000	\$ 3,976,875	\$ --	\$ --
Due after one through five years	40,568,573	40,172,591	--	--
Due after five through ten years	41,342,845	40,907,632	1,000,000	988,125
Due after ten years	43,928,094	42,989,578	1,998,697	1,975,626
Total	\$129,839,512	\$128,046,676	\$2,998,697	\$2,963,751

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5. MORTGAGE-BACKED SECURITIES

Mortgage-backed securities are summarized as follows:

	Held To Maturity September 30, 2006			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
GNMA pass-through certificates	\$46,991,401	\$157,936	\$ (896,360)	\$46,252,977
FNMA pass-through certificates	1,448,326	--	(52,683)	1,395,643
FHLMC pass-through certificates	1,920,007	22	(42,275)	1,877,754
Total	\$50,359,734	\$157,958	\$ (991,318)	\$49,526,374

	Available For Sale September 30, 2006			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
FNMA pass-through certificates	\$ 4,534,743	\$ 80,564	\$--	\$4,615,307
Total	\$ 4,534,743	\$ 80,564	\$--	\$4,615,307

Held To Maturity  
September 30, 2005

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	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
GNMA pass-through certificates	\$62,448,606	\$775,040	\$ (445,674)	\$62,777,972
FNMA pass-through certificates	1,837,531	4,618	(32,129)	1,810,020
FHLMC pass-through certificates	2,541,478	12,158	(18,169)	2,535,467
Total	\$66,827,615	\$791,816	\$ (495,972)	\$67,123,459

During fiscal 2006, \$4.6 million of mortgage-backed securities were sold at a pre-tax gain of \$48,000. Although these securities were classified under FASB Statement No. 115 as "Held to Maturity", at the time of purchase, the sale was permissible because the remaining balances of the investments were 15% or less than their original purchased par value. Simultaneously, we purchased \$4.6 million in mortgage-backed securities classified as available-for-sale.

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The following table shows the gross unrealized losses and related estimated fair values of the Company's mortgage-backed securities and length of time that individual securities have been in a continuous loss position at September 30, 2006, all mortgage-backed-securities available-for-sale were in an unrealized gain position:

	Less Than 12 Months		More Than 12 Months	
	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value
Securities held to maturity:				
GNMA pass-through certificates	\$526,169	\$25,601,666	\$370,191	\$11,199,818
FNMA pass-through certificates	52,209	1,395,273	474	369
FHLMC pass-through certificates	42,275	1,876,570	--	--
Total	\$620,653	\$28,873,509	\$370,665	\$11,200,187

The following table shows the gross unrealized losses and related estimated fair values of the Company's mortgage-backed securities, aggregated by investment category and length of time that individual securities have been in a continuous loss position at September 30, 2005:

	Less Than 12 Months		More Than 12 Months	
	Gross Unrealized	Estimated Fair	Gross Unrealized	Estimated Fair

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	Losses	Value	Losses	Value
	-----	-----	-----	-----
Securities held to maturity:				
GNMA pass-through certificates	\$164,896	\$17,370,682	\$280,778	\$6,883,330
FNMA pass-through certificates	31,588	1,628,044	541	641
FHLMC pass-through certificates	1,323	2,003,186	16,846	128,191
	-----	-----	-----	-----
Total	\$197,807	\$21,001,912	\$298,165	\$7,012,162
	=====	=====	=====	=====

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Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. For all securities that are in an unrealized loss position for an extended period of time and for all securities whose fair value is significantly below amortized cost, the Company performs an evaluation of the specific events attributable to the market decline of the security. The Company considers the length of time and extent to which the security's market value has been below cost as well as the general market conditions, industry characteristics, and the fundamental operating results of the issuer to determine if the decline is other-than-temporary. The Company also considers as part of the evaluation its intent and ability to hold the security until its market value has recovered to a level at least equal to the amortized cost. When the Company determines that a security's unrealized loss is other-than-temporary, a realized loss is recognized in the period in which the decline in value is determined to be other-than-temporary. The write-downs are measured based on public market prices of the security at the time the Company determines the decline in value was other-than-temporary.

At September 30, 2006, mortgage-backed securities in a gross unrealized loss position for twelve months or longer consist of 7 securities having an aggregate depreciation of 3.2% from the Company's amortized cost basis. Mortgage-backed securities in a gross unrealized loss position for less than twelve months consist of 26 securities having an aggregate depreciation of 2.1% from the Company's amortized cost basis. The unrealized losses disclosed above are primarily related to movement in market interest rates. Although the fair value will fluctuate as the market interest rates move, the majority of the Company's mortgage-backed securities portfolio consists of low-risk securities from U.S. government sponsored enterprises. If held to maturity, the contractual principal and interest payments of such securities are expected to be received in full. As such, no loss in value is expected over the lives of the securities. Although not all of the securities are classified as held to maturity, the Company has the ability to hold these securities until they mature and does not intend to sell the securities at a loss. Based on the above, management believes that the unrealized losses are temporary. The determination of whether a decline in market value is temporary is necessarily a matter of subjective judgment. The timing and amount of any realized losses reported in the Company's financial statements could vary if conclusions other than those made by management were to determine whether an other-than-temporary impairment exists.

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6. LOANS RECEIVABLE

Loans receivable consist of the following:

	September 30,	
	----- 2006 -----	----- 2005 -----
One-to-four family residential	\$155,453,827	\$135,393,637
Multi-family residential	5,073,903	2,541,328
Commercial real estate	11,338,845	9,874,562
Construction and land development	82,800,690	52,093,242
Commercial business	233,979	188,429
Consumer	1,239,063	1,346,470
	-----	-----
Total loans	256,140,307	201,437,668
Less:		
Undisbursed portion of loans-in-process	(36,257,661)	(25,823,681)
Deferred loan fees	152,841	34,957
Allowance for loan losses	(617,956)	(557,956)
	-----	-----
Net	\$219,417,531	\$175,090,988
	=====	=====

The Bank originates loans to customers in its local market area. The ultimate repayment of these loans is dependent, to a certain degree, on the local economy and real estate market.

The Bank originates or purchases both adjustable and fixed interest rate loans. At September 30, 2006 and 2005, the Bank had \$67,772,442 and \$52,179,447 of adjustable-rate loans, respectively. The adjustable-rate loans have interest rate adjustment limitations and are generally indexed to the one-year U.S. Treasury note rate, Prime rate or the Average Contract Interest Rate for previously occupied houses as reported by the Federal Housing Finance Board.

Certain officers of the Bank have loans with the Bank. Such loans were made in the ordinary course of business at the Bank's normal credit terms, including interest rate and collateralization, and do not represent more than a normal risk of collection. The aggregate dollar amount of these loans outstanding to related parties along with an analysis of the activity is summarized as follows:

	Year Ended September 30,		
	----- 2006 -----	----- 2005 -----	----- 2004 -----
Balance--beginning of year	\$ 543,047	\$561,363	\$536,807
Additions	475,000	--	42,560
Repayments	(341,538)	(18,316)	(18,004)
	-----	-----	-----
Balance--end of year	\$ 676,509	\$543,047	\$561,363
	=====	=====	=====

The following schedule summarizes the changes in the allowance for loan

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losses:

	Year Ended September 30,		
	2006	2005	2004
Balance, beginning of year	\$557,956	\$557,956	\$553,422
Provision for loan losses	60,000	--	50,000
Charge-offs	--	--	(78,000)
Recoveries	--	--	32,534
Balance, end of year	\$617,956	\$557,956	\$557,956

A loan is considered to be impaired when, based upon current information and events, it is probable that the Bank will be unable to collect all amounts due according to the contractual terms of the loan. During the periods presented, loan impairment was evaluated based on the fair value of the loan's collateral. Impairment losses are included in the provision for loan losses. Large groups of smaller balance, homogeneous loans are collectively evaluated for impairment, except for those loans restructured under a troubled debt restructuring. Loans collectively evaluated for impairment include smaller balance commercial real estate loans, residential real estate loans and consumer loans. The Bank had no loans determined to be impaired at September 30, 2006 or 2005.

Interest income on impaired loans other than nonaccrual loans is recognized on an accrual basis. Interest income on nonaccrual loans is recognized only as collected.

Nonperforming loans (which consist of nonaccrual loans and loans in excess of 90 days delinquent and still accruing interest) at September 30, 2006 and 2005, amounted to approximately \$151,000 and \$239,000, respectively.

### 7. OFFICE PROPERTIES AND EQUIPMENT

Office properties and equipment are summarized by major classifications as follows:

	September 30,	
	2006	2005
Land	\$ 246,594	\$ 246,594
Buildings and improvements	2,081,509	2,051,909
Furniture and equipment	2,405,682	2,286,487
Automobiles	72,062	72,062
Total	4,805,847	4,657,052
Accumulated depreciation	(3,084,709)	(2,910,453)
Total office properties and equipment, net of accumulated depreciation	\$ 1,721,138	\$ 1,746,599

For the years ended September 30, 2006, 2005 and 2004, depreciation expense amounted to \$242,452, \$261,055 and \$270,462, respectively.

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8. DEPOSITS

Deposits consist of the following major classifications:

	September 30,			
	2006		2005	
	Amount	Percent	Amount	Percent
Money market deposit accounts	\$ 64,498,290	18.6%	\$ 59,906,583	17.8%
NOW accounts	34,202,808	9.8	44,535,148	13.2
Passbook, club and statement savings	76,989,307	22.2	87,709,111	26.1
Certificates maturing in six months or less	77,904,032	22.4	44,709,277	13.3
Certificates maturing over six months or more	93,698,054	27.0	99,607,721	29.6
Total	\$347,292,491	100.0%	\$336,467,840	100.0%

At September 30, 2006 and 2005, the weighted average cost of deposits was 3.5% and 2.7%, respectively.

The amount of scheduled maturities of certificate accounts was as follows:

	September 30, 2006
One year or less	\$124,398,763
One through two years	27,299,416
Two through three years	4,897,645
Three through four years	4,859,721
Four through five years	10,146,541
Total	\$171,602,086

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The weighted average rate paid on certificates at September 30, 2006 and 2005, was 4.6% and 3.5%, respectively. Certificates of deposit of \$100,000 or more at each of such dates were approximately \$44,918,000 and \$32,490,000, respectively.

Interest expense on deposits was comprised of the following:

	Year Ended September 30,		
	2006	2005	2004
NOW and money market deposits accounts	\$ 3,080,777	\$2,272,596	\$1,865,247
Passbook, club and statement savings accounts	2,458,610	1,728,980	1,654,235
Certificate accounts	5,303,693	4,520,896	4,685,274
Total	\$10,843,080	\$8,522,472	\$8,204,756

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### 9. ADVANCES FROM FEDERAL HOME LOAN BANK

Advances from Federal Home Loan Bank totaled \$31,783,751 and \$13,823,411 at September 30, 2006 and 2005, respectively.

The following is a schedule of six advances made under the low-income housing program in which the Bank is a participant. Three of the advances are at an interest rate of 3.0%, one advance is at an interest rate of 2.0% and two advances are non-interest bearing. Repayment of the advances is as follows:

	September 30,	
	2006	2005
1 to 12 months	\$ 40,630	\$ 39,661
13 to 24 months	41,625	40,630
25 to 36 months	42,644	41,625
Thereafter	658,852	701,495
<b>Total</b>	<b>\$783,751</b>	<b>\$823,411</b>

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Advances from Federal Home Loan Bank, not part of the low-income housing program at September 30, 2006 and 2005, consist of the following:

	September 30,			
	2006		2005	
DUE	Amount	Fixed Interest Rate	Amount	Fixed Interest Rate
October 2006	\$18,000,000	5.45%	\$ --	
July 2010	2,000,000	5.98%	2,000,000	5.98%
August 2010	3,000,000	5.93%	3,000,000	5.93%
September 2010	8,000,000	5.69%	8,000,000	5.69%
	<b>\$31,000,000</b>		<b>\$13,000,000</b>	

The advances are collateralized by all of the Federal Home Loan Bank stock and substantially all qualifying first mortgage loans.

### 10. INCOME TAXES

The Company's income tax provision consists of the following:

	Year Ended September 30,		
	2006	2005	2004
<b>Current:</b>			
Federal	\$1,595,998	\$1,568,607	\$ 911,346
State	50,332	165,602	45,878

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Total current taxes	1,646,330	1,734,209	957,224
Deferred income tax expense	126,744	152,222	289,227
Total income tax provision	\$1,773,074	\$1,886,431	\$1,246,451

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Items that gave rise to significant portions of deferred income taxes are as follows:

	September 30,	
	2006	2005
Deferred tax assets:		
Deposit premium	\$ 314,054	\$362,998
Allowance for loan losses	246,632	255,030
Other	39,639	41,092
Total	600,325	659,120
Deferred tax liabilities:		
Unrealized gain on available for sale securities	286,336	202,066
Property	406,834	363,009
Mortgage servicing	9,754	11,978
Deferred loan fees	50,788	10,466
Employee stock ownership plan	--	13,973
Total	753,712	601,492
Net deferred tax (liability) asset	\$ (153,387)	\$ 57,628

The income tax expense differs from that computed at the statutory federal corporate tax rate as follows:

	Year Ended September 30,			
	2006		2005	
	Amount	Percentage Of Pretax Income	Amount	Percentage Of Pretax Income
Tax at statutory rate	\$1,907,392	34.0%	\$1,794,522	34.0%
Adjustments resulting from:				
State tax, net of federal tax effect	33,218	0.6	109,297	2.1
Other	(167,536)	(3.0)	(17,388)	(0.3)
Income tax expense per statements of income	\$1,773,074	31.6%	\$1,886,431	35.7%

As of October 1, 1997, the Bank changed its method of computing reserves for bad debts to the experience method. The bad debt deduction allowable under this method is available to small banks with assets of less than \$500 million. Generally, this method allows the Bank to deduct an annual addition to the reserve for bad debts equal to the increase in the balance of the Bank's reserve for bad debts at the end of the year to an amount equal to the percentage of total loans at the end of the year, computed using the ratio of the previous six years' net charge-offs divided by the sum of the previous six years' total outstanding loans at year-end.

A thrift institution required to change its method of computing reserves for bad debts treats such change as a change in a method of accounting determined solely with respect to the "applicable excess reserves" of the institution. The amount of the applicable excess reserves is being taken into account ratably over a six-taxable-year period. The timing of this recapture was delayed for a one-year period since certain residential loan requirements were met. For financial reporting purposes, the Bank has not incurred any additional tax expense. Stockholders' Equity includes approximately \$6,575,000 at both September 30, 2006 and 2005, representing bad debt deductions for which no deferred income taxes have been provided.

#### 11. REGULATORY CAPITAL REQUIREMENTS

The Company and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory - and possibly additional discretionary - actions by regulators that, if undertaken, could have a direct material effect on the Company's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Company's and the Bank's capital amounts and the Bank's 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 Company and the Bank to maintain minimum amounts and ratios (set forth in the table below) of Tier 1 capital (as defined in the regulations) to average assets (as defined) and risk-weighted assets (as defined), and of total capital (as defined) to risk-weighted assets. Management believes, as of September 30, 2006 and 2005, that the Company and the Bank met all regulatory capital adequacy requirements to which they are subject.

As of September 30, 2006 and 2005, the most recent notification from the Federal Deposit Insurance Corporation categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum Tier 1 capital, Tier 1 risk-based, and total risk-based ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed the Bank's category.

The Company's and the Bank's actual capital amounts and ratios are also presented in the following table:

	Actual		Required For Capital Adequacy Purposes		To Be Well Capitaliz Under Promp Corrective Act Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Rat
(DOLLARS IN THOUSANDS)						
September 30, 2006:						
Tier 1 capital (to average assets)						
Company	\$86,914	18.64%	\$18,646	4.0%	N/A	N/A
Bank	68,937	14.74	18,703	4.0	\$23,379	5.0
Tier 1 capital (to risk weighted assets)						
Company	86,914	39.23	8,861	4.0	N/A	N/A
Bank	68,937	31.12	8,861	4.0	13,292	6.0
Total capital (to risk weighted assets)						
Company	87,894	39.68	17,722	8.0	N/A	N/A
Bank	69,917	31.56	17,722	8.0	22,153	10.0
September 30, 2005:						
Tier 1 capital (to average assets)						
Company	\$90,450	20.98%	\$17,247	4.0%	N/A	N/A
Bank	64,681	14.55	17,783	4.0	\$22,229	5.0
Tier 1 capital (to risk weighted assets)						
Company	90,450	48.54	7,454	4.0	N/A	N/A
Bank	64,681	34.71	7,454	4.0	11,181	6.0
Total capital (to risk weighted assets)						
Company	91,284	48.98	14,908	8.0	N/A	N/A
Bank	65,515	35.16	14,908	8.0	18,635	10.0

## 12. EMPLOYEE BENEFITS

The Bank is a member of a multi-employer defined benefit pension plan covering all employees meeting certain eligibility requirements. The Bank's policy is to fund pension costs accrued. Information regarding the actuarial present values of vested and nonvested benefits and fair value of plan assets for the separate employers in the plan is not available. The expense relating to this plan for the years ended September 30, 2006, 2005, and 2004 was \$549,700, \$437,900 and \$1,071,935, respectively.

The Bank also has a defined contribution plan for employees meeting certain eligibility requirements. The defined contribution plan may be terminated at any time at the discretion of the Bank. The expense relating to this plan for the years ended September 30, 2006, 2005 and 2004 was \$-0-, \$71,461 and \$119,225, respectively. The elimination of the expense in 2006 reflected the Company's decision to discontinue the employer match in conjunction with the establishment of the employee stock ownership plan discussed below.

In fiscal 2005, the Bank established an employee stock ownership plan

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("ESOP") for substantially all of its full-time employees meeting certain eligibility requirements. The purchase of shares of the Company's common stock by the ESOP was funded by a loan from the Company. The loan will be repaid principally from the Bank's contributions to the ESOP. Shares of the Company's common stock purchased by the ESOP are held in a suspense account and released for allocation to

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participants on a pro rata basis as debt service payments are made on the loan. Shares released are allocated to each eligible participant based on the ratio of each such participant's base compensation, as defined in the ESOP, to the total base compensation of all eligible plan participants. As the unearned shares are released and allocated among participants, the Bank recognizes compensation expense equal to the current market price of the shares released. The ESOP purchased 452,295 shares of the Company's common stock on the open market for approximately \$4.5 million. The average purchase price was \$9.86 per share. As of September 30, 2006 the Company had allocated a total of 16,965 shares from the suspense account to participants and committed to release an additional 16,965 shares. The expense relating to this plan for the years ended September 30, 2006, 2005 and 2004 was \$287,471, 120,622, and \$-0- respectively.

### 13. COMMITMENTS AND CONTINGENT LIABILITIES

At September 30, 2006, the Bank had \$4,932,800 in outstanding commitments to originate fixed and variable-rate loans with market interest rates ranging from 6.00% to 9.25%. At September 30, 2005, the Bank had \$21,371,785 in outstanding commitments to originate fixed and variable-rate loans with market interest rates ranging from 5.50% to 7.75%.

The Bank also had commitments under unused lines of credit of \$6,706,481 and \$5,966,399 and letters of credit outstanding of \$110,000 and \$110,000 at September 30, 2006 and 2005, respectively.

The Company is subject to various pending claims and contingent liabilities arising in the normal course of business which are not reflected in the accompanying consolidated financial statements. Management considers that the aggregate liability, if any, resulting from such matters will not be material.

Among the Bank's contingent liabilities are exposures to limited recourse arrangements with respect to the Bank's sales of whole loans and participation interests. At September 30, 2006, the exposure, which represents a portion of credit risk associated with the sold interests, amounted to \$64,451. This exposure is for the life of the related loans and payables, on our proportionate share, as actual losses are incurred.

### 14. FAIR VALUE OF FINANCIAL INSTRUMENTS

The following disclosure of the estimated fair value of financial instruments is made in accordance with the requirements of SFAS No. 107, DISCLOSURE ABOUT 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 necessarily 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.

	September 30,			
	2006		2005	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
<b>Assets:</b>				
Cash and cash equivalents	\$ 13,427,536	\$ 13,427,536	\$ 26,815,017	\$ 26,815,017
Investment securities held to maturity	132,083,883	129,593,126	129,839,512	128,046,676
Investment securities held available for sale	38,747,089	38,747,089	38,584,474	38,584,474
Mortgage-backed securities held to maturity	50,359,734	49,526,374	66,827,615	67,123,459
Mortgage-backed securities available for sale	4,615,307	4,615,307	--	--
Loans receivable, net	219,417,531	216,235,333	175,090,988	174,652,932
Federal Home Loan Bank stock	2,217,100	2,217,100	1,811,500	1,811,500
<b>Liabilities:</b>				
NOW accounts	34,202,808	34,202,808	44,535,148	44,535,148
Money market deposit accounts	64,498,290	64,498,290	59,906,583	59,906,583
Passbook, club and statement savings accounts	76,989,307	76,989,307	87,709,110	87,709,110
Certificates of deposit	171,602,086	171,659,900	144,316,998	144,887,781
Advances from Federal Home Loan Bank	31,783,751	32,053,344	13,823,411	14,405,169

CASH AND CASH EQUIVALENTS--For cash and cash equivalents, the carrying amount is a reasonable estimate of fair value.

INVESTMENTS AND MORTGAGE-BACKED SECURITIES--The fair value of investment securities and mortgage-backed securities is based on quoted market prices, dealer quotes, and prices obtained from independent pricing services.

LOANS RECEIVABLE--The fair value of loans is estimated based on present value using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities.

FEDERAL HOME LOAN BANK (FHLB) STOCK--Although FHLB stock is an equity interest in an FHLB, it is carried at cost because it does not have a readily determinable fair value as its ownership is restricted and it lacks a market. The estimated fair value approximates the carrying amount.

NOW ACCOUNTS, MONEY MARKET DEPOSIT ACCOUNTS, PASSBOOK ACCOUNTS, CLUB ACCOUNTS, STATEMENT SAVINGS ACCOUNTS, AND CERTIFICATES OF DEPOSIT--The fair

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value of passbook accounts, club accounts, statement savings accounts, NOW accounts, and money market deposit accounts is the amount

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reported in the financial statements. The fair value of certificates of deposit is based on a present value estimate using rates currently offered for deposits of similar remaining maturity.

ADVANCES FROM FEDERAL HOME LOAN BANK--The fair value of advances from FHLB is the amount payable on demand at the reporting date.

COMMITMENTS TO EXTEND CREDIT AND LETTERS OF CREDIT--The majority of the Bank's commitments to extend credit and letters of credit carry current market interest rates if converted to loans. Because commitments to extend credit and letters of credit are generally unassignable by either the Bank or the borrower, they only have value to the Bank and the borrower. The estimated fair value approximates the recorded deferred fee amounts, which are not significant. As discussed in Note 13, the related amounts at September 30, 2006 and 2005 were \$11,749,281 and \$27,448,184, respectively.

The fair value estimates presented herein are based on pertinent information available to management as of September 30, 2006 and 2005, respectively. 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 that date and, therefore, current estimates of fair value may differ significantly from the amounts presented herein.

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### 15. PRUDENTIAL BANCORP, INC. OF PENNSYLVANIA (PARENT COMPANY ONLY)

#### STATEMENT OF FINANCIAL CONDITION

At September 30,	2006	2005
-----		
<b>Assets:</b>		
Cash	\$14,158,770	\$21,787,223
ESOP loan receivable	4,273,287	4,430,233
Accrued interest receivable on ESOP loan	--	63,684
Investment in Bank	69,470,789	65,057,120
Other assets	27,367	18,092
	-----	-----
Total assets	\$87,930,213	\$91,356,352
	=====	=====
<b>Liabilities:</b>		
Accrued dividend payable	\$ 482,573	\$ 499,898
Accounts payable and accrued expenses		31,156
	-----	-----
Total liabilities	482,573	531,054
	-----	-----
<b>Stockholders' equity:</b>		
Preferred stock	--	--
Common stock	125,638	125,638
Additional paid-in-capital	54,798,121	54,733,760
Unearned ESOP shares	(4,126,501)	(4,349,611)

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Treasury stock	(6,422,478)	(654,415)
Retained earnings	42,538,790	40,594,661
Accumulated other comprehensive income	534,070	375,265
	-----	-----
Total stockholders' equity	87,447,640	90,825,298
	-----	-----
Total liabilities and stockholders' equity	\$87,930,213	\$91,356,352
	=====	=====

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INCOME STATEMENT

For the year ended September 30,	2006	2005
-----	-----	-----
Interest on ESOP loan	\$ 250,291	\$ 108,844
Equity in the undistributed earnings of the Bank	3,967,394	1,860,836
Other income	520	275
	-----	-----
Total income	4,218,205	1,969,955
	-----	-----
Professional services	302,382	122,385
Other expense	128,576	10,694
	-----	-----
Total expense	430,958	133,079
	-----	-----
Income before income taxes	3,787,247	1,836,876
Income tax (benefit) expense	(49,658)	15,000
	-----	-----
Net income	\$3,836,905	\$1,821,876
	=====	=====

CASH FLOWS

For the year ended September 30,	2006	2005
-----	-----	-----
Operating activities:		
Net income	\$ 3,836,905	\$ 1,821,876
Decrease (increase) in assets	54,410	(45,593)
(Decrease) increase in liabilities	(31,156)	13,064
Equity in the undistributed earnings of the Bank	(3,967,394)	(1,860,836)
	-----	-----
Net cash provided by operating activities	(107,235)	(71,489)
	-----	-----
Investing activities:		
ESOP loan to Bank	--	(4,461,166)
Repayments received on ESOP loan	156,946	30,933
	-----	-----
Net cash provided by (used in) investing activities	156,946	(4,430,233)
	-----	-----
Financing activities:		
Proceeds from issuance of common stock	--	27,425,166
Cash dividends paid	(1,910,101)	(481,806)
Payment to repurchase common stock	(5,768,063)	(654,415)
	-----	-----
Net cash (used in) provided by financing activities	(7,678,164)	26,288,945
	-----	-----
Net (decrease) increase in cash and cash equivalents	(7,628,453)	21,787,223
	-----	-----
Cash and cash equivalents, beginning of year	21,787,223	--
	-----	-----

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Cash and cash equivalents, end of year \$14,158,770    \$21,787,223  
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16. QUARTERLY FINANCIAL DATA (UNAUDITED)

Unaudited quarterly financial data for the years ended September 30, 2006 and 2005 is as follows:

	September 30, 2006				September 30, 2005		
	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	1st Qtr	2nd Qtr	3rd Qtr
	(In thousands)				(In thousands)		
Interest income	\$5,786	\$5,922	\$6,235	\$6,599	\$4,994	\$5,124	\$5,414
Interest expenses	2,620	2,754	3,110	3,451	2,235	2,291	2,285
Net interest income	3,166	3,168	3,125	3,148	2,759	2,833	3,129
Provision for loan losses	0	0	30	30	0	0	0
Net income after provision for loan losses	3,166	3,168	3,095	3,118	2,759	2,833	3,129
Non-interest income	170	299	209	259	164	137	127
Non-interest expense	1,828	2,005	2,008	2,034	1,863	1,601	1,682
Income before income taxes	1,508	1,462	1,296	1,343	1,060	1,369	1,574
Income tax expense	422	507	414	430	363	475	567
Net income	\$1,086	\$ 955	\$ 882	\$ 913	\$ 697	\$ 894	\$1,007
Per share:							
Earnings for share - basic	\$ 0.09	\$ 0.08	\$ 0.07	\$ 0.08	(1)	(2)	\$ 0.08
Earnings per share - diluted	0.09	0.08	0.07	0.08	(1)	(2)	0.08
Dividends per share	0.04	0.04	0.04	0.04	(1)	(2)	0.04

(1) For periods prior to March 29, 2005, no shares of common stock were outstanding. Therefore, there is no earnings per share or dividends per share data for those periods noted.

(2) Due to timing of the Bank's reorganization into the mutual holding company form and the completion of the Company's initial public offering on March 29, 2005, earnings per share information for the quarter ended March 31, 2005 is not considered meaningful and is not shown. There were no dividends declared during the period March 29, 2005 and March 31, 2005.

17. SUBSEQUENT EVENTS

The Company, at its Board of Directors meeting held on December 20, 2006, declared a quarterly cash dividend of \$0.04 per share on the common stock of the Company payable on January 31, 2007 to the shareholders of record at the close of business on January 12, 2007.

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ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not Applicable.

ITEM 9A. CONTROLS AND PROCEDURES

Our management evaluated, with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness 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 September 30, 2006. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and regulations and are operating in an effective manner.

No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15(d)-15(f) under the Securities Exchange Act of 1934) occurred during the fourth fiscal quarter of fiscal 2006 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

Not applicable.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The information required herein is incorporated by reference from the sections captioned "Information with Respect to Nominees for Director, Continuing Directors and Executive Officers" and "Beneficial Ownership of Common Stock by Certain Beneficial Owners and Management - Section 16(a) Beneficial Ownership Reporting Compliance" in the Company's Definitive Proxy Statement for the Annual Meeting of Shareholders to be held on February 9, 2007, which will be filed with the SEC on or about January 5, 2007 ("Definitive Proxy Statement").

The Company has adopted a code of ethics policy, which applies to its principal executive officer, principal financial officer, principal accounting officer, as well as its directors and employees generally. The Company will provide a copy of its code of ethics to any person, free of charge, upon request. Any requests for a copy should be made to our shareholder relation's administrator, Prudential Bancorp, Inc. of Pennsylvania, 1834 Oregon Avenue, Philadelphia, Pennsylvania 19145.

ITEM 11. EXECUTIVE COMPENSATION

The information required herein is incorporated by reference from the sections captioned "Management Compensation," "Report of the Compensation Committee" and "Performance Graph" in the Company's Definitive Proxy Statement.

The report of the Compensation Committee included in the Definitive

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Proxy Statement should not be deemed filed or incorporated by reference into this filing or any other filing by the Company under the Exchange Act or Securities Act of 1933 except to the extent the Company specifically incorporates said reports herein or therein by reference thereto.

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### ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT. Information regarding security ownership of certain beneficial owners and management is incorporated by reference to "Beneficial Ownership of Common Stock by Certain Beneficial Owners and Management" in the Definitive Proxy Statement.

EQUITY COMPENSATION PLAN INFORMATION. As of September 30, 2006, the Company did not have any shares of common stock that may be issued under equity compensation plans.

### ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information required herein is incorporated by reference from the section captioned "Management Compensation - Indebtedness of Management and Related Party Transactions" in the Definitive Proxy Statement.

### ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required herein is incorporated by reference from the section captioned "Ratification of Appointment of Independent Registered Public Accounting Firm" in the Definitive Proxy Statement.

## PART IV

### ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

- (a) Documents Filed as Part of this Report.
- (1) The following financial statements are incorporated by reference from Item 8 hereof:
- Consolidated Statements of Financial Condition
  - Consolidated Statements of Income
  - Consolidated Statements of Changes in Stockholders' Equity and Comprehensive Income
  - Consolidated Statements of Cash Flows
  - Notes to Consolidated Financial Statements
- (2) All schedules for which provision is made in the applicable accounting regulation of the SEC are omitted because of the absence of conditions under which they are required or because the required information is included in the consolidated financial statements and related notes thereto.
- (3) The following exhibits are filed as part of this Form 10-K, and this list includes the Exhibit Index.

Exhibit No.	Description
3.1	Articles of Incorporation of Prudential Bancorp, Inc. of

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- Pennsylvania(1)
- 3.2 Bylaws of Prudential Bancorp, Inc. of Pennsylvania(1)
- 4.0 Form of Stock Certificate of Prudential Bancorp, Inc. of Pennsylvania(1)
- 10.1 Employment Agreement by and between Thomas A. Vento, Prudential Bancorp, Inc. of Pennsylvania and Prudential Savings Bank(2)\*
- 10.2 Employment Agreement by and between Joseph R. Corrato, Prudential Bancorp, Inc. of Pennsylvania and Prudential Savings Bank(2)\*

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- 10.3 Form of Endorsement Split Dollar Insurance Agreement, dated January 1, 2006, by and between, Thomas Vento, Joseph Corrato and David Krauter (3)\*
- 10.4 Prudential Savings Bank 2006 Bonus Program (3)\*
- 21.0 Subsidiaries of the Registrant - Reference is made to "Item 1. Business - Subsidiaries" for the required information
- 23.0 Consent of Deloitte & Touche LLP
- 31.1 Section 1350 Certification of the Chief Executive Officer
- 31.2 Section 1350 Certification of the Chief Financial Officer
- 32.0 Section 906 Certification

\* Management contract or compensatory plan or arrangement required to be filed as an exhibit to this Form 10-K pursuant to Item 15(b) hereof.

- (1) Incorporated by reference from the Company's Registration Statement on Form S-1 (Commission File No. 333-119130) filed with the Commission on September 30, 2004.
- (2) Incorporated by reference from the Company's Current Report on Form 8-K, dated March 29, 2005 and filed with the Commission on March 30, 2005 (Commission File No. 000-51214).
- (3) Incorporated by reference from the Company's Current Report on Form 8-K, filed with the Commission on December 21, 2006 (Commission File No. 000-51214).

(b) Exhibits

The exhibits listed under (a)(3) of this Item 15 are filed herewith.

(c) Reference is made to (a)(2) of this Item 15.

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SIGNATURES

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

PRUDENTIAL BANCORP, INC. OF PENNSYLVANIA

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December 22, 2006

By: /S/ THOMAS A. VENTO

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Thomas A. Vento  
President and Chief Executive Officer

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

/S/ JOSEPH W. PACKER, JR. December 22, 2006

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Joseph W. Packer, Jr.  
Chairman of the Board

/S/ THOMAS A. VENTO December 22, 2006

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Thomas A. Vento  
President and Chief Executive Officer

/S/ JEROME R. BALKA, ESQ. December 22, 2006

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Jerome R. Balka, Esq.  
Director

/S/ A. J. FANELLI December 22, 2006

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A. J. Fanelli  
Director

/S/ JOHN P. JUDGE December 22, 2006

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John P. Judge  
Director

/S/ FRANCIS V. MULCAHY December 22, 2006

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Francis V. Mulcahy  
Director

/S/ JOSEPH R. CORRATO December 22, 2006

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Joseph R. Corrato  
Executive Vice President, Chief  
Financial Officer and Chief Accounting  
Officer