

GUARANTY FEDERAL BANCSHARES INC
Form 10-K
March 30, 2007

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

FORM 10-K

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

For the fiscal year ended December 31, 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: 0-23325

GUARANTY FEDERAL BANCSHARES, INC.
(Exact Name of Registrant as Specified in Its Charter)

Delaware
(State or Other Jurisdiction of Incorporation or Organization)

43-1792717
(I.R.S. Employer Identification No.)

1341 West Battlefield, Springfield, Missouri
(Address of Principal Executive Offices)

65807
(Zip Code)

Registrant's telephone number, including area code: (417) 520-4333

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

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

Common Stock, par value \$.10 per share
(Title of Class)

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 Exchange Act. Yes No

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

required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

Indicate by check mark whether the registrant is a large accelerated 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 and non-voting common stock held by non-affiliates of the registrant, based on the average bid and asked prices of the registrant's Common Stock as quoted on the National Market of The NASDAQ Stock Market on June 30, 2006 (the last business day of the registrant's most recently completed second quarter) was \$66.7 million. As of March 30, 2007 there were 2,902,495 shares of the registrant's Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

1. Portions of the Annual Report to Stockholders (the "2006 Annual Report") for the fiscal year ended December 31, 2006 (Parts I and II).
2. Portions of the Proxy Statement for the Annual Meeting of Stockholders (the "Proxy Statement") to be held on May 23, 2007 (Part III).

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Signatures

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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

GUARANTY FEDERAL BANCSHARES, INC. (THE "COMPANY") MAY FROM TIME TO TIME MAKE WRITTEN OR ORAL "FORWARD-LOOKING STATEMENTS", INCLUDING STATEMENTS CONTAINED IN THE COMPANY'S FILINGS WITH THE SECURITIES AND EXCHANGE COMMISSION (INCLUDING THIS ANNUAL REPORT ON FORM 10-K AND THE EXHIBITS THERETO), IN ITS REPORTS TO STOCKHOLDERS AND IN OTHER COMMUNICATIONS BY THE COMPANY, WHICH ARE MADE IN GOOD FAITH BY THE COMPANY PURSUANT TO THE "SAFE HARBOR" PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995. WHEN USED IN THIS ANNUAL REPORT ON FORM 10-K, WORDS SUCH AS "ANTICIPATES," "ESTIMATES," "BELIEVES," "EXPECTS," AND SIMILAR EXPRESSIONS ARE INTENDED TO IDENTIFY SUCH FORWARD-LOOKING STATEMENTS BUT ARE NOT THE EXCLUSIVE MEANS OF IDENTIFYING SUCH STATEMENTS.

THESE FORWARD-LOOKING STATEMENTS INVOLVE RISKS AND UNCERTAINTIES, SUCH AS STATEMENTS OF THE COMPANY'S PLANS, OBJECTIVES, EXPECTATIONS, ESTIMATES AND INTENTIONS, THAT ARE SUBJECT TO CHANGE BASED ON VARIOUS IMPORTANT FACTORS (SOME OF WHICH ARE BEYOND THE COMPANY'S CONTROL). THE FOLLOWING FACTORS, AMONG OTHERS, COULD CAUSE THE COMPANY'S FINANCIAL PERFORMANCE TO DIFFER MATERIALLY FROM THE PLANS, OBJECTIVES, EXPECTATIONS, ESTIMATES AND INTENTIONS EXPRESSED IN SUCH FORWARD-LOOKING STATEMENTS: THE STRENGTH OF THE UNITED STATES ECONOMY IN GENERAL AND THE STRENGTH OF THE LOCAL ECONOMIES IN WHICH THE COMPANY CONDUCTS OPERATIONS; THE EFFECTS OF, AND CHANGES IN, TRADE, MONETARY AND FISCAL POLICIES AND LAWS, INCLUDING INTEREST RATE POLICIES OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, INFLATION, INTEREST RATES, MARKET AND MONETARY FLUCTUATIONS; THE TIMELY DEVELOPMENT OF AND ACCEPTANCE OF NEW PRODUCTS AND SERVICES OF THE COMPANY AND THE PERCEIVED OVERALL VALUE OF THESE PRODUCTS AND SERVICES BY USERS, INCLUDING THE FEATURES, PRICING AND QUALITY COMPARED TO COMPETITORS' PRODUCTS AND SERVICES; THE WILLINGNESS OF USERS TO SUBSTITUTE COMPETITORS' PRODUCTS AND SERVICES FOR THE COMPANY'S PRODUCTS AND SERVICES; THE SUCCESS OF THE COMPANY IN GAINING REGULATORY APPROVAL OF ITS PRODUCTS AND SERVICES, WHEN REQUIRED; THE IMPACT OF CHANGES IN FINANCIAL SERVICES' LAWS AND REGULATIONS (INCLUDING LAWS CONCERNING TAXES, BANKING, SECURITIES AND INSURANCE); TECHNOLOGICAL CHANGES; ACQUISITIONS; CHANGES IN CONSUMER SPENDING AND SAVING HABITS; THE SUCCESS OF THE COMPANY AT MANAGING THE RISKS RESULTING FROM THESE FACTORS; AND OTHER FACTORS SET FORTH IN REPORTS AND OTHER DOCUMENTS FILED BY THE COMPANY WITH THE SECURITIES AND EXCHANGE COMMISSION FROM TIME TO TIME. FOR FURTHER INFORMATION ABOUT THESE AND OTHER RISKS, UNCERTAINTIES AND FACTORS, PLEASE REVIEW THE DISCLOSURE INCLUDED IN ITEM 1A. OF THIS FORM 10-K.

THE COMPANY CAUTIONS THAT THE LISTED FACTORS ARE NOT EXCLUSIVE. THE COMPANY DOES NOT UNDERTAKE TO UPDATE ANY FORWARD-LOOKING STATEMENT, WHETHER WRITTEN OR ORAL, THAT MAY BE MADE FROM TIME TO TIME BY OR ON BEHALF OF THE COMPANY.

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PART I

Item 1. Business

Business of the Company

Guaranty Federal Bancshares, Inc. (the "Company") is a Delaware-chartered corporation that was created in September 1997 at the direction of Guaranty Federal Savings Bank, a federal savings bank (the "Bank"). The Company became a unitary savings and loan holding company for the Bank on December 30, 1997, in connection with a plan of conversion and reorganization involving the Bank and its then existing mutual holding company. The mutual holding company structure had been created in April 1995 at which time more than a majority of the shares of the Bank were issued to the mutual holding company and the remaining shares were sold in a public offering. In connection with the conversion and reorganization on December 30, 1997, the shares of the Bank held by the mutual holding company were extinguished along with the mutual holding company, and the shares of the Bank held by the public were exchanged for shares of the Company. All of the shares of the Bank which remained outstanding after the conversion are owned by the Company. Shares of the Company were issued on December 30, 1997.

On June 27, 2003, the Bank converted from a federal savings bank to a state-chartered trust company with banking powers in Missouri, and the Company became a bank holding company. On this date, the name of the Bank was changed from Guaranty Federal Savings Bank to Guaranty Bank. The primary activity of the Company is to oversee its investment in the Bank. The Company engages in few other activities. For this reason, unless otherwise specified, references to the Company include operations of the Bank. Further, information in a chart or table based on Bank only data is identical to or immaterially different from information that would be provided on a consolidated basis. In addition to the Bank, the Company owns Guaranty Statutory Trust I and Guaranty Statutory Trust II, both Delaware statutory trusts.

In 2003, the Company changed its fiscal year end from June 30 to a calendar year end of December 31. As a result, the Company reported a six month transition period ended December 31, 2003 (the "Transition Period") in order to change to this new calendar year end.

Business of the Bank

The Bank's principal business has been, and continues to be, attracting retail deposits from the general public and investing those deposits, together with funds generated from operations, in permanent one-to four-family residential mortgage loans, multi-family residential mortgage loans, construction loans, commercial real estate loans, and consumer and other loans. The Bank also invests in mortgage-backed securities, U.S. Government and federal agency securities and other marketable securities. The Bank's revenues are derived principally from interest on its loans and other investments and fees charged for services provided, and gains generated from sales of loans and investment securities, and the Bank's results of operations are primarily dependent on net interest margin, which is the difference between interest income on interest-earning assets and interest expense on interest-bearing liabilities. The Bank's primary sources of funds are: deposits; borrowings; amortization and prepayments of loan principal; and amortizations, prepayments and maturities of mortgage-backed securities.

The Bank is regulated by the Missouri Division of Finance and its deposits are insured by the Savings Association Insurance Fund ("SAIF") of the Federal Deposit Insurance Corporation (the "FDIC"). See discussion under section captioned "Regulation" in this report. The Bank is a member of the Federal Home Loan Bank of Des Moines (the "FHLB"), which is one of twelve regional Federal Home Loan Banks. As a member, the Bank is required to purchase and maintain stock in the FHLB in an amount equal to 0.12% of its assets plus 4.45% of its outstanding FHLB advances. At December 31, 2006, the Bank had \$5,382,700 in FHLB stock, which was in compliance with this

requirement.

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Information regarding (i) average balances related to interest earning assets and interest bearing liabilities and an analysis of net interest earnings for the last three fiscal years and (ii) changes in interest income and interest expense resulting from changes in average balances and average rates for the last two fiscal years is provided under the section captioned "Management's Discussion and Analysis of Financial Condition and Results of Operation" of the 2006 Annual Report is incorporated herein by reference.

Market Area

The Bank's primary market areas are Greene and Christian Counties, which are in the southwestern corner of Missouri and includes the cities of Springfield and Nixa, Missouri. There is a large regional health care presence with two large regional hospitals employing over 14,000. There also are four accredited colleges and one major university with total enrollment approaching 25,000. Part of the area's growth can be attributed to its proximity to Branson, Missouri, which has developed a strong tourism industry related to country music and entertainment. Branson is located 30 miles south of Springfield, and attracts between five and six million tourists each year, many of whom pass through Springfield.

Lending Activities

Set forth below is selected data relating to the composition of the Bank's loan portfolio at the dates indicated:

| | 2006 | | As of December 31, | | | | 2003 | | As of June 30, | |
|--|------------|------|--------------------|------|---------|------|------------|------|------------------------|------|
| | \$ | % | 2005 | 2004 | 2003 | 2003 | \$ | % | | |
| | | | \$ | % | \$ | % | \$ | % | (Dollars in Thousands) | |
| Mortgage loans (includes loans held for sale): | | | | | | | | | | |
| One to four family | \$ 89,650 | 18% | 103,532 | 23% | 121,307 | 31% | \$ 129,477 | 37% | 144,404 | 40% |
| Multi-family | 50,366 | 10% | 53,631 | 12% | 52,259 | 13% | 44,242 | 13% | 41,022 | 11% |
| Construction | 83,967 | 17% | 70,390 | 16% | 45,090 | 11% | 49,814 | 14% | 64,464 | 18% |
| Commercial real estate | 155,801 | 32% | 122,884 | 28% | 97,550 | 25% | 72,105 | 21% | 71,046 | 19% |
| Total mortgage loans | 379,784 | 78% | 350,437 | 79% | 316,206 | 80% | 295,638 | 86% | 320,936 | 88% |
| Commercial business loans | 82,676 | 17% | 66,370 | 15% | 55,606 | 14% | 24,618 | 7% | 18,967 | 5% |
| Consumer loans | 23,708 | 5% | 24,264 | 6% | 25,172 | 6% | 25,441 | 7% | 25,486 | 7% |
| Total consumer and other loans | 106,384 | 22% | 90,634 | 21% | 80,778 | 20% | 50,059 | 14% | 44,453 | 12% |
| Total loans | 486,168 | 100% | 441,071 | 100% | 396,984 | 100% | 345,697 | 100% | 365,389 | 100% |
| Less: | | | | | | | | | | |
| Loans in process | - | | - | | - | | 9,425 | | 25,539 | |
| Deferred loan fees/costs, net | 115 | | 141 | | 106 | | 237 | | 211 | |
| Unearned discounts | - | | 3 | | 7 | | 19 | | 26 | |
| Allowance for loan losses | 5,784 | | 5,400 | | 4,537 | | 3,886 | | 2,775 | |
| Total Loans, Net | \$ 480,269 | | 435,527 | | 392,334 | | \$ 332,130 | | 336,838 | |

The following table sets forth the maturity of the Bank's loan portfolio as of December 31, 2006. The table shows loans that have adjustable rates as due in the period during which they contractually mature. The table does not include prepayments or scheduled principal amortization.

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| Loan Maturities | Due in One Year or Less | Due After One | Due After Five | Total |
|---------------------------|--|-----------------------|----------------|------------|
| | | Through Five Years | Years | |
| (Dollars in thousands) | | | | |
| One to four family | \$ 7,133 | 17,437 | 65,080 | 89,650 |
| Multi family | 9,294 | 24,213 | 16,859 | 50,366 |
| Construction | 57,740 | 26,227 | - | 83,967 |
| Commercial real estate | 50,676 | 92,903 | 12,222 | 155,801 |
| Commercial loans | 39,549 | 39,358 | 3,769 | 82,676 |
| Consumer loans | 1,897 | 5,982 | 15,829 | 23,708 |
| Total loans (1) | \$ 166,289 | 206,119 | 113,759 | 486,168 |
| Less: | | | | |
| Deferred loan fees/costs | | | | 115 |
| Unearned discounts | | | | - |
| Allowance for loan losses | | | | 5,784 |
| Loans receivable net | | | | \$ 480,269 |
| (1) | Includes mortgage loans held for sale of \$3,005 | | | |

The following table sets forth the dollar amount, before deductions for unearned discounts, deferred loan fees/costs and allowance for loan losses, as of December 31, 2006 of all loans due after December 2007, which have pre-determined interest rates and which have adjustable interest rates.

Fixed and Adjustable Rate Loans by Type

| | Fixed Rates | Adjustable | Total | % ARM |
|------------------------|-------------|------------|---------|-------|
| | | Rates | | |
| (Dollars in Thousands) | | | | |
| One-to four-family | \$ 22,269 | 60,248 | 82,517 | 73% |
| Multi-family | 23,623 | 17,449 | 41,072 | 42% |
| Construction | 550 | 25,677 | 26,227 | 98% |
| Commercial real estate | 38,069 | 67,056 | 105,125 | 64% |
| Commercial loans | 5,536 | 37,590 | 43,126 | 87% |
| Consumer loans | 5,549 | 16,263 | 21,812 | 75% |
| Total loans (1) | \$ 95,596 | 224,283 | 319,879 | 70% |

(1) Before deductions for unearned discounts, deferred loan fees/costs and allowances for loan losses.

One- to Four-Family Mortgage Loans. The Bank offers fixed- and adjustable-rate (“ARM”) first mortgage loans secured by one- to four-family residences in the Bank's primary lending area. Typically, such residences are single family homes that serve as the primary residence of the owner. However, there are a significant number of loans originated by the Bank which are secured by non-owner occupied properties. Loan originations are generally obtained from existing or past customers, members of the local community, attorney referrals, established builders, and realtors within the Bank's market area. Originated mortgage loans in the Bank's portfolio include due-on-sale clauses which provide the Bank with the contractual right to deem the loan immediately due and payable in the event that the borrower transfers ownership of the property without the Bank's consent.

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As of December 31, 2006, \$89.7 million or 18% of the Bank's total loan portfolio consisted of one- to four-family residential loans, of which 74% were ARM loans. The Bank currently offers ARM and balloon loans that have fixed interest rate periods of one to seven years. Generally, ARM loans provide for limits on the maximum interest rate adjustment ("caps") that can be made at the end of each applicable period and throughout the duration of the loan. ARM loans are originated for a term of up to 30 years on owner-occupied properties and generally up to 25 years on non-owner occupied properties. Typically, interest rate adjustments are calculated based on U.S. treasury securities adjusted to a constant maturity of one year (CMT), plus a 2.50% to 2.75% margin. Interest rates charged on fixed-rate loans are competitively priced based on market conditions and the cost of funds existing at the time the loan is committed. The Bank's fixed-rate mortgage loans are made for terms of 15 to 30 years which are currently being sold on the secondary market.

Generally, ARM loans pose credit risks different from the risks inherent in fixed-rate loans, primarily because as interest rates rise the underlying payments of the borrower rise, thereby increasing the potential for default. At the same time, the marketability of the underlying property may be adversely affected by higher interest rates. The Bank does not originate ARM loans that provide for negative amortization.

The Bank generally originates both owner occupied and non-owner occupied one- to four-family residential mortgage loans in amounts up to 80% of the appraised value or the selling price of the mortgaged property, whichever is lower. The Bank on occasion may make loans up to 95% of appraised value or the selling price of the mortgage property, whichever is lower. However, the Bank typically requires private mortgage insurance for the excess amount over 80% for mortgage loans with loan to value percentages greater than 80%.

Multi-Family Mortgage Loans. The Bank originates multi-family mortgage loans in its primary lending area. As of December 31, 2006, \$50.4 million or 10% of the Bank's total loan portfolio consisted of multi-family residential real estate loans. With regard to multi-family mortgage loans, the Bank generally requires personal guarantees of the principals as well as a security interest in the real estate. Multi-family mortgage loans are generally originated in amounts of up to 80% of the appraised value of the property. The majority of the Bank's multi-family mortgage loans have been originated with adjustable rates of interest which are quoted at a spread to the FHLB advance rate for the initial fixed rate period with subsequent adjustments based on the Wall Street prime rate. The loan-to-one-borrower limitation, \$15.7 million as of December 31, 2006, is the maximum the Bank will lend on a multi-family residential real estate loan.

Loans secured by multi-family residential real estate generally involve a greater degree of credit risk than one- to four-family residential mortgage loans and carry larger loan balances. This increased credit risk is a result of several factors, including the concentration of principal in a limited number of loans and borrowers, the effects of general economic conditions on income producing properties, and the increased difficulty of evaluating and monitoring these types of loans. Furthermore, the repayment of loans secured by multi-family residential real estate is typically dependent upon the successful operation of the related real estate property. If the cash flow from the project is reduced, the borrower's ability to repay the loan may be impaired.

Construction Loans. As of December 31, 2006, construction loans totaled \$84 million or 17% of the Bank's total loan portfolio. Construction loans originated by the Bank are generally secured by permanent mortgage loans for the construction of owner-occupied residential real estate or to finance speculative construction secured by residential real estate or owner-operated commercial real estate. This portion of the Bank's loan portfolio predominantly consists of speculative loans, i.e., loans to builders who are speculating that they will be able to locate a purchaser for the underlying property prior to or shortly after the time construction has been completed.

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Construction loans are made to contractors who have sufficient financial strength and a proven track record, for the purpose of resale, as well as on a "pre-sold" basis. Construction loans made for the purpose of resale generally provide for interest only payments at floating rates and have terms of six months to fifteen months. Construction loans to a borrower who will occupy a home, or to a builder who has pre-sold the home, typically have loan to value ratios of up to 85%. Construction loans for speculative purposes, models, and commercial properties typically have loan to value ratios of up to 80%. Loan proceeds are disbursed in increments as construction progresses and as inspections warrant.

Construction lending by its nature entails significant additional risks as compared with one-to four-family mortgage lending, attributable primarily to the fact that funds are advanced upon the security of the project under construction prior to its completion. As a result, construction lending often involves the disbursement of substantial funds with repayment dependent on the success of the ultimate project and the ability of the borrower or guarantor to repay the loan. Because of these factors, the analysis of the prospective construction loan projects requires an expertise that is different in significant respects from that which is required for residential mortgage lending. The Bank attempts to address these risks through its underwriting and construction monitoring procedures.

Commercial Real Estate Loans. As of December 31, 2006, the Bank has commercial real estate loans totaling \$155.8 million or 32% of the Bank's total loan portfolio. Commercial real estate loans are generally originated in amounts up to 80% of the appraised value of the mortgaged property. The majority of the Bank's commercial real estate loans have been originated with adjustable rates of interest, the majority of which are quoted at a spread to the FHLB advance rate for the initial fixed rate period with subsequent adjustments at a spread to the Wall Street prime rate. The Bank's commercial real estate loans are generally permanent loans secured by improved property such as office buildings, retail stores, small shopping centers, medical offices, motels, churches and other non-residential buildings.

To originate commercial real estate loans, the Bank generally requires a mortgage and security interest in the subject real estate, personal guarantees of the principals, a security interest in the related personal property, and a standby assignment of rents and leases. The Bank has established its loan-to-one borrower limitation, which was \$15.7 million as of December 31, 2006, as its maximum commercial real estate loan amount. Because of the small number of commercial real estate loans and the relationship of each borrower to the Bank, each such loan has differing terms and conditions applicable to the particular borrower.

Loans secured by commercial real estate are generally larger and involve a greater degree of risk than residential mortgage loans. Because payments on loans secured by commercial real estate are often dependent on successful operation or management of the properties, repayment of such loans may be subject, to a greater extent, to adverse conditions in the real estate market or the economy. The Bank seeks to minimize these risks by careful underwriting, requiring personal guarantees, lending only to established customers and borrowers otherwise known by the Bank, and generally restricting such loans to its primary market area.

As of December 31, 2006, the Bank's commercial real estate loan portfolio included approximately \$31 million in loans to develop land into residential lots. The Bank utilizes its knowledge of the local market conditions and appraisals to evaluate the development cost and estimate projected lot prices and absorption rates to assess loans on residential subdivisions. The Bank typically loans up to 80% of the appraised value over terms up to two years. Development loans generally involve a greater degree of risk than residential mortgage loans because (1) the funds are advanced upon the security of the land which has a materially lower value prior to completion of the infrastructure required of a subdivision, (2) the cash flow available for debt repayment is a function of the sale of the individual lots, and (3) the amount of interest required to service the debt is a function of the time required to complete the development and sell the lots.

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Commercial Business Loans. As of December 31, 2006, the Bank has commercial business loans totaling \$82.7 million or 17% of the Bank's total loan portfolio. Commercial business loans are generally secured by business assets, such as accounts receivable, equipment and inventory. Unlike residential mortgage loans, which generally are made on the basis of the borrower's ability to make repayment from his or her employment and other income and which are secured by real property whose value tends to be more easily ascertainable, commercial business loans are of higher risk and typically are made on the basis of the borrower's ability to make repayment from the cash flow of the borrower's business. As a result, the availability of funds for the repayment of commercial business loans may be substantially dependent on the success of the business itself. Further, the collateral securing the loans may depreciate over time, may be difficult to appraise and may fluctuate in value based on the success of the business. The Bank expects to continue to expand its commercial business lending as opportunities present themselves.

Consumer and Other Loans. The Bank also offers other loans, primarily consisting of loans secured by certificates of deposit, consumer loans, home equity loans and automobile loans. As of December 31, 2006, the Bank has such loans totaling \$23.7 million or 5% of the Bank's total loan portfolio. The Bank expects to continue to expand its consumer lending as opportunities present themselves.

Loan Approval Authority and Underwriting. All loans to borrowers with aggregate indebtedness exceeding \$1.5 million must have the approval of the members of the Bank's Loan Committee which consists of eight senior officers of the Bank. The Loan Committee meets weekly to review and approve loans made within the scope of its authority.

For all loans originated by the Bank, upon receipt of a completed loan application from a prospective borrower, a credit report is requested, income, assets, and certain other information are verified, and, if necessary, additional financial information is requested. An appraisal of the real estate intended to secure the proposed loan is generally required and is performed by certified appraisers. It is the Bank's policy to obtain appropriate insurance protection on all real estate first mortgage loans. Borrowers generally must also obtain hazard insurance prior to closing and generally are required to advance funds for certain items such as real estate taxes, flood insurance and private mortgage insurance, when applicable.

Delinquencies, Non-Performing and Problem Assets.

Delinquent Loans. As of December 31, 2006, the Bank has twenty-three loans 90 days or more past due with a principal balance of \$2,013,477 and sixty-eight loans between 30 and 89 days past due with an aggregate principal balance of \$4,407,718. The Bank generally does not accrue interest on loans past due more than 90 days.

The following table sets forth the Bank's loans that were accounted for on a non-accrual basis or 90 days or more delinquent at the dates indicated.

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| | 2006 | 2005 | As of December 31, 2004 | 2003 | As of June 30, 2003 |
|---|------------------------|--------|-------------------------------|-------|---------------------------|
| | (Dollars in Thousands) | | | | |
| Loans accounted for on a non-accrual basis or contractually past due 90 days or more | | | | | |
| Mortgage Loans: | | | | | |
| One- to four-family | \$ 883 | \$ 452 | 770 | 703 | 331 |
| Multi-family | - | - | - | - | - |
| Construction | 1,780 | - | - | - | - |
| Commercial real estate | - | 131 | 158 | - | - |
| | 2,663 | 583 | 928 | 703 | 331 |
| Non-mortgage loans: | | | | | |
| Commercial loans | 44 | - | - | - | - |
| Consumer and other loans | 41 | 138 | 79 | 40 | - |
| | 85 | 138 | 79 | 40 | - |
| Total non-accrual loans | 2,748 | 721 | 1,007 | 743 | 331 |
| Accruing loans which are contractually past maturity or past due 90 days or more: | | | | | |
| Mortgage Loans: | | | | | |
| One- to four-family | - | - | - | - | - |
| Multi-family | - | - | - | - | - |
| Construction | - | - | - | - | - |
| Commercial real estate | - | - | - | - | - |
| | - | - | - | - | - |
| Non-mortgage loans: | | | | | |
| Commercial loans | - | - | - | - | - |
| Consumer and other loans | - | - | - | - | - |
| | - | - | - | - | - |
| Total past maturity or past due accruing loans | - | - | - | - | - |
| Total accounted for on a non-accrual basis or contractually past maturity or 90 days or more past due | \$ 2,748 | \$ 721 | 1,007 | 743 | 331 |
| Total accounted for on a non-accrual basis or contractually past maturity or 90 days or more past due as a percentage of net loans | 0.58% | 0.17% | 0.26% | 0.22% | 0.10% |
| Total accounted for on a non-accrual basis or contractually past maturity or 90 days or more past due as a percentage of total assets | 0.52% | 0.15% | 0.23% | 0.19% | 0.08% |

Non-Performing Assets. Loans are reviewed on a regular basis and are placed on non-accrual status when, in the opinion of management, the collection of all interest at contractual rates becomes doubtful. Included as part of such review, mortgage loans are placed on non-accrual status generally when either principal or interest is more than 90 days past due. Interest accrued and unpaid at the time a loan is placed on non-accrual status is charged against interest

income.

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Real estate acquired by the Bank as a result of foreclosure or by deed in lieu of foreclosure is deemed a foreclosed asset held for sale until such time as it is sold. When a foreclosed asset held for sale is acquired it is recorded at its estimated fair value, less estimated selling expenses. Valuations of such foreclosed assets are periodically performed by management, and any subsequent decline in estimated fair value is charged to operations.

The following table shows the principal amount of non-performing assets which are not performing under regulatory guidelines and all foreclosed assets, including assets acquired in settlement of loans and the resulting impact on interest income for the periods then ended.

Non-Performing Assets

| | 2006 | As of December 31, | | | As of |
|--|----------|------------------------|-------|-------|------------------|
| | | 2005 | 2004 | 2003 | June 30, 2003 |
| | | (Dollars in Thousands) | | | |
| Non-accrual loans: | | | | | |
| Mortgage loans: | | | | | |
| One- to four-family | \$ 883 | \$ 452 | 770 | 703 | 331 |
| Multi-family | - | - | - | - | - |
| Construction | 1,780 | - | - | - | - |
| Commercial real estate | - | 131 | 158 | - | - |
| | 2,663 | 583 | 928 | 703 | 331 |
| Non-mortgage loans: | | | | | |
| Commercial loans | 44 | - | - | - | - |
| Consumer and other loans | 41 | 138 | 79 | 40 | - |
| | 85 | 138 | 79 | 40 | - |
| Total non-accrual loans | 2,748 | 721 | 1,007 | 743 | 331 |
| Real estate and other assets acquired in settlement of loans | 173 | 27 | 78 | 6 | 182 |
| Total non-performing assets | \$ 2,921 | \$ 748 | 1,085 | 749 | 513 |
| Total non-accrual loans as a percentage of net loans | 0.57% | 0.17% | 0.26% | 0.22% | 0.10% |
| Total non-performing assets as a percentage of total assets | 0.56% | 0.16% | 0.25% | 0.19% | 0.13% |
| Impact on interest income for the period: | | | | | |
| Interest income that would have been recorded on non-accruing loans | \$ 69 | 8 | 23 | 15 | 13 |

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Problem Assets. Federal regulations require that the Bank review and classify its assets on a regular basis to determine those assets considered to be of lesser quality. In addition, in connection with examinations of insured institutions, bank examiners have authority to identify problem assets and, if appropriate, require them to be classified. There are three classifications for problem assets: substandard, doubtful, and loss. "Substandard assets" must have one or more defined weaknesses and are characterized by the distinct possibility that the insured institution will sustain some loss if the deficiencies are not corrected. "Doubtful assets" have the weaknesses of substandard assets with the additional characteristic that the weaknesses make collection or liquidation in full on the basis of currently existing facts, conditions, and values questionable, and there is a high possibility of loss. An asset classified "loss" is considered uncollectible and of such little value that continuance as an asset of the institution is not warranted. The regulations have also created a "special mention" category, described as assets which do not currently expose an insured institution to a sufficient degree of risk to warrant classification but do possess credit deficiencies or potential weaknesses deserving management's close attention. Federal regulations require the Bank to establish general allowances for loan losses from assets classified as substandard or doubtful. If an asset or portion thereof is classified as loss, the insured institution must either establish specific allowances for loan losses in the amount of 100% of the portion of the asset classified loss or charge off such amount. A portion of general loss allowances established to cover possible losses related to assets classified substandard or doubtful may be included in determining an institution's regulatory capital, while specific valuation allowances for loan losses generally do not qualify as regulatory capital.

For management purposes, the Bank also designates certain loans for additional attention. Such loans are called "Special Mention" and have identified weaknesses, that if the situation deteriorates, the loans would merit a substandard classification.

The following table shows the aggregate amounts of the Bank's classified assets as of December 31, 2006.

| Classification of Assets | Special Mention | | Substandard | | Doubtful | | Loss | | Total | |
|--------------------------|-----------------|----------|-------------|----------|----------|--------|--------|--------|--------|-----------|
| | Number | Amount | Number | Amount | Number | Amount | Number | Amount | Number | Amount |
| (Dollars in Thousands) | | | | | | | | | | |
| Loans: | | | | | | | | | | |
| One- to four-family | 4 | \$ 444 | 35 | \$ 1,979 | - | \$ - | - | \$ - | 39 | \$ 2,423 |
| Multi-family | 1 | 1,248 | - | - | - | - | - | - | 1 | 1,248 |
| Construction | 7 | 681 | 8 | 1,400 | - | - | - | - | 15 | 2,081 |
| Commercial real estate | 3 | 2,288 | - | - | - | - | - | - | 3 | 2,288 |
| Commercial | 6 | 3,063 | 11 | 1,530 | - | - | - | - | 17 | 4,593 |
| Land | - | - | 9 | 380 | - | - | - | - | 9 | 380 |
| Other loans | 2 | 5 | 11 | 127 | 1 | 6 | - | - | 14 | 138 |
| Total loans | 23 | 7,730 | 74 | 5,415 | 1 | 6 | - | - | 98 | 13,150 |
| Foreclosed assets | | | | | | | | | | |
| held-for-sale: | | | | | | | | | | |
| One- to four-family | - | - | 1 | 109 | - | - | - | - | 1 | 109 |
| Land and other assets | - | - | 2 | 63 | - | - | - | - | 2 | 63 |
| Total foreclosed assets | - | - | 3 | 173 | - | - | - | - | 3 | 173 |
| Total | 23 | \$ 7,730 | 77 | \$ 5,588 | 1 | \$ 6 | - | \$ - | 101 | \$ 13,323 |

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Allowance for Loan Losses

The allowance for loan losses is established through a provision for loan losses based on management's evaluation of the risk inherent in its loan portfolio and the general economy. Such evaluation, which includes a review of all loans on which full collectibility may not be reasonably assured, considers among other matters, the estimated fair value of the underlying collateral, economic conditions, historical loan loss experience, and other factors that warrant recognition in providing for an adequate loan loss allowance. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance for loan losses and valuation of foreclosed assets held for sale. Such agencies may require the Bank to recognize additions to the allowance based on their judgments about information available to them at the time of their examination.

As of December 31, 2006 the Bank's total allowance for loan losses was \$5.8 million or 1.19% of total loans. This allowance reflects not only management's determination to maintain an allowance for loan losses consistent with regulatory expectations for non-performing or problem assets, but also reflects the regional economy and the Bank's policy of evaluating the risks inherent in its loan portfolio.

For fiscal years 2001 through 2006, the Bank experienced loan charge offs in excess of recoveries, and based on the loan portfolio review discussed above, elected to add to the allowance through a provision for loan loss, as shown in the table below. Management anticipates the need to continue adding to the allowance through charges to provision for loan losses as anticipated growth in the loan portfolio or other circumstances warrant.

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The following tables set forth certain information concerning the Bank's allowance for loan losses for the periods indicated.

| Allowance for Loan Losses | Year ended | | | Six months ended | Year ended |
|---|------------------------|-------------------|--------------|-----------------------|---------------|
| | 2006 | December 31, 2005 | 2004 | December 31, 2003 (1) | June 30, 2003 |
| | (Dollars in Thousands) | | | | |
| Beginning balance | \$ 5,400 | 4,537 | 3,886 | 2,775 | 2,650 |
| Gross loan charge offs | | | | | |
| Mortgage Loans: | | | | | |
| One- to four-family | (286) | (22) | (188) | (41) | (358) |
| Multi-family | - | - | - | - | - |
| Construction | (29) | - | - | - | (11) |
| Commercial real estate | - | - | - | - | - |
| | (315) | (22) | (188) | (41) | (369) |
| Non-mortgage loans: | | | | | |
| Commercial loans | (206) | (12) | - | - | - |
| Consumer and other loans | (126) | (119) | (43) | (14) | (168) |
| | (126) | (119) | (43) | (14) | (168) |
| Total charge offs | (647) | (153) | (231) | (55) | (537) |
| Recoveries | | | | | |
| Mortgage Loans: | | | | | |
| One- to four-family | 109 | 61 | 9 | 1 | 19 |
| Multi-family | - | - | - | - | - |
| Construction | 29 | - | - | 1 | 6 |
| Commercial real estate | - | - | - | - | - |
| | 138 | 61 | 9 | 2 | 25 |
| Non-mortgage loans: | | | | | |
| Commercial loans | 103 | - | - | - | - |
| Consumer and other loans | 40 | 10 | 9 | 2 | 27 |
| | 143 | 10 | 9 | 2 | 27 |
| Total recoveries | 281 | 71 | 18 | 4 | 52 |
| Net loan charge-offs | (366) | (82) | (213) | (51) | (485) |
| Provision for loan losses charged to expense | 750 | 945 | 864 | 1,162 | 610 |
| Ending balance | \$ 5,784 | \$ 5,400 | 4,537 | 3,886 | 2,775 |
| Net charge-offs as a percentage of average loans, net | 0.08% | 0.02% | 0.07% | 0.02% | 0.15% |
| Allowance for loan losses as a percentage of average loans, net | 1.28% | 1.29% | 1.39% | 1.19% | 0.85% |
| Allowance for loan losses as a percentage of total non-performing loans | 210% | 749% | 451% | 523% | 838% |

(1) In 2003, the Company determined to change its fiscal year end from June 30 to a calendar year end of December 31. As a result, the Company reported a six-month transition period ended December 31, 2003 in order to change to

this new calendar year end.

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Table of Contents**Allocation of Allowance for Loan Losses**

The following table shows the amount of the allowance allocated to the mortgage and non-mortgage loan categories and the respective percent of that loan category to total loans.

Allocation of Allowance for Loan Losses

| | 2006 | | 2005 | | As of December 31, 2004 | | 2003 | | As of June 30, 2003 | |
|-----------------------|------------------------|------|----------|------|-------------------------------|------|----------|------|---------------------------|------|
| | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % |
| | (Dollars in thousands) | | | | | | | | | |
| Mortgage Loans | \$ 4,512 | 78% | \$ 4,266 | 79% | \$ 3,630 | 80% | \$ 3,342 | 86% | \$ 2,442 | 88% |
| Non-Mortgage Loans | 1,272 | 22% | 1,134 | 21% | 907 | 20% | 544 | 14% | 333 | 12% |
| Total | \$ 5,784 | 100% | \$ 5,400 | 100% | \$ 4,537 | 100% | \$ 3,886 | 100% | \$ 2,775 | 100% |

Investment Activities

The investment policy of the Company, which is established by the Company's Board of Directors and reviewed by the Investment Committee of the Company's Board of Directors, is designed primarily to provide and maintain liquidity, to generate a favorable return on investments without incurring undue interest rate and credit risk, and to complement the Bank's lending activities. The policy currently provides for held-to-maturity and available-for-sale investment security portfolios. The Company has adopted an investment policy which strictly prohibits speculation in investment securities. The Company does not currently engage in trading investment securities and does not anticipate doing so in the future. As of December 31, 2006, the Company has investment securities with a carrying value of \$8.7 million and an estimated fair value of \$8.7 million. See Note 1 of Notes to Consolidated Financial Statements for description of accounting policy for investments. Based on the carrying value of these securities, \$7.9 million, or 90.8%, of the Company's investment securities portfolio are available-for-sale.

The Company has the authority to invest in various types of liquid assets, including United States Treasury obligations, securities of various federal agencies, trust preferred securities, certain certificates of deposit of insured banks and savings institutions, certain bankers' acceptances, repurchase agreements, and sale of federal funds.

Table of Contents**Composition of Investment Securities Portfolio**

The following tables set forth the amortized cost and approximate fair market values of the available-for-sale securities and held-to-maturity securities:

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized (Losses) | Approximate Fair Value |
|--------------------------------|----------------|------------------------------|---------------------------------|---------------------------|
| As of December 31, 2006 | | | | |
| AVAILABLE-FOR-SALE SECURITIES: | | | | |
| Equity Securities: | | | | |
| FHLMC stock | \$ 35,847 | 2,449,293 | - | 2,485,140 |
| Debt Securities: | | | | |
| U. S. government agencies | 4,870,979 | 1,346 | (12,074) | 4,860,251 |
| Mortgage-backed securities | 563,704 | - | (2,774) | 560,930 |
| HELD-TO-MATURITY SECURITIES: | | | | |
| U. S. government agencies | 158,661 | - | (481) | 158,180 |
| Mortgage-backed securities | 604,364 | 31,920 | - | 636,284 |
| | \$ 6,233,555 | 2,482,559 | (15,329) | 8,700,785 |

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized (Losses) | Approximate Fair Value |
|--------------------------------|----------------|------------------------------|---------------------------------|---------------------------|
| As of December 31, 2005 | | | | |
| AVAILABLE-FOR-SALE SECURITIES: | | | | |
| Equity Securities: | | | | |
| FHLMC stock | \$ 47,595 | 3,128,415 | - | 3,176,010 |
| Debt Securities: | | | | |
| U. S. government agencies | 3,579,513 | 2,021 | (397) | 3,581,137 |
| HELD-TO-MATURITY SECURITIES: | | | | |
| U. S. government agencies | 189,974 | - | (2,478) | 187,496 |
| Mortgage-backed securities | 754,750 | 39,550 | - | 794,300 |
| | \$ 4,571,832 | 3,169,986 | (2,875) | 7,738,943 |

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| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized (Losses) | Approximate Fair Value |
|-----------------------------------|----------------|------------------------------|---------------------------------|---------------------------|
| As of December 31, 2004 | | | | |
| AVAILABLE-FOR-SALE SECURITIES: | | | | |
| Equity Securities: | | | | |
| FHLMC stock | \$ 66,588 | 4,945,012 | - | 5,011,600 |
| Other stock | 2,000,000 | - | (560,000) | 1,440,000 |
| Debt Securities: | | | | |
| Trust preferred securities | 6,570,814 | 84,468 | - | 6,655,282 |
| U. S. government agencies | 1,994,798 | 88 | - | 1,994,886 |
| HELD-TO-MATURITY SECURITIES: | | | | |
| U. S. government agencies | 228,807 | 375 | - | 229,182 |
| Mortgage-backed securities | 1,076,351 | 77,737 | - | 1,154,088 |
| | \$ 11,937,358 | 5,107,680 | (560,000) | 16,485,038 |

The following table sets forth certain information regarding the weighted average yields and maturities of the Bank's investment securities portfolio as of December 31, 2006:

| Investment Portfolio Maturities and Average Weighted Yields | Amortized Cost | Weighted Average Yield | Approximate Fair Value |
|--|----------------|---------------------------|---------------------------|
| Due within one year | \$ 996,506 | 4.81% | \$ 994,219 |
| Due within five years | 3,874,473 | 4.31% | 4,426,962 |
| Due after ten years | 158,661 | 4.25% | 158,180 |
| Equity securities not due on a single maturity date | 35,847 | 0.00% | 2,485,140 |
| Mortgage-backed securities not due on a single maturity date | 1,168,068 | 5.65% | 636,284 |
| | \$ 6,233,555 | 4.62% | \$ 8,700,785 |

Table of Contents**Sources of Funds**

General. The Company's primary sources of funds are deposits, borrowings (including issuances of subordinated debentures), amortization and prepayments of loans and amortization, prepayments and maturities of mortgage-backed securities.

Deposits. The Bank offers a variety of deposit accounts having a range of interest rates and terms. The Bank's deposits principally consist of fixed-term certificates of deposit, savings, money market, individual retirement accounts, and NOW (checking) accounts. The flow of deposits is influenced significantly by general economic conditions, changes in money market and prevailing interest rates, local competition, and competition from non-bank financial service providers. The Bank's deposits are typically obtained from the areas in which its offices are located. The Bank relies primarily on customer service and long-standing relationships with customers to attract and retain these deposits.

The Bank seeks to maintain a high level of stable core deposits by providing high quality service through its employees and its convenient office and branch locations.

Deposit Account Types

The following table sets forth the distribution of the Bank's deposit accounts at the dates indicated.

Deposit Account Types

| | As of December 31, 2006 | | | As of December 31, 2005 | | | As of December 31, 2004 | | |
|---|-----------------------------|-------------------|------------------------------------|-----------------------------|-------------------|------------------------------------|-----------------------------|-------------------|------------------------------------|
| | Average Interest Rate | Amount | Percent of Total Deposits | Average Interest Rate | Amount | Percent of Total Deposits | Average Interest Rate | Amount | Percent of Total Deposits |
| NOW | 1.18% | \$ 35,469 | 10% | 0.33% | \$ 35,864 | 11% | 0.53% | \$ 34,605 | 12% |
| Savings | 2.67% | 14,316 | 4% | 1.80% | 14,298 | 5% | 1.08% | 15,153 | 5% |
| Money Market | 3.38% | 52,314 | 15% | 2.47% | 43,897 | 14% | 1.81% | 52,010 | 18% |
| Non-interest bearing demand | 0.00% | 26,894 | 8% | 0.00% | 36,194 | 11% | 0.00% | 25,583 | 9% |
| Total | | 128,993 | 37% | | 130,253 | 41% | | 127,351 | 44% |
| Certificates of Deposit: (fixed-rate, fixed-term) | | | | | | | | | |
| 1-11 months | 4.81% | 167,852 | 48% | 3.56% | 125,336 | 39% | 2.32% | 89,389 | 30% |
| 12-23 months | 5.02% | 35,424 | 10% | 3.74% | 48,149 | 15% | 2.81% | 42,019 | 14% |
| 24-35 months | 4.93% | 11,930 | 3% | 4.20% | 9,670 | 3% | 3.49% | 26,608 | 9% |
| 36-47 months | 4.82% | 3,724 | 1% | 3.94% | 4,248 | 1% | 4.16% | 6,012 | 2% |
| 48-59 months | 5.24% | 2,847 | 1% | 4.14% | 1,851 | 1% | 3.92% | 3,982 | 1% |
| 60-71 months | 5.41% | 1,171 | 0% | 4.64% | 552 | 0% | 3.98% | 1,013 | 0% |
| 72-95 months | 5.44% | 289 | 0% | 0.00% | - | 0% | 4.06% | 13 | 0% |
| Total | | 223,237 | 63% | | 189,806 | 59% | | 169,036 | 56% |
| Total Deposits | | \$ 352,230 | 100% | | \$ 320,059 | 100% | | \$ 296,387 | 100% |

Table of Contents**Maturities of Certificates of Deposit of \$100,000 or More**

The following table indicates the approximate amount of the Bank's certificate of deposit accounts of \$100,000 or more by time remaining until maturity as of December 31, 2006.

| | (Dollars in thousands) As of December 31, 2006 |
|--------------------------------|--|
| Three months or less | \$ 40,712 |
| Over three through six months | 12,638 |
| Over six through twelve months | 19,114 |
| Over twelve months | 15,331 |
| Total | \$ 87,796 |

Borrowings

The Company's borrowings consist primarily of FHLB advances and issuances of junior subordinated debentures.

Deposits are the primary source of funds for the Bank's lending activities and other general business purposes. However, during periods when supply of lendable funds cannot meet the demand for such loans, the FHLB System, to which the Bank is a member of, makes available, subject to compliance eligibility standards, a portion of the funds necessary through loans (advances) to its members. The following table presents certain data for FHLB advances as of the dates indicated.

Selected Data for Federal Home Loan Bank Advances

| | 2006 | As of December 31, 2005 | 2004 |
|--|------------------------|-------------------------------|-------------------|
| | (Dollars in Thousands) | | |
| Remaining maturity: | | | |
| Less than one year | \$ 85,414 | \$ 72,414 | \$ 61,264 |
| One to two years | 13,650 | 3,000 | 12,500 |
| Two to three years | 386 | 16,650 | 3,000 |
| Three to four years | 3,000 | 386 | 16,650 |
| Four to five years | - | 3,000 | 386 |
| Over five years | 5,550 | 4,550 | 6,200 |
| Total | \$ 108,000 | \$ 100,000 | \$ 100,000 |
| Weighted average rate at end of period | 5.35% | 4.55% | 3.62% |
| For the period: | | | |
| Average outstanding balance | \$ 110,810 | 111,104 | \$ 111,169 |
| Weighted average interest rate | 5.16% | 4.04% | 3.17% |
| Maximum outstanding as of any month end | \$ 124,000 | 132,000 | \$ 120,086 |

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Junior Subordinated Debentures: On December 15, 2005, the Company completed an offering of \$15 million of “Trust Preferred Securities” (defined hereinafter). The Company formed two wholly-owned subsidiaries, each a Delaware statutory trust (each a “Trust”, and collectively, the “Trusts”), for the purpose of issuing the \$15 million of Trust Preferred Securities. The proceeds of the sale of Trust Preferred Securities, together with the proceeds of the Trusts’ sale of their common securities to the Company, were used by each Trust to purchase certain debentures from the Company. The Company issued 30-year junior subordinated deferrable interest debentures to the Trusts in the principal amount of \$5,155,000 (“Trust I Debentures”) and \$10,310,000 (“Trust II Debentures”, and together with the Trust I Debentures, the “Debentures”) pursuant to the terms of Indentures dated December 15, 2005 by and between the Company and Wilmington Trust Company, as trustee. The Trust I Debentures bear interest at a fixed rate of 6.92%, payable quarterly. The Trust II Debentures bear interest at a fixed rate of 6.47% for 5 years, payable quarterly, after issuance and thereafter at a floating rate equal to the three month LIBOR plus 1.45%. The interest payments by the Company to the Trusts will be used to pay the dividends payable by the Trusts to the holders of the Trust Preferred Securities.

The Debentures mature on February 23, 2036. Subject to prior approval by the Federal Reserve Board, the Debentures and the Trust Preferred Securities are each callable by the Company or the Trusts, respectively and as applicable, at its option after five years from issuance, and sooner in the case of a special redemption at a special redemption price ranging up to 103.2% of the principal amount thereof, and upon the occurrence of certain events, such as a change in the regulatory capital treatment of the Trust Preferred Securities, either Trust being deemed an investment company or the occurrence of certain adverse tax events. In addition, the Company and the Trusts may defer interest and dividend payments, respectively, for up to five consecutive years without resulting in a default. An event of default may occur if the Company declares bankruptcy, fails to make the required payments within 30 days or breaches certain covenants within the Debentures. The Debentures are subordinated to the prior payment of any other indebtedness of the Company.

Pursuant to two guarantee agreements by and between the Company and Wilmington Trust Company, the Company issued a limited, irrevocable guarantee of the obligations of each Trust under the Trust Preferred Securities whereby the Company has guaranteed any and all payment obligations of the Trusts related to the Trust Preferred Securities including distributions on, and the liquidation or redemption price of, the Trust Preferred Securities to the extent each Trust does not have funds available.

The Company used the proceeds of the sale of the Trust Preferred Securities for general corporate purposes by investing in the Bank. Including funding of the Bank’s loan portfolio growth, restructuring of the Bank’s investment portfolio and repaying the Bank’s FHLB advances.

The following table sets forth certain information as to the Company's subordinated debentures issued to the Trusts at the dates indicated.

| | 2006 | As of December 31, 2005 | 2004 |
|---|------------------------|-------------------------------|------|
| | (Dollars in Thousands) | | |
| Subordinated debentures | \$ 15,465 | \$ 15,465 | - |
| Weighted average interest rate of subordinated debentures | 6.62% | 6.62% | - |

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Subsidiary Activity and Segment Information

The Company has three wholly-owned subsidiaries: (i) the Bank, the Company's principal subsidiary and a state-chartered trust company with banking powers in Missouri; (ii) Guaranty Statutory Trust I, a Delaware statutory trust ("Trust I"); and (iii) Guaranty Statutory Trust II, a Delaware statutory trust ("Trust II", and together with Trust I, the "Trusts"). Trust I and Trust II were formed in December 2005 for the exclusive purpose of issuing trust preferred securities to acquire junior subordinated debentures issued by the Company. Those debentures are the sole assets of the Trusts. The interest payments by the Company on the debentures are the sole revenues of the Trusts and are used by the Trusts to pay the dividends to the holders of the trust preferred securities. The Company has guaranteed any and all payment obligations of the Trusts related to the trust preferred securities.

The Bank has one service corporation subsidiary, Guaranty Financial Services of Springfield, Inc., a Missouri corporation. This service corporation, which has been inactive since February 1, 2003, had agreements with third party providers for the sale of securities and casualty insurance products.

The Company's banking operation conducted through its principal subsidiary, the Bank, is the Company's only reportable segment. Other information about the Company's business segments is contained in the section captioned "Segment Information" in Note 1 to the consolidated financial statements in the 2006 Annual Report. This information is incorporated herein by reference.

Critical Accounting Policies

"Management's Discussion and Analysis of Financial Condition and Results of Operations" contained in Item 8 of this report is based upon the Company's consolidated financial statements and the notes thereto, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported periods. On an on-going basis, management evaluates its estimates and judgments.

Management bases its estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. There can be no assurance that actual results will not differ from those estimates. If actual results are different than management's judgments and estimates, the Company's financial results could change, and such change could be material to the Company.

Material estimates and judgments that are particularly susceptible to significant change relate to the determination of the allowance for loan losses and the valuation of real estate acquired in connection with foreclosures or in satisfaction of loans. In connection with the determination of the allowance for loan losses and the valuation of foreclosed assets held for sale, management obtains independent appraisals for significant properties.

The Company has identified the accounting policies for the allowance for loan losses and related significant estimates and judgments as critical to its business operations and the understanding of its results of operations. For a detailed discussion on the application of these significant estimates and judgments and our accounting policies, also see Note 1 to the Consolidated Financial Statements in the 2006 Annual Report.

Table of Contents**Return on Equity and Assets**

The following table sets forth certain dividend, equity and asset ratios of the Company for the periods indicated.

| | Year ended December 31, 2006 | Year ended December 31, 2005 | Year ended December 31, 2004 |
|--------------------------------|------------------------------------|------------------------------------|------------------------------------|
| Dividend Payout Ratio | 28% | 32% | 43% |
| Return on Average Assets | 1.33% | 1.28% | 1.04% |
| Return on Average Equity | 14.66% | 15.08% | 10.74% |
| Stockholders' Equity to Assets | 8.55% | 8.75% | 9.25% |
| <hr/> | | | |
| EPS Diluted | \$ 2.34 | 2.03 | 1.47 |
| Dividends | \$ 0.67 | 0.65 | 0.63 |

Employees

As of March 21, 2007, the Bank has 114 full-time employees and 44 part-time employees. As of December 31, 2006 the Company had no salaried employees. None of the Bank's employees are represented by a collective bargaining group. The Bank believes that its relationship with its employees is good.

Competition

The Bank experiences substantial competition both in attracting and retaining deposit accounts and in the making of mortgage and other loans.

Direct competition for savings accounts comes from other savings institutions, credit unions, regional bank and thrift holding companies, and commercial banks located in its primary market area. Significant competition for the Bank's other deposit products and services comes from money market mutual funds, brokerage firms, insurance companies, and retail stores. The primary factors in competing for loans are interest rates and loan origination fees and the range of services offered by various financial institutions. Competition for origination of real estate and other loans normally comes from commercial banks, savings institutions, mortgage bankers, mortgage brokers, and insurance companies.

The Bank's primary competition comprises the financial institutions near each of the Bank's offices. In the Springfield metropolitan area, where the Bank's main office and branch offices are located, primary competition consists of 23 commercial banks, 12 credit unions, and 1 savings institution.

The Bank believes it is able to compete effectively in its primary market area by offering competitive interest rates and loan fees, and a variety of deposit products, and by emphasizing personal customer service.

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Website

The Company maintains a website at the following internet address: www.gbankmo.com.

Regulation

Set forth below is a brief description of certain laws which relate to the regulation of the Company and the Bank. These laws, and regulations adopted under these laws, are primarily intended for the protection of the Bank's customers and depositors and not for the benefit of the stockholders of the Company. The following description does not purport to be complete and is qualified in its entirety by reference to the applicable laws and regulations.

Regulation of the Company

General. The Company is a registered bank holding company subject to regulation and supervision of the Board of Governors of the Federal Reserve System ("FRB") under the Bank Holding Company Act of 1956 ("BHCA").

Capital. The FRB has adopted risk-based capital guidelines for bank holding companies. The minimum guideline for the ratio ("Risk-Based Capital Ratio") of total capital ("Total Capital") to risk-weighted assets (including certain off-balance-sheet commitments such as standby letters of credit) is 8%. At least one-half of Total Capital must be composed of Tier 1 Capital which generally consists of common shareholders' equity, minority interests in the equity accounts of consolidated subsidiaries, noncumulative perpetual preferred stock, a limited amount of cumulative perpetual preferred stock and certain nonfinancial equity investments, less goodwill and certain other intangible assets. The remainder, denominated "Tier 2 Capital," generally consists of limited amounts of subordinated debt, qualifying hybrid capital instruments, other preferred stock, loan loss reserves and unrealized gains on certain equity securities.

In addition, the FRB has established minimum leverage ratio guidelines for bank holding companies. These guidelines provide for a minimum ratio of Tier 1 Capital to average total assets less goodwill ("Leverage Ratio") of 3% for bank holding companies that meet certain specified criteria, including those having the highest regulatory rating. All other bank holding companies generally are required to maintain a Leverage Ratio of at least 4%. The guidelines also provide that bank holding companies anticipating or experiencing internal growth or making acquisitions are expected to maintain strong capital positions substantially above the minimum supervisory levels without significant reliance upon intangible assets. Furthermore, the FRB has indicated that it will consider a "tangible Tier 1 Leverage Ratio" (after deducting all intangibles) and other indicia of capital strength in evaluating proposals for expansion or new activities.

The Bank is subject to Risk-Based Capital and Leverage Ratio requirements adopted by the FDIC, which are substantially similar to those adopted by the FRB. See "Regulation of the Bank - Prompt Corrective Action." In addition, a bank's capital classifications may affect a bank's activities. For example, under regulations adopted by the FDIC governing the receipt of brokered deposits, a bank may not lawfully accept, roll over or renew brokered deposits unless either (i) it is well capitalized or (ii) it is adequately capitalized and receives a waiver from the FDIC.

As of December 31, 2006, the Company and the Bank met their minimum capital adequacy guidelines, and the Bank was categorized as well capitalized. Applicable capital and ratio information is contained under the section titled "Regulatory Matters" in Note 1 to the Consolidated Financial Statements in the 2006 Annual Report.

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Dividend Restrictions and Share Repurchases. The Company's source of cash flow (including cash flow to pay dividends to stockholders) is dividends paid to it by the Bank. The right of the Company to receive dividends or other distributions from the Bank is subject to the prior claims of creditors of the Bank, including depositors.

There are statutory and regulatory limitations on the payment of dividends to the Company by the Bank. See discussion under "Regulation of the Bank - Dividend Limitations." Future dividends will depend primarily upon the level of earnings of the Bank. Banking regulators also have the authority to prohibit banks and bank holding companies from paying a dividend if they should deem such payment to be an unsafe or unsound practice.

Unless a bank holding company is well capitalized immediately before and after the repurchase of its equity securities, is well managed and is not subject to any unresolved supervisory issues, it must notify the FRB prior to the purchase or redemption of its outstanding equity securities if the gross consideration for the purchase or redemption, when combined with the net consideration (gross consideration paid minus the gross consideration received from the sale of equity securities) paid by the Company during the preceding twelve months, is equal to 10% or more of the Company's consolidated net worth. The FRB may disapprove of the purchase or redemption if it determines, among other things, that the proposal would constitute an unsafe or unsound business practice.

Support of Banking Subsidiaries. Under FRB policy, the Company is expected to act as a source of financial strength to the Bank and, where required, to commit resources to support the Bank. Moreover, if the Bank should become undercapitalized, the Company would be required to guarantee the Bank's compliance with its capital restoration plan in order for such plan to be accepted by the FDIC.

Acquisitions. Under the BHCA, the Company must obtain the prior approval of the FRB before it may acquire all or substantially all of the assets of any bank, acquire direct or indirect ownership or control of more than 5% of the voting shares of any bank, or merge or consolidate with any other bank holding company. The BHCA also restricts the Company's ability to acquire direct or indirect ownership or control of 5% or more of any class of voting shares of any nonbanking corporation. The FRB is required to consider the financial and managerial resources and future prospects of the bank holding companies and banks concerned and the convenience and needs of the community to be served. Consideration of financial resources generally focuses on capital adequacy. Consideration of convenience and needs issues includes the involved institutions' performance under the Community Reinvestment Act of 1977, as amended (the "CRA"). Under the CRA, all financial institutions have a continuing and affirmative obligation consistent with safe and sound operation to help meet the credit needs of their entire communities, including low-to-moderate income neighborhoods. Based on its most recent CRA compliance examinations, the Bank has received a "satisfactory" CRA rating.

Transactions With Affiliates. There are various legal restrictions on the extent to which a bank holding company may borrow or otherwise obtain credit from or sell assets or affiliate securities to its bank subsidiary. In general, covered transactions with a bank subsidiary must be on nonpreferential terms and cannot exceed, as to any one of the holding company or the holding company's nonbank subsidiaries, 10% of the bank's capital stock and surplus, and as to the holding company and all of its nonbank subsidiaries in the aggregate, 20% of such capital stock and surplus. Special collateral requirements also apply to covered extensions of credit.

Regulation of the Bank

General. The Bank is regulated and supervised by the Missouri Division of Finance, and its deposits are insured by the Savings Association Insurance Fund ("SAIF") of the FDIC. Lending activities and other investments must comply with various federal statutory and regulatory requirements. The Bank is also subject to certain reserve requirements promulgated by the FRB.

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The Missouri Division of Finance, in conjunction with the FDIC, will regularly examine the Bank and provide reports to the Bank's Board of Directors on any deficiencies that are found in the Bank's operations. The Bank's relationship with its depositors and borrowers is also regulated to a great extent by federal and state law, especially in such matters as the ownership of savings accounts and the form and content of the Bank's mortgage documents.

The Bank must file reports with the Missouri Division of Finance and the FDIC concerning its activities and financial condition, in addition to obtaining regulatory approvals prior to entering into certain transactions such as mergers with or acquisitions of other banks or savings institutions. This regulation and supervision establishes a comprehensive framework of activities in which an institution can engage and is intended primarily for the protection of the SAIF and depositors. The regulatory structure also gives the regulatory authorities extensive discretion in connection with their supervisory and enforcement activities and examination policies, including policies with respect to the classification of assets and the establishment of adequate loan loss reserves for regulatory purposes.

Insurance of Deposit Accounts. The deposit accounts held by the Bank are insured by the SAIF to a maximum of \$100,000 for each insured depositor (as defined by law and regulation). Insurance of deposits may be terminated by the FDIC upon a finding that the institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC or the institution's primary regulator.

The FDIC charges an annual assessment for the insurance of deposits based on the risk a particular institution poses to its deposit insurance fund. Under this system, SAIF members pay within a range of 0 cents to 27 cents per \$100 of domestic deposits, depending upon the institution's risk classification. Risk classification is based on an institution's capital group and supervisory subgroup assignment. In addition, all FDIC-insured institutions are required to pay assessments to the FDIC at an annual rate of approximately .0172% of insured deposits to fund interest payments on bonds issued by the Financing Corporation ("FICO"), an agency of the Federal government established to recapitalize the predecessor to the SAIF. These assessments will continue until the FICO bonds mature in 2017.

See "Recent Legislation and Legislative and Regulatory Initiatives" below for recent legislation which affects insurance on deposit accounts and other matters.

Prompt Corrective Action. The FDIC is required to take prompt corrective action if a depository institution for which it is the regulator, including the Bank, does not meet its minimum capital requirements. A depository institution is considered to be significantly undercapitalized if it has a Total Capital Ratio of less than 6.0%; a Tier I Capital ratio of less than 3.0%; or a Leverage Ratio of less than 3.0%. An institution that has a tangible equity capital to assets ratio equal to or less than 2.0% is deemed to be critically undercapitalized. "Tangible equity" includes core capital elements counted as Tier 1 Capital for purposes of the risk-based capital standards, plus the amount of outstanding cumulative perpetual preferred stock (including related surplus), minus all intangible assets, with certain exceptions.

The FDIC may, under certain circumstances, reclassify a well capitalized insured depository institution as adequately capitalized. It is also permitted to require an adequately capitalized or undercapitalized institution to comply with the supervisory provisions as if the institution were in the next lower category (but not treat a significantly undercapitalized institution as critically undercapitalized) based on supervisory information other than the capital levels of the institution. An institution may be reclassified if the FDIC determines (after notice and opportunity for hearing) that the institution is in an unsafe or unsound condition or deems the institution to be engaging in an unsafe or unsound practice.

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As stated previously, the Company and the Bank met their minimum capital adequacy guidelines, and the Bank was categorized as well capitalized, as of December 31, 2006. Applicable capital and ratio information is contained under the section titled "Regulatory Matters" in Note 1 to the Consolidated Financial Statements in the 2006 Annual Report.

Safety and Soundness Standards. Federal bank regulators are required to prescribe standards, by regulations or guidelines, relating to the internal controls, information systems and internal audit systems, loan documentation, credit underwriting, interest-rate-risk exposure, asset growth, asset quality, earnings, stock valuation and compensation, fees and benefits and such other operational and managerial standards as the agencies may deem appropriate. The federal bank regulatory agencies have adopted guidelines prescribing safety and soundness standards, which require, among other things, appropriate systems and practices to identify and manage the risks and exposures specified in the guidelines.

Anti-Terrorism Legislation. The USA Patriot Act of 2001 contains anti-money laundering measures affecting insured depository institutions, broker-dealers and certain other financial institutions. U.S. financial institutions are required to adopt policies and procedures to combat money laundering and the Treasury Secretary is granted broad authority to establish regulations and to impose requirements and restrictions on financial institutions' operations.

Dividend Limitations. In the event the Bank would fail to meet federal minimum capital adequacy guidelines, its ability to pay dividends to the Company would be restricted. In addition, under Missouri law dividends paid by banks are restricted by a statutory formula, which provides for the maintenance of a surplus fund and prohibits the payment of dividends which would impair the surplus fund.

Recent Legislation and Legislative and Regulatory Initiatives

On February 8, 2006, the Federal Deposit Insurance Reform Act of 2005 ("FDIRA") was signed into law as part of the Deficit Reduction Act of 2005 (conforming amendments are contained in the Federal Deposit Insurance Conforming Amendments Act of 2005 signed into law on February 15, 2006). Under FDIRA, the SAIF and the FDIC's Bank Insurance Fund ("BIF") was merged into the new Deposit Insurance Fund ("DIF"). In addition, while general coverage remains at \$100,000, beginning April 1, 2010 and the first day of each subsequent five year period the coverage is subject to increases for inflation, and FDRIA increases the deposit insurance coverage for individual retirement accounts and certain other employee benefit plan accounts to \$250,000, subject to increases for inflation, and provides pass-through coverage for employee benefit plans. FDRIA also authorizes the FDIC to set deposit insurance premium assessments for depository institutions in amounts the FDIC determines to be necessary or appropriate, taking into consideration certain factors, including the estimated operating expenses of the DIF, the estimated case resolution expenses and income of the DIF, the projected effects on the capital and earnings of depository institutions, the risk factors taken into consideration under the risk-based assessment system and any other factors deemed by the FDIC to be appropriate. Further, FDRIA establishes the DIF's reserve ratio to range from 1.15% to 1.50%, the ratio to be determined annually by the FDIC regulations, and requires the FDIC to declare dividends payable to depository institutions equal to 100% of the amount of the reserve in excess of 1.50% and 50% of the amount of the reserve between 1.35% and 1.50%. Other than the merger of the SAIF and the BIF, which was effective July 1, 2006, the foregoing and other provisions of FDRIA will be effective upon the FDIC prescribing final regulations implementing the provisions, which shall not be later than 270 days after enactment of FDRIA.

Additional proposals to change the laws governing the financial institutions industry may be introduced in the United States Congress and in state legislatures, and the various banking agencies often modify existing regulations or adopt new regulations. It cannot be determined what impact future legislation or regulations will have on the financial institutions industry generally or on the Company and the Bank.

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Executive Officers of the Registrant

Set forth below is information concerning the executive officers of the Company.

Shaun A. Burke joined the Bank in March 2004 as president and Chief Executive Officer. Mr. Burke was appointed president and Chief Executive Officer of the Company on February 28, 2005. Mr. Burke was previously with Signature Bank for seven years where he served as executive vice president, senior credit officer, and was a member of the board of directors. Mr. Burke has a total of 22 years banking experience. Mr. Burke is also a past member of the United Way Allocations and Agency Relations Executive Committee, Salvation Army Board, and Big Brothers Big Sisters Board.

Carter Peters is Executive Vice President and Chief Financial Officer and Chief Operations Officer of the Bank and the Company. He joined the Bank and the Company in August 2005 as Executive Vice President and Chief Operations Officer and was appointed as the Chief Financial Officer of the Bank and the Company on February 12, 2007. Mr. Peters has over 14 years of experience in the financial services and public accounting industries. Prior to joining the Company, Mr. Peters served as the Chief Financial Officer of Southern Missouri Bank for approximately two years and was employed by BKD, LLP, a certified public accounting and advising firm, for approximately eleven years. He is a Certified Public Accountant with a Bachelor of Science Degree in Accounting from Missouri State University. He is a member of the American Institute of Certified Public Accountants and the Missouri Society of Certified Public Accountants. He is a current Board member of the local Make-A-Wish Foundation and a member of the advisory committee for Families for Children, a project of the Council of Churches of the Ozarks.

H. Michael Mattson is Executive Vice President and Chief Lending Officer of the Bank. He joined the Bank in June 2006. Mr. Mattson has over 28 years of commercial banking experience. He was previously with Liberty Bank for six years, including four as Senior Loan Officer. Mr. Mattson is currently Board President of Ozarks Food Harvest, Inc., member of the Springfield Area Chamber of Commerce and has served on its board nominating committee and venture capital committee. He is a member of Leadership Springfield Class XI and a graduate of Rockhurst University and the Graduate School of Banking of The South at Baton Rouge, LA.

As of December 31, 2006, the age of these individuals was 44 for Mr. Burke, 37 for Mr. Peters, and 53 for Mr. Mattson.

Item 1A. Risk Factors

The Company's business and operations are subject to, and may be adversely affected by, certain risks and uncertainties. The following risks and other information in this report that is incorporated in this report by reference, including the Company's consolidated financial statements and related notes and "Management's Discussion and Analysis of Financial Condition and Results of Operations", should be carefully considered. These risks are not the only ones facing the Company. Additional risks and uncertainties that management is not aware of or focused on may also adversely affect the Company's business and operation. This Form 10-K is qualified in its entirety by all these risk factors.

The market price of the Company's common stock may fluctuate significantly in response to a number of factors, including:

- Changes in securities analysts' estimates of financial performance
- Volatility of stock market prices and volumes

- Rumors or erroneous information

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- Changes in market valuations of similar companies
 - Changes in interest rates
- New developments in the banking industry
- Variations in quarterly or annual operating results
- New litigation or changes in existing litigation
 - Regulatory actions

Changes in accounting policies or procedures as may be required by the Financial Accounting Standards Board or other regulatory agencies

Geographical Risk

The Company's main markets are in Greene and Christian counties in southwest Missouri. Since the Company does not have significant presence in other parts of the country, a prolonged economic downturn in these markets could negatively impact the Company.

Industry Risk

The Company operates in the financial services industry, a rapidly changing environment having numerous competitors including other banks and insurance companies, securities dealers, brokers, trust and investment companies and mortgage bankers. The pace of consolidation among financial service providers is accelerating and there are many new changes in technology, product offerings and regulation.

The Company must continue to make investments in its products and delivery systems to stay competitive with the industry as a whole or its financial performance may suffer.

Regulatory Risk

The Company and its subsidiaries are subject to extensive state and federal regulation, supervision and legislation that govern nearly every aspect of its operations. Changes to these laws could affect the Company's ability to deliver or expand its services and diminish the value of its business.

Interest Rate Risk

The Company's net interest income is the largest source of overall revenue to the Company and is mainly based on the difference between interest earned on loans and investment securities, and the interest paid on deposits and other borrowings. Interest rates are beyond the Company's control, and they fluctuate in response to general economic conditions and the policies of various governmental and regulatory agencies, in particular, the Federal Reserve Board. Changes in monetary policy, including changes in interest rates, will influence the origination of loans, the purchase of investments, the generation of deposits, and the rates received on loans and investment securities and paid on deposits.

Lending Risk

There are inherent risks associated with the Company's lending activities. Changes in economic conditions and changes in interest rates among other things could impact borrowers' capabilities to repay the Company outstanding loans. For a complete discussion of the risk elements of the Company's loan portfolio, please refer to page 7.

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Litigation Risk

From time to time, the Company is subject to claims and litigation from customers and other individuals. Whether such claims and legal action are founded or unfounded, if such claims and legal actions are not resolved in a manner favorable to the Company, they may result in significant financial liability and/or adversely affect the market perception of the Company and its products and services. Any financial liability or reputation damage could have a material adverse effect on the Company's business and financial performance.

Item 1B. Unresolved Staff Comments

Not applicable.

Item 2. Properties

The offices of the Company are located in the main office of the Bank.

The Bank's office facilities currently consist of its main office located at 1341 W. Battlefield in Springfield, Greene County, Missouri, six full-service branch offices in Springfield and one full-service branch and one in-store branch located in the Wal-Mart Supercenter in Nixa, Christian County, Missouri. The Bank has a relatively new main office building, which provides the Bank with a modern office for customer services and projects a favorable image for the Bank in the local marketplace. The Bank also leases facilities in West Plains, Mountain Grove and Marshfield, Missouri for recently established loan production offices.

The Bank maintains a network of Automated Teller Machines ("ATMs"). A total of 20 ATMs are located at various branches and primarily convenience stores located in Greene and Christian Counties in Missouri. In addition, the Bank is a member of the TransFund ATM network which provides its customers surcharge free access to over 80 area ATMs and over 700 ATMs nationwide. The Bank will evaluate and relocate existing ATMs as needed.

Item 3. Legal Proceedings

(a) Material Legal Proceedings

The Company and the Bank, from time to time, may be parties to ordinary routine litigation, which arises in the normal course of business, such as claims to enforce liens, and condemnation proceedings, on properties in which the Bank holds security interests, claims involving the making and servicing of real property loans, and other issues incident to the business of the Company and the Bank. As of December 31, 2006, there were no claims or lawsuits pending or known to be contemplated against the Company or the Bank that would have had a material effect on the Company or the Bank.

(b) Proceedings Terminated During the Last Quarter of the Fiscal Year Covered by This Report

Not applicable.

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

No matter was submitted to a vote of security holders during the last quarter of the fiscal year ended December 31, 2006.

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

The information contained in the section captioned "Investor Information-Common Stock Prices and Dividends" on page 1 of the 2006 Annual Report is incorporated herein by reference.

With respect to the equity compensation plan information required by this item, see "Item 12. Security Ownership of Certain Owners and Management and Related Stockholder Matters" in this report.

Issuer Purchase of Equity Securities

The following table summarizes the repurchase activity of the Company's Common Stock during the Company's fourth quarter ended December 31, 2006.

| Period | (a) Total Number of Shares Purchased | (b) Average Price Paid per Share | (c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1) | (d) Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs |
|---------------------------------------|--------------------------------------|----------------------------------|--|--|
| October 1, 2006 to October 31, 2006 | 500 | 28.57 | 500 | 200,977 |
| November 1, 2006 to November 30, 2006 | 18,400 | 28.47 | 18,400 | 182,577 |
| December 1, 2006 to December 31, 2006 | 19,100 | 28.65 | 19,100 | 163,477 |
| Total | 38,000 | - | 38,000 | |

(1) The Company has a repurchase plan which was announced on July 25, 2006. This plan authorizes the purchase by the Company of 250,000 shares of the Company's common stock. There is no expiration date for this plan. There are no other repurchase plans in effect at this time.

The information included under the caption "Junior Subordinated Debentures" in Item 1 of Part 1 of this Report, which relates to the offer and sale of certain trust preferred securities, is incorporated herein by reference. The securities were offered and sold in a private placement in reliance upon the exemption set forth in Section 4(2) of the Securities Act of 1933, as amended (the "Act"), to a selected group of institutional purchasers who are "accredited investors" within the meaning of Section 501(a) of Regulation D under the Act. The Company paid \$30,000 in legal fees on this offering.

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Item 6. Selected Financial Data

The information contained on page 4 under the section captioned “Selected Consolidated Financial and Other Data” of the 2006 Annual Report is incorporated herein by reference.

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

The information contained on pages 6 through 20 under the section captioned “Management’s Discussion and Analysis of Financial Condition and Results of Operations” of the 2006 Annual Report is incorporated herein by reference.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

The information contained on page 14 and 15 under the sections captioned “Asset/Liability Management” and “Interest Rate Sensitivity Analysis” of the 2006 Annual Report is incorporated herein by reference.

Item 8. Financial Statements and Supplementary Data

The financial statements set forth on pages 21 to 48 of the 2006 Annual Report and the financial information contained under the section captioned “Summary of Unaudited Quarterly Operating Results” set forth on page 20 of the 2006 Annual Report are incorporated herein by reference.

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

Not applicable.

Item 9A. Controls and Procedures

(a) The Company maintains disclosure controls and procedures as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), that are designed to ensure that information required to be disclosed in the Company’s Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission’s rules and forms, and that such information is accumulated and communicated to the Company’s management, including its Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

The Company carried out an evaluation, under the supervision and with the participation of the Company’s management, including the Company’s Chief Executive Officer and Chief Financial Officer, of the effectiveness of the Company’s disclosure controls and procedures. Based on the foregoing evaluation, the Company’s Chief Executive Officer and Chief Financial Officer concluded that the Company’s disclosure controls and procedures were effective as of December 31, 2006.

(b) There have been no changes in the Company’s internal control over financial reporting during the fourth quarter ending December 31, 2006 that have materially affected, or are reasonably likely to materially affect, the Company’s internal controls over financial reporting.

Item 9B. Other Information

Not applicable.

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PART III

Item 10. Directors, Executive Officers and Corporate Governance

The information contained under the section captioned "First Proposal: Election of Directors" (excluding any information contained under the section captioned "Meetings and Committees of the Board of Directors") of the Proxy Statement is incorporated herein by reference.

The Company has adopted a Code of Conduct and Ethics, and it applies to all of the members of the board of directors, officers and employees of the Company (including the Bank), with special emphasis on compliance by the directors of the Company and the Company's Chief Executive Officer, Chief Financial Officer, Principal Accounting Officer or Controller or persons performing similar functions for the Company. The Company's Code of Conduct and Ethics is available on the Company's website at www.gbankmo.com and may be accessed by logging onto the Company's website and clicking on the "About Us" link and then the "Code of Conduct" link. You will then be able to click on, and access, the Company's Code of Conduct and Ethics. Amendments to, and waivers granted under, the Company's Code of Conduct and Ethics, if any, will be posted to the Company's website as well.

The information required by Item 10 regarding an audit committee financial expert and the identification of the members of the audit committee, a separately designated committee of the Company's board of directors established in accordance with section 3(a)(58)(A) of the Securities Exchange Act of 1934, is contained under the section captioned "Report of the Audit Committee" of the Proxy Statement and is incorporated herein by reference.

Additional information required by this item is contained (i) in the Proxy Statement under the section captioned "Section 16(a) Beneficial Ownership Reporting Compliance" and is incorporated herein by reference, and (ii) under the section captioned "Executive Officers of the Registrant" in Item 1 of this report.

Item 11. Executive Compensation

The information contained in the Proxy Statement under the section captioned "Report of the Compensation Committee" is incorporated herein by reference.

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

Except as set forth below, information required by this item is contained under the section captioned "Voting Securities and Principal Holders Thereof" in the Proxy Statement and is incorporated herein by reference.

Table of Contents**Equity Compensation Plan Information**

| <u>Plan category</u> | (a) Number of securities to be issued upon exercise of outstanding options, warrants and rights | (b) Weighted-average exercise price of outstanding options, warrants and rights | (c) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) |
|---|--|---|---|
| Equity compensation plans approved by security holders | 231,559 | 16.59 | 215,582 |
| Equity compensation plans not approved by security holders | 39,138 | 18.44 | 3,498 |
| Totals | 270,697 | 16.86 | 219,080 |

Description of Stock Plans Not Approved by Stockholders

2000 Stock Compensation Plan. During the year ended June 30, 2000, the directors of the Company established the 2000 Stock Compensation Plan (the “2000 SCP”) with both a stock award component and a stock option component for a term of ten years. A committee of the Bank’s Board of Directors (the “Committee”) administers this plan and the 2001 SCP (discussed below). Stock options awarded under the plan are considered non-qualified for federal income tax purposes. Officers, directors and employees of the Company and its subsidiaries are eligible under the plan. Stock awards and stock options vest at the rate of 20% per year over a five year period and become fully vested in the event of a “change in control” as defined in the plan. In addition, the price of the stock options may not be less than the market value of the Company’s common stock on the date of grant, and the stock options expire no later than ten years from the date of grant. Under the stock award component of this plan, the Committee awarded 7,125 restricted shares of the Company’s common stock. As of December 31, 2006, there are no restricted shares in this plan that are not vested. There have been 17,875 options granted under this plan at an exercise price of \$10.50 per share. The maximum number of shares of the Company’s common stock permitted to be awarded under this plan (25,000) have been awarded. Previously issued awards or options which expire, become unexercisable, or are forfeited prior to their exercise may be granted as new awards or options under the plan for the number of shares which were subject to such expired or forfeited awards or options.

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2001 Stock Compensation Plan. During the year ended June 30, 2001, the directors of the Company established the 2001 Stock Compensation Plan (the "2001 SCP") with both a stock award component and a stock option component for a term of ten years. Stock options awarded under the plan are considered non-qualified for federal income tax purposes. Officers, directors and employees of the Company and its subsidiaries are eligible under the plan. Stock awards and stock options vest at the rate of 20% per year over a five year period and become fully vested in the event of a "change in control" as defined in the plan. In addition, the price of the stock options may not be less than the market value of the Company's common stock on the date of grant, and the stock options expire no later than ten years from the date of grant. Under the stock award component of this plan, the Committee awarded 10,239 restricted shares of the Company's common stock. As of December 31, 2006, all restricted shares in this plan are vested. There have been 13,236 options granted under this plan at an exercise price of \$23.61 per share. The maximum number of shares of the Company's Common Stock permitted to be awarded under this plan is 25,000 shares. Previously issued awards or options which expire, become exercisable, or are forfeited prior to their exercise may be granted as new awards or options under the plan for the number of shares which were subject to such expired or forfeited awards or options.

2003 Stock Option Agreement. During the period ended December 31, 2003, the independent directors of the Company authorized the issuance of 5,000 stock options as an employment inducement to a new officer of the Bank pursuant to an individual stock option agreement. Stock options awarded under this agreement are considered non-qualified for federal income tax purposes, vest at the rate of 20% per year over a five year period, become fully vested in the event of a "change in control" as defined in the agreement and expire no later than ten years from the date of grant. In addition, pursuant to the term of the stock option agreement which requires that the price of the stock options granted thereunder may not be less than the market value of the Company's common stock on the date of grant, all of these options were granted at an exercise price of \$17.20 per share.

2004 Stock Option Agreement. Pursuant to the authorization of the independent directors of the Company, 25,000 stock options were issued by the Company on March 9, 2004 as an employment inducement to a new officer (Shaun Burke) of the Bank under an individual stock option agreement. Stock options awarded under this agreement are considered non-qualified for federal income tax purposes, vest at the rate of 20% per year over a five year period, become fully vested in the event of a "change in control" as defined in the agreement and expire no later than ten years from the date of grant. In addition, pursuant to the term of the stock option agreement which requires that the price of the stock options granted thereunder may not be less than the market value of the Company's common stock on the date of grant, all of these options were granted at an exercise price of \$19.62 per share.

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

The information required by this item is contained under the sections captioned "Indebtedness of Management and Directors and Transactions with Certain Related Persons" and "Director Independence" in the Proxy Statement and is incorporated herein by reference.

Item 14. Principal Accountant Fees and Services

The information required by this item is contained under the section captioned "Principal Accountant Fees and Services" in the Proxy Statement and is incorporated herein by reference.

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PART IV

Item 15. Exhibits and Financial Schedules

1. The following financial statements and the report of independent registered public accounting firm included in the 2006 Annual Report are filed as part of this Report and incorporated herein by reference.

Report of Independent Registered Public Accounting Firm

Consolidated Balance Sheets as of December 31, 2006 and 2005.

Consolidated Statements of Income for the Years Ended December 31, 2006, 2005 and 2004.

Consolidated Statements of Stockholders' Equity for the Years Ended December 31, 2006, 2005 and 2004.

Consolidated Statements of Cash Flows for the Years Ended December 31, 2006, 2005 and 2004.

Notes to Consolidated Financial Statements.

2. Financial statement schedules for which provision is made in the applicable accounting regulations of the SEC are not required under the related instructions or are inapplicable and therefore have been omitted.

3. The following exhibits are filed with this Report or incorporated herein by reference:

Index to Exhibits

Exhibit

Number Exhibit Description

| | |
|-------|--|
| 3(i) | Restated Certificate of Incorporation of Guaranty Federal Bancshares, Inc. (1) |
| 3(ii) | Bylaws of Guaranty Federal Bancshares, Inc., as amended (7) |
| 4 | Rights Agreement dated January 20, 1999 concerning the issuance of preferred stock and related rights. (2) The Company hereby agrees to furnish the SEC upon request, copies of the instruments defining the rights of the holders of each issue of its junior subordinated debentures. |
| 10.1 | 1994 Stock Option Plan *(3) |
| 10.2 | Recognition and Retention Plan *(4) |
| 10.3 | 1998 Stock Option Plan *(5) |
| 10.4 | Restricted Stock Plan *(6) |
| 10.5 | Form of Change in Control Severance Agreement *(6) |
| 10.6 | 2000 Stock Compensation Plan *(6) |
| 10.7 | 2001 Stock Compensation Plan *(6) |
| 10.8 | 2003 Stock Option Agreement *(8) |
| 10.9 | Employment Agreement effective as of March 9, 2004 by and between the Bank and Shaun A. Burke *(9) |

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| 10.10 | 2004 Stock Option Agreement dated March 9, 2004 between the Company and Shaun A. Burke *(10) |
| 10.11 | 2004 Stock Option Plan *(11) |
| 10.12 | Form of Incentive Stock Option Agreement under the 2004 Stock Option Plan * |
| 10.13 | Form of Non-Incentive Stock Option Agreement under the 2004 Stock Option Plan * |
| 10.14 | Form of Incentive Stock Option Agreement under the 1994 Stock Option Plan *(12) |
| 10.15 | Form of Non-Incentive Stock Option Agreement under the 1994 Stock Option Plan *(13) |
| 10.16 | Incentive Stock Option Agreement dated March 17, 2005 between the Company and Shaun A. Burke (issued pursuant to the 2001 Stock Option Plan) *(14) |
| 10.17 | Resignation and Separation Agreement and Release of All Claims effective as of October 1, 2005 between the Bank and Eldon Erwin * |
| 10.18 | Resignation and Separation Agreement and Release of All Claims effective as of August 6, 2005 between the Company, the Bank and William B. Williams *(15) |
| 10.19 | Written Description of Compensatory Arrangement with Chief Operating Officer and Chief Financial Officer * |
| 11 | Computation of per share earnings is set forth in Note 1 of the Notes to the Consolidated Financial Statements under the section captioned “Earnings Per Share” in the 2006 Annual Report. |
| <u>13</u> | Annual Report to Stockholders for the fiscal period ended December 31, 2006 (only those portions incorporated by reference in this document are deemed “filed”) |
| 21 | Subsidiaries of the Registrant (See Item 1. Business - Subsidiary and Segment Information) |
| <u>23</u> | Consent of BKD, LLP |
| <u>31(i).1</u> | Certification of the Principal Executive Officer pursuant to Rule 13a-14(a) of the Exchange Act |
| <u>31(i).2</u> | Certification of the Principal Financial Officer pursuant to Rule 13a-14(a) of the Exchange Act |
| <u>32.1</u> | CEO certification pursuant to 18 U.S.C. Section 1350 |
| <u>32.2</u> | CFO certification pursuant to 18 U.S.C. Section 1350 |

* Management contract or compensatory plan or arrangement

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- (1) Filed as an exhibit to the Annual Report on Form 10-K for the fiscal year ended June 30, 1998 (SEC File No. 0-23325) and incorporated herein by reference.
- (2) Filed as an exhibit to the Form 8A filed by Registrant on January 22, 1999 and incorporated herein by reference.
- (3) Filed as Exhibit 10.1 of the Registration Statement on Form S-1 filed by the Registrant on September 23, 1997 (SEC File No. 333-36141) and incorporated herein by reference.
- (4) Filed as Exhibit 10.2 of the Registration Statement on Form S-1 filed by the Registrant on September 23, 1997 (SEC File No. 333-36141) and incorporated herein by reference.
- (5) Filed as Exhibit 4 to the Form S-8 Registration Statement filed by the Registrant on March 6, 2002 (SEC File No. 333-83822) and incorporated herein by reference.
- (6) Filed as an exhibit to the Annual Report on Form 10-K for the fiscal year ended June 30, 2001 (SEC File No. 0-23325) and incorporated herein by reference.
- (7) Filed as Exhibit 3(ii) to the Quarterly Report on Form 10-Q for the quarter ended June 30, 2004 filed by the Registrant on August 10, 2004 (SEC File No. 0-23325) and incorporated herein by reference.
- (8) Filed as Exhibit 10.8 to the Annual Report on Form 10-K for the transition period ended December 31, 2003 filed by the Registrant on March 30, 2004 (SEC File No. 0-23325) and incorporated herein by reference.
- (9) Filed as Exhibit 10.9 to the Current Report on Form 8-K filed by the Registrant on January 24, 2005 (SEC File No. 0-23325) and incorporated herein by reference.
- (10) Filed as Exhibit 10.10 to the Current Report on Form 8-K filed by the Registrant on January 24, 2005 (SEC File No. 0-23325) and incorporated herein by reference.
- (11) Filed as Appendix A to the proxy statement for the annual meeting of stockholders held on May 19, 2004 (SEC File No. 0-23325) and incorporated herein by reference.
- (12) Filed as Exhibit 4.2 to the Form S-8 Registration Statement filed by the Registrant on March 3, 1998 (SEC File No. 333-47241) and incorporated herein by reference.
- (13) Filed as Exhibit 4.3 to the Form S-8 Registration Statement filed by the Registrant on March 3, 1998 (SEC File No. 333-47241) and incorporated herein by reference.
- (14) Filed as Exhibit 10.16 to the Current Report on Form 8-K filed by the Registrant on March 22, 2005 (SEC File No. 0-23325) and incorporated herein by reference.
- (15) Filed as Exhibit 10.18 to the Quarterly Report on Form 10-Q for the quarter ended June 30, 2005 filed by the Registrant on August 15, 2005 (SEC File No. 0-23325) and incorporated herein by reference.

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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.

**GUARANTY FEDERAL BANCSHARES,
INC.**

Dated: March 31, 2007

By: /s/ Shaun A. Burke
Shaun A. Burke
President and Chief Executive Officer
(Duly Authorized Representative)

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

By: /s/ Shaun A. Burke
Shaun A. Burke
President and Chief Executive Officer
and Director
(Principal Executive Officer)
Date: March 31, 2007

By: /s/ Tim Rosenbury
Tim Rosenbury
Director
Date: March 31, 2007

By: /s/ Carter Peters
Carter Peters
EVP and Chief Financial Officer
(Principal Accounting and Financial Officer)
Date: March 31, 2007

By: /s/ James R. Batten
James R. Batten
Director
Date: March 31, 2007

By: /s/ Wayne V. Barnes
Wayne V. Barnes
Director
Date: March 31, 2007

By: /s/ Don M. Gibson
Don M. Gibson
Chairman of the Board and Director
Date: March 31, 2007

By: /s/ Gregory V. Ostergren
Gregory V. Ostergren
Director
Date: March 31, 2007

By: /s/ James L. Sivils, III
James L. Sivils, III
Director
Date: March 31, 2007

By: /s/ Kurt D. Hellweg
Kurt D. Hellweg
Director
Date: March 31, 2007

By: /s/ Jack L. Barham
Jack L. Barham
Director
Date: March 31, 2007