

CENTRAL FEDERAL CORP

Form 10QSB

May 14, 2007

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-QSB**

(Mark one)

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

**For the quarterly period ended March 31, 2007**

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

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

Commission File Number 0-25045

**CENTRAL FEDERAL CORPORATION**

(Exact name of small business issuer as specified in its charter)

Delaware  
(State or other jurisdiction of  
incorporation or organization)  
34-1877137  
(IRS Employer  
Identification No.)  
2923 Smith Road, Fairlawn, Ohio 44333  
(Address of principal executive offices)  
(330) 666-7979  
(Issuer's telephone number)

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

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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

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

Class: Common stock, \$0.01 par value	Outstanding at April 30, 2007 4,559,787 shares
Transitional Small Business Disclosure Format (check one) Yes <input type="radio"/> No <input checked="" type="radio"/>	

CENTRAL FEDERAL CORPORATION  
FORM 10-QSB  
QUARTER ENDED MARCH 31, 2007  
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CENTRAL FEDERAL CORPORATION  
PART I. Financial Information  
Item 1. Financial Statements  
CONSOLIDATED BALANCE SHEETS  
(Dollars in thousands except per share data)

	March 31, 2007 (unaudited)	December 31, 2006
<b>ASSETS</b>		
Cash and cash equivalents	\$ 4,278	\$ 5,403
Securities available for sale	30,519	29,326
Loans held for sale	1,029	2,000
Loans, net of allowance of \$2,150 and \$2,109	190,455	184,695
Federal Home Loan Bank stock	1,963	2,813
Loan servicing rights	197	201
Premises and equipment, net	4,535	4,105
Bank owned life insurance	3,678	3,646
Deferred tax asset	1,958	2,044
Accrued interest receivable and other assets	2,120	1,795
	\$ 240,732	236,028
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
Deposits		
Non-interest bearing	\$ 9,872	\$ 11,114
Interest bearing	155,647	156,477
Total deposits	165,519	167,591
Federal Home Loan Bank advances	38,170	32,520
Advances by borrowers for taxes and insurance	79	137
Accrued interest payable and other liabilities	2,946	1,540
Subordinated debentures	5,155	5,155
Total liabilities	211,869	206,943
Shareholders equity		
Preferred stock, 1,000,000 shares authorized; none issued		
Common stock, \$.01 par value; 6,000,000 shares authorized; 2007 - 4,628,320 shares issued, 2006 - 4,612,195 shares issued	46	46
Additional paid-in capital	27,249	27,204
Retained earnings	2,317	2,643
Accumulated other comprehensive income (loss)	34	(25)
Treasury stock, at cost (2007 - 68,533 shares, 2006 - 68,533 shares)	(783)	(783)
Total shareholders equity	28,863	29,085

\$ 240,732      \$ 236,028

See accompanying notes to consolidated financial statements.

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CENTRAL FEDERAL CORPORATION  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(Dollars in thousands except per share data)  
(Unaudited)

	Three months ended March 31,	
	2007	2006
Interest and dividend income		
Loans, including fees	\$ 3,538	\$ 2,301
Securities	376	407
Federal Home Loan Bank stock dividends	40	38
Federal funds sold and other	4	23
	3,958	2,769
Interest expense		
Deposits	1,669	1,008
Federal Home Loan Bank advances and other debt	381	137
Subordinated debentures	106	95
	2,156	1,240
Net interest income	1,802	1,529
Provision for loan losses	35	290
Net interest income after provision for loan losses	1,767	1,239
Noninterest income		
Service charges on deposit accounts	57	51
Net gains on sales of loans	75	32
Loan servicing fees, net	21	14
Earnings on bank owned life insurance	32	32
Other	15	51
	200	180
Noninterest expense		
Salaries and employee benefits	1,063	929
Occupancy and equipment	119	114
Data processing	134	118
Franchise taxes	69	47
Professional fees	88	166
Director fees	37	42
Postage, printing and supplies	51	50
Advertising and promotion	24	20

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Telephone	29	26
Loan expenses	5	45
Foreclosed assets, net	6	10
Depreciation	143	105
Other	84	97
	1,852	1,769
Income (loss) before income taxes	115	(350)
Income tax expense (benefit)	30	(126)
Net income (loss)	\$ 85	\$ (224)
Earnings (loss) per share:		
Basic	\$ 0.02	\$ (0.05)
Diluted	\$ 0.02	\$ (0.05)

See accompanying notes to consolidated financial statements.

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CENTRAL FEDERAL CORPORATION  
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY  
(Dollars in thousands except per share data)  
(Unaudited)

	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Shareholders' Equity
Balance at January 1, 2007	\$ 46	\$ 27,204	\$ 2,643	\$ (25)	\$ (783)	\$ 29,085
Comprehensive income:						
Net income			85			85
Other comprehensive income				59		59
Total comprehensive income						144
Release of 4,517 stock based incentive plan shares		43				43
Stock option expense		2				2
Cash dividends declared (\$0.09 per share)			(411)			(411)
Balance at March 31, 2007	\$ 46	\$ 27,249	\$ 2,317	\$ 34	\$ (783)	\$ 28,863

See accompanying notes to consolidated financial statements.

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CENTRAL FEDERAL CORPORATION  
 CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)  
 (Dollars in thousands)  
 (Unaudited)

	Three months ended	
	March 31,	
	2007	2006
Net income (loss)	\$ 85	\$ (224)
Change in net unrealized gain (loss) on securities available for sale	89	(204)
Tax effect	(30)	69
Other comprehensive income (loss)	59	(135)
Comprehensive income (loss)	\$ 144	\$ (359)

See accompanying notes to consolidated financial statements.

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CENTRAL FEDERAL CORPORATION  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
 (Dollars in thousands)  
 (Unaudited)

	Three months ended March 31,	
	2007	2006
Cash flows from operating activities	\$ 1,091	\$ (656)
Cash flows from investing activities		
Available-for-sale securities:		
Maturities, prepayments and calls	934	1,874
Purchases	(749)	(6,379)
Loan originations and payments, net	(3,675)	(15,884)
Loans purchased	(2,104)	(3,708)
Proceeds from redemption of FHLB stock	850	
Additions to premises and equipment	(573)	(156)
Proceeds from the sale of premises and equipment		43
Net cash from investing activities	(5,317)	(24,210)
Cash flows from financing activities		
Net change in deposits	(2,082)	8,831
Net change in short-term borrowings from the Federal Home Loan Bank and other debt	3,450	1,800
Proceeds from Federal Home Loan Bank advances and other debt	3,200	
Repayments on Federal Home Loan Bank advances and other debt	(1,000)	(1,000)
Net change in advances by borrowers for taxes and insurance	(58)	(50)
Cash dividends paid	(409)	(202)
Proceeds from issuance of common stock in public offering		14,558
Net cash from financing activities	3,101	23,937
Net change in cash and cash equivalents	(1,125)	(929)
Beginning cash and cash equivalents	5,403	2,972
Ending cash and cash equivalents	\$ 4,278	\$ 2,043
Supplemental cash flow information:		
Interest paid	\$ 2,091	\$ 1,196
Income taxes paid	10	
Supplemental noncash disclosures:		
Transfers from loans to repossessed assets	\$	\$ 60

See accompanying notes to consolidated financial statements.

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CENTRAL FEDERAL CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Dollars in thousands except per share data)

**NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Basis of Presentation:**

The accompanying consolidated financial statements have been prepared pursuant to rules and regulations of the Securities and Exchange Commission (the SEC) and in compliance with U.S. generally accepted accounting principles. Because this report is based on an interim period, certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accounting principles have been condensed or omitted.

In the opinion of the management of Central Federal Corporation (the Company), the accompanying consolidated financial statements as of March 31, 2007 and December 31, 2006 and for the three months ended March 31, 2007 and 2006 include all adjustments necessary for a fair presentation of the financial condition and the results of operations for those periods. The financial performance reported for the Company for the three months ended March 31, 2007 are not necessarily indicative of the results to be expected for the full year. This information should be read in conjunction with the Company's Annual Report to Shareholders and Form 10-KSB for the period ended December 31, 2006. Reference is made to the accounting policies of the Company described in Note 1 of the Notes to Consolidated Financial Statements contained in the Company's 2006 Annual Report that was filed as Exhibit 13 to the Form 10-KSB. The Company has consistently followed those policies in preparing this Form 10-QSB.

**Earnings Per Share:**

Basic earnings per common share is net income divided by the weighted average number of common shares outstanding during the period. Stock based incentive plan shares are considered outstanding as they are earned over the vesting period. Diluted earnings per common share include the dilutive effect of stock based incentive plan shares and additional potential common shares issuable under stock options.

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CENTRAL FEDERAL CORPORATION  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 (Dollars in thousands except per share data)

**NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

The factors used in the earnings (loss) per share computation follow.

	Three months ended March 31,	
	2007	2006
Basic		
Net income (loss)	\$ 85	\$ (224)
Weighted average common shares outstanding	4,532,596	4,223,273
Basic earnings (loss) per common share	\$ 0.02	\$ (0.05)
Diluted		
Net income (loss)	\$ 85	\$ (224)
Weighted average common shares outstanding for basic earnings (loss) per share	4,532,596	4,223,273
Add: Dilutive effects of assumed exercises of stock options and stock based incentive plan shares	42	
Average shares and dilutive potential common shares	4,532,638	4,223,273
Diluted earnings (loss) per common share	\$ 0.02	\$ (0.05)

The following potential average common shares were anti-dilutive and not considered in computing diluted loss per share because the Company had a loss from continuing operations, the exercise price of the options was greater than the average stock price for the periods, or the fair value of the stock based incentive plan shares at the date of grant was greater than the average stock price for the periods.

	Three months ended March	
	2007	31, 2006
Stock options	280,389	282,472
Stock based incentive plan shares	19,664	20,829

**Reclassifications:**

Some items in the prior year period financial statements were reclassified to conform to the current presentation.

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CENTRAL FEDERAL CORPORATION  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 (Dollars in thousands except per share data)

**NOTE 2 LOANS**

Loans were as follows:

	March 31, 2007	December 31, 2006
Commercial	\$ 29,803	\$ 31,913
Real estate:		
Single-family residential	29,587	30,209
Multi-family residential	37,923	47,247
Commercial	65,082	47,474
Consumer	30,487	30,246
Subtotal	192,882	187,089
Less: Net deferred loan fees	(277)	(285)
Allowance for loan losses	(2,150)	(2,109)
Loans, net	\$ 190,455	\$ 184,695

Real estate loans include \$5,177 and \$4,454 in construction loans at March 31, 2007 and December 31, 2006.

Activity in the allowance for loan losses was as follows.

	Three months ended March 31,	
	2007	2006
Beginning balance	\$ 2,109	\$ 1,495
Provision for loan losses	35	290
Loans charged-off	(8)	(70)
Recoveries	14	15
Ending balance	\$ 2,150	\$ 1,730

Nonperforming loans were as follows:

	March 31, 2007	December 31, 2006
Loans past due over 90 days still on accrual	\$	\$
Nonaccrual loans	296	297

Nonperforming loans include both smaller balance single-family mortgage and consumer loans that are collectively evaluated for impairment and individually classified impaired loans. Impaired loans were not material for any period

presented.

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CENTRAL FEDERAL CORPORATION  
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**NOTE 3 STOCK COMPENSATION PLANS**

The Company has two share based compensation plans as described below. Total compensation cost that has been charged against income for those plans was \$45 and \$ 67 for the three months ended March 31, 2007 and 2006. The total income tax benefit was \$15 and \$23.

Stock-based incentive plans provide for stock option grants and restricted stock awards to directors, officers and employees. The 1999 Stock-based Incentive Plan was approved by shareholders on July 13, 1999. The plan provided 193,887 shares for stock option grants and 77,554 shares for restricted stock awards. The 2003 Equity Compensation Plan was ratified by shareholders on April 23, 2003 and provided an aggregate of 100,000 shares for stock option grants and restricted stock awards, including up to a maximum of 30,000 shares for restricted stock awards. An amendment and restatement of the 2003 Equity Compensation Plan was approved by stockholders on April 20, 2004 to provide an additional 100,000 shares of Company stock for stock option grants and restricted stock awards, including up to a maximum of 30,000 shares for restricted stock awards. A second amendment and restatement of the 2003 Equity Compensation Plan was approved by stockholders on May 20, 2005 to provide an additional 100,000 shares of Company stock for stock option grants and restricted stock awards, including up to a maximum of 30,000 shares for restricted stock awards.

**Stock Options**

The Plans permit the grant of share options to directors, officers and employees for up to 493,887 shares of common stock. The Company believes that such awards better align the interests of its employees with those of its shareholders. Option awards are granted with an exercise price equal to the market price of the Company's common stock at the date of grant; those option awards generally have vesting periods ranging from 3 to 5 years and have 10-year contractual terms.

The fair value of each option award is estimated on the date of grant using a closed form option valuation (Black-Scholes) model that uses the assumptions noted in the table below. Expected volatilities are based on historical volatilities of the Company's common stock. The Company uses historical data to estimate option exercise and post-vesting termination behavior. (Employee and management options are tracked separately.) The expected term of options granted is based on historical data and represents the period of time that options granted are expected to be outstanding, which takes into account that the options are not transferable. The risk-free interest rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of the grant.

The fair value of options granted was determined using the following weighted-average assumptions as of grant date for options granted during the three months ended March 31, 2007. There were no options granted during the three months ended March 31, 2006.

	Three months ended March 31, 2007
Risk-free interest rate	4.68%
Expected option life (years)	6
Expected stock price volatility	23%
Dividend yield	4.90%
Weighted average fair value of options granted during the period	\$ 1.19
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CENTRAL FEDERAL CORPORATION  
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 (Dollars in thousands except per share data)

**NOTE 3 STOCK COMPENSATION PLANS (continued)**

A summary of stock option activity in the plan for the three months ended March 31, 2007 follows:

		Three months ended March 31, 2007		
	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Intrinsic Value
Options outstanding, beginning of period	273,272	\$ 11.23	6.7	
Granted	21,350	7.35	9.9	
Exercised				
Forfeited or expired				
Options outstanding, end of period	294,622	\$ 10.95	6.7	\$
Options exercisable, end of period	273,272	\$ 11.23	6.4	\$

Information related to the stock option plan during each period follows:

	Three months ended March 31,	
	2007	2006
Intrinsic value of options exercised	\$	\$
Cash received from option exercises		
Related tax benefit realized from option exercises		
Weighted average fair value of options granted	\$ 1.19	

As of March 31, 2007, there was \$23 of total unrecognized compensation cost related to nonvested stock options granted under the plan. The cost is expected to be recognized over a weighted-average period of 2.8 years.

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CENTRAL FEDERAL CORPORATION  
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**NOTE 3 STOCK COMPENSATION PLANS (continued)****Restricted Stock Awards**

The Plans permit the grant of restricted stock awards to directors, officers and employees. Compensation expense is recognized over the vesting period of the shares based on the market value of the shares at issue date. Shares issuable under the plans totaled 125 at March 31, 2007, and 18,250 shares were issued during the three months ended March 31, 2007. No shares were issued during the three months ended March 31, 2006.

A summary of changes in the Company's nonvested shares for the period follows:

	Three months ended March 31, 2007	
	Shares	Weighted Average Grant-Date Fair Value
Nonvested shares outstanding at beginning of period	29,552	\$ 11.36
Granted	18,250	7.35
Vested	(7,777)	12.64
Forfeited		
Nonvested shares outstanding at end of period	40,025	\$ 9.29

As of March 31, 2007, there was \$201 of total unrecognized compensation cost related to nonvested shares granted under the plans. The cost is expected to be recognized over a weighted-average period of 1.5 years. The total fair value of shares vested during the three months ended March 31, 2007 and 2006 was \$98 and \$104.

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CENTRAL FEDERAL CORPORATION  
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 (Dollars in thousands except per share data)

**NOTE 4 FEDERAL HOME LOAN BANK ADVANCES**

Advances from the Federal Home Loan Bank were as follows.

	March 31, 2007	December 31, 2006
Maturity April 2007 at 5.35% floating rate	\$ 24,700	\$
Maturity January 2007 at 5.18% floating rate		21,250
Maturities July 2007 thru March 2010, fixed at rates from 2.69% to 5.60%, averaging 4.51% at March 31, 2007, and maturities March 2007 thru June 2009, fixed at rates from 2.44% to 5.60%, averaging 4.16% at December 31, 2006	13,470	11,270
Total	\$ 38,170	\$ 32,520

The fixed rate advances are due in full at their maturity date, with a penalty if prepaid. Floating rate advances can be prepaid at any time with no penalty.

The advances were collateralized as follows.

	March 31, 2007	December 31, 2006
First mortgage loans under a blanket lien arrangement	\$ 26,636	\$ 30,422
Second mortgage loans	673	679
Multi-family mortgage loans	13,342	12,580
Home equity lines of credit	10,052	10,495
Commercial real estate loans	44,092	35,028
Securities	10,658	10,748
Total	\$ 105,453	\$ 99,952

Based on this collateral and the Company's holdings of FHLB stock, the Company is eligible to borrow up to \$53,993 at March 31, 2007.

**Payment information**

Required payments over the next five years are:

March 31, 2008	\$ 28,970
March 31, 2009	3,200
March 31, 2010	6,000
Total	\$ 38,170

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CENTRAL FEDERAL CORPORATION  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 (Dollars in thousands except per share data)

**NOTE 5 SEGMENT INFORMATION**

The reportable segments are determined by the products and services offered, primarily distinguished between banking and mortgage banking operations. Loans, securities, deposits and servicing fees provide the revenues in the banking operation, and single-family residential mortgage loan sales provide the revenues in mortgage banking. All operations are domestic.

The accounting policies used are the same as those described in the summary of significant accounting policies. Segment performance is evaluated using net income. Income taxes are allocated and transactions among segments are made at fair value. Parent and Other includes activities that are not directly attributed to the reportable segments and is comprised of the parent company and elimination entries between all segments. Information reported internally for performance assessment follows:

	Banking	Mortgage Banking	Parent and Other	Consolidated Total
<u>For the three months ended March 31, 2007:</u>				
Net interest income (expense)	\$ 1,885	\$ 23	\$ (106)	\$ 1,802
Provision for loan losses	(35)			(35)
Net gain (loss) on sales of loans	(30)	105		75
Other revenue	117		8	125
Depreciation and amortization	(136)	(7)		(143)
Other expense	(1,486)	(129)	(94)	(1,709)
Income (loss) before income tax	315	(8)	(192)	115
Income tax expense (benefit)	98	(3)	(65)	30
Net income (loss)	\$ 217	\$ (5)	\$ (127)	\$ 85

March 31, 2007

Segment assets	\$ 237,981	\$ 1,178	\$ 1,573	\$ 240,732
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	Banking	Mortgage Banking	Parent and Other	Consolidated Total
<u>For the three months ended March 31, 2006:</u>				
Net interest income (expense)	\$ 1,605	\$ 19	\$ (95)	\$ 1,529
Provision for loan losses	(290)			(290)
Net gain (loss) on sales of loans	(1)	33		32
Other revenue	143	(3)	8	148
Depreciation and amortization	(98)	(7)		(105)
Other expense	(1,413)	(157)	(94)	(1,664)

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Loss before income tax	(54)	(115)	(181)	(350)
Income tax benefit	(25)	(39)	(62)	(126)
Net loss	\$ (29)	\$ (76)	\$ (119)	\$ (224)
<u>March 31, 2006</u>				
Segment assets	\$ 192,362	\$ 3,206	\$ 1,094	\$ 196,662

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CENTRAL FEDERAL CORPORATION

Item 2.

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following analysis discusses changes in financial condition and results of operations during the periods included in the Consolidated Financial Statements which are part of this filing.

**Forward-Looking Statements**

This Form 10-QSB contains forward-looking statements which may be identified by the use of such words as may, believe, expect, anticipate, should, plan, estimate, predict, continue and potential or the negative of these words or other comparable terminology. Examples of forward-looking statements include, but are not limited to, estimates with respect to our financial condition, results of operations and business that are subject to various factors which could cause actual results to differ materially from these estimates. These factors include, but are not limited to (i) general and local economic conditions, (ii) changes in interest rates, deposit flows, demand for mortgages and other loans, real estate values and competition, (iii) changes in accounting principles, policies or guidelines, (iv) changes in legislation or regulation and (v) other economic, competitive, governmental, regulatory and technological factors affecting our operations, pricing, products and services.

Any or all of our forward-looking statements in this Form 10-QSB and in any other public statements we make may turn out to be wrong. They can be affected by inaccurate assumptions we might make or by known or unknown risks and uncertainties. Consequently, no forward-looking statement can be guaranteed and we caution readers not to place undue reliance on any such forward-looking statements. We undertake no obligation to publicly release revisions to any forward-looking statements to reflect events or circumstances after the date of such statements.

**Business Overview**

Central Federal Corporation is a unitary savings and loan holding company incorporated in Delaware in 1998. Our primary business is the operation of our principal subsidiary, CFBank, a federally chartered savings association formed in Ohio in 1892.

CFBank is a community-oriented financial institution offering a variety of financial services to meet the needs of the communities we serve. Our client-centric method of operation emphasizes personalized service, clients' access to decision makers, solution-driven lending and quick execution, efficient use of technology and the convenience of remote deposit, telephone banking, corporate cash management and online internet banking. We attract deposits from the general public and use the deposits, together with borrowings and other funds, primarily to originate commercial and commercial real estate loans, single-family and multi-family residential mortgage loans and home equity lines of credit.

**General**

Our results of operations are dependent primarily on net interest income, which is the difference between the interest income earned on loans and securities and the cost of funds, consisting of interest paid on deposits and borrowed funds. Net interest income is affected by regulatory, economic and competitive factors that influence interest rates, loan demand and deposit flows. Net income is also affected by, among other things, loan fee income, provisions for loan losses, service charges, gains on loan sales, operating expenses and franchise and income taxes. Operating expenses principally consist of employee compensation and benefits, occupancy and other general and administrative expenses. Results of operations are significantly affected by general economic and competitive conditions, particularly changes in market interest rates, government policies and actions of regulatory authorities. Future changes in applicable laws, regulations or government policies may also materially impact our performance.

**Management Strategy**

We continued to successfully execute our plan for growth and generated net income of \$85 for the quarter ended March 31, 2007, our 4<sup>th</sup> consecutive profitable quarter. Total assets increased \$4.7 million or 8% on an annualized basis during the 1<sup>st</sup> quarter of 2007 and included an increase of \$6.2 million, or a 19.6% annualized growth rate for commercial, commercial real estate and multi-family loans, which are the focus of our growth plan.

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## CENTRAL FEDERAL CORPORATION

## Item 2.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

As a result of \$44.1 million growth in assets since March 31, 2006, particularly commercial, commercial real estate and multi-family loans, gross interest income increased 43% from \$2.8 million in the 1<sup>st</sup> quarter of 2006 to \$4.0 million in the 1<sup>st</sup> quarter of 2007. The current market interest rate environment continued to negatively affect funding costs, and interest expense increased 74% from \$1.2 million in the 1<sup>st</sup> quarter of 2006 to \$2.2 million in the 1<sup>st</sup> quarter of 2007. Net interest income increased 18% from \$1.5 million in the 1<sup>st</sup> quarter of 2006 to \$1.8 million in the 1<sup>st</sup> quarter of 2007. Continued downward pressure on margins is expected with the current flat/inverted yield curve and as a result, management of the net interest margin will continue to be a challenge.

Other than described above, we are not aware of any market or institutional trends, events or uncertainties that are expected to have a material effect on liquidity, capital resources or operations or any current recommendations by regulators which would have a material effect if implemented.

**Financial Condition**

*General.* Assets totaled \$240.7 million at March 31, 2007 and increased \$4.7 million or 2.0% from \$236.0 million at December 31, 2006 due to growth in the loan portfolio, which was funded with Federal Home Loan Bank (FHLB) advances.

*Securities.* Securities available for sale totaled \$30.5 million at March 31, 2007, an increase of \$1.2 million or 4.1% compared to \$29.3 million at December 31, 2006 due to current period purchases offset by repayments on mortgage-backed securities.

*Loans.* Net loans totaled \$190.5 million at March 31, 2007 and increased \$5.8 million from \$184.7 million at December 31, 2006. Commercial, commercial real estate and multi-family loans totaled \$132.8 million at March 31, 2007 and increased \$6.2 million from \$126.6 million at December 31, 2006. Mortgage loans totaled \$29.6 million at March 31, 2007 and decreased \$622,000 from \$30.2 million at December 31, 2006 as most of our mortgage loan production was originated for sale. Consumer loans totaled \$30.5 million at March 31, 2007 compared to \$30.2 million at December 31, 2006. The Company purchased auto loans totaling \$2.1 million during the quarter.

*Deposits.* Deposits totaled \$165.5 million at March 31, 2007 and declined \$2.1 million, or 1.2% from \$167.6 million at December 31, 2006. The decline in deposits was due to a decrease of \$1.5 million in certificate of deposit accounts, \$1.2 million in noninterest bearing deposits, \$497,000 in money market accounts and \$300,000 in traditional savings account balances offset by an increase of \$1.5 million in interest bearing checking accounts. The decrease in certificate of deposit accounts included \$1.2 million in brokered deposits which matured during the quarter ended March 31, 2007 and were not replaced.

*FHLB advances.* FHLB advances totaled \$38.2 million at March 31, 2007 and increased \$5.7 million or 17.4% compared to \$32.5 million at December 31, 2006. A \$2.2 million economic development advance was drawn during the March 2007 quarter to fund construction of our new Columbus regional office in Worthington. Relocation of the existing Columbus office is expected to occur in the 2<sup>nd</sup> quarter of 2007. The remaining increase in FHLB advances was used to fund loan growth.

*Shareholders' equity.* Shareholders' equity totaled \$28.9 million at March 31, 2007 and decreased \$222,000 or .8% compared to \$29.1 million at December 31, 2006 as a result of dividend payments offset by net income in the first quarter of 2007.

**Comparison of the Results of Operations for the Three Months Ended March 31, 2007 and 2006**

*General.* Net income improved \$309,000 in the first quarter of 2007 and totaled \$85,000 or \$.02 per diluted share compared to a net loss of (\$224,000) or (\$.05) per diluted share in the first quarter of 2006. Sustained customer and asset growth resulting in improved profitability continues to be our focus.



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## MANAGEMENT'S DISCUSSION AND ANALYSIS

*Net interest income.* Net interest income totaled \$1.8 million for the quarter ended March 31, 2007, an increase of \$273,000 or 17.9% compared to \$1.5 million for the quarter ended March 31, 2006. Both the volume and yield on interest-earning assets increased in the first quarter of 2007 compared to the prior year quarter. The resultant growth in interest income was partially offset by increased interest expense due to an increase in volume and cost of interest-bearing liabilities in the current year quarter.

Average interest earning assets increased \$50.0 million or 29.1% to \$222.0 million in the first quarter of 2007 from \$172.0 million in the first quarter of 2006 due to loan growth offset by a decline in the average balance of securities, FHLB stock and other interest earning assets. The yield on interest earning assets increased 69 basis points (bp) to 7.13% in the first quarter of 2007 from 6.44% in the prior year quarter reflecting higher yields on home equity lines of credit, commercial, commercial real estate and multi-family loans due to higher market interest rates in the current year quarter. Interest income increased \$1.2 million or 42.9% to \$4.0 million in the first quarter of 2007 from \$2.8 million in the prior year quarter due to growth in interest income on loans offset by a decline in income on securities and other interest earning assets. Interest income on loans increased \$1.2 million or 53.8% to \$3.5 million for the quarter ended March 31, 2007 from \$2.3 million in the prior year quarter due to an increase in both volume and yield on loans. Average loan balances increased \$54.4 million, or 40.3% to \$189.4 million in the first quarter of 2007 from \$135.0 million in the prior year quarter. The average yield on loans increased 65 bp to 7.47% in the first quarter of 2007 from 6.82% in the prior year quarter due to commercial, commercial real estate and multi-family mortgage loan growth and an increase in yields on home equity lines of credit due to a higher prime interest rate in the current year quarter. Interest income on securities decreased \$31,000 or 7.6% to \$376,000 in the first quarter of 2007 from \$407,000 in the prior year quarter due to a decline in the average securities balance. Average securities balances decreased \$2.4 million or 7.6% and totaled \$29.9 million in the first quarter of 2007 compared to \$32.3 million in the prior year quarter due principal repayments on mortgage-backed securities. The average yield on securities was unchanged at 5.03%. The average balance of FHLB stock declined \$126,000 as a result of a redemption of \$850,000 offset by stock dividends. Interest income on other earning assets declined \$19,000 and totaled \$4,000 in the first quarter of 2007 compared to \$23,000 in the prior year quarter due to a decline in the average balance of other earning assets offset by an increase in the yield on these assets. The average balance of other earning assets declined \$1.7 million to \$320,000 for the first quarter of 2007 compared to \$2.0 million for the first quarter of 2006 representing lower levels of overnight funds available for loan funding in the current year period. The yield on other earning assets increased 39 bp to 5.00% from 4.61% in the first quarter of 2006 due to higher market interest rates in the current year quarter.

Average interest-bearing liabilities increased \$51.8 million or 35.7% to \$197.2 million in the first quarter of 2007 from \$145.4 million in the first quarter of 2006 due to an increase in the average balance of deposits and borrowings. The average cost of interest-bearing liabilities increased 96 bp or 28.2% to 4.37% in the first quarter of 2007 from 3.41% in the first quarter of 2006 primarily due to higher short-term interest rates in the current year quarter which increased both deposit and borrowing costs. Interest expense on deposits increased \$661,000 or 65.6% to \$1.7 million for the quarter ended March 31, 2007 from \$1.0 million in the prior year quarter. Average deposit balances increased \$31.9 million or 25.8% to \$155.5 million in the first quarter of 2007 from \$123.6 million in the prior year quarter due to an increase in certificate of deposit and money market accounts. The average cost of deposits increased 103 bp to 4.29% in the first quarter of 2007 from 3.26% in the prior year quarter in response to higher market interest rates during the current year quarter. Interest expense on FHLB advances and other debt, including subordinated debentures increased \$255,000 to \$487,000 in the first quarter of 2007 from \$232,000 in the prior year quarter due to a \$19.8 million increase in average borrowing balances in the first quarter of 2007 to \$41.6 million compared to \$21.8 million in the prior year quarter as FHLB advances were used to fund loan growth and construction costs of the Worthington office. The average cost of borrowings increased 42 bp to 4.68% in the first quarter of 2007 from 4.26% in the prior year quarter due to higher short-term interest rates in the current year quarter.

Net interest margin decreased 32 bp to 3.24% for the quarter ended March 31, 2007 compared to 3.56% in the prior year quarter. Use of proceeds from the stock offering to fund growth in the prior year quarter positively impacted

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## CENTRAL FEDERAL CORPORATION

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## MANAGEMENT'S DISCUSSION AND ANALYSIS

the net interest margin in the quarter ended March 31, 2006. The flat/inverted yield curve environment that existed in the first quarter of 2007 negatively impacted the margin for the quarter ended March 31, 2007.

*Provision for loan losses.* Management analyzes the adequacy of the allowance for loan losses regularly through reviews of the performance of the loan portfolio giving consideration to economic conditions, changes in interest rates and the effect of such changes on real estate values, and changes in the composition of the loan portfolio. The allowance for loan losses is established through a provision for loan losses based on management's evaluation of the risk in the loan portfolio. The evaluation includes a review of all loans for which full collectibility may not be reasonably assured and considers, among other factors, the estimated fair value of the underlying collateral, economic conditions, historical loan loss experience, changes in the size and growth of the loan portfolio and additional factors that warrant recognition in providing for an adequate loan loss allowance. Future additions to the allowance for loan losses will be dependent on these factors.

Based on management's review, the provision for loan losses totaled \$35,000 in the first quarter of 2006, a decrease of \$255,000 from \$290,000 in the prior year quarter, reflecting lower commercial, commercial real estate and multi-family loan growth in the quarter ended March 31, 2007. Growth in these loan types totaled \$6.2 million in the first quarter of 2007 compared to \$17.8 million in the first quarter of 2006. At March 31, 2007, the allowance for commercial, commercial real estate and multi-family mortgage loans totaled \$2.0 million, an increase of \$53,000 or 2.7% from \$1.9 at December 31, 2006 as these loan types increased from 67.7% of the loan portfolio at year-end 2006 to 68.9% at March 31, 2006. The allowance for loan losses represented 1.12% of total loans at March 31, 2007 compared to 1.13% at December 31, 2006. Nonperforming loans (all of which are nonaccrual loans) totaled \$296,000 or 0.15% of total loans at March 31, 2007, and \$297,000 or 0.16% of total loans at December 31, 2006. Single-family homes in our primary market area secured over 97% of the nonperforming loan balances. Management believes the allowance for loan losses is adequate to absorb probable incurred credit losses in the loan portfolio at March 31, 2007; however, future additions to the allowance may be necessary based on changes in economic conditions and the factors discussed in the previous paragraph.

*Noninterest income.* Noninterest income totaled \$200,000 during the quarter ended March 31, 2007 and was \$20,000 or 11.1% higher than during the quarter ended March 31, 2006 due to an increase in gains on loan sales offset by a decline in other noninterest income. Net gain on sales of loans increased 134.4% from the prior year quarter and totaled \$75,000 during the quarter ended March 31, 2007 compared to \$32,000 during the quarter ended March 31, 2006 due to increased mortgage loan originations during the current year period. Other noninterest income decreased \$29,000 and totaled \$68,000 for the quarter ended March 31, 2007 compared to \$97,000 in the prior year quarter due to a \$43,000 gain on the sale of a parcel of land at CFBank's Calcutta, Ohio office to the State of Ohio through eminent domain in the quarter ended March 31, 2006.

*Noninterest expense.* Noninterest expense increased \$83,000 and totaled \$1.9 million in the quarter ended March 31, 2007, compared to \$1.8 million in the quarter ended March 31, 2006 due to increased salaries and employee benefits offset by a decline in professional fees. Noninterest expense to average assets improved to 3.11% in the quarter ended March 31, 2007 from 3.80% in the quarter ended March 31, 2006 and the efficiency ratio improved to 92.51% from 103.51% in the same periods. The positive movement in these ratios resulted from control of noninterest expense, growth in the balance sheet and increased net interest income and noninterest income.

*Income taxes.* Income taxes totaled \$30,000 for the quarter ended March 31, 2007 compared to an income tax benefit of \$126,000 in the prior year quarter due a loss in the prior period.

**Critical Accounting Policies**

We follow financial accounting and reporting policies that are in accordance with U.S. generally accepted accounting principles and conform to general practices within the banking industry. These policies are presented in Note 1 to our audited consolidated financial statements in our 2006 Annual Report to Shareholders incorporated by reference into our 2006 Annual Report on Form 10-KSB. Some of these accounting policies are considered to be critical accounting policies, which are those policies that require management's most difficult, subjective or



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## CENTRAL FEDERAL CORPORATION

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## MANAGEMENT'S DISCUSSION AND ANALYSIS

complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. Application of assumptions different than those used by management could result in material changes in our financial position or results of operations. We believe that the judgments, estimates and assumptions used in the preparation of the consolidated financial statements are appropriate given the factual circumstances at the time. We have identified accounting policies that are critical accounting policies, and an understanding of these is necessary to understand our financial statements. One critical accounting policy relates to determining the adequacy of the allowance for loan losses. The Allowance for Loan Losses Policy provides a thorough, disciplined and consistently applied process that incorporates management's current judgments about the credit quality of the loan portfolio into determination of the allowance for loan losses in accordance with generally accepted accounting principles and supervisory guidance. Management estimates the required allowance balance using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. Management believes that an adequate allowance for loan losses has been established. Additional information regarding this policy is included in the previous section captioned "Provision for Loan Losses" and in the notes to the consolidated financial statements in our 2006 Annual Report to Shareholders incorporated by reference into our 2006 Annual Report on Form 10-KSB, Note 1 (Summary of Significant Accounting Policies) and Note 3 (Loans).

Another critical accounting policy relates to valuation of the deferred tax asset for net operating losses. Net operating losses totaling \$2.2 million, \$2.7 million and \$431,000 expire in 2023, 2024 and 2025, respectively. No valuation allowance has been recorded against the deferred tax asset for net operating losses because the benefit is more likely than not to be realized. As we continue our strategy to expand into business financial services and focus on growth, the resultant increase in interest-earning assets is expected to increase profitability. Additional information is included in Notes 1 and 13 to our audited consolidated financial statements in our 2006 Annual Report to Shareholders incorporated by reference into our 2006 Annual Report on Form 10-KSB.

**Liquidity and Capital Resources**

In general terms, liquidity is a measurement of ability to meet cash needs. The primary objective in liquidity management is to maintain the ability to meet loan commitments or to repay deposits and other liabilities in accordance with their terms without an adverse impact on current or future earnings. Principal sources of funds are deposits, amortization and prepayments of loans, maturities, sales and principal receipts of securities available for sale, borrowings and operations. While maturities and scheduled amortization of loans are predictable sources of funds, deposit flows and loan prepayments are greatly influenced by general interest rates, economic conditions and competition.

CFBank is required by regulation to maintain sufficient liquidity to ensure its safe and sound operation. Thus, adequate liquidity may vary depending on CFBank's overall asset/liability structure, market conditions, the activities of competitors and the requirements of its own deposit and loan customers. Management believes that CFBank's liquidity is sufficient.

Liquidity management is both a daily and long-term responsibility of management. We adjust our investments in liquid assets, primarily cash, short-term investments and other assets that are widely traded in the secondary market, based on management's assessment of expected loan demand, deposit flows, yields available on interest-earning deposits and securities and the objective of our asset/liability management program. In addition to liquid assets, we have other sources of liquidity available including, but not limited to access to advances from the FHLB, use of brokered deposits and the ability to obtain deposits by offering above-market interest rates.

CFBank relies primarily on competitive rates, customer service and relationships with customers to retain deposits. Based on our historical experience with deposit retention and current retention strategies, we believe that, although it is not possible to predict future terms and conditions upon renewal, a significant portion of deposits will remain with CFBank.

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MANAGEMENT'S DISCUSSION AND ANALYSIS

At March 31, 2007, CFBank exceeded all of its regulatory capital requirements to be considered well-capitalized with a Tier 1 capital level of \$22.9 million, or 9.6% of adjusted total assets, which exceeds the required level of \$11.9 million, or 5.0%; Tier 1 risk-based capital level of \$22.9 million, or 11.0% of risk-weighted assets, which exceeds the required level of \$12.5 million, or 6.0%; and risk-based capital of \$25.0 million, or 12.0% of risk-weighted assets, which exceeds the required level of \$20.9 million, or 10.0%.

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CENTRAL FEDERAL CORPORATION

Item 3.

CONTROLS AND PROCEDURES

*Evaluation of disclosure controls and procedures.* We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our 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 our management, including our principal executive and financial officers, as appropriate to allow timely decisions regarding required disclosure. Management, with the participation of our principal executive and financial officers, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)) as of the end of the period covered by this report. Based on such evaluation, our principal executive and financial officers have concluded that, as of the end of such period, our disclosure controls and procedures were effective in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by us in the reports we file or submit under the Exchange Act.

*Changes in internal control over financial reporting.* We made no change in our internal control over financial reporting during the last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II. Other Information

Item 1. Legal Proceedings

Information required by Item 103 of Regulation S-B is incorporated by reference to our 2006 Annual Report on Form 10-KSB filed with the SEC on March 29, 2007 under the caption "Item 3. Legal Proceedings".

Item 6. Exhibits

(a) Exhibit

Number    Exhibit

- 3.1\*    Certificate of Incorporation
- 3.2\*    Bylaws
- 4.0\*    Form of Common Stock Certificate
- 11.1    Statement Re: Computation of Per Share Earnings
- 31.1    Rule 13a-14(a) Certifications of the Chief Executive Officer
- 31.2    Rule 13a-14(a) Certifications of the Chief Financial Officer
- 32.1    Section 1350 Certifications of the Chief Executive Officer and Chief Financial Officer

\* Incorporated by reference to the Exhibits included with the registrant's Registration Statement on Form SB-2 No. 333-64089, filed with the Commission on September 23, 1998

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CENTRAL FEDERAL CORPORATION  
SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CENTRAL FEDERAL CORPORATION

Dated: May 14, 2007

By: /s/ Mark S. Allio

Mark S. Allio  
Chairman of the Board, President and  
Chief Executive Officer

Dated: May 14, 2007

By: /s/ Therese Ann Liutkus

Therese Ann Liutkus, CPA  
Treasurer and Chief Financial Officer

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