PFS BANCORP INC
Form 10QSB
August 15, 2005

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

FORM 10-QSB

(Mark One)

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

For the quarterly period ended June 30, 2005

OR

[ ] TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT

For the transition period from ____________ to _______________

Commission File Number: 033233

PFS BANCORP, INC.

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

Indiana	35-2142534
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

Second & Bridgeway Streets, Aurora, Indiana 47001

(Address of principal executive offices)

(812) 926-0631

(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 Sections 13 or 15(d) of the Securities Exchange Act of 1934 during the past

12 months (or for such shorter period that the issuer was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes [X]   No [   ]

APPLICABLE ONLY TO CORPORATE ISSUERS

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date:
August 12, 2005 - 1,473,728 shares of common stock

Transitional Small Business Disclosure Format (Check one): Yes [ ] No [X]

INDEX

PFS Bancorp, Inc.

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

(In thousands, except share data)

ASSETS	June 30, 2005 (unaudited)	December 31 2004
Cash and due from banks	$ 1,381	$ 995
Interest-bearing deposits in other financial institutions	4,219	6,489
Cash and cash equivalents	5,600	7,484
Investment securities designated as available for sale - at market	4,054	5,014
Investment securities held to maturity - at amortized cost, which approximates market	133	143
Loans receivable - net	121,210	114,673
Office premises and equipment - at depreciated cost	871	940
Federal Home Loan Bank stock - at cost	1,086	975
Accrued interest receivable	560	441
Prepaid expenses and other assets	299	64
Prepaid income taxes	19	20
Deferred income taxes	148	-
Total assets	$133,980	$129,754
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits	$ 90,539	$ 86,939
Advances from the Federal Home Loan Bank	21,500	17,500
Note payable	-	3,500
Advances by borrowers for taxes and insurance	152	201
Accrued interest payable	11	11
Other liabilities	1,137	1,061
Deferred income taxes	-	13
Total liabilities	113,339	109,225
Commitments	-	-
Shareholders' equity		
Preferred stock, 5,000,000 shares authorized, $.01 par value; no shares issued	-	-
Common stock - 10,000,000 shares authorized, $.01 par value; 1,551,293 shares issued	16	16
Additional paid-in capital	15,106	15,106
Retained earnings - restricted	7,534	7,298
Less 77,565 shares of treasury stock - at cost	(1,282)	(1,282)
Shares acquired by stock benefit plans	(1,608)	(1,608)
Accumulated other comprehensive income - unrealized gains on securities designated as available for sale, net of related tax effects	875	999
Total shareholders' equity	20,641	20,529

Total liabilities and shareholders' equity	$133,980	$129,754

PFS Bancorp, Inc.

CONSOLIDATED STATEMENTS OF EARNINGS

(In thousands, except per share data)

	Six months ended June 30,		Three months ended June 30,	
	2005	2004	2005	2004
		(Unaudited)		
Interest income				
Loans	$3,151	$2,558	$1,620	$1,281
Investment securities	106	165	53	80
Interest-bearing deposits and other	50	19	26	9
Total interest income	3,307	2,742	1,699	1,370
Interest expense				
Deposits	889	709	468	340
Borrowings	367	56	188	33
Total interest expense	1,256	765	656	373
Net interest income	2,051	1,977	1,043	997
Provision for losses on loans	48	48	24	24
Net interest income after provision for losses on loans	2,003	1,929	1,019	973
Other operating income				
Gain on sale of investment securities	51	-	-	-
Loss on sale of repossessed property	-	(5)	-	(5)
Service charges	156	165	83	85
Other operating	91	82	47	44
Total other income	298	242	130	124
General, administrative and other expense				
Employee compensation and benefits	889	829	417	402
Occupancy and equipment	164	163	80	79
Data processing	141	124	69	62
Federal deposit insurance premiums	26	25	13	12
Other operating	315	290	174	169
Total general, administrative and other expense	1,535	1,431	753	724
Earnings before income taxes	766	740	396	373
Income taxes				
Current	405	296	324	138
Deferred	(96)	6	(164)	14
Total income taxes	309	302	160	152

NET EARNINGS	$ 457	$ 438	$ 236	$ 221
EARNINGS PER SHARE				
Basic	$.33	$.32	$.17	$.16
Diluted	$.32	$.31	$.16	$.15

4

PFS Bancorp, Inc.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

	Six months ended June 30, 2005	2004	Three 20
	(Unaudited)		
Net earnings	$457	$438	$2
Other comprehensive income (loss), net of tax:			
Unrealized holding gains (losses) on securities during the period, net of taxes (benefits) of $(81), $6, $17 and $(2) for the respective periods	(158)	12	
Reclassification adjustment for realized gains included in earnings, net of taxes of $17 in 2005	34	-	-
Comprehensive income	$333	$450	$2
Accumulated comprehensive income	$875	$871	$8

5

PFS Bancorp, Inc.

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the six months ended June 30,
(In thousands)

	2005	2004
	(Unaudited)	
Cash flows from operating activities:		
Net earnings for the period	$ 457	$ 438
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Amortization of deferred loan origination fees	(23)	(21)
Amortization of premiums and discounts on investment securities - net	21	33
Dividends on Federal Home Loan Bank stock	(21)	(18)
Depreciation	79	79
Provision for losses on loans	48	48
Gain on sale of investment securities	(51)	-
Loss on sale of repossessed property	-	5
Deferred compensation liability	23	-
Increase (decrease) in cash due to changes in:		
Accrued interest receivable	(119)	(16)
Prepaid expenses and other assets	(235)	1
Other liabilities	53	216
Accrued interest payable	-	(2)
Income taxes		
Current	1	(75)
Deferred	(96)	6
Net cash provided by operating activities	137	694
Cash flows provided by (used in) investing activities:		
Purchase of investment securities designated as available for sale	-	(11,932)
Proceeds from maturities and repayment of investment securities	760	12,844
Proceeds from sale of investment securities	51	-
Loan principal repayments	16,461	12,542
Loan disbursements	(23,023)	(20,763)
Purchase of office premises and equipment	(10)	(4)
Proceeds from sale of real estate acquired through foreclosure	-	214
Purchase of FHLB Stock	(90)	-
Net cash used in investing activities	(5,851)	(7,099)
Cash flows provided by (used in) financing activities:		
Net increase (decrease) in deposits	3,600	(1,998)
Repayment of note payable	(3,500)	-
Proceeds from Federal Home Loan Bank advances	6,000	8,000
Repayment of Federal Home Loan Bank advances	(2,000)	-

Advances by borrowers for taxes and insurance	(49)	66
Dividends paid on common stock	(221)	(221)
Net cash provided by financing activities	3,830	5,847
Net decrease in cash and cash equivalents	(1,884)	(558)
Cash and cash equivalents at beginning of period	7,484	5,187
Cash and cash equivalents at end of period	$ 5,600	$ 4,629

6

PFS Bancorp, Inc.

CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)

For the six months ended June 30,
(In thousands)

	2005	2004
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Income taxes	$ 420	$390
Interest on deposits and borrowings	$ 1,256	$767
Supplemental disclosure of noncash investing activities:		
Unrealized gains (losses) on securities designated as available for sale, net of related tax effects	$ (124)	$ 12
Transfers from loans to real estate acquired through foreclosure	$ -	$ 50

PFS Bancorp, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the six and three months ended June 30, 2005 and 2004

Forward-Looking Statements

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

1. Basis of Presentation

The accompanying unaudited consolidated financial statements were prepared in accordance with instructions for Form 10-QSB and, therefore, do not include information or footnotes necessary for a complete presentation of financial position, results of operations and cash flows in conformity with accounting principles generally accepted in the United States of America. Accordingly, these financial statements should be read in conjunction with the Consolidated Financial Statements and Notes thereto of the Company for the year ended December 31, 2004. However, in the opinion of management, all adjustments (consisting of only normal recurring accruals) which are necessary for a fair presentation of the consolidated financial statements have been included. The results of operations for the six and three month periods ended June 30, 2005, are not necessarily indicative of the results which may be expected for the entire year.

2. Principles of Consolidation

The accompanying consolidated financial statements include the accounts of PFS Bancorp, Inc. (the "Company") and its wholly-owned subsidiary, Peoples Federal Savings Bank (the "Savings Bank"). All significant intercompany items have been eliminated.

3. Earnings Per Share

Basic earnings per share is computed based upon the weighted-average common shares outstanding during the period less shares in the ESOP that are unallocated and not committed to be released. Weighted-average common shares deemed outstanding, which gives effect to 75,597 and 86,632 unallocated ESOP shares at June 30, 2005 and 2004, respectively. Diluted earnings per share is computed by taking into consideration common shares outstanding and the dilutive effect of additional potential common shares issuable under the Company's stock option plan. The computations are as follows:

	Six months ended June 30,		Three months ended June 30,	
	2005	2004	2005	2004
Weighted-average common shares outstanding (basic)	1,398,131	1,387,096	1,398,131	1,387,096
Dilutive effect of assumed exercise of stock options	29,856	9,325	31,502	9,218
Weighted-average common shares outstanding (diluted)	1,427,987	1,396,421	1,429,633	1,396,314

4. Stock Option Plan

The Board of Directors had previously adopted the PFS Bancorp, Inc. Stock Option Plan (the "Plan") which provides for the issuance of 152,088 shares of authorized but unissued shares of common stock at fair value at the date of grant. Stock options were granted in June 2003 for 79,316 shares at an exercise price equal to fair value of $13.22 (adjusted for the $5.00 special dividend in 2004). The Plan provides that one-fifth of the options granted become exercisable on each of the first five anniversaries of the date of grant and each option has an exercise period of ten years from the grant date.

The Company accounts for the Plan in accordance with SFAS No. 123, "Accounting for Stock-Based Compensation," which contains a fair value-based method for valuing stock-based compensation that entities may use, which measures compensation cost at the grant date based on the fair value of the award. Compensation is then recognized over the service period, which is usually the vesting period. Alternatively, SFAS No. 123 permits entities to continue to account for stock options and similar equity instruments under Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees." Entities that continue to account for stock options using APB Opinion No. 25 are required to make pro forma disclosures of net earnings and earnings per share, as if the fair value-based method of accounting defined in SFAS No. 123 had been applied.

The Company applies APB Opinion No. 25 and related Interpretations in accounting for the Plan. Accordingly, no compensation cost has been recognized for the Plan. Had compensation cost for the Plan been determined based on the fair value at the grant date for awards under the Plan consistent with the accounting method utilized in SFAS No. 123, the Company's net earnings and earnings per share would have been reported as the pro forma amounts indicated below:

		Six months ended June 30, 2005	Six months ended June 30, 2004	Three months ended June 30, 2005	Three months ended June 30, 2004
Net earnings (In thousands)	As reported	$457	$438	$236	$221
	Stock-based compensation, net of tax	(18)	(14)	(9)	(7)
	Pro-forma	$439	$424	$227	$214
Earnings per share					
Basic	As reported	$.33	$.32	$.17	$.16
	Stock-based compensation, net of tax	(.02)	(.01)	(.01)	(.01)
	Pro-forma	$.31	$.31	$.16	$.15
Diluted	As reported	$.32	$.31	$.16	$.15
	Stock-based compensation, net of tax	(.01)	(.01)	-	-
	Pro-forma	$.31	$.30	$.16	$.15

PFS Bancorp, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

For the six and three months ended June 30, 2005 and 2004

4. Stock Option Plan (continued)

A summary of the status of the Plan as of June 30, 2005 and December 31, 2004 and 2003 is presented below:

	June 30, 2005 Shares	June 30, 2005 Weighted-average exercise price	December 31, 2004 Shares	December 31, 2004 Weighted-average exercise price	December 31, 2003 Shares	December 31, 2003 Weigh aver exer pri
Outstanding at beginning of period	79,316	$13.22	79,316	$13.22	-	$ -
Granted	-	-	-	-	79,316	13.
Exercised	-	-	-	-	-	-
Forfeited	-	-	-	-	-	-

Outstanding at end of period	79,316	$13.22	79,316	$13.22	79,316	$13.
	======	=====	======	=====	======	===
Options exercisable at period-end	31,726	$13.22	15,863	$13.22	-	$ -
	======	=====	======	=====	======	===
Weighted-average fair value of options granted during the period		N/A		N/A		$ 3.
		===		===		==

The following information applies to options outstanding at June 30, 2005:

Number outstanding	79,316
Exercise price	$13.22
Weighted-average exercise price	$13.22
Weighted-average remaining contractual life	8 years

5. Critical Accounting Policies

Certain of the Company's accounting policies are important to the portrayal of the Company's financial condition, since they require management to make difficult, complex or subjective judgments, some of which may relate to matters that are inherently uncertain. Estimates associated with these policies are susceptible to material changes as a result of changes in facts and circumstances. Facts and circumstances which could affect these judgments include, but without limitation, changes in interest rates, changes in the performance of the economy or changes in the financial condition of borrowers. Management believes that its critical accounting policies primarily focuses on determining the allowance for loan losses. The Company's critical accounting policies are discussed in detail in its Annual Report for the year ended December 31, 2004 (incorporated by reference into the Company's 10-KSB filing) in Note A of the Notes to the Consolidated Financial Statements under "Allowance for Loan Losses." If management were to underestimate the allowance for loan losses, earnings could be reduced in the future as a result of greater than expected net loan losses. Overestimations of the required allowance could result in future increases in income, as loan loss recoveries increase or provisions for losses on loans decrease.

PFS Bancorp, Inc.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Discussion of Financial Condition Changes from December 31, 2004 to June 30, 2005

At June 30, 2005, the Company's assets totaled $134.0 million, an increase of $4.2 million, or 3.3%, compared to total assets at December 31, 2004. The increase in assets was comprised primarily of a $6.5 million, or 5.7%, increase in loans receivable which was principally funded by an increase in deposits of $3.6 million, or 4.1%, to $90.5 million at June 30, 2005 and a $1.9 million decrease in cash and interest-bearing deposits in other financial institutions.

Liquid assets (i.e. cash and interest-bearing deposits) decreased by

$1.9 million, or 25.2%, from December 31, 2004 levels, to a total of $5.6 million at June 30, 2005. Investment securities available for sale totaled $4.1 million at June 30, 2005, a decrease of $1.0 million, or 19.1%, from December 31, 2004 levels. The decrease in investment securities was due to sales and maturities of securities totaling $811,000 and a decrease of $239,000 in the market value of the investment securities during the 2005 six month period.

As previously stated, loans receivable increased by $6.5 million, or 5.7%, during the six month period ended June 30, 2005, to a total of $121.2 million. Loan disbursements amounted to $23.0 million and were partially offset by principal repayments of $16.5 million. During the six months ended June 30, 2005, loan originations were comprised of $11.6 million in loans secured by one- to four-family residential real estate, $6.3 million in loans secured by commercial and nonresidential real estate, and $5.1 million in consumer and other loans.

The allowance for loan losses totaled $874,000 and $833,000 at June 30, 2005 and December 31, 2004, respectively. Nonperforming and impaired loans totaled $261,000 and $816,000 at June 30, 2005 and December 31, 2004, respectively. The decrease in nonperforming and impaired loans was primarily due to the repayment in full of a $500,000 nonperforming loan during the six month period ended June 30, 2005. The allowance for loan losses represented 334.9% and 102.1% of nonperforming and impaired loans as of June 30, 2005 and December 31, 2004, respectively. The allowance represented approximately .71% and .70% of the total loan portfolio at June 30, 2005 and December 31, 2004, respectively. At June 30, 2005, nonperforming and impaired loans were comprised of $251,000 in loans secured by one- to four-family residential real estate and $10,000 in commercial, consumer and other loans. Management believes such loans are adequately collateralized and does not presently expect to incur any additional material losses on such loans. Although management believes that its allowance for loan losses at June 30, 2005 was sufficient to cover known and inherent losses in the loan portfolio based upon the available facts and circumstances, there can be no assurance that additions to such allowance will not be necessary in future periods, which could adversely affect the Company's results of operations.

Deposits totaled $90.5 million at June 30, 2005, an increase of $3.6 million, or 4.1%, from December 31, 2004 levels. While management generally strives to maintain a moderate level of growth in deposits through marketing and pricing strategies, the recent rise in interest rates has contributed to the increase in deposits as depositors are attracted by the higher yields. The increase in deposits was used to fund increased loan demand. Federal Home Loan Bank advances increased by $4.0 million to $21.5 million at June 30, 2005. The increase in advances was used to pay off the outstanding balance of the $3.5 million note payable.

Shareholders' equity amounted to $20.6 million at June 30, 2005, an increase of $112,000, or .5% from December 31, 2004 levels. The increase resulted primarily from the net earnings of $457,000, which was reduced by a $124,000 decline in unrealized gains on securities designated as available for sale and by the payment of dividends of $221,000.

The Saving Bank is required to meet minimum capital standards promulgated by the Office of Thrift Supervision ("OTS"). At June 30, 2005, the Savings Bank's regulatory capital was well in excess of the minimum capital requirements.

Comparison of Operating Results for the Three-Month Periods Ended June 30, 2005 and 2004

General

Net earnings for the three months ended June 30, 2005 amounted to $236,000, an increase of $15,000, or 6.8%, compared to the $221,000 in net earnings reported for the three month period ended June 30, 2004. The increase in earnings was due primarily to a $46,000, or 4.6%, increase in net interest income and a $6,000, or 4.8%, increase in other income, which were partially offset by a $29,000, or 4.0%, increase in general, administrative and other expense and an $8,000, or 5.3%, increase in income taxes.

Net Interest Income

Total interest income amounted to $1.7 million for the three-month period ended June 30, 2005, an increase of $329,000, or 24.0%, from the same period in 2004. Interest income on loans totaled $1.6 million during the 2005 period, an increase of $339,000, or 26.5%, from the 2004 period. This increase was due primarily to a $14.8 million, or 13.9%, increase in the average balance of loans outstanding quarter to quarter, coupled with a 53 basis point increase in the weighted-average yield to 5.33% for the quarter ended June 30, 2005. The increase in the average balance was due to the growth in the loan portfolio, in particular, residential and nonresidential real estate. The increase in yield was due to the upward repricing of our adjustable rate mortgages reflecting recent increases in market interest rates.

Interest income on investment securities decreased by $27,000, or 33.8%, for the three months ended June 30, 2005, compared to the same quarter in 2004. This decline was due primarily to a $4.4 million, or 42.5%, decrease in the average balance outstanding which was partially offset by a 47 basis point increase in the weighted-average yield to 3.55% for the quarter ended June 30, 2005. The decrease in the average balance of investment securities was primarily due to the maturity of investment securities from which the funds were used to partially pay a $5.00 per share special dividend in October 2004. Interest income on other interest-bearing deposits increased by $17,000 during the three months ended June 30, 2005, compared to the same period in 2004, due primarily to a 197 basis point increase in the weighted-average yield, to 2.87% for the 2005 quarter, partially offset by a $385,000, or 9.6%, decrease in the average balance outstanding for the three month period. The increase in the weighted average yield of interest-bearing deposits was primarily due to the rise in short term interest rates.

Interest expense on deposits totaled $468,000 for the three month period ended June 30, 2005, an increase of $128,000, or 37.6%, from the $340,000 recorded for the same period in 2004. The increase in interest on deposits was due primarily to a 53 basis point increase in the weighted-average cost of deposits in the 2005 period, coupled with a $3.8 million, or 4.7%, increase in the average balance outstanding quarter to quarter. Interest expense on borrowings increased by $155,000 to $188,000 for the three month period ended June 30, 2005, as compared to $33,000 in borrowing costs in the 2004 quarter. The increase in borrowing costs was due to a $13.5 million increase in the average balance of borrowings outstanding quarter to quarter. The increase in borrowings was used to fund increased loan demand.

Comparison of Operating Results for the Three-Month Periods Ended June 30, 2005 and 2004 (continued)

Provision for Losses on Loans

As a result of an analysis of historical experience, the volume and type of lending conducted by the Savings Bank, the status of past due principal and interest payments, general economic conditions, particularly as such conditions relate to the Savings Bank's market area, and other factors related to the collectibility of the Savings Bank's loan portfolio, management recorded a provision for losses on loans totaling $24,000 for each of the quarters ending June 30, 2005 and 2004. The current period provision was predicated primarily upon the continuing change in the loan portfolio mix, including an increase in loans secured by nonresidential real estate, as well as an increase in the size of the loan portfolio. There can be no assurance that the loan loss allowance will be sufficient to cover estimated loan losses in the future.

Other Income

Other income totaled $130,000 for the three month period ended June 30, 2005, an increase of $6,000, or 4.8%, over the same period in 2004. The increase in other income was due primarily to the absence of a $5,000 loss on the sale of real estate recognized in the 2004 quarter. Excluding the loss on repossessed property, other income would have increased by $1,000 from quarter to quarter. This increase is a result of a $3,000, or 6.8%, increase in other operating income which was partially offset by a $2,000, or 2.4%, decrease in service charge fees.

General, Administrative and Other Expense

General, administrative and other expense totaled $753,000 for the three months ended June 30, 2005, an increase of $29,000, or 4.0%, compared to the same quarter in 2004. This increase was due primarily to a $15,000, or 3.7%, increase in employee compensation and benefits, a $7,000, or 11.3%, increase in data processing expenses, and a $5,000, or 3.0%, increase in other operating expenses. The increase in employee compensation and benefits was attributable to increased costs associated with the Company's stock benefit plan and insurance premiums, as well as normal merit increases quarter to quarter. The increase in data processing expenses and other operating expenses is primarily due to increased check processing costs and legal expense related to the on-going compliance costs of being a stock company.

Income Taxes

The income tax provision totaled $160,000 for the three month period ended June 30, 2005, an increase of $8,000, or 5.3%, compared to the same quarter in 2004. The income tax provision includes expense for federal and Indiana state income taxes. The combined effective tax rates were 40.4% and 40.8% for the three month periods ended June 30, 2005 and 2004, respectively.

Comparison of Operating Results for the Six-Month Periods Ended June 30, 2005 and 2004

General

Net earnings for the six months ended June 30, 2005 amounted to $457,000, an increase of $19,000, or 4.3%, compared to the $438,000 in net earnings reported for the six month period ended June 30, 2004. The increase in earnings was due primarily to a $74,000, or 3.7%, increase in net interest income and a $56,000, or 23.1%, increase in other income, which were partially offset by an $104,000, or 7.3%, increase in general, administrative and other expense and a $7,000, or 2.3%, increase in income taxes.

Net Interest Income

Total interest income amounted to $3.3 million for the six-month period ended June 30, 2005, an increase of $565,000, or 20.6%, from the same period in 2004. Interest income on loans totaled $3.2 million during the 2005 period, an increase of $593,000, or 23.2%, from the 2004 period. This increase was due primarily to a $14.8 million, or 14.1%, increase in the average balance of loans outstanding period to period, coupled with a 39 basis point increase in the weighted-average yield to 5.25% for the six months ended June 30, 2005. The increase in the average balance was due to the growth in the loan portfolio, in particular, residential and nonresidential real estate. The increase in yield was due to the upward repricing of our adjustable rate mortgages reflecting recent increases in market interest rates.

Interest income on investment securities decreased by $59,000, or 35.8%, for the six months ended June 30, 2005, compared to the same period in 2004. This decline was due primarily to a $4.5 million, or 42.6%, decrease in the average balance outstanding which was partially offset by a 38 basis point increase in the weighted-average yield to 3.53% for the period ended June 30, 2005. The decrease in the average balance of investment securities was primarily due to the maturity of investment securities from which the funds were used to partially pay a $5.00 per share special dividend in October 2004. Interest income on other interest-bearing deposits increased by $31,000 during the six months ended June 30, 2005, compared to the same period in 2004, due primarily to a 153 basis point increase in the weighted-average yield, to 2.47% for the 2005 period, partially offset by a $20,000, or .5%, decrease in the average balance outstanding for the six month period. The increase in the weighted average yield of interest-bearing deposits was primarily due to the rise in short term interest rates.

Interest expense on deposits totaled $889,000 for the six month period ended June 30, 2005, an increase of $180,000, or 25.4%, from the $709,000 recorded for the same period in 2004. The increase in interest on deposits was due primarily to a 37 basis point increase in the weighted-average cost of deposits in the 2005 period, coupled with a $2.7 million, or 3.3%, increase in the average balance outstanding period to period. Interest expense on borrowings increased by $311,000 to $367,000 for the six month period ended June 30, 2005, as compared to $56,000 in borrowing costs in the 2004 period. The increase in borrowing costs is due to a $15.4 million increase in the average borrowings outstanding period to period. The increase in borrowings was used to fund increased loan demand.

Comparison of Operating Results for the Six-Month Periods Ended June 30, 2005 and 2004 (continued)

Provision for Losses on Loans

As a result of an analysis of historical experience, the volume and type of lending conducted by the Savings Bank, the status of past due principal and interest payments, general economic conditions, particularly as such conditions relate to the Savings Bank's market area, and other factors related to the collectibility of the Savings Bank's loan portfolio, management recorded a provision for losses on loans totaling $48,000 for each of the six month periods ending June 30, 2005 and 2004. The current period provision was predicated primarily upon the continuing change in the loan portfolio mix, including an increase in loans secured by nonresidential real estate, as well as an increase in the size of the loan portfolio. There can be no assurance that the loan loss allowance will be sufficient to cover estimated loan losses in the future.

Other Income

Other income totaled $298,000 for the six month period ended June 30, 2005, an increase of $56,000, or 23.1%, over the same period in 2004. The increase in other income was due primarily to a $51,000 gain from the sale of investment securities in 2005 as well as the absence of a $5,000 loss on the sale of repossessed property in 2004. Excluding the investment securities gain and the loss on sale of repossessed property, other income would have been $247,000 for each of the six month periods. A $9,000, or 11.0%, increase in other operating income was offset by a $9,000, or 5.5%, decrease in service charge fees.

General, Administrative and Other Expense

General, administrative and other expense totaled $1.5 million for the six months ended June 30, 2005, an increase of $104,000, or 7.3%, compared to the same period in 2004. This increase was due primarily to a $60,000, or 7.2%, increase in employee compensation and benefits, a $25,000, or 8.6%, increase in other operating expenses and a $17,000, or 13.7%, increase in data processing expenses. The growth in employee compensation and benefits was primarily due to increased pension costs totaling $51,000. Excluding pension costs, employee compensation and benefits increased $9,000, or 1.1%, period to period. The increase in other operating expenses is primarily due to increased check processing costs and legal expense related to the on-going compliance costs of being a stock company.

Income Taxes

The income tax provision totaled $309,000 for the six month period ended June 30, 2005, an increase of $7,000, or 2.3%, compared to the same quarter in 2004. The income tax provision includes expense for federal and Indiana state income taxes. The combined effective tax rates were 40.3% and 40.8% for the six month periods ended June 30, 2005 and 2004, respectively.

PFS Bancorp, Inc.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

Other Events

On May 4, 2005, the Company announced that it entered into an agreement and plan of merger with Peoples Community Bancorp, Inc. (Peoples Community), whereby Peoples Community will pay $23.00 per share in cash, or approximately $33.8 million in the aggregate, for 100% of the outstanding common shares of the Company. The transaction is subject to shareholder and regulatory approval with a tentative closing date in the fourth quarter of calendar 2005.

Impact of Inflation and Changing Prices

The financial statements and related financial data presented herein have been prepared in accordance with instructions to Form 10-QSB, which require the measurement of financial position and operating results in terms of historical dollars, without considering changes in relative purchasing power over time due to inflation.

Unlike most industrial companies, virtually all of the Savings Bank's assets and liabilities are monetary in nature. As a result, interest rates generally have a more significant impact on a financial institution's performance than does the effect of inflation.

ITEM 3: Controls and Procedures

Our management evaluated, with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures (as defined under Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities and Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and regulations and are operating in an effective manner.

PFS Bancorp, Inc.
PART II

ITEM 1. Legal Proceedings

Not applicable

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

Not applicable

ITEM 3. Defaults Upon Senior Securities

Not applicable

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

Not applicable

ITEM 5. Other Information

None.

ITEM 6. Exhibits

EX-31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a)

EX-31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a)

EX-32.1 Section 1350 Certification of the Chief Executive Officer

EX-32.2 Section 1350 Certification of the Chief Financial Officer

PFS Bancorp, Inc.

SIGNATURES

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

Date: August 15, 2005 By: /s/Mel E. Green

Mel E. Green
President and Chief Executive Officer

Date: August 15, 2005 By: /s/Stuart M. Suggs

Stuart M. Suggs
Corporate Treasurer, Chief Operating Officer, and Chief Financial Officer