HDFC BANK LTD
Form 20-F
July 27, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington D.C. 20549

FORM 20-F

¨ **REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934**
OR

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended March 31, 2012

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from to

OR

¨ **SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
Date of event requiring this shell company report

Commission file number 001-15216

HDFC BANK LIMITED

(Exact name of Registrant as specified in its charter)

Not Applicable

(Translation of Registrant s name into English)

India

(Jurisdiction of incorporation or organization)

HDFC Bank House, Senapati Bapat Marg, Lower Parel, Mumbai 400013, India

(Address of principal executive offices)

Name: Sanjay Dongre, Executive Vice President (Legal) and Company Secretary

Telephone: 91-22-2490-2934 /or 91-22-2498-8484, Ext. 3473

Email: sanjay.dongre@hdfcbank.com

Address: 2nd floor, Process House, Kamala Mills Compound, Senapati Bapat Marg, Lower Parel, Mumbai 400 013, India.

(Name, telephone, e-mail and/or facsimile number and address of company contact person)

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

Title of each class	Name of each exchange on which registered
American Depositary Shares, each representing three Equity Shares, Par value Rs. 2.0 per share	**The New York Stock Exchange**

Securities registered or to be registered pursuant to Section 12(g) of the Act: **Not Applicable**

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: **Not Applicable**

Indicate the number of outstanding shares of each of the issuer s classes of capital or common stock as of the close of the period covered by the annual report:

Equity Shares, as of March 31, 2012 2,346,688,270

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

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes ¨ No x

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 x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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 x Accelerated filer ¨ Non-accelerated filer ¨

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP x International Financial Reporting Standards as issued by the International Accounting Standards Board ¨ Other ¨

If Other has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow: Item 17 ¨ Item 18 ¨

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

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CROSS REFERENCE SHEET

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EXCHANGE RATES AND CERTAIN DEFINED TERMS

In this document, all references to we, us, our, HDFC Bank or the Bank shall mean HDFC Bank Limited or where the context requires also t subsidiaries whose financials are consolidated for accounting purposes. References to the U.S. or United States are to the United States of America, its territories and its possessions. References to India are to the Republic of India. References to $ or US$ or dollars or U.S. dollars to the legal currency of the United States and references to Rs. or rupees or INR or Indian rupees are to the legal currency of India.

Our financial statements are presented in Indian rupees and in some cases translated into U.S. dollars. The financial statements and all other financial data included in this report, except as otherwise noted, are prepared in accordance with United States generally accepted accounting principles, or U.S. GAAP. US GAAP differs in certain material respects from accounting principles generally accepted in India, the requirements of India s Banking Regulations Act and related regulations issued by the Reserve Bank of India (RBI) (collectively Indian GAAP), which form the basis of our statutory general purpose financial statements in India. Principal differences insofar as they relate to us include: determination of the allowance for credit losses, classification and valuation of investments, accounting for deferred income taxes, stock-based compensation, employee benefits, loan origination fees, derivative financial instruments, business combinations and the presentation format and disclosures of the financial statements and related notes.

References to a particular fiscal year are to our fiscal year ended March 31 of such year.

Fluctuations in the exchange rate between the Indian rupee and the U.S. dollar will affect the U.S. dollar equivalent of the Indian rupee price of the equity shares on the Indian stock exchanges and, as a result, will affect the market price of our American Depositary Shares (ADSs) in the United States. These fluctuations will also affect the conversion into U.S. dollars by the depositary of any cash dividends paid in Indian rupees on the equity shares represented by ADSs.

During fiscal 2008 the rupee appreciated against the USD. Strong capital flows ensured that the rupee moved with an upside bias in the period. However, in fiscal 2009 the trend reversed on account of the sub-prime crisis and global risk aversion that led to a portfolio outflows and ensured that the rupee came under strong selling pressure in the period. The INR managed to recover somewhat in fiscal 2010 in line with the pickup in the domestic economy and improvement in global risk appetite. In fiscal 2011 the rupee was range bound as capital flows just about managed to balance the drag from external debt servicing and import payments. However, in fiscal year 2012 the INR depreciated (the high and low during fiscal 2012 was Rs. 53.71 per US$ and Rs. 44.00 per US$ respectively) coming under strain amidst a widening current account deficit, thin capital inflows and rising global uncertainty spurred by lingering financial and economic instability in Europe and the USA.

The following table sets forth, for the periods indicated, information concerning the exchange rates between Indian rupees and U.S. dollars based on the noon buying rate in The City of New York:

Fiscal Year	Period End(1)	Average(1)(2)	High	Low
2008	40.02	40.13	43.05	38.48
2009	50.87	45.84	51.96	39.73
2010	44.95	47.39	50.48	44.94
2011	44.54	45.49	47.49	43.90
2012	50.89	47.81	53.71	44.00

(1) The noon buying rate at each period end and the average rate for each period differed from the exchange rates used in the preparation of our financial statements.

(2) Represents the average of the noon buying rate for all days during the period.

The following table sets forth the high and low noon buying rate for the Indian rupee for each of the previous six months:

Month	Period End	Average	High	Low
January 2012	49.54	51.00	53.11	49.39
February 2012	48.99	49.18	49.48	48.65

March 2012	50.89	50.36	51.38	49.14
April 2012	52.65	51.69	52.65	50.64
May 2012	56.38	54.33	56.38	52.50
June 2012	55.57	55.94	57.13	54.91

Although we have translated selected Indian rupee amounts in this document into U.S. dollars for convenience, this does not mean that the Indian rupee amounts referred to could have been, or could be, converted to U.S. dollars at any particular rate, the rates stated above, or at all. Unless otherwise stated, all translations from Indian rupees to U.S. dollars are based on the noon buying rate in the City of New York for cable transfers in Indian rupees at US$1.00 = Rs. 50.89 on March 31, 2012. The noon buying rate on July 20, 2012 was Rs. 55.27 per US$1.00.

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FORWARD-LOOKING STATEMENTS

We have included statements in this report which contain words or phrases, such as will , aim , believe , expect , will continue , anticipate , intend , plan , future , objective , project , should , and similar expressions or variations of these expressions, that are forward-looking stater Actual results may differ materially from those suggested by the forward-looking statements due to certain risks or uncertainties associated with our expectations with respect to, but not limited to, our ability to implement our strategy successfully, the market acceptance of and demand for various banking services, future levels of our non-performing loans, our growth and expansion, the adequacy of our allowance for credit and investment losses, technological changes, volatility in investment income, our ability to market new products, cash flow projections, the outcome of any legal, tax or regulatory proceedings in India and in other jurisdictions we are or become a party to, the future impact of new accounting standards, our ability to pay dividends, the impact of changes in banking regulations and other regulatory changes in India and other jurisdictions on us, our ability to roll over our short-term funding sources and our exposure to market and operational risks. By their nature, certain of the market risk disclosures are only estimates and could be materially different from what may actually occur in the future. As a result, actual future gains, losses or impact on net income could materially differ from those that have been estimated. Our forward looking statements speak only as of the date on which they are made and we do not undertake any obligation, and we do not intend, to update or revise any forward looking statements to reflect events or circumstances after the date in the statement, even if our expectations or any related events or circumstances change.

In addition, other factors that could cause actual results to differ materially from those estimated by the forward-looking statements contained in this document include, but are not limited to: general economic and political conditions, instability or uncertainty in India and other countries which have an impact on our business activities or investments caused by any factor including the global financial crisis and problems in the Eurozone countries, terrorist attacks in India, the United States or elsewhere, anti-terrorist or other attacks by the United States, a United States-led coalition or any other country, tensions between India and Pakistan related to the Kashmir region, military armament or social unrest in any part of India, the monetary and interest rate policies of the government of India, natural calamities, inflation, deflation, unanticipated turbulence in interest rates, foreign exchange rates, equity prices or other rates or prices, the performance of the financial markets in India and globally, changes in Indian and foreign laws and regulations, including tax, accounting and banking regulations, changes in competition and the pricing environment in India, and regional or general changes in asset valuations. For further discussion on the factors that could cause actual results to differ, see Risk Factors .

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BUSINESS

Overview

We are a new generation private sector bank in India. Our goal is to be the preferred provider of financial services to upper and middle income individuals and corporations in India. Our strategy is to provide a comprehensive range of financial products and services to our customers through multiple distribution channels, with what we believe is high quality service and superior execution. We have three principal business activities: retail banking, wholesale banking and treasury operations.

We have grown rapidly since commencing operations in January 1995. In the five years ended March 31, 2012, we expanded our operations from 684 branches and 1,605 Automated Teller Machines (ATMs) in 320 cities to 2,544 branches and 8,913 ATMs in 1,399 cities. On account of the expansion in our geographical reach and the resultant increase in market penetration, our assets have grown from Rs. 1,013.2 billion as of March 31, 2007 to Rs. 3,571.2 billion as of March 31, 2012. Our net income has increased from Rs. 11.0 billion for fiscal 2007 to Rs. 49.8 billion for fiscal 2012.

We acquired Centurion Bank of Punjab Limited (CBoP), a new generation private sector Indian bank that offered retail, small and medium enterprise and corporate banking products and services, similar to ours. Our shareholders approved the acquisition on March 27, 2008, and it became effective May 23, 2008. As consideration for the acquisition, every 29 equity shares of CBoP were exchanged for one of our equity shares. The primary purpose of the acquisition was to realize potential synergies and growth opportunities. We acquired over two million customers, approximately Rs. 266,834.6 million in assets and assumed approximately Rs. 239,003.1 million in liabilities. The fair value of the net assets we acquired was Rs. 27,831.5 million on the date we acquired CBoP, which resulted in goodwill of Rs. 74,937.9 million.

Our financial condition and results of operations are affected by general economic conditions prevailing in India. It was a challenging year for the Indian economy with lingering concerns over global growth prospects and financial stability weighing on external demand and international funding. Further, local headwinds such as inflation, rising interest rates and policy impediments exacerbated the impact of a shaky global environment on domestic growth. Aggressive monetary tightening curtailed leveraged spendings pulling private consumption growth lower from 8.1% for fiscal 2011 to 6.5% for fiscal 2012, while policy hurdles such as land acquisition problems and environmental clearances dampened investment momentum, with investment growth lower at 5.8% from 11.1% a year ago. The intensification of the debt crisis in Europe as well as a moderation in emerging markets across the globe reduced export growth sharply in the second half of fiscal 2012 to 6% from close to 25% in the first half of fiscal 2012, weakening a vital support for GDP growth in fiscal 2012. Despite a slowdown in growth over fiscal year 2012, India has continued to outperform the global economy. With world output growth likely to remain relatively feeble at 3.3% in 2012 against 3.8% in 2011, we believe structural supports from a rapidly expanding rural and semi-urban economy, favorable demographics and low product penetration are likely to continue to keep domestic growth higher than world growth.

Notwithstanding our pace of growth, we believe, we have maintained a strong balance sheet and a low cost of funds. As of March 31, 2012, our net non-performing customer assets (which consist of loans and credit substitutes) constituted 0.2% of net customer assets. In addition, our net customer assets represented 81.9% of our customer deposits and customer deposits represented 69.0% of our total liabilities and shareholders equity. The average non-interest bearing current accounts and low-interest bearing savings accounts represented 47.3% of average total deposits for fiscal 2012. These low-cost deposits led to an average cost of funds including equity for fiscal 2012 of 4.9%.

We are part of the HDFC group of companies established by our principal shareholder, Housing Development Finance Corporation Limited (HDFC Limited), a listed public limited company established under the laws of India. HDFC Limited is primarily engaged in financial services, including mortgages, property-related lending and deposit services. The subsidiaries and associated companies of HDFC Limited are also largely engaged in a range of financial services, including asset management, and life and other insurance. HDFC Limited and its subsidiaries owned 23.15% of our outstanding equity shares as of March 31, 2012. Our Chairman and Managing Director were nominated by HDFC Limited and appointed with the approval of our shareholders and the Reserve Bank of India (RBI). Mr. Keki Mistry Vice Chairman and Chief Executive Officer of HDFC Limited, and Mrs. Renu Karnad Managing Director of HDFC Limited are members of our Board of Directors. See also Principal Shareholders . We have no agreements with HDFC Limited or any of its group companies that restrict us from competing with them. We currently distribute products of HDFC Limited and its group companies, such as home loans of HDFC Limited, life and general insurance products of HDFC Standard Life Insurance Company Limited and HDFC ERGO General Insurance Company Limited respectively and mutual funds of HDFC Asset Management Company Limited.

We had a cash outflow of approximately Rs. 6.0 billion, Rs. 5.8 billion and Rs. 7.9 billion in fiscals 2010, 2011 and 2012, respectively, principally for property, plant and equipment, including our branch network expansion and our technology and communications infrastructure. We have current plans for aggregate capital expenditures of approximately Rs. 13.7 billion in fiscal 2013. This budgeted amount includes Rs. 2.0 billion to expand our branch and back office network, Rs. 0.9 billion to expand our ATM network, Rs. 0.5 billion to expand our Electronic Data Capture terminal network and Rs. 10.3 billion to upgrade and expand our hardware, data center, network and other systems. Our capital expenditure needs may change depending on, among other factors, the business environment prevailing at the time, consequently our actual capital expenditures may be higher or lower than our budgeted amounts.

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We have two subsidiaries as per local laws: HDFC Securities Limited (HSL) and HDB Financial Services Limited (HDBFS). HSL is primarily in the business of providing brokerage services through the internet and other channels. HDBFS is a non-deposit taking non-bank finance company (NBFC). We have consolidated the financial statements of Atlas Documentary Facilitators Company Private Limited (ADFC), which provides back office transaction processing services, in our U.S. GAAP financial statements.

Our principal corporate and registered office is located at HDFC Bank House, Senapati Bapat Marg, Lower Parel, Mumbai 400 013, India. Our telephone number is 91-22-6652-1000. Our agent in the United States for the 2007 ADS offering is Depositary Management Corporation, 570 Lexington Avenue, 44th Floor, New York, NY 10022 and that for the 2001 and 2005 ADS offerings and Patriot Act information gathering is CT Corporation, 111 Eighth Avenue, New York, NY 10011.

Our Competitive Strengths

We attribute our growth and continuing success to the following competitive strengths:

Our use of technology

Since our inception, we have made and continue to make investments in our technology platform and systems, to build multiple distribution channels, including an electronically linked branch network, automated telephone banking, internet banking and banking through mobile phones, to offer our customers convenient access to various products. During fiscal 2012, we added more capability to our internet banking platform, launched mobile banking for 2G customers and launched applications for various mobile platforms.

We have templatized credit underwriting through automated customer data de-duplication and real-time scoring in our loan origination process. Having enhanced our cross selling and up-selling capabilities through data mining and analytical customer relationship management solutions, our technology enables us to have a 360º view of our customers. We employ event detection technology-based customer messaging and have deployed an enterprise wide data warehousing solution as a back bone to our business intelligence system.

We have implemented a risk management engine for internet transactions coupled with various multi-factor authentication, which has reduced phishing attacks. We have also implemented a digital certificate-based security engine for corporate internet banking customers. Credit and debit cards usage of our customers is secured by a proactive risk manager technology solution which uses rules-based SMS alerts as well as prompts customer service representatives to call the customer on detecting abnormal usage behavior. This helps in minimizing probable losses to customers on account of frauds, if the card gets stolen or is not hot listed by the customer.

Sophisticated automated switch-over and switch-back solutions power our Business Continuity and Disaster Recovery management strategy for core banking and other key applications. We conduct drills periodically to upgrade this capability and to improve the availability of our services to our customers.

We deliver high quality service with superior execution

Through intensive training of our staff and the use of our technology platform, we believe, we deliver efficient service with rapid response time. Our focus on knowledgeable and personalized service, we believe, draws customers to our products and increases existing customer loyalty.

Many of our operational processes are certified under the International Organization for Standardization (ISO) 9001:2008. This certification requires the underlying processes to be robust, effective and efficient. The ISO certification ensures that: a) we have a set of procedures that cover key processes; b) our processes are monitored to ensure effectiveness; c) adequate records are maintained; and d) outputs are monitored for any defects so that appropriate and accurate remedial actions can be undertaken.

Some of our operational achievements, which we believe have enabled us to deliver high quality service, include: i) deposit accounts processed by our operations team with a turnaround time of less than two working days; ii) welcome kits dispatched to customers within two working days of opening a deposit account; and iii) internet banking personal identification numbers (PINs) generated within one working day of a request logged in our systems.

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We offer a range of products to our clients in order to service their banking needs

Whether in retail or wholesale banking, we consider ourselves a one-stop shop for our customers banking needs. Our retail banking products range from retail loans to deposit products and other products and services, such as private banking, depositary accounts, foreign exchange services, distribution of third party products (such as insurance and mutual funds), bill payments and sale of precious metals (such as gold and silver). In addition we offer our customers broking accounts through our subsidiary HSL. On the wholesale banking side we offer customers working capital loans, term loans, bill collections, letters of credit and guarantees and foreign exchange and derivative products. In addition we offer a range of deposit and transaction banking services such as cash management, custodial and clearing bank services and correspondent banking. We collect taxes for the government and are bankers to issuances of equity shares and bonds to the public by companies. Our wide range of products creates multiple cross-selling opportunities for us and, we believe, improves our customer retention rates.

We have an experienced management team

Many of the members of our senior management team have been with us since our inception. They have substantial experience in banking across various countries and share our common vision of excellence in execution. We believe this team is well suited to leverage the competitive strengths we have already developed as well as to create new opportunities for our business. See Management .

Our Business Strategy

Our business strategy emphasizes the following elements:

Increase our market share of India s expanding banking and financial services industry

In addition to benefiting from the overall growth in India s economy and financial services industry, we believe we can increase our market share by continuing to focus on our competitive strengths. We also aim to increase geographic and market penetration by expanding our branch and ATM networks and increasing our efforts to cross-sell our products.

Maintain strong asset quality through disciplined credit risk management

We have maintained high quality loan and investment portfolios through careful targeting of our customer base and by putting in place what we believe are comprehensive risk assessment processes and diligent risk monitoring and remediation procedures. Our ratio of gross non-performing assets to customer assets was 0.9% as of March 31, 2012 and our net non-performing assets amounted to 0.2% of net customer assets. We have restructured the payment terms of certain loans. As of March 31, 2012, these represented 0.2% of our gross customer assets. We believe we can maintain strong asset quality appropriate to the loan portfolio composition, while achieving growth.

Maintain a low cost of funds

We believe we can maintain a relatively low-cost funding base as compared to our competitors, by leveraging on our strengths and expanding our base of retail savings and current deposits and increasing the free float generated by transaction services, such as cash management and stock exchange clearing. During fiscal 2012, our average cost of funds (including equity) was 4.9%.

Focus on high earnings growth with low volatility

Our net income has grown at a compounded average rate of 35.2% during the five-year period ended March 31, 2012. We intend to maintain our focus on steady earnings growth through conservative risk management techniques and low-cost funding. In addition, we aim not to rely heavily on volatile streams of income such as those from trading and other big ticket fees (such as those from investment banking) so as to maintain earnings growth.

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Our Principal Business Activities

Our principal business activities consist of retail banking, wholesale banking and treasury operations. The following table sets forth our net revenues attributable to each area for the last three years.

	Year ended March 31,						
	2010		2011		2012		
	(in millions, except percentages)						
Retail banking	Rs. 84,685.7	80.1%	Rs. 122,321.0	84.0%	Rs. 140,761.6	US$ 2,766.0	82.2%
Wholesale banking	14,125.6	13.4%	21,151.9	14.5%	29,098.7	571.8	17.0%
Treasury operations	6,825.8	6.5%	2,122.9	1.5%	1,289.9	25.3	0.8%
Net revenue	Rs. 105,637.1	100%	Rs. 145,595.8	100%	Rs. 171,150.2	US$ 3,363.1	100%

Retail Banking

Overview

We consider ourselves a one-stop shop for the financial needs of upper and middle income individuals. We provide a comprehensive range of financial products, including deposit products, loans, credit cards, debit cards, third-party mutual funds and insurance products, investment advice, bill payment services and other services. Our retail banking loan products include loans to small and medium enterprises for commercial vehicles, construction equipment and other business purposes, which together account for slightly more than a third of our total retail banking loans. We group these loans as part of our retail banking business considering, among other things, the customer profile, the nature of the product, the differing risks and returns, our organization structure and our internal business reporting mechanism. Such grouping ensures optimum utilization and deployment of specialized resources in our retail banking business.

We market our services aggressively through our branches and alternate sales channels, as well as through our relationships with automobile dealers and corporate clients. We seek to establish a relationship with a retail customer and then expand it by offering more products. As part of our growth strategy we continue to expand our distribution channels so as to make it easier for the customer to do business with us. We believe this strategy, together with the general growth of the Indian economy and the Indian upper and middle classes, affords us significant opportunities for growth.

As of March 31, 2012, we had 2,544 branches and 8,913 ATMs in 1,399 cities. We also provide telephone banking, internet and mobile banking to our customers. We plan to continue to expand our branch and ATM network as well as our other distribution channels, subject to receiving regulatory approvals.

Retail Loans and Other Asset Products

We offer a wide range of retail loans, including loans for the purchase of automobiles, personal loans, retail business banking loans, loans for the purchase of commercial vehicles and construction equipment finance, two-wheeler loans, credit cards and loans against securities. Our retail loans were 66.1% of our gross loans of which 21.1% were unsecured as of March 31, 2012. Apart from our branches, we use our ATM screens and the internet to promote our loan products and we employ additional sales methods depending on the type of products. We perform our own credit analyses of the borrowers and the value of the collateral. See Risk Management Credit Risk Retail Credit Risk . We also buy mortgage and other asset-backed securities and invest in retail loan portfolios through assignments. In addition to taking collateral in many cases, we generally obtain post-dated checks covering all payments at the time a retail loan is made. It is a criminal offense in India to issue a bad check. We also sometimes obtain instructions to debit the customer s account directly for the making of payments. However, unsecured personal loans are still a greater credit risk for us than our secured loan portfolio because they are not supported by any collateral. We may be unable to collect in part or at all on an unsecured personal loan in the event of non-payment by the borrower. Accordingly, personal loans are granted at a higher loan yield since they carry a higher credit risk as compared to secured loans. Also see Risk Factors *Our unsecured loan portfolio is not supported by any collateral that could help ensure repayment of the loan, and in the event of non-payment by a borrower of one of these loans, we may be unable to collect the unpaid balance* .

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The following table shows the value and share of our retail credit products:

	Value at March 31, 2012 (in millions)		% of Total Value
Retail Loans:			
Auto loans	Rs. 310,822.5	US$ 6,107.7	23.0
Personal loans / Credit Cards	219,137.9	4,306.1	16.2
Retail business banking	284,431.5	5,589.1	21.1
Commercial vehicle and construction equipment finance	228,751.1	4,495.0	17.0
Housing loans	142,897.4	2,808.0	10.6
Other Retail Loans	158,926.4	3,123.0	11.8
Total retail loans	1,344,966.8	26,428.9	99.7
Mortgage-backed securities	3,310.9	65.1	0.2
Asset-backed securities	585.3	11.5	0.1
Total retail assets	Rs. 1,348,863.0	US$ 26,505.5	100.0

Note: The figures above exclude securitized-out receivables. Mortgaged-backed securities and asset-backed securities are reflected at fair values.

Auto Loans

We offer loans at fixed interest rates for financing new and used automobile purchases. In addition to our general marketing efforts for retail loans, we market this product through our relationships with car dealers, direct sales agents, corporate packages and joint promotion programs with automobile manufacturers.

Personal Loans / Credit Cards

We offer unsecured personal loans at fixed rates to specific customer segments, including salaried individuals and self-employed professionals. In addition, we offer unsecured personal loans to small businesses and individual businessmen.

We also offer credit cards from the VISA and MasterCard stable, including gold, silver, corporate, platinum, titanium, signature, infinite, regalia, superia and world credit cards. We had approximately 5.1 million cards outstanding as of March 31, 2011, as against 5.6 million cards outstanding as of March 31, 2012.

Retail Business Banking

We address the borrowing needs of the community of small businessmen primarily located near our bank branches by offering facilities such as credit lines, term loans for expansion or addition of facilities and discounting of receivables. We classify these business banking loans as a retail product. Such lending is typically secured with current assets as well as immovable property and fixed assets in some cases. We also offer letters of credit, guarantees and other basic trade finance products, foreign exchange and cash management services to such businesses.

Commercial Vehicles and Construction Equipment Finance

We provide secured financing for commercial vehicles and provide working capital, bank guarantees and trade advances to transport operators. In addition to funding domestic assets, we also finance imported assets for which we open foreign letters of credit and offer treasury services, such as forward exchange covers. We coordinate with manufacturers to jointly promote our financing options to their clients.

Housing Loans

In fiscal 2003, we entered the home loan business through an arrangement with HDFC Limited. Under this arrangement, we source home loans provided by HDFC Limited, which approves the credit sanctioning and disburses the loans. The loans are kept on the balance sheet of HDFC Limited, and we are paid a sourcing fee. Under the arrangement, HDFC Limited is obligated to offer us up to 70% of the disbursed home loans sourced under the arrangement. We have the option to purchase the loans at the underlying yields less a spread of 1.25% payable towards the administration and servicing of the loans. A part of the home loans may also qualify for our directed lending requirement.

Other Retail Loans

Two-Wheeler Loans

We offer loans for financing the purchase of scooters and motorcycles. We market this product in ways similar to our marketing of auto loans.

Loans Against Securities

We offer loans against equity shares, mutual fund units, bonds issued by the RBI and other securities that are on our approved list. We limit our loans against equity shares to Rs. 2.0 million per retail customer in line with regulatory guidelines and limit the amount of our total exposure secured by particular securities. We lend only against shares in book-entry (dematerialized) form, which ensures that we obtain perfected and first-priority security interests. The minimum margin for lending against shares is prescribed by the RBI.

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We also offer loans which primarily include overdrafts against time deposits, health care equipment financing loans, tractor loans, loans against gold and ornaments, loans to self-help groups and small loans to farmers.

Mortgage-backed Securities

We also invest in mortgage-backed securities of other originators. These mortgages are generally in India. Most of these securities also qualify towards our directed lending obligations.

After our acquisition of CBoP, the portfolio of home loans of CBoP was transferred to our loan book.

Asset-backed Securities

We invest in auto loans, two-wheeler loans, commercial vehicle loans and other asset-backed securities, represented by pass-through certificates (PTCs). These securities are normally credit-enhanced and may qualify for our directed lending requirements. These assets are generally in India.

Loan Assignments

We purchase loan portfolios, generally in India, from other banks, financial institutions and financial companies, which are similar to asset-backed securities, except that such loans are not represented by PTCs. Some of these loans also qualify toward our directed lending obligations. Such loans are included within the categories described above based on underlying exposures.

Sale/Transfer of Receivables

We enter into assignment transactions from time to time, which are similar to asset-backed securitization transactions through special purpose entities (SPE), except that such portfolios of receivables are assigned directly to the purchaser and are not represented by pass-through certificates. We also securitize our retail loan receivables through independent SPEs. In respect of these transactions, recourse is in the form of our investment in subordinated securities issued by SPEs, cash collateral and other credit and liquidity enhancements. In fiscals 2011 and 2012 we did not sell any performing loans.

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Retail Deposit Products

Retail deposits provide us with a low cost, stable funding base and have been a key focus area for us since commencing operations. Retail deposits represented approximately 72% of our total deposits as of March 31, 2012. The following chart shows the number of accounts and value of our retail deposits by our various deposit products:

	At March 31, 2012						
	Value (in millions)				% of total	Number of accounts (in thousands)	% of total
Savings	Rs.	717,675.5	US$	14,102.5	40.2	16,159	74.5
Current		253,295.7		4,977.3	14.2	1,853	8.5
Time		813,582.3		15,987.1	45.6	3,674	17.0
Total	Rs.	1,784,553.5	US$	35,066.9	100.0	21,686	100.0

Our individual retail account holders have access to the benefits of a wide range of direct banking services, including debit and ATM cards, access to internet and phone banking services, access to our growing branch and ATM network, access to our other distribution channels and eligibility for utility bill payments and other services. Our retail deposit products include the following:

Savings accounts, which are demand deposits, designed primarily for individuals and trusts. From May 2011, the RBI mandated that interest payable on savings deposits be increased to 4% from 3.5%, and in October 2011, the interest rate was de-regulated by RBI; see also Supervision and Regulation .

Current accounts, which are non-interest bearing checking accounts designed primarily for business customers. Customers have a choice of regular and premium product offerings with different minimum average account balance requirements.

Time deposits, which pay a fixed return over a predetermined time period.

We also offer special value-added accounts, which offer our customers added value and convenience. These include a time deposit account that allows for automatic transfers from a time deposit account to a savings account, as well as a time deposit account with an automatic overdraft facility.

Other Retail Services and Products

Debit Cards

We had around 11.5 million debit cards outstanding as of March 31, 2011 as compared to around 14.1 million debit cards outstanding as of March 31, 2012. The cards can be used at ATMs and point-of-sales terminals in India and in other countries across the world.

Individual Depositary Accounts

We provide depositary accounts to individual retail customers for holding debt and equity instruments. Securities traded on the Indian exchanges are generally not held through a broker s account or in a street name. Instead, an individual has his own account with a depositary participant. Depositary participants, including us, provide services through the major depositaries established by the two major stock exchanges. Depositary participants record ownership details and effectuate transfers in book-entry form on behalf of the buyers and sellers of securities. We provide a complete package of services, including account opening, registration of transfers and other transactions and information reporting.

Mutual Fund Sales

We offer our retail customers units in most of the large and reputable mutual funds in India. In some cases we earn front-end commissions for new sales and additional fees in subsequent years. We distribute mutual fund products primarily through our branches and our private banking advisors.

Insurance

We have arrangements with HDFC Standard Life Insurance Company Limited and HDFC ERGO General Insurance Company Limited to distribute their life insurance and general insurance product, respectively, to our customers. We earn upfront commissions on new premiums collected as well as some trailing income in subsequent years in some cases while the policy is still in force.

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Precious Metals

We import gold and silver bars for sale to our retail customers through our branch network.

Investment Advice

We offer our customers a broad range of investment advice, including advice regarding the purchase of Indian debt, equity shares and mutual funds. We provide our high net worth private banking customers with a personal investment advisor who can consult with them on their individual investment needs.

Bill Payment Services

We offer our customers utility bill payment services for leading utility companies, including electricity, telephone and internet service providers. Customers can also review and access their bill details through our direct banking channels. We believe this is a valuable convenience that we offer our customers. We offer these services to customers through multiple distribution channels ATMs, telephone banking, internet banking and mobile telephone banking.

Corporate Salary Accounts

We offer Corporate Salary Accounts, which allow employers to make salary payments to a group of employees with a single transfer. We then transfer the funds into the employees individual accounts and offer them preferred services, such as lower minimum balance requirements. As of March 31, 2012, these accounts constituted approximately 53% of our total retail savings accounts by number and approximately 31% of our retail savings deposits by value.

Non-Resident Indian Services

Non-resident Indians are an important target market segment for us given their relative affluence and strong ties with family members in India. Our non-resident deposits amounted to Rs. 172.2 billion as of March 31, 2012. Effective December 2011, the RBI permitted banks the flexibility to offer varying rates of interests on non-resident deposits.

Retail Foreign Exchange

We purchase foreign currency from and sell foreign currency to retail customers in the form of cash, traveler s checks, demand drafts, foreign exchange cards and other remittances, including services offered in partnership with third parties, such as Western Union. We also carry out foreign currency check collections.

Customers and Marketing

Our target market for our retail services is comprised of upper and middle income individuals and high net worth customers. As of March 31, 2012, around 14% of our retail deposit customers contributed approximately 69% of our retail deposits. We also target small businesses, trusts and non-profit corporations. We market our products through our branches, telemarketing and a dedicated sales staff for niche market segments. We also use third-party agents and direct sales associates to market certain products and to identify prospective new customers.

Additionally, we obtain new customers through joint marketing efforts with our wholesale banking department, such as our Corporate Salary Account package. We cross-sell many of our retail products to our customers. We also market our auto loan and two-wheeler loan products through joint efforts with relevant manufacturers and distributors.

We have programs that target other particular segments of the retail market. For example, our private and preferred banking programs provide customized financial planning to high net worth individuals in order to preserve and enhance their wealth. Private banking customers receive a personal investment advisor who serves as their single-point contact and compiles personalized portfolio tracking products, including mutual fund and equity tracking statements. Our private banking program also offers equity investment advisory products. While not as service-intensive as our private banking program, preferred banking offers similar services to a slightly broader target segment. Top revenue-generating customers of our preferred banking program are channeled into our private banking program.

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Wholesale Banking

Overview

We provide our corporate and institutional clients a range of commercial banking products and transactional services.

Our principal commercial banking products include a range of financing products, documentary credits (primarily letters of credit) and bank guarantees, foreign exchange and derivative products and corporate deposit products. Our financing products include loans, overdrafts, bill discounting and credit substitutes, such as commercial papers, debentures, preference shares and other funded products. Our foreign exchange and derivatives products assist companies in managing their currency and interest rate exposures.

For our commercial banking products, our customers include companies that are part of private sector business houses, public sector enterprises and multinational corporations, as well as small and mid-sized businesses. Our customers also include suppliers and distributors of corporations to whom we provide credit facilities and with whom we thereby establish relationships as part of a supply chain initiative for both our commercial banking products and transactional services. We aim to provide our corporate customers with high quality customized service. We have relationship managers who focus on particular clients and who work with teams that specialize in providing specific products and services, such as cash management and treasury advisory services.

Loans to small and medium enterprises, which are generally in the nature of loans for commercial vehicles, construction equipment and business purposes, are included as part of our retail banking business. We group these loans as part of our retail banking business considering, among other things, the customer profile, the nature of the product, the differing risks and returns, our organization structure and our internal business reporting mechanism. Such grouping ensures optimum utilization and deployment of specialized resources in our retail banking business.

Our principal transactional services include cash management services, capital markets transactional services and correspondent banking services. We provide physical and electronic payment and collection mechanisms to a range of corporations, financial institutions and government entities. Our capital markets transactional services include custodial services for mutual funds and clearing bank services for the major Indian stock exchanges and commodity exchanges. In addition, we provide correspondent banking services, including cash management services and funds transfers, to foreign banks and co-operative banks.

Commercial Banking Products

Commercial Loan Products and Credit Substitutes

Our principal financing products are working capital facilities and term loans. Working capital facilities primarily consist of cash credit facilities and bill discounting. Cash credit facilities are revolving credits provided to our customers that are secured by working capital, such as inventory and accounts receivable. Bill discounting consists of short-term loans which are secured by bills of exchange that have been accepted by our customers or drawn on another bank. In many cases, we provide a package of working capital financing that may consist of loans and a cash credit facility as well as documentary credits or bank guarantees. Term loans consist of short- and medium-term loans which are typically loans of up to five years in duration. More than 90% of our loans are denominated in rupees with the balance being denominated in various foreign currencies, principally the U.S. dollar.

We also purchase credit substitutes, which are typically comprised of commercial paper, debentures and preference shares issued by the same customers with whom we have a lending relationship in our wholesale banking business. Investment decisions for credit substitute securities are subject to the same credit approval processes as loans, and we bear the same customer risk as we do for loans extended to these customers. Additionally, the yield and maturity terms are generally directly negotiated by us with the issuer.

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The following table sets forth the asset allocation of our commercial loans and financing products by asset type. For accounting purposes, we classify commercial paper, debentures and preference shares as credit substitutes (which in turn are classified as investments).

	As of March 31,			
	2010	2011	2012	2012
	(in millions)			
Gross commercial loans	Rs. 587,956.8	Rs. 668,605.7	Rs. 689,314.4	US$ 13,545.2
Credit substitutes:				
Commercial paper	Rs. 197.1	Rs. 11,906.8	Rs. 7,791.0	US$ 153.1
Non-convertible debentures	2,279.2	2,584.3	4,009.5	78.8
Total credit substitutes	Rs. 2,476.3	Rs. 14,491.1	Rs. 11,800.5	US$ 231.9
Gross commercial loans plus credit substitutes	Rs. 590,433.1	Rs. 683,096.8	Rs. 701,114.9	US$ 13,777.1

While we generally lend on a cash-flow basis, we also require collateral from some of our borrowers. As of March 31, 2012, approximately 70.3% of the aggregate principal amount of our gross wholesale loans was secured by collateral (approximately Rs. 204.9 billion in aggregate principal amount of loans were unsecured). However, collateral securing each individual loan may not be adequate in relation to the value of the loan. All borrowers must meet our internal credit assessment procedures, regardless of whether the loan is secured. See Risk Management Credit Risk Wholesale Credit Risk .

We price our loans based on a combination of our own cost of funds, market rates, our rating of the customer and the overall revenues from the customer. An individual loan is priced on a fixed or floating rate, the pricing is based on a margin that depends on the credit assessment of the borrower.

The RBI requires banks to lend to specific sectors of the economy. For a detailed discussion of these requirements, see Supervision and Regulation Regulations Relating to Making Loans Directed Lending .

Bill Collection, Documentary Credits and Bank Guarantees

We provide bill collection, documentary credit facilities and bank guarantees for our corporate customers. Documentary credits and bank guarantees are typically provided on a revolving basis. The following table sets forth, for the periods indicated, the value of transactions processed with respect to our bill collection, documentary credits and bank guarantees:

	Years ended March 31,			
	2010	2011	2012	2012
	(in millions)			
Bill collection	Rs. 1,876,968.0	Rs. 1,968,026.5	Rs. 3,466,005.7	US$ 68,107.8
Documentary credits	319,658.0	429,856.9	653,828.7	12,847.9
Bank guarantees	88,439.1	133,783.9	199,600.1	3,922.2
Total	Rs. 2,285,065.1	Rs. 2,531,667.3	Rs. 4,319,434.5	US$ 84,877.9

Bill collection: We provide bill collection services for our corporate clients in which we collect bills on behalf of a corporate client from the bank of our client s customer. We do not advance funds to our client until receipt of payment.

Documentary credits: We issue documentary credit facilities on behalf of our customers for trade financing, sourcing of raw materials and capital equipment purchases.

Bank guarantees: We provide bank guarantees on behalf of our customers to guarantee their payment or performance obligations. A small part of our guarantee portfolio consists of margin guarantees to brokers issued in favor of stock exchanges.

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Foreign Exchange and Derivatives

Our foreign exchange and derivative product offering to our customers covers a range of products, including foreign exchange and interest rate transactions and hedging solutions, such as spot and forward foreign exchange contracts, forward rate agreements, currency swaps, currency options and interest rate derivatives. These transactions enable our customers to transfer, modify or reduce their foreign exchange and interest rate risks. A specified group of relationship managers from our treasury front office works on such product offerings jointly with the relationship managers from Wholesale Banking.

Forward exchange contracts are commitments to buy or sell foreign currency at a future date at the contracted rate. Currency swaps are commitments to exchange cash flows by way of interest in one currency against another currency and exchange of principal amount at maturity based on predetermined rates. Rupee interest rate swaps are commitments to exchange fixed and floating rate cash flows in rupees. A forward rate agreement gives the buyer the ability to determine the underlying rate of interest for a specified period commencing on a specified future date (the settlement date) when the settlement amount is determined being the difference between the contracted rate and the market rate on the settlement date. Currency options give the buyer, the right but not an obligation, to buy or sell specified amounts of currency at agreed rates of exchange on or before a specified future date.

The following table presents the aggregate notional principal amounts of our outstanding foreign exchange and derivative contracts with our customers as of March 31, 2010, 2011 and 2012, together with the fair values on each reporting date:

	As of March 31,							
	2010		2011		2012		2012	
	Notional	Fair Value	Notional	Fair Value	Notional	Fair Value	Notional	Fair Value
	(In millions)							
Interest rate swaps and forward rate agreements	Rs. 191,878.3	Rs. (1,462.7)	Rs. 168,279.9	Rs. 500.0	Rs. 399,622.3	Rs. 1,496.4	US$ 7,852.6	US$ 29.5
Forward exchange contracts, currency swaps, currency options and interest rate caps and floors	Rs. 420,632.2	Rs. 1,565.9	Rs. 454,323.6	Rs. 1,138.4	Rs. 433,469.2	Rs. 8,346.0	US$ 8,517.8	US$ 164.0

Investment Banking

Our investment banking services currently focus on providing debt and loan syndication as well as private placements for our wholesale banking customers.

Precious Metals

We are in the business of importing gold and silver bullion to leverage our distribution and servicing strengths and cater to the domestic bullion trader segment. We generally import bullion on a consignment basis so as to minimize price risk. The imports are typically on a back-to-back basis and are priced to the customer based on the price quoted by the supplier. We earn a fee on such wholesale bullion transactions.

Wholesale Deposit Products

As of March 31, 2012, we had wholesale deposits aggregating over Rs. 675 billion, which represented approximately 28% of our total deposits. We offer both non-interest bearing current accounts and time deposits. We are allowed to vary the interest rates on our wholesale deposits based on the size of the deposit (for deposits greater than Rs. 1.5 million) so long as the rates booked on a day are the same for all customers of that deposit size for that maturity. See Selected Statistical Information for further information about our total deposits.

Transactional Services

Cash Management Services

We provide cash management services in India. Our services make it easier for our corporate customers to expedite inter-city check collections, make payments to their suppliers more efficiently, optimize liquidity and reduce interest costs. In addition to benefiting from the cash float, which reduces our overall cost of funds, we may also earn commissions for these services.

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Our primary cash management service is check collection and payment. Through our electronically linked branch network, correspondent bank arrangements and centralized processing, we can effectively provide nationwide collection and disbursement systems for our corporate clients. This is especially important because there is no nationwide payment system in India, and checks must generally be returned to the city from which written, in order to be cleared. Because of mail delivery delays and the variations in city-based inter-bank clearing practices, check collections can be slow and unpredictable, and can lead to uncertainty and inefficiencies in cash management. We believe we have a strong position in this area relative to most other participants in this market. Although the public sector banks have extensive branch networks, many of their branches typically are still not electronically linked. The foreign banks are restricted in their ability to expand their branch network.

Our wholesale banking clients also use our cash management services. These clients include Indian private sector companies, public sector undertakings and multinational companies. We also provide these services to Indian insurance companies, mutual funds, brokers, financial institutions and various government entities.

We have also implemented a straight-through processing solution to link our wholesale banking and retail banking systems. This has led to reduced manual intervention in transferring funds between the corporate accounts which are in the wholesale banking system and beneficiary accounts residing in retail banking systems. This initiative helps reduce transaction costs. We have a large number of commercial clients using our corporate internet banking for financial transactions with their vendors, dealers and employees who bank with us.

In 2005, the RBI introduced an inter-bank settlement system called the Real Time Gross Settlement (RTGS) system. The RTGS system facilitates real time settlements primarily between banks and therefore could have an adverse impact on our cash management services. However, we believe our cash management services offer certain advantages not present in RTGS, including the provision of greater information to our clients regarding the source and identity of payments. In addition, through our cash management services our clients receive checks from their customers, which we believe many of our clients prefer because the issuance of a bad check is a criminal offense in India. See Risk Factors Risks Relating to Our Business *The development of a well entrenched nationwide inter-bank settlement system would adversely impact our cash float and decrease fees we receive in connection with check collection* .

Clearing Bank Services for Stock and Commodity Exchanges

We serve as a cash-clearing bank for major stock and commodity exchanges in India, including the National Stock Exchange of India Limited (National Stock Exchange) and the Bombay Stock Exchange Limited. As a clearing bank, we provide the exchanges or their clearing corporations with a means for collecting cash payments due to them from their members or custodians and a means of making payments to these institutions. We make payments once the broker or custodian deposits the funds with us. In addition to benefiting from the cash float, which reduces our overall cost of funds, in certain cases we also earn commissions on such services.

Custodial Services

We provide custodial services principally to Indian mutual funds, as well as to domestic and international financial institutions. These services include safekeeping of securities and collection of dividend and interest payments on securities. Most of the securities under our custody are in book-entry (dematerialized) form, although we provide custody for securities in physical form as well for our wholesale banking clients. We earn revenue from these services based on the value of assets under safekeeping and the value of transactions handled.

Correspondent Banking Services

We act as a correspondent bank for co-operative banks, co-operative societies and foreign banks. We provide cash management services, funds transfers and services, such as letters of credit, foreign exchange transactions and foreign check collection. We earn revenue on a fee-for-service basis and benefit from the cash float, which reduces our overall cost of funds.

We are well positioned to offer this service to co-operative banks and foreign banks in light of the structure of the Indian banking industry and our position within it. Co-operative banks are generally restricted to a particular state and foreign banks have limited branch networks. The customers of these banks frequently need services in other areas of the country where their own banks cannot provide. Because of our technology platforms, our geographical reach and the electronic connectivity of our branch network, we can provide these banks with the ability to provide such services to their customers. By contrast, although the public sector banks have extensive branch networks and also provide correspondent banking services, many of them have not yet created electronically connected networks and their branches typically operate independently of one another.

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Tax Collections

We were the first private sector bank to be appointed by the government of India to collect direct taxes. In fiscal 2012, we collected Rs. 1,145 billion of direct taxes for the government of India. We are also appointed to collect sales, excise and service tax within certain jurisdictions in India. In fiscal 2012, we collected over Rs. 370 billion of such indirect taxes for the government of India and relevant state governments. We earn a fee from each tax collection and benefit from the cash float. We hope to expand our range of transactional services by providing more services to government entities.

Treasury

Our treasury group manages our balance sheet, including our maintenance of reserve requirements and the management of market and liquidity risk. Our treasury group also provides advice and execution services to our corporate and institutional customers with respect to their foreign exchange and derivatives transactions. In addition, our treasury group seeks to optimize profits from our proprietary trading, which is principally concentrated on Indian government securities.

Our client-based activities consist primarily of advising corporate and institutional customers and transacting spot and forward foreign exchange contracts and derivatives. Our primary customers are multinational corporations, large and medium sized domestic corporations, financial institutions, banks and public sector undertakings. We also advise and enter into foreign exchange contracts with some small companies and non-resident Indians.

The following describes our activities in the foreign exchange and derivatives markets, domestic money markets and debt securities desk and equities market. See also Risk Management for a discussion of our management of market risk.

Foreign Exchange and Derivatives

We enter into forward exchange contracts, currency options, forward rate agreements, currency swaps and rupee interest rate swaps with inter-bank participants, similar to our Wholesale Banking business, where we enter into such transactions with our customers. To support our clients activities, we are an active participant in the Indian inter-bank foreign exchange market. We also trade, to a more limited extent, for our own account. We also engage in proprietary trades of rupee-based interest rate swaps and use them as part of our asset liability management. Forward exchange contracts are commitments to buy or sell foreign currency at a future date at the contracted rate. Currency swaps are commitments to exchange cash flows by way of interest in one currency against another currency and exchange of principal amount at maturity based on predetermined rates. Rupee interest rate swaps are commitments to exchange fixed and floating rate cash flows in rupees. A forward rate agreement gives the buyer the ability to determine the underlying rate of interest for a specified period commencing on a specified future date (the settlement date) when the settlement amount is determined being the difference between the contracted rate and the market rate on the settlement date. Currency options give the buyer, the right but not an obligation, to buy or sell specified amounts of currency at agreed rates of exchange on or before a specified future date.

The following table presents the aggregate notional principal amounts of our outstanding foreign exchange and derivative inter-bank contracts as of March 31, 2010, 2011 and 2012, together with the fair values on each reporting date:

	As of March 31,							
	2010		2011		2012		2012	
	Notional	Fair Value	Notional	Fair Value	Notional	Fair Value	Notional	Fair Value
	(in millions)							
Interest rate swaps and forward rate agreements	Rs. 1,830,447.4	Rs. (98.0)	Rs. 1,877,858.9	Rs. (2,449.3)	Rs. 1,952,713.1	Rs. (2,114.6)	US$ 38,371.3	US$ (41.6)
Forward exchange contracts, currency swaps, currency	Rs. 2,260,135.8	Rs. 2,597.9	Rs. 2,946,160.8	Rs. 2,002.7	Rs. 5,489,502.9	Rs. (2,465.8)	US$ 107,870.0	US$ (48.5)

options and
interest rate
caps and
floors

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Domestic Money Market and Debt Securities Desk

Our principal activity in the domestic money market and debt securities market is to ensure that we comply with our reserve requirements. These consist of a cash reserve ratio, which we meet by maintaining balances with the RBI, and a statutory liquidity ratio, which we meet by purchasing Indian government securities. See also Supervision and Regulation Legal Reserve Requirements . Our local currency desk primarily trades Indian government securities for our own account. We also participate in the inter-bank call deposit market and engage in limited trading of other debt instruments.

Equities Market

We trade a limited amount of equities of Indian companies for our own account. As of March 31, 2012, we had an internal approved limit of Rs. 400 million for secondary market purchases and Rs. 100 million for primary purchases of equity investments for proprietary trading and our exposure as of March 31, 2012 was within the said limits. We set limits on the amount invested in any individual company as well as stop-loss limits.

Distribution Channels

We deliver our products and services through a variety of distribution channels, including branches, ATMs, telephone and mobile telephone banking and internet banking.

Branches

As of March 31, 2012, we had an aggregate of 2,544 branches covering 1,399 cities. All of our branches are electronically linked so that our customers can access their accounts from any branch regardless of where they have their accounts.

Almost all of our branches focus exclusively on providing retail services and products, though a few also provide wholesale banking services. The range of products and services available at each branch depends in part on the size and location of the branch. We offer various banking services to our customers through our arrangements with correspondent banks and exchange houses in overseas locations.

As of March 31, 2011, 793 of our branches were in semi-urban or rural areas as compared to 1,159 as of March 31, 2012. As part of its branch licensing conditions, the RBI requires that at least 25% of all incremental branches added during the year, with effect from November 2011, must be located in unbanked rural areas. An unbanked rural area is defined as a center that does not have a brick and mortar structure of any scheduled commercial bank for customer-based banking transactions. The RBI has given a general permission to Scheduled Commercial Banks to open branches in locations having a population lower than 100,000 and in the case of the north eastern states of India, including the state of Sikkim, without having the need to obtain prior approvals.

We have representative offices in the United Arab Emirates and Kenya and have a wholesale banking branch in Bahrain which commenced operations in September 2008. We have a full service banking branch in Hong Kong which commenced its operation in October 2010. Through this branch, we provide services to Indian corporates and their affiliates to cater to their international banking requirements, as well as to retail customers.

Automated Teller Machines

As of March 31, 2012, we had a total of 8,913 ATMs, of which 3,823 were located at our branches or extension counters and 5,090 were located off site, including at large residential developments, or on major roads in metropolitan areas.

Customers can use our ATMs for a variety of functions, including withdrawing cash, monitoring bank balances, depositing cash / checks and paying utility bills. Customers can access their accounts from any of the HDFC Bank ATMs or non-HDFC Bank ATMs. ATM cards issued by other banks in the Plus, Cirrus and Amex networks can be used in our ATMs and we receive a fee for each transaction. Our debit cards can be used on ATMs of other banks while our ATM cards can be used on most of the ATM networks.

Telephone Banking

We provide telephone banking services to our customers in 1,397 cities. Customers can access their accounts over the phone through our 24-hour automated voice response system and can order check books, conduct balance inquiries and order stop payments on checks. In select cities, customers can also engage in financial transactions (such as cash transfers, opening deposits and ordering demand drafts). In certain cities, we also have staff available during select hours to assist customers who want to speak directly to one of our telephone bankers.

Mobile Telephone Banking

Using our mobile banking platform, customers can perform enquiry based non-financial transactions such as balance enquiries, requests for account statements and requests for mini-statements of their transactions etc. We offer our customers the ability to carry out financial transactions from their mobile phone using ngpay . Customers can carry out financial transactions, such as transferring funds within and outside the Bank and mobile commerce using their HDFC Bank account by downloading this application on their mobile phones.

Internet Banking

Through our net banking channel, customers can access account information, track transactions, order check books, request stop check payments, transfer funds between accounts and to third parties who maintain accounts with us, open fixed deposits, give instructions for the purchase and sale of units in mutual funds, pay bills and make demand draft requests. We encourage use of our internet banking service by offering some key services for free or at a lower cost.

Risk Management

Risk is inherent in our business and sound risk management is critical to our success. The major types of risk we face are credit risk, market risk, including liquidity and interest rate risks and operational risk. We have developed and implemented comprehensive policies and procedures to identify, assess, monitor and manage our risk.

Credit Risk

Credit risk is the possibility of loss due to the failure of any counterparty to abide by the terms and conditions of any financial contract with us. We identify and manage this risk through a) our target market definitions; b) our credit approval process; c) our post-disbursement monitoring; and d) our remedial management procedures.

Wholesale Credit Risk

The wholesale credit risk team, within the Credit & Market Risk Group, is primarily responsible for implementing the credit risk strategy approved by the Board, developing procedures and systems for managing credit risk, carrying out an independent assessment of credit risk, approving individual credit exposures and ensuring portfolio composition and quality. In addition to the credit approval process, there is also an independent framework for the review and approval of credit ratings.

For our wholesale banking products, we target private businesses and public sector enterprises in India, subsidiaries of multinational companies and leaders in the Small and Medium Enterprises (SME) segment. We also have product specific offerings for entities engaged in the capital markets and commodities businesses.

We consider credit risk of a counter-party comprehensively, and thus, our credit policies and procedures apply to not only credit exposures but also credit substitutes and contingent exposures. Our Credit Policies & Procedure Manual and Credit Program (Credit Policies) are central in controlling credit risk in various activities and products. These articulate our credit risk strategy and thereby the approach for credit origination, approval and maintenance. The Credit Policies generally address such areas as target markets, portfolio mix, prudential exposure ceilings, concentration limits, price and non-price terms, structure of limits, approval authorities, exception reporting system, prudential accounting and provisioning norms. Each credit is evaluated by the business units against the credit standards prescribed in our Credit Policies. They are then subjected to a greater degree of risk analysis based on product type and customer profile by credit risk specialists in the Credit & Market Risk Group.

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We have in place a process of grading each borrower according to its financial health and the performance of its business and each borrower is graded as pass/labeled/impaired based on a rating scale of HDB 1 to HDB 10 (HDB 1 indicating the best and HDB 10 the worst). We have specific models applicable to each significant segment of wholesale credit (e.g. large corporate, SME manufacturing, SME Services and NBFCs). Each model assesses the overall risk over four major categories industry risk, business risk, management risk and financial risk. The inputs in each of the categories are combined to provide an aggregate numerical rating, which is a function of the aggregate weighted scores based on the assessment under each of these four risk categories.

Based on what we believe is an adequately comprehensive risk assessment, credit exposure limits are set on individual counterparties. These limits take into account the overall potential exposure on the counterparty, be it on balance sheet or off balance sheet, across the banking book and the trading book, including foreign exchange and derivatives exposures. These are reviewed in detail at annual or more frequent intervals.

We do not extend credit on the judgment of one officer alone. Our credit approval process is based on a three approval system that combines credit approval authorities and discretionary powers. The required three approvals are provided by credit approvers who derive their authority from their credit skills and experience. The level for approval of a credit varies depending upon the grading of the borrower, the quantum of facilities required and whether we have been dealing with the customer by providing credit facilities in the past. Thus, initial approvals would typically require a higher level of approval for a borrower with the same grading and for sanctioning the same facility.

To ensure adequate diversification of risk, concentration limits have been set up in terms of:

a) *Borrower / business group*: Exposure to a borrower/business group is subject to the general ceilings established by the RBI from time to time, or specific approval by RBI. The exposure-ceiling limit for a single borrower is 15% of a bank s capital funds, computed as per RBI guidelines. This limit may be exceeded by an additional 5% (i.e. up to 20%) provided the additional credit exposure is on account of lending to infrastructure projects. The exposure-ceiling limit in the case of a borrower group is 40% of the bank s capital funds. This limit may be exceeded by an additional 10% (i.e. up to 50%) provided the additional credit exposure is on account of extensions of credit for infrastructure projects. In addition to the above exposure limit, a bank may, in exceptional circumstances, with the approval of its board, consider increasing its exposure to a borrower up to an additional 5% of its capital funds. For certain blue chip clients and reputed groups or in particular for entities whose borrowings / bonds qualify as Priority Sector Lending, a bank may approach the RBI for single/group borrower ceilings higher than the prescribed limits. Exposures (both lending and investment, including off balance sheet exposures) of a bank to a single Non-Banking Finance Company (NBFC) / NBFC Asset Financing Company (AFC) / NBFC Infrastructure Finance Company (IFC) should not exceed 10%, 15% and 15%, respectively, of the bank s capital funds. The bank may, however, assume exposures on a single NBFC /NBFC-AFC /NBFC-IFC, up to 15%, 20% and 20%, respectively, of its capital funds, provided the exposure in excess of 10%, 15% and 15% specified earlier is on account of funds on-lent by the NBFC /NBFC-AFC / NBFC-IFC to the infrastructure sector.

b) *Industry*: Exposure to any one industry cannot exceed 12% of aggregate exposures for this purpose advances and investments as well as non-fund based exposures are aggregated. Retail advances are exempt from such ceiling. Further, exposure to banks and state sponsored financial institutions is capped at a level of 25%.

c) *Risk grading*: As part of our constant endeavor at augmenting our risk management systems and in order to bring about a greater degree of risk differentiation of our credit exposures, particularly in the investment scale, to facilitate quality underwriting and better portfolio monitoring, we migrated to a credit risk rating scale of HDB 1 to HDB 10, where HDB 1 to HDB 7 are investment grade ratings while HDB 8 or worse are non-investment grade ratings (the previous rating scale was HDFC 1 to HDFC 10, where HDFC 1 to HDFC 6 were investment grade ratings while HDFC 7 or worse were non-investment grade ratings). Accordingly, we do not assume any incremental exposures on borrowers with an internal risk rating of HDB 8 or worse, except on a highly secured basis or as part of a rehabilitation/restructuring plan. Further, we have set quantitative ceilings on aggregate funded plus non-funded exposure (excluding retail assets) specific to each risk rating category.

While we primarily make our credit decisions on a cash flow basis, we also obtain security for a significant portion of credit facilities extended by us as a second potential remedy. This can take the form of a floating charge on the movable assets of the borrower or a (first or residual) charge on the fixed assets and properties owned by the borrower. We may also require guarantees and letters of support from the flagship companies of the group in cases where facilities are granted based on our comfort level or relationship with the parent company.

We have a process for regular monitoring of accounts at several levels. These include periodic calls on the customer, plant visits, credit reviews and monitoring of secondary data. These are designed to detect any early warning signals of deterioration in credit quality so that we can take timely corrective action.

The RBI restricts us from lending to companies with which we have any directors in common. Also, the RBI directs a portion of our lending to certain specified sectors (Priority Sector Lending). See Supervision and Regulation Regulations Relating to Making Loans Directed Lending .

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Retail Credit Risk

We offer a range of retail products, such as auto loans, personal loans, credit cards, business banking, two-wheeler loans, loans against securities and commercial vehicle loans. Our retail credit policy and approval process are designed for the fact that we have high volumes of relatively homogeneous, small value transactions in retail loans. There are product programs for each of these products, which define the target markets, credit philosophy and process, detailed underwriting criteria for evaluating individual credits, exception reporting systems and individual loan exposure caps.

For individual customers to be eligible for a loan, minimum credit parameters, so defined, are to be met for each product. Any deviations need to be approved at the designated levels. The product parameters have been selected based on the perceived risk characteristics specific to the product. The quantitative parameters considered include income, residence stability, the nature of the employment/business, while the qualitative parameters include accessibility, contactability and profile. Our credit policies/product programs are based on a statistical analysis of our own experience and industry data, in combination with the judgment of our senior officers.

The retail credit risk team manages credit risk in retail assets and has the following constituents:

a) *Central Risk Unit*: The central risk unit drives credit risk management centrally for retail assets. It is responsible for formulating policies and evaluates proposals for launch of new products and new geographies. The central risk unit also conducts periodic reviews that cover portfolio management information system (MIS), credit MIS and post-approval reviews. The product risk teams conduct detailed studies on portfolio performance in each customer segment.

b) *Retail Underwriting:* This unit is primarily responsible for approving individual credit exposures and ensuring portfolio composition and quality. The unit ensures implementation of all policies/procedures, as applicable.

c) *Risk Intelligence and Control:* This unit is responsible for sampling of documents to ensure prospective borrowers with fraudulent intent are prevented from availing themselves of loans. The unit initiates market reference checks to avoid recurrence of frauds and financial losses.

d) *Retail Collections Unit:* This unit is responsible for remedial management of problem exposures in retail assets. The collections unit uses specific strategies for various segments and products for remedial management.

We mine data on our borrower account behavior as well as static data regularly to monitor the portfolio performance of each product segment regularly, and use these as inputs in revising our product programs, target market definitions and credit assessment criteria to meet our twin objectives of combining volume growth and maintenance of asset quality.

Our retails loans are generally secured by a charge on the asset financed (vehicle loans, property loans and loans against gold and securities). In most cases we obtain direct debit instructions or post-dated checks from the customer. It is a criminal offence in India to issue a bad check.

Market Risk

Market risk refers to the potential loss on account of adverse changes in market variables or other risk factors which affect the value of financial instruments which we hold. The financial instrument holdings may include investment in securities and money market instruments, including equities, bonds, foreign exchange products and derivative instruments (linear as well as non-linear products).

The market variables which affect the valuation of these instruments typically include interest rates, equity prices, commodity prices, exchange rates and volatilities. Any change in the relevant market risk variable has an adverse or favorable impact on the valuation depending on the direction of the change and the type of position held (long or short). While the positions are taken with a view to earning from the upside potential, there is always a possibility of downside risk. Thus, we have to constantly review the positions to ensure that the risk on account of such positions is within our overall risk appetite. Our risk appetite is set through a pre-approved treasury limit, equity limit, counterparty exposure limit and Asset Liability Management (ALM) limit. The process for monitoring and review of risk exposure is outlined in the various risk policies.

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Our Board of Directors has delegated the responsibility for ongoing balance sheet market risk management to the asset liability committee. This committee, which is chaired by the Managing Director and includes the heads of the business groups, meets every other week and more often when conditions require. The committee reviews the product pricing for deposits and assets as well as the maturity profile and mix of our assets and liabilities. It articulates the interest rate view and decides on future business strategy with respect to interest rates. It reviews and sets funding policy and also reviews developments in the markets and the economy and their impact on the balance sheet and business. Finally, it ensures adherence to ALM market risk limits and decides on the inter-segment transfer pricing policy.

The market risk department formulates procedures for portfolio risk valuation, assesses market risk factors and recommends various market risk controls and limits for the treasury portfolio. The treasury mid-office is responsible for monitoring and reporting market risks arising from the treasury desks. The financial control department is responsible for collecting data, preparing regulatory and analytical reports and monitoring whether the interest rate and other policies and limits established by the asset liability committee are being observed. Our treasury group also assists in implementing our asset liability strategy and in providing information to the asset liability committee.

Policies and Procedures

The following sections briefly describe our policies and procedures with respect to trading risk (price risk) and asset liability management risk (interest rate risk in the banking book and liquidity risk).

I. Trading Risk

Trading risk is the risk arising from price fluctuations due to market factors, such as changes in interest rates, equity prices, commodity prices and exchange rates in respect of the trading portfolio held by the Bank. The trading portfolio includes holdings in the held-for-trading and available for-sale-portfolios as per the RBI guidelines and, comprise of positions in bonds and securities, interest rate swaps and cross currency interest rate swaps.

The trading risk is managed by putting in place a sound process for price validation and by setting various limits, such as Value at Risk (VaR), Stop Loss Trigger Limit (SLTL), Price Value per basis point (PV01) and position limit, which are set in the Treasury Limits Package and Equity Limits Package.

Price validation is conducted by the Treasury Analytics team, is reviewed by the market risk department and governed by the model validation policy approved by the Board of Directors.

The Treasury Limits and Equity Limits are recommended by management for approval to the Board of Directors. The limits are reviewed annually or more frequently depending on market conditions or the introduction of new products.

Trading risk policy sets the framework for market risk monitoring. The risk on account of semi-liquid or illiquid positions in trading is mitigated through the Non-Standard Product policy. The Non-Standard Product Policy stipulates restrictions and requires case specific evaluation of risk exposure in respect of non-standard products (that is products which are not part of the standard product list decided by Treasury and our Market Risk Department).

II. Asset Liability Management (ALM)

Our Board of Directors has approved an ALM policy that covers all balance sheet and off-balance sheet items. The policy seeks to define liquidity and interest rate risk in the banking book, the measurement of these risks and their control. Other risks, namely currency risk, commodity price risk and equity price risk are governed by the market risk policy as approved by the Board.

We have interest rate risk and liquidity risk measurement, monitoring and control functions which are sufficiently independent from position-taking functions. Our ALM risk management process operates in the following hierarchical manner:

a) The Board of Directors

b) The Risk Policy & Monitoring Committee (RPMC)

c) The Asset Liability Committee (ALCO)

d) ALM operational groups

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A. Interest Rate Risk in the Banking Book (IRRBB)

IRRBB, or non-trading interest rate risk, arises from the provision of retail and wholesale (non-trading) banking products and services, when the interest rate repricing date for assets is different from the repricing date for liabilities. This includes balance sheet items which do not have a defined maturity date and an interest rate that does not change when the base rate changes.

Interest rate risk in the banking book is measured and controlled using both income metrics (Earnings at Risk) and present value metrics (Economic Value of Equity). Earnings at Risk (EaR) measures the sensitivity of net interest income over the next 12 months. It is calculated as the difference between the estimated income using the current yield curve and the lowest estimated income following an increase/decrease in interest rates. Economic Value of Equity (EVE) calculates the change in the present value of the banking book following an upward/downward interest rate shock. This calculation is equivalent to EaR except that EVE is a present value sensitivity, while EaR is a measure of income sensitivity. We undertake periodic stress testing for our banking book based on stress scenarios. This provides a measure to assess our financial resilience from extreme but plausible interest rate fluctuations.

B. Liquidity Risk Management

We monitor our liquidity positions on a daily basis using the statement of structural liquidity prepared according to RBI s prescribed format. We assess the level and outlook of liquidity risk using early warning indicators derived from our portfolio and market data. Additionally, we conduct stress tests to assess the impact on our liquidity position under plausible stress scenarios.

We consider the full range of legal and regulatory restrictions on the availability of liquidity support. We also take into consideration the circumstances in which we may be obliged to transfer liquidity resources to other entities in our group. Our aim is to ensure that our funding sources are well diversified such that we are not prone to funding liquidity risks in the event of one or more of our funding resources being withdrawn. We maintain diversified and stable sources of funding, such as deposits, money market borrowings and bond issuances.

Operational Risk

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.

Strategies

Our operational risk framework has been reviewed by risk and control teams. Key aspects of operational risk management include identification, assessment, review, control and reporting of key operational risks.

Process and measurement

Some of the key principles of our operational risk management strategy include segregation of functions, clear reporting guidelines, well defined processes, operating manuals and job cards, transactions verification and authorization, distributed processing and staff training and a strong management team with experience in diverse fields. We are in the process of implementing various principles and guidelines laid out in respect of operational risk management by the Basel committee on banking supervision in the Basel II guidelines and by RBI in its circulars and guidance note on operational risk and advance measurement approach guidelines. Our operational risk management committee oversees implementation of sound operational risk management framework. We have a process of reporting operational losses and issues relating to operational risk, wherein the relevant areas are quickly reviewed and any gap suitably addressed. This is further being enhanced with a framework that has integrated capabilities to monitor losses, evaluate operational key risk indicators and qualitatively evaluate risk-control environments among other sound principles and practices.

We have implemented disaster recovery capabilities for our information technology for critical components apart from having integrated Business Continuity Planning (BCP) initiatives for business operations. A BCP committee oversees strategy and implementation of our disaster and business continuity framework. We have an information security committee which oversees strategy and implementation of our information security policies and procedures.

Risk reporting

As a part of our overall operational risk management strategy, there is a clear line of reporting at every function which facilitates reporting and monitoring of operational risk events. Further, measurement and reporting is also achieved through various management information systems attached with each operational process which are generated and monitored regularly.

Mitigation

We manage our various operational risks by adopting, what we believe are, best practices in business processes through checks and balances, embedding monitoring and control mechanisms as a part of day-to-day operations and having an effective internal audit process. Various operational risk exposures are monitored regularly and reviewed periodically by us to ensure effective implementation. Control and mitigation guidelines are part of our various product, process operation manual and documents. We cover risk on account of natural disasters through appropriate insurance.

Operational risk capital

Currently we are following the Basic Indicator Approach for operational risk capital assessment as mandated by the RBI.

Competition

We face strong competition in all our principal lines of business. Our primary competitors are large public sector banks, other private sector banks, foreign banks and, in some product areas, non-banking financial institutions.

Retail Banking

In retail banking, our principal competitors are the large public sector banks, which have much larger deposit bases and branch networks than ours, other new generation private sector banks, old generation private sector banks, foreign banks and non-banking finance companies (in the case of retail loan products). The retail deposit share of foreign banks is quite small by comparison to the public sector banks. However, some of the foreign banks have a significant presence among non-resident Indians and also compete for non-branch-based products.

In mutual fund sales and other investment related products, our principal competitors are brokers, foreign banks and new private sector banks.

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Wholesale Banking

Our principal competitors in wholesale banking are public and new private sector banks as well as foreign banks. The large public sector banks have traditionally been the market leaders in commercial lending. Foreign banks have focused primarily on serving the needs of multinational companies and Indian corporations with cross-border financing requirements, including trade and transactional services and foreign exchange products and derivatives, while the large public sector banks have extensive branch networks and large local currency funding capabilities.

Treasury

In our treasury advisory services for corporate clients, we compete principally with foreign banks in foreign exchange and derivatives, as well as public sector banks and new private sector banks in the foreign exchange and money markets business.

Employees

The number of our employees has increased from 55,752 as of March 31, 2011 to 66,076 as of March 31, 2012. Most of our employees are located in India. We consider our relations with our employees to be good. A few employees of CBoP continue to be part of a labor union. These employees represent less than 1% of our total employee strength.

Our compensation structure has fixed as well as variable pay components. Our variable pay is paid out by way of sales incentives as well as performance-linked bonuses. In addition to basic compensation, employees are eligible to participate in our provident fund and other employee benefit plans. The provident fund, to which both we and our employees contribute, is a savings scheme, required by government regulation, under which the fund is required to pay to employees a minimum annual return, which at present is 8.25%. We have no liability for future provident fund benefits other than our annual contribution and the shortfall, if any, between the government specified minimum rate and the yield on the fund s assets. Our provident fund has generated sufficient funds internally to meet the annual return requirement since inception of the fund. We have also set up a superannuation fund to which we contribute defined amounts. We also contribute specified amounts to a pension fund in respect of certain of our erstwhile CBoP employees. In addition, we contribute specified amounts to a gratuity fund set up pursuant to Indian statutory requirements.

We focus on training our employees on a continuous basis. We have a training center in Mumbai, where we conduct regular training programs for our employees. Management and executive trainees generally undergo up to eight-week training modules covering most aspects of banking. We offer courses conducted by both internal and external faculty. In addition to ongoing on-the-job training, we provide employees courses in specific areas or specialized operations on an as-needed basis.

Properties

Our registered office and corporate headquarters is located at HDFC Bank House, Senapati Bapat Marg, Lower Parel, Mumbai 400 013, India. In addition to the corporate office, we have administrative offices in most other major cities in India.

As of March 31, 2012, we had a network consisting of 2,544 branches and 8,917 ATMs, including 5,090 ATMs at non-branch locations. These facilities are located throughout India with the exception of two branches which are located in Bahrain and Hong Kong.

Legal Proceedings

We are involved in a number of legal proceedings in the ordinary course of our business. However, there are currently no legal proceedings, which if adversely determined, might affect our financial condition or the results of our operations materially.

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RISK FACTORS

You should carefully consider the following risk factors in evaluating us and our business.

Risks Relating to our Business

If we are unable to manage our rapid growth, our operations may suffer and our performance may decline.

Our asset growth rate has been significantly higher than India s gross domestic product (GDP) growth rate as well as the growth rate of the Indian banking industry over the last three fiscal years. For example, our total advances in the three-year period ended March 31, 2011 grew at a compounded annual growth rate of about 31%, as against slightly over 14% for the Indian Banking Industry for fiscal 2011. Our total advances in the three-year period ended March 31, 2012 grew at a compounded annual growth rate of about 26%,

Our rapid growth has placed, and if it continues will place, significant demands on our operational, credit, financial and other internal risk controls including:

- recruiting, training and retaining sufficient skilled personnel;
- upgrading and expanding our technology platform;
- developing and improving our products and delivery channels;
- preserving our asset quality as our geographical presence increases and customer profile changes;
- complying with regulatory requirements such as the Know Your Customer (KYC) norms; and
- maintaining high levels of customer satisfaction.

The growth in our business is partly attributable to the expansion of our branch network. As at March 31, 2008, we had a branch network comprised of 761 branches, which increased to 2,544 as at March 31, 2012. We need to seek permission from the RBI before we can open a branch in a Tier I centers (locations with a population greater than 100,000). This permission, among other factors, is dependent on the number of branches that we have opened in under-banked or un-banked areas of the country as well as in centers with a population below 100,000. Additionally, the RBI considers our performance in the areas of priority sector lending, financial inclusion and customer service. If we are unable to perform in a manner satisfactory to the RBI in any of the above areas, it may have an impact on the number of branches we will be able to open and would in turn have an impact on our future growth.

If we fail to properly manage our rapid growth, our operations would suffer and our performance as a whole would be materially adversely affected.

Our business is particularly vulnerable to interest rate risk and volatility in interest rates could adversely affect our net interest margin, the value of our fixed income portfolio, our treasury income and our financial performance.

Our results of operations depend to a great extent on our net interest revenue. During fiscal 2012, net interest revenue after allowances for credit losses represented 69.3% of our net revenue. Changes in market interest rates affect the interest rates charged on our interest-earning assets differently from the interest rates paid on our interest-bearing liabilities and also affect the value of our investments. An increase in interest rates could result in an increase in interest expense relative to interest revenue if we are not able to increase the rates charged on our loans, which would lead to a reduction in our net interest revenue and net interest margin. Further, an increase in interest rates could negatively affect demand for our loans and credit substitutes. A decrease in interest rates could result in a decrease in interest revenue relative to interest expense due to the repricing of our loans at a pace faster than the rates we pay on our interest-bearing liabilities. The quantum of the changes in interest rates for our assets and liabilities may also be different, especially since a portion of our deposits are at rates of interest regulated by the RBI.

Interest rates in India continued to rise during fiscal 2012. There is a possibility that they will rise further due to many factors beyond our control, including the monetary policies of central banks such as the RBI, deregulation of the financial sector, domestic and international inflation, economic and political conditions and other factors. Yields on the Indian government s ten-year bonds were 7.9%, 8.0% and 8.6% as of March 31, 2010, 2011 and 2012, respectively. If interest rates increase and demand for loans is negatively affected, we may not be able to achieve our volume growth, which would adversely affect our net income. Any volatility in interest rates could adversely affect our net income. See Selected Statistical Information Analysis of Changes in Interest Revenue and Interest Expense: Volume and Rate and Selected Statistical Information Yields, Spreads and Margins .

If the level of non-performing loans in our portfolio increases, we will be required to increase our provisions, which would negatively impact our income.

Our gross non-performing loans and impaired credit substitutes represented 0.9% of our gross customer assets as of March 31, 2012. Our non-performing loans and impaired credit substitutes net of specific loan loss provisions represented 0.2% of our net customer assets portfolio as of March 31, 2012. We have restructured the payment terms of certain loans. As of March 31, 2012 these represented 0.2% of our gross customer assets. Our management of credit risk involves having appropriate credit policies, underwriting standards, approval processes, loan portfolio monitoring, remedial management and overall architecture for managing credit risk. In the case of our secured loan portfolio, the frequency of the valuation of collateral may vary based on the nature of the loan and the type of collateral. A decline in the value of collateral or an inappropriate collateral valuation increases the risk in the secured loan portfolio because of inadequate coverage of collateral. As of March 31, 2012, approximately 76% of our loan book was partially or fully secured by collateral. Our risk mitigation and risk monitoring techniques may not be accurate or appropriately implemented and we may not be able to anticipate future economic and financial events, leading to an increase in our non-performing loans. See note 11 Loans in our consolidated financial statements.

Provisions are created by a charge to expense, and represent our estimate for loan losses and risks inherent in the credit portfolio. See Selected Statistical Information Non-Performing Loans . The determination of an appropriate level of loan losses and provisions required inherently involves a degree of subjectivity and requires that we make estimates of current credit risks and future trends, all of which may undergo material changes. Our provisions may not be adequate to cover any further increase in the amount of non-performing loans or any further deterioration in our non-performing loan portfolio. In addition, we are a relatively young bank operating in a growing economy and we have yet not experienced a significant and prolonged downturn in the economy.

A number of factors outside of our control affect our ability to control and reduce non-performing loans. These factors include developments in the Indian economy, domestic or global turmoil, global competition, changes in interest rates and exchange rates and changes in regulations, including with respect to regulations requiring us to lend to certain sectors identified by the RBI, or the government of India. These factors coupled with other factors such as volatility in commodity markets and declining business and consumer confidence and decreases in business and consumer spending could impact the operations of our customers and in turn impact their ability to fulfill their obligations under the loans granted to them by us. In addition, the expansion of our business may cause our non-performing loans to increase and the overall quality of our loan portfolio to deteriorate. If our non-performing loans increase, we will be required to increase our provisions, which would result in our net income being less than it otherwise would be and would adversely affect our financial condition.

We have high concentrations of exposures to certain customers and sectors and if any of these exposures were to become non-performing, the quality of our portfolio could be adversely affected and our ability to meet capital requirements could be jeopardized.

We calculate customer and industry exposure (i.e. the loss we will incur due to the downfall of a customer or an industry) in accordance with the policies established by RBI, computed based on our Indian GAAP financial statements. In the case of customer exposures, we aggregate the higher of the outstanding balances of, or limits on, funded and non-funded exposures. Funded exposures include loans and investments (excluding investments in government securities, units of mutual funds, deposit certificates issued by banks and equity shares). As of March 31, 2012, our largest single customer exposure was Rs. 91.2 billion, representing 24.0% of our capital funds valuation, and our ten largest customer exposures totaled Rs. 394.7 billion, representing 104.1% of our capital funds valuation, in each case computed in accordance with RBI guidelines. None of our ten largest customer exposures were classified as non-performing as on March 31, 2012. However, if any of our ten largest customer exposures were to become non-performing, our net income would decline and, due to the magnitude of the exposures, our ability to meet capital requirements could be jeopardized. See Management s Discussion and Analysis of Financial Condition and Results of Operations for a detailed discussion on customer exposures. We monitor concentration of exposures to individual industries as a proportion of funded exposures. As of March 31, 2012, our largest industry concentrations, in each case based on RBI guidelines, were as follows: banks and financial institutions 7.7%, wholesale and retail trade 7.6% and road transportation 6.0%. In addition, as of March 31, 2012, 45.9% of the concentration of our exposures was retail (except where otherwise included in the above classification). Industry-specific difficulties in these or other sectors may increase our level of non-performing customer assets. If we experience a downturn in an industry in which we have concentrated exposure, our net income will likely decline significantly and our financial condition may be materially adversely affected. As of March 31, 2012, our total non-performing loans and credit substitutes in accordance with US GAAP were concentrated in the following industries: NBFC/financial intermediaries (9.4%), textiles and garments (7.5%), wholesale and retail trade (4.8%), food and beverages (4.4%), and information technology (2.8%).

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We are required to undertake directed lending under RBI guidelines. Consequently, we may experience a higher level of non-performing assets in our directed lending portfolio, which could adversely impact the quality of our loan portfolio, our business and the price of our equity shares and ADSs. Further, in the case of any shortfall in complying with these requirements, we may be required to invest in deposits of Indian development banks as directed by the RBI. These deposits yield low returns, thereby impacting our profitability.

The RBI prescribes guidelines on priority sector lending in India. Under these guidelines banks in India are required to lend 40.0% of their adjusted net bank credit (ANBC) as defined by the RBI and computed in accordance with Indian GAAP figures to certain eligible sectors categorized as priority sectors. The priority sector requirements must be met as of the last reporting Friday of the fiscal year with reference to the ANBC of the previous fiscal year. Of the total priority sector advances, agricultural advances are required to be 18.0% of ANBC, including direct agricultural advances of at least 13.5% made directly to individual or groups of individual farmers and indirect agricultural advances of not more than 4.5% made for agricultural purposes such as loans to food and agri-processing industrial units, and financing farmers indirectly through the co-operative system. Advances to sections termed weaker by the RBI are required to be 10.0% of ANBC. The balance of the priority sector lending requirement can be met by lending directly or indirectly to a range of sectors, including small businesses and residential mortgages satisfying certain criteria.

In the case of non-achievement of priority sector lending targets, we are required to invest in deposits of Indian development banks, such as the National Bank of Agriculture and Rural Development and the Small Industries Development Bank of India, as may be directed by the RBI. The amount to be deposited, interest rates on such deposits and periods of deposits, and other terms, are determined by the RBI from time to time. The interest rates on such deposits may be lower than the interest rates which the Bank would have obtained by investing these funds at its discretion. Additionally, as per RBI guidelines, non-achievement of priority sector targets and sub-targets will be taken into account by RBI when granting regulatory clearances/approvals for various purposes.

We may experience a higher level of non-performing assets in our directed lending portfolio, particularly in loans to the agricultural sector, small enterprises and weaker sections, where we are less able to control the portfolio quality and where economic difficulties are likely to affect our borrowers more severely. Our gross non-performing assets in the directed lending sector as a percentage to gross loans were 0.4% as of March 31, 2012.

Future changes by the RBI in the directed lending norms may result in our inability to meet the priority sector lending requirements as well as require us to increase our lending to relatively more risky segments and may result in an increase in non-performing loans.

We may be unable to foreclose on collateral in a timely fashion or at all when borrowers default on their obligations to us, or the value of collateral may decrease, any of which may result in failure to recover the expected value of collateral security, increased losses and a decline in net income.

Although we typically lend on a cash-flow basis, many of our loans are secured by collateral, which consists of liens on inventory, receivables and other current assets, and in some cases, charges on fixed assets, such as property, movable assets (such as vehicles) and financial assets (such as marketable securities). As of March 31, 2012, approximately 76% of our loans were partially or fully secured by collateral.

Although there is legislation in place that strengthens the rights of creditors and leads to quicker realization of collateral in the event of a default, we may not be able to realize the full value of the collateral, due to, among other things, delays on our part in taking immediate action, delays in bankruptcy foreclosure proceedings, stock market downturns, defects in the perfection of collateral and fraudulent transfers by borrowers. In the event that a specialized regulatory agency gains jurisdiction over the borrower, creditor actions can be further delayed. In addition, the value of collateral may be less than we expect or may decline. For example, the global economic slowdown and other domestic factors had led to a downturn in real estate prices in India. If we are unable to foreclose on our collateral or realize adequate value, our losses will increase and our net income will decline. The RBI has set forth guidelines on Corporate Debt Restructuring (CDR) via the corporate debt restructuring cell. The guidelines envisage that for debt amounts of Rs. 0.1 billion and above, 60% of the creditors by number, in addition to 75% of creditors by value, can decide to restructure the debt and such a decision would be binding on the remaining creditors. In situations where we own 20% or less of the debt of a borrower, we could be forced to agree to an extended restructuring of debt, instead of foreclosure of security or a one-time settlement, which has generally been our practice. See Management s Discussion and Analysis of Financial Condition and Results of Operations Contractual Obligations and Commercial Commitments Commercial Commitments .

Our success depends in large part upon our management team and skilled personnel and our ability to attract and retain such persons.

We are highly dependent on our management team, including the efforts of our Chairman, our Managing Director, our Executive Directors and members of our senior management. Our future performance is dependent on the continued service of these persons. We also face a continuing challenge to recruit and retain a sufficient number of skilled personnel, particularly if we continue to grow. Competition for management and other skilled personnel in our industry is intense, and we may not be able to attract and retain the personnel we need in the future. The loss of key personnel may restrict our ability to grow and consequently have a material adverse impact on our results of operations and financial position.

Our unsecured loan portfolio is not supported by any collateral that could help ensure repayment of the loan, and in the event of non-payment by a borrower of one of these loans, we may be unable to collect the unpaid balance.

We offer unsecured personal loans and credit cards to the retail customer segment, including salaried individuals and self-employed professionals. In addition, we offer unsecured loans to small businesses and individual businessmen. Unsecured loans are a greater credit risk for us than our secured loan portfolio because they may not be supported by realizable collateral that could help ensure an adequate source of repayment for the loan. Although we normally obtain direct debit instructions or postdated checks from our customers for our unsecured loan products, we may be unable to collect in part or at all in the event of non-payment by a borrower. Further, any expansion in our unsecured loan portfolio could require us to increase our provision for credit losses, which would decrease our earnings. Also see Business Retail Banking Retail Loans and Other Asset Products .

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In order to support and grow our business, we must maintain a minimum capital adequacy ratio, and a lack of access to the capital markets may prevent us from maintaining an adequate ratio.

The RBI requires a minimum capital adequacy ratio of 9% of our total risk-weighted assets. We adopted the Basel II framework as of March 31, 2009. Our capital adequacy ratio, calculated in accordance with Indian GAAP, was 16.5% as of March 31, 2012 as per Basel II. Our ability to support and grow our business would be limited by a declining capital adequacy ratio. While we anticipate accessing the capital markets to offset declines in our capital adequacy ratio, we may be unable to access the markets at the appropriate time or the terms of any such financing may be unattractive due to various reasons attributable to changes in the general environment, including political, legal and economic conditions.

The Basel Committee on Banking Supervision issued a comprehensive reform package entitled Basel III: A global regulatory framework for more resilient banks and banking systems in December 2010. On May 2, 2012, the RBI released guidelines on implementation of Basel III capital regulations in India. The key items covered under these guidelines are as follows: i) improving the quality, consistency and transparency of the capital base; ii) enhancing risk coverage; iii) graded enhancement of the total capital requirement; iv) introduction of capital conservation buffer and countercyclical buffer; and v) supplementing the risk-based capital requirement with a leverage ratio. One of the major changes proposed by the Basel III capital regulations is that the Tier 1 capital will predominantly consist of common equity of the banks which inter alia includes common shares, reserves and stock surplus. Innovative instruments and perpetual non-cumulative preference shares will not be considered a part of Common Equity Tier I capital. Basel III also defines criteria for instruments to be included in Tier 2 capital to improve their loss absorbency. The guidelines also set-out criteria for loss absorption through conversion/write-off of all non-common equity regulatory capital instruments at the point of non-viability. Point of non-viability is defined as a trigger event upon the occurrence of which non-common equity Tier 1 and Tier 2 instruments issued by banks in India may be required to, at the option of the RBI, write off such instruments or convert them into common equity. The capital requirement including the capital conservation buffer will be 11.5% (against the current requirement of 9%) once these guidelines are fully phased-in. The transitional arrangements will begin from January 1, 2013 and the guidelines will be fully phased-in and implemented as of March 31, 2018. For the fiscal year ending on March 31, 2013, banks will have to disclose capital ratios under the existing Basel II guidelines on capital adequacy as well as those computed under the Basel III capital adequacy framework. Our ability to support and grow our business could be adversely affected if we are unable to meet with the revised requirements.

Material changes in Indian banking regulations may adversely affect our business and our future financial performance.

We operate in a highly regulated environment in which the RBI extensively supervises and regulates all banks. Our business could be directly affected by any changes in policies for banks in respect of directed lending, reserve requirements and other areas. For example, the RBI could change its methods of enforcing directed lending standards so as to require more lending to certain sectors, which could require us to change certain aspects of our business. In addition, we could be subject to other changes in laws and regulations, such as those affecting the extent to which we can engage in specific businesses or those that reduce our income through a cap on either fees or interest rates chargeable to our customers or those affecting foreign investment in the banking industry, as well as changes in other governmental policies and enforcement decisions, income tax laws, foreign investment laws and accounting principles. Laws and regulations governing the banking sector may change in the future and any changes may adversely affect our business, our future financial performance and the price of our equity shares and ADSs.

We compete directly with banks that are much larger than we are and which benefit from economies of scale, which makes it challenging for us to offer competitive prices to retain existing customers and solicit new business.

We face strong competition in all areas of our business, and some of our competitors are much larger than we are. We compete directly with the large public sector banks, which generally have much larger customer, asset and deposit bases, larger branch networks and more capital than we do. These banks are becoming more competitive as they improve their customer services and technology. One of the other private sector banks in India is also larger than we are, based on such measurements. In addition, we compete directly with foreign banks, which include some of the largest multinational financial companies in the world. The economies of scale that our larger competitors benefit from, make it difficult for us to offer competitive pricing on products and services to retain existing customers and attract new customers so that we can execute our growth strategy successfully. If we are unable to retain and attract new customers, our revenue and net income will decline, which could materially adversely affect our financial condition. See Business Competition .

Our funding is primarily short-and medium-term and if depositors do not roll over deposited funds upon maturity our net income may decrease.

Most of our funding requirements are met through short-term and medium-term funding sources, primarily in the form of retail deposits. Short-term deposits are those with a maturity not exceeding one year. Medium-term deposits are those with a maturity of greater than one year but not exceeding three years. See Selected Statistical Information Funding . However, a portion of our assets have long-term maturities, which sometimes causes funding mismatches. As of March 31, 2012, about 40% of our loans were short-term and about 44% of our loans were medium-term. As of March 31, 2012, about 29% of our deposits were short-term and about 45% of our deposits were medium-term. In our experience, a substantial portion of our customer deposits has been rolled over upon maturity and has been, over time, a stable source of funding. However, if a substantial number of our depositors do not roll over deposited funds upon maturity, our liquidity position will be adversely affected and we may be required to seek more expensive sources of funding to finance our operations, which would result in a decline in our net income and have a material adverse effect on our financial condition.

Any increase in interest rates would have an adverse effect on the value of our fixed income securities portfolio and could have a material adverse effect on our net income.

Any increase in interest rates would have an adverse effect on the value of our fixed income securities portfolio and could have a material adverse effect on our net revenue. Successive increases in policy rates since February 2010 to date have meant that the ongoing bout of interest rate tightening in India has been faster than many other economies. The RBI has raised key policy rates from 5.25% (repo rate) in April 2010 to 8.0% currently. As a result of certain reserve requirements of the RBI, we are more structurally exposed to interest rate risk than banks in many other countries. See Supervision and Regulation Legal Reserve Requirements. These requirements result in us maintaining (as per extant RBI guidelines currently in force) at least 24% of our liabilities (computed as per guidelines issued by the RBI) in Government issued bonds and we could be adversely impacted by a rise in interest rates, especially if the rise were sudden or sharp. A rise in yields on fixed income securities, including government securities, will impact our profitability. The above requirements would also have a negative impact on our net interest income and net interest margins since interest earned on our investments in government issued securities is generally lower than that earned on our other interest earning assets.

The development of a well entrenched nationwide inter-bank settlement system would adversely impact our cash float and decrease fees we receive in connection with check collection.

Currently, there is no well entrenched nationwide payment system in India, and checks must generally be returned to the city from which they were written in order to be cleared. Because of mail delivery delays and the variation in city-based inter-bank clearing practices, check collections can be slow and unpredictable. Through our electronically linked branch network, correspondent bank arrangements and centralized processing, we effectively provide a nationwide collection and disbursement system for our corporate clients. We enjoy cash float and earn fees from these services. In 2005, the RBI introduced the RTGS inter-bank settlement system which facilitates real time settlements primarily between banks. Although we believe our services offer advantages not offered by payment systems currently available, the development of a robust payments system would have an adverse impact on the cash float and fees we have enjoyed from our cash management services, which could materially adversely affect our financial condition.

We could experience a decline in our revenue generated from activities on the equity markets if there is a prolonged or significant downturn on the Indian stock exchanges, or we may face difficulties in getting regulatory approvals necessary to conduct our business if we fail to meet regulatory limits on capital market exposures.

We provide a variety of services and products to participants involved with the Indian stock exchanges. These include working capital funding and margin guarantees to share brokers, personal loans secured by shares and initial public offering finance for retail customers, stock exchange clearing services, collecting bankers to various public offerings and depositary accounts. If there is a prolonged or significant downturn on the Indian stock exchanges, our revenue generated by offering these products and services may decrease, which would have a material adverse effect on our financial condition.

We are required to maintain our capital market exposures within the limits as prescribed by the RBI. Our capital market exposures are comprised primarily of investments in equity shares, loans to share brokers and financial guarantees issued to stock exchanges on behalf of share brokers.

As per RBI norms, a bank s capital market exposure is limited to 40% of its net worth under Indian GAAP, both on a consolidated and non-consolidated basis. Our capital market exposure as of March 31, 2012 was 30.2% of our net worth on a non-consolidated basis and 30.4% on a consolidated basis. See Supervision and Regulation Regulations Relating to Capital Market Exposure Limits . In the future if we fail to meet these regulatory limits, we may face difficulties in getting other regulatory approvals necessary to conduct business in the normal course, which would have a material adverse effect on our business and operations.

Significant fraud, system failure or calamities would disrupt our revenue generating activities in the short-term and could harm our reputation and adversely impact our revenue-generating capabilities.

Our business is highly dependent on our ability to efficiently and reliably process a high volume of transactions across numerous locations and delivery channels. We place heavy reliance on our technology infrastructure for processing this data and therefore ensuring system security and availability is of paramount importance. Our systemic and operational controls may not be adequate to prevent adverse impact from frauds, errors, hacking and system failures. A significant system breakdown or system failure caused due to intentional or unintentional acts would have an adverse impact on our revenue-generating activities and lead to financial loss. We have established a geographically remote disaster recovery site to support critical applications, and we believe that we will be able to restore data and resume processing. However it may take considerable time to make the system fully operational and achieve complete business resumption using the alternate site. Therefore, in such a scenario, where the primary site is completely unavailable, there may be significant disruption to our operations, which would materially adversely affect our reputation and financial condition.

Our business and financial results could be impacted materially by adverse results in legal proceedings.

We establish reserves for legal claims when payments associated with claims become probable and the costs can be reasonably estimated. We may still incur legal costs for a matter even if we have not established a reserve. In addition, the actual cost of resolving a legal claim may be substantially higher than any amounts reserved for that matter. The ultimate resolution of any pending or future legal proceeding, depending on the remedy sought and granted, could materially adversely affect our results of operations and financial condition.

Negative publicity could damage our reputation and adversely impact our business and financial results.

Reputation risk, or the risk to our business, earnings and capital from negative publicity, is inherent in our business. The reputation of the financial services industry in general has been closely monitored as a result of the financial crisis and other matters affecting the financial services industry. Negative public opinion about the financial services industry generally or us specifically could adversely affect our ability to keep and attract customers, and expose us to litigation and regulatory action. Negative publicity can result from our actual or alleged conduct in any number of activities, including lending practices, mortgage servicing and foreclosure practices, corporate governance, regulatory compliance, mergers and acquisitions, and related disclosure, sharing or inadequate protection of customer information, and actions taken by government regulators and community organizations in response to that conduct. Although we take steps to minimize reputation risk in dealing with customers and other constituencies, we, as a large financial services organization with a high industry profile, are inherently exposed to this risk.

Cyber threats, such as phishing and trojans, could intrude into our network for data theft or to seek sensitive information, which may cause damage to our reputation and adversely impact our business and financial results.

We offer internet banking services to our customers. Our internet banking channel includes multiple services such as electronic funds transfer, bill payment services, usage of credit cards on-line, requesting account statements, and requesting check books. We are therefore exposed to cyber threats, such as phishing and trojans, targeting our customers, wherein fraudsters send unsolicited mails to our customers seeking account sensitive information, hacking, wherein hackers seek to hack into our website with the primary intention of causing a reputational damage to us, and data theft, wherein cyber criminals may intrude into our network with the intention of stealing our data or information. Although we have implemented various measures to mitigate risks that emanate from offering online banking services to our customers, we, as a large financial services organization with a high industry profile, are inherently exposed to this risk.

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HDFC Limited controls a significant percentage of our share capital and exercises substantial influence over board decisions, which could result in HDFC Limited making decisions or foregoing opportunities to benefit HDFC Limited that restrict our growth and harm our financial condition.

HDFC Limited and its subsidiaries owned 23.2% of our equity as of March 31, 2012. So long as HDFC Limited and its subsidiaries hold at least a 20% equity stake in us, HDFC Limited is entitled to nominate two directors including our Chairman and Managing Director who are not required to retire by rotation to our board, subject to RBI approval. Our current Chairman and Managing Director were nominated by HDFC Limited and appointed with the approval of our shareholders and the RBI. Two of our other directors, Mr. Keki Mistry is the Vice Chairman and Chief Executive Officer and Mrs. Renu Karnad, is the Managing Director of HDFC Limited. Accordingly, HDFC Limited can exercise substantial influence over our board and over matters subject to a shareholder vote. Mr. D. M. Sukthankar is the father of our Executive Director, Mr. Paresh Sukthankar, and serves as an independent director on the board of HDFC Limited. Mr. D. M. Sukthankar has been on the board of HDFC Limited since 1989. Mr. Paresh Sukthankar was one of our early employees and also a part of the initial senior management team. He was appointed as our Executive Director in October 2007. Both are associated with the respective companies in their independent professional capacities and we believe that none is in a position to exercise influence over the other.

There have been reports in the Indian media suggesting that we may merge with HDFC Limited. We consider business combination opportunities as they arise. At present, we are not actively considering a business combination with HDFC Limited. Any significant business combination would involve compliance with regulatory requirements and shareholder and regulatory approvals. Were such a combination to occur, we cannot predict the impact it would have on our business, growth prospects or the prices of our equity shares and ADSs.

We may face conflicts of interest relating to our principal shareholder, HDFC Limited, which could cause us to forgo business opportunities and consequently have an adverse effect on our financial performance.

HDFC Limited is primarily engaged in financial services, including home loans, property-related lending and deposit products. The subsidiaries and associated companies of HDFC Limited are also largely engaged in a range of financial services, including asset management, life and other insurance and mutual funds. Although we have no agreements with HDFC Limited or any other HDFC group companies that restrict us from offering products and services that are offered by them, our relationship with these companies may cause us not to offer products and services that are already offered by other HDFC group companies and may effectively prevent us from taking advantage of business opportunities. See Related Party Transactions in our Annual Report on Form 20-F for fiscal 2010, 2011 and 2012 for a summary of transactions we have engaged in and strategic investments made with HDFC Limited during fiscal 2010, 2011 and 2012. Also see Note 28 Related party transactions , in our consolidated financial statements. We currently distribute products of HDFC Limited and its group companies. If we forego opportunities because of our relationship with HDFC Limited, it could have a material adverse effect on our financial performance.

RBI guidelines relating to ownership in private banks could discourage or prevent a change of control or other business combination involving us, such as with HDFC Limited, which could restrict the growth of our business and operations.

RBI guidelines prescribe a policy framework for the ownership and governance of private sector banks. The guidelines state that no single entity or group of entities will be permitted to own or control, directly or indirectly, more than 10% of the paid-up capital of a private sector bank without RBI approval. The implementation of such a restriction could discourage or prevent a change in control, merger, consolidation, takeover or other business combination involving us, which might be beneficial to our shareholders. The RBI s acknowledgement is required for the acquisition or transfer of a bank s shares, which will increase the aggregate holding (direct and indirect, beneficial or otherwise) of an individual or a group to the equivalent of 5% or more of its total paid-up capital. The RBI, when considering whether to grant an approval, may take into account all matters that it considers relevant to the application, including ensuring that shareholders whose aggregate holdings are above specified thresholds meet fitness and propriety tests. The RBI has accorded its approval for HDFC Limited to hold more than 10% of our stock. HDFC Limited s substantial stake in us could discourage or prevent another entity from exploring the possibility of a combination with us. These obstacles to potentially synergistic business combinations could negatively impact our share price and have a material adverse effect on our ability to compete effectively with other large banks and consequently our ability to maintain and improve our financial condition.

We may face increased competition as a result of revised guidelines that relax restrictions on the presence of foreign banks in India and a proposal by the RBI to grant fresh banking licenses for the establishment of new banks in the private sector which could cause us to lose existing business or be unable to compete effectively for new business.

The Government of India regulates foreign ownership in private sector banks. The total foreign ownership in a private sector bank cannot exceed 74% of its paid-up capital. The RBI, on February 28, 2005, released a Roadmap for Presence of Foreign Banks in India and Guidelines on ownership and Governance in Private Sector Banks (the Roadmap).

The Roadmap envisages two phases. During the first phase, between March 2005 and March 2009, foreign banks were permitted to establish their presence in India by way of setting up a wholly-owned banking subsidiary (WOS) or converting their existing branches into a WOS. The WOS must have minimum capital of Rs. 3 billion and ensure sound corporate governance.

Initially, equity participation by banks would be permitted only in the private sector banks that are identified by the RBI for restructuring. On an application made by a foreign bank for acquisition of 5% or more in any private bank, the RBI would consider the standing and reputation of the foreign bank and shall permit such acquisition only if it is satisfied that the investment by such foreign bank is in the long-term interest of all the stakeholders of the investee bank.

It was proposed that in the second phase, beginning April 2009, the RBI would allow foreign banks to acquire up to 74% of equity capital in private sector banks in India. However, in light of the global financial turmoil and concerns regarding financial strength of banks around the world, the RBI decided to put on hold the second phase of the Roadmap and leave unchanged its policy on the presence of foreign banks in the country. While announcing its annual policy for fiscal 2010, the RBI said that it would continue with the current policy and procedures governing the presence of foreign banks in India. A review will happen once there is greater clarity regarding stability, recovery of the global financial system, and a shared understanding on the regulatory and supervisory architecture around the world. In January 2011, the RBI released a discussion paper on the presence of foreign banks in India, seeking comments and suggestions. Any growth in the presence of foreign banks or in foreign investments in Indian banks may increase the competition that we face and as a result have a material adverse effect on our business. See Restrictions on Foreign Ownership of Indian Securities .

On August 29, 2011 the RBI released draft guidelines for licensing of new banks in the private sector. The key items covered under these draft guidelines are as follows: i) promoters eligible to apply for banking licenses; ii) corporate structure; iii) minimum capital requirements for new banks; iv) foreign shareholding cap; v) corporate governance; and vi) business model. The RBI has called for wider comments and feedback from relevant stakeholders and the public. Final guidelines will be issued and the process of inviting applications for setting up of new banks will be initiated after the RBI has received feedback, comments and suggestions on the draft guidelines, and after certain vital amendments to the Banking Regulation Act are in place.

If the number of banks in the country increase, we will face increased competition in the businesses we operate in. This could have a material adverse effect on our business and financial results.

Delays in obtaining prior RBI approval for opening new branches to increase our infrastructure and expand our reach into different geographical segments will restrict our expansion plans and have a negative impact on our future financial performance by preventing us from realizing anticipated revenue from the new branches.

The RBI issued a master circular on July 1, 2009, incorporating the instructions and guidelines issued to banks on branch authorization. Pursuant to the master circular, the process by which the RBI authorized the opening of individual branches on a case-by-case basis was replaced by a system of aggregated approvals on an annual basis. While processing authorization requests, the RBI gives importance to the nature and scope of banking services, particularly in under-banked areas, actual credit flow to priority sectors, pricing of products, overall efforts to promote financial inclusion, the need to induce enhanced competition in the banking sector, the bank s regulatory compliance, quality of corporate governance, risk management and relationships with subsidiaries and affiliates.

We have applied for branches under the policy in the past and obtained approvals for opening branches under the policy. See Supervision and Regulation Regulation Relating to the Opening of Branches . However, there can be no assurance that we will receive licenses promptly or at all, and any prolonged delay in the receipt of such licenses will adversely affect our financial performance by preventing us from realizing anticipated revenue from the new branches.

If the goodwill recorded in connection with our recent acquisitions becomes impaired, we may be required to record impairment charges, which would decrease our net income and total assets.

In accordance with US GAAP, we have accounted for our acquisitions using the purchase method of accounting. We recorded the excess of the purchase price over the fair value of the assets and liabilities of the acquired companies as goodwill. US GAAP requires us to test goodwill for impairment at least annually, or more frequently if events or changes in circumstances indicate that goodwill may be impaired. Goodwill is tested by initially estimating fair value of the reporting unit and then comparing it against the carrying amount including goodwill. If the carrying amount of a reporting unit exceeds its estimated fair value, we are required to record an impairment loss. The amount of impairment and the remaining amount of goodwill, if any, is determined by comparing the fair value of the reporting unit as of the test date against the fair value of the assets and liabilities of that reporting unit as of the same date. See Note 2u- Business Combination , in our consolidated financial statements.

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Many of our branches have been recently added to our branch network and are not operating with the same efficiency as compared to the rest of our existing branches, which adversely affects our profitability.

As at March 31, 2009, we had 1,412 branches. As a result of our acquisition of Centurion Bank of Punjab effective May 23, 2008, our network expanded by over 400 branches while we continued to grow organically by commissioning new branches. As at March 31, 2012, we had 2,544 branches, a significant increase in the number of branches over the last three fiscal years. Some of the newly added branches are currently operating at a lower efficiency level as compared with our established branches. While we believe that the newly added branches will achieve the productivity benchmark set for our entire network over time, the success in achieving our benchmark level of efficiency and productivity will depend on various internal and external factors, some of which are not under our control. The sub-optimal performance of the newly added branches, if continued over an extended period of time, would have a material adverse effect on our profitability.

Risks Relating to Investments in Indian Companies

A slowdown in economic growth in India would cause us to experience slower growth in our asset portfolio and deterioration in the quality of our assets.

Our performance and the quality and growth of our assets are necessarily dependent on the health of the overall Indian economy. The global slowdown of the financial market and economies had contributed and may continue to cause a slowdown in the Indian financial and economic environment, with attendant higher unemployment rates and decreases in purchasing power. While the domestic economy started witnessing an overall improvement in the general financial and economic conditions, we have begun to witness a reversal on account of high inflation and higher interest rates. These conditions, including global financial crisis and problems in the Eurozone countries, could result in a prolonged slowdown in the Indian economy, which would adversely affect our business, including our ability to grow our asset portfolio, the quality of our assets and our ability to implement our strategy. In particular, because India depends significantly on imported oil for its energy needs, the Indian economy is adversely affected by volatile oil prices, consequent inflation and weather conditions adversely affecting agriculture or other factors. In addition, the Indian economy is in a state of transition. The share of the services sector of the economy is rising, while that of the industrial, manufacturing and agricultural sectors is declining. Finally, India faces major challenges in sustaining its growth, which include the need for substantial infrastructure development and improving access to healthcare and education. If the Indian economy deteriorates, our asset base may erode, which would result in a material decrease in our net income and total assets.

Political instability or changes in the government in India could delay the liberalization of the Indian economy and adversely affect economic conditions in India generally, which would impact our financial results and prospects.

Since 1991, successive Indian governments have pursued policies of economic liberalization, including significantly relaxing restrictions on the private sector. Nevertheless, the roles of the Indian central and state governments in the Indian economy as producers, consumers and regulators have remained significant. The leadership of India has changed many times since 1996. The current coalition-led central government, which came to power in May 2009, has announced policies and taken initiatives that support the economic liberalization policies that have been pursued by previous central governments. However, we cannot assure you that these liberalization policies will continue in the future. The rate of economic liberalization is subject to change and specific laws and policies affecting banking and finance companies, foreign investment, currency exchange and other matters affecting investment in our securities are continuously evolving as well. Any significant change in India s economic liberalization and deregulation policies would adversely affect business and economic conditions in India generally and our business in particular.

Terrorist attacks, civil unrest and other acts of violence or war involving India and other countries would negatively affect the Indian market where our shares trade and lead to a loss of confidence and impair travel, which could reduce our customers appetite for our products and services.

Terrorist attacks, such as those in Mumbai in November 2008, and other acts of violence or war may negatively affect the Indian markets on which our equity shares trade and also adversely affect the worldwide financial markets. These acts may also result in a loss of business confidence, make travel and other services more difficult and as a result ultimately adversely affect our business. In addition, any deterioration in relations between India and Pakistan might result in investor concern about stability in the region, which could adversely affect the price of our equity shares and ADSs.

India has also witnessed civil disturbances in recent years and future civil unrest as well as other adverse social, economic and political events in India could have an adverse impact on us. Such incidents also create a greater perception that investment in Indian companies involves a higher degree of risk, which could have an adverse impact on our business and the price of our equity shares and ADSs.

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Risks Relating to the ADSs and Equity Shares

Historically, our ADSs have traded at a premium to the trading prices of our underlying equity shares, a situation which may not continue.

Historically, our ADSs have traded on the New York Stock Exchange (the NYSE) at a premium to the trading prices of our underlying equity shares on the Indian stock exchanges, although this premium has declined in recent years. See Price Range of Our American Depositary Shares and Equity Shares for the underlying data. We believe that this price premium has resulted from the relatively small portion of our market capitalization previously represented by ADSs, restrictions imposed by Indian law on the conversion of equity shares into ADSs, and an apparent preference for investors to trade dollar-denominated securities. Over time, some of the restrictions on issuance of ADSs imposed by Indian law have been relaxed and we expect that other restrictions may be relaxed in the future. It is possible that in the future our ADSs will not trade at any premium to our equity shares and could even trade at a discount to our equity shares.

Investors in ADSs will not be able to vote.

Investors in ADSs will have no voting rights, unlike holders of the equity shares. Under the deposit agreement, the depositary will abstain from voting the equity shares represented by the ADSs. If you wish, you may withdraw the equity shares underlying the ADSs and seek to vote (subject to Indian restrictions on foreign ownership) the equity shares you obtain upon withdrawal. However, this withdrawal process may be subject to delays, additional costs and you may not be able to redeposit the equity shares. For a discussion of the legal restrictions triggered by a withdrawal of the equity shares from the depositary facility upon surrender of ADSs, see Restrictions on Foreign Ownership of Indian Securities and Description of American Depository Shares Voting Rights .

Your ability to withdraw equity shares from the depositary facility is uncertain and may be subject to delays.

India s restrictions on foreign ownership of Indian companies limit the number of equity shares that may be owned by foreign investors and generally require government approval for foreign investments. Investors who withdraw equity shares from the ADS depositary facility for the purpose of selling such equity shares will be subject to Indian regulatory restrictions on foreign ownership upon withdrawal. The withdrawal process may be subject to delays. For a discussion of the legal restrictions triggered by a withdrawal of equity shares from the depositary facility upon surrender of ADSs, see Restrictions on Foreign Ownership of Indian Securities .

There is a limited market for the ADSs.

Although our ADSs are listed and traded on the NYSE, any trading market for our ADSs may not be sustained, and there is no assurance that the present price of our ADSs will correspond to the future price at which our ADSs will trade in the public market. Indian legal restrictions may also limit the supply of ADSs. The only way to add to the supply of ADSs would be through an additional issuance. We cannot guarantee that a market for the ADSs will continue.

Conditions in the Indian securities market may affect the price or liquidity of our equity shares and ADSs.

The Indian securities markets are smaller and more volatile than securities markets in more developed economies. The Indian stock exchanges have in the past experienced substantial fluctuations in the prices of listed securities. Currently prices of securities listed on Indian exchanges are displaying signs of volatility linked among other factors to the uncertainty in the global markets and the rising inflationary and interest rate pressures domestically. The governing bodies of the Indian stock exchanges have from time to time imposed restrictions on trading in certain securities, limitations on price movements and margin requirements. Future fluctuations could have a material adverse effect on the price of our equity shares and ADSs.

Settlement of trades of equity shares on Indian stock exchanges may be subject to delays.

The equity shares represented by our ADSs are listed on the National Stock Exchange and Bombay Stock Exchange Limited. Settlement on these stock exchanges may be subject to delays and an investor in equity shares withdrawn from the depositary facility upon surrender of ADSs may not be able to settle trades on these stock exchanges in a timely manner.

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You may be unable to exercise preemptive rights available to other shareholders.

A company incorporated in India must offer its holders of equity shares preemptive rights to subscribe and pay for a proportionate number of shares to maintain their existing ownership percentages prior to the issuance of any new equity shares, unless these rights have been waived by at least 75.0% of the company s shareholders present and voting at a shareholders general meeting. U.S. investors in our ADSs may be unable to exercise preemptive rights for our equity shares underlying our ADSs unless a registration statement under the Securities Act of 1933 (the Securities Act) is effective with respect to those rights or an exemption from the registration requirements of the Securities Act is available. Our decision to file a registration statement will depend on the costs and potential liabilities associated with any registration statement as well as the perceived benefits of enabling U.S. investors in our ADSs to exercise their preemptive rights and any other factors we consider appropriate at the time. We do not commit to filing a registration statement under those circumstances. If we issue any securities in the future, these securities may be issued to the depositary, which may sell these securities in the securities markets in India for the benefit of the investors in our ADSs. There can be no assurance as to the value, if any, the depositary would receive upon the sale of these securities. To the extent that investors in our ADSs are unable to exercise preemptive rights, their proportional interests in us would be reduced.

Because the equity shares underlying our ADSs are quoted in rupees in India, you may be subject to potential losses arising out of exchange rate risk on the Indian rupee and risks associated with the conversion of rupee proceeds into foreign currency.

Fluctuations in the exchange rate between the U.S. dollar and the Indian rupee may affect the value of your investment in our ADSs. Specifically, if the relative value of the Indian rupee to the U.S. dollar declines, each of the following values will also decline:

- the U.S. dollar equivalent of the Indian rupee trading price of our equity shares in India and, indirectly, the U.S. dollar trading price of our ADSs in the United States;

- the U.S. dollar equivalent of the proceeds that you would receive upon the sale in India of any equity shares that you withdraw from the depositary; and

- the U.S. dollar equivalent of cash dividends, if any, paid in Indian rupees on the equity shares represented by our ADSs.

You may not be able to enforce a judgment of a foreign court against us.

We are a limited liability company incorporated under the laws of India. All of our directors and members of our senior management and some of the experts named in this report are residents of India and almost all of our assets and the assets of these persons are located in India. It may not be possible for investors in our ADSs to effect service of process outside India upon us or our directors and members of our senior management and experts named in the report that are residents of India or to enforce judgments obtained against us or these persons in foreign courts predicated upon the liability provisions of foreign countries, including the civil liability provisions of the federal securities laws of the United States. Moreover, it is unlikely that a court in India would award damages on the same basis as a foreign court if an action were brought in India or that an Indian court would enforce foreign judgments if it viewed the amount of damages as excessive or inconsistent with Indian practice.

There may be less company information available on Indian securities markets than securities markets in developed countries.

There is a difference between the level of regulation and monitoring of the Indian securities markets and the activities of investors, brokers and other participants and that of markets in the United States and other developed economies. SEBI and the stock exchanges are responsible for improving disclosure and other regulatory standards for the Indian securities markets. SEBI has issued regulations and guidelines on disclosure requirements, insider trading and other matters. There may, however, be less publicly available information about Indian companies than is regularly made available by public companies in developed economies.

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PRICE RANGE OF OUR AMERICAN DEPOSITARY SHARES AND EQUITY SHARES

Our ADSs, each representing three equity shares, par value Rs. 2.0 per share, are listed on the NYSE under the symbol HDB . Our equity shares, including those underlying the ADSs, are listed on the National Stock Exchange under the symbol HDFCBANK and the Bombay Stock Exchange Limited under the code 500180. Our fiscal quarters end on June 30 of each year for the first quarter, September 30 for the second quarter, December 31 for the third quarter and March 31 for the fourth quarter.

Trading Prices of Our ADSs on the NYSE

The following table shows:

- the reported high and low prices for our ADSs in U.S. dollars on the NYSE; and

- the average daily trading volume for our ADSs on the NYSE.

Fiscal	Price per ADS High	Price per ADS Low	Average daily ADS trading volume (Number of ADSs)
2008	U.S.$ 29.1	U.S.$ 12.7	2,294,535
2009	23.9	9.0	3,459,043
2010	28.2	11.9	1,915,617
2011			
First Quarter	31.3	25.3	1,437,000
Second Quarter	37.2	28.0	1,323,844
Third Quarter	38.3	30.5	1,207,961
Fourth Quarter	34.5	27.8	1,587,185
2012			
First Quarter	35.6	30.6	1,044,357
Second Quarter	36.8	27.5	1,037,488
Third Quarter	32.7	24.5	1,102,389
Fourth Quarter	35.9	26.6	939,853
Most Recent Six Months			
January 2012	32.1	26.6	1,057,890
February 2012	35.9	31.2	1,085,885
March 2012	35.2	32.6	699,791
April 2012	35.2	33.0	645,490
May 2012	34.4	27.8	856,905
June 2012	32.6	27.3	805,943
July 1, 2012 to July 20, 2012	35.0	32.5	486,860

Our shareholders at the Annual General Meeting held on July 6, 2011 approved the subdivision of our one equity share having a nominal value of Rs. 10.0 each into 5 (five) equity shares having a nominal value of Rs. 2.0 each. Necessary instructions were issued to JP Morgan Chase Bank, the Depository, for the American Depository Shares (ADSs) to effect the split in the ADSs so as to ensure that the ratio between the ADSs and the underlying equity shares remains 1:3 as on the date prior to the subdivision.

The closing price for our ADSs on the NYSE was US$ 33.5 per ADS on July 20, 2012.

Trading Prices of Our Equity Shares on the National Stock Exchange

The following table shows:

the reported high and low market prices for our equity shares in rupees on the National Stock Exchange;

the imputed high and low closing sales prices for our equity shares translated into U.S. dollars; and

the average daily trading volume for our equity shares on the National Stock Exchange.

	Price per equity share		Price per equity share		Average daily equity share trading volume
	High	Low	High	Low	
Fiscal Year					
2008	Rs. 357.8	Rs. 180.3	US$ 7.0	US$ 3.5	3,037,709
2009	309.6	159.7	6.1	3.1	7,736,578
2010	393.1	200.0	7.7	3.9	5,339,359
2011					
First Quarter	400.3	360.8	7.9	7.1	3,282,369
Second Quarter	499.1	381.5	9.8	7.5	3,891,951
Third Quarter	500.2	432.6	9.8	8.5	3,699,951
Fourth Quarter	478.1	400.6	9.4	7.9	4,789,346
2012					
First Quarter	505.0	441.6	9.9	8.7	3,729,841
Second Quarter	519.0	436.2	10.2	8.6	3,310,964
Third Quarter	497.0	400.3	9.8	7.9	3,726,123
Fourth Quarter	539.9	419.5	10.6	8.2	2,941,348
Most Recent Six Months					
January 2012	504.0	419.5	9.9	8.2	2,471,063
February 2012	539.9	481.4	10.6	9.5	3,797,786
March 2012	534.5	493.0	10.5	9.7	2,633,053
April 2012	558.0	515.9	11.0	10.1	2,351,758
May 2012	558.0	482.2	11.0	9.5	2,982,980
June 2012	564.9	485.1	11.1	9.5	2,945,019
July 1, 2012 to July 20, 2012	593.8	560.0	11.7	11.0	2,361,242

Our shareholders, by a special resolution on July 6, 2011, approved a stock split resulting in a reduction in the par value of each equity share from Rs.10.0 to Rs. 2.0 effective as of July 16, 2011.

The closing price for our equity shares on the National Stock Exchange was Rs. 582.6 per share on July 20, 2012.

As of March 31, 2012, there were 447,924 holders of record of our equity shares, including the shares underlying ADSs and GDRs, of which 222 had registered addresses in the United States and held an aggregate of 214,350 equity shares representing 0.05% of our shareholders. In our books only, the depositories, J.P. Morgan Chase Bank and Deutsche Bank Trust Company Americas, are the shareholders with respect to equity shares underlying ADSs and GDRs.

Upon our acquisition of CBoP in 2008, CBoP had global depository receipts (GDRs) outstanding, representing the right to receive shares in CBoP, which, upon the consummation of the acquisition, converted into our GDRs, representing the right to receive our shares. As of March 31, 2012, there were 23,691,290 GDRs outstanding, representing 11,845,645 shares of the Bank (in the aggregate 0.5% of our paid-up capital).

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DESCRIPTION OF EQUITY SHARES

The Company

We are registered under Corporate Identity Number (CIN) L65920MH1994PLC080618 with the Registrar of Companies, Maharashtra State, India. Our Memorandum of Association permits us to engage in a wide variety of activities, including all the activities in which we currently engage or intend to engage, as well as other activities in which we currently have no intention of engaging.

Dividends

Under Indian law, a company pays dividends upon a recommendation by its board of directors and approval by a majority of its shareholders at the annual general meeting of shareholders held within six months of the end of each fiscal year. The shareholders have the right to decrease but not increase the dividend amount recommended by the board of directors. Dividends are generally declared as a percentage of par value (on per share basis) and distributed and paid to shareholders. The Companies Act provides that shares of a company of the same class must receive equal dividend treatment.

These distributions and payments are required to be deposited into a separate bank account and paid to shareholders within 30 days of the annual general meeting where the resolution for declaration of dividends is approved.

The Companies Act states that any dividends that remain unpaid or unclaimed after that period are to be transferred to a special bank account. Any money that remains unclaimed for seven years from the date of the transfer is to be transferred by us to a fund created by the Government of India. No claims for the payment of dividends unpaid or unclaimed for a period of seven years shall lie against the fund of the Government of India or against us.

Our Articles authorize our board of directors to declare interim dividends, the amount of which must be deposited in a separate bank account within five days and paid to the shareholders within 30 days of the declaration.

Under the Companies Act, final dividends payable can be paid only in cash to the registered shareholder at a record date fixed prior to the relevant annual general meeting, to his order or to the order of his banker.

Before paying any dividend on our shares, we are required under the Indian Banking Regulation Act to write off all capitalized expenses (including preliminary expenses, organization expenses, share-selling commission, brokerage, amounts of losses incurred or any other item of expenditure not represented by tangible assets). We are permitted to declare dividends of up to 35.0% of net profit calculated under Indian GAAP without prior RBI approval subject to compliance with certain prescribed requirements. Further, upon compliance with the prescribed requirements, we are also permitted to declare interim dividends subject to the above-mentioned cap computed for the relevant accounting period.

Dividends may only be paid out of our profits for the relevant year and in certain contingencies out of the reserves of the company. Before declaring dividends, we are required, under the Indian Banking Regulation Act, to transfer 25% of the balance of profits of each year to a reserve fund.

Bonus Shares

In addition to permitting dividends to be paid out of current or retained earnings calculated under Indian GAAP, the Companies Act permits our board of directors, subject to the approval of our shareholders, to distribute to the shareholders, in the form of fully paid-up bonus equity shares, an amount transferred from the capital surplus reserve or legal reserve to stated capital. Bonus equity shares can be distributed only with the prior approval of the RBI. These bonus equity shares must be distributed to shareholders in proportion to the number of equity shares owned by them.

Preemptive Rights and Issue of Additional Shares

The Companies Act gives shareholders the right to subscribe for new shares in proportion to their existing shareholdings unless otherwise determined by a resolution passed by three-fourths of the shareholders present and voting at a general meeting. Under the Companies Act and our Articles, in the event of an issuance of securities, subject to the limitations set forth above, we must first offer the new shares to the holders of equity shares on a fixed record date. The offer, required to be made by notice, must include:

the right, exercisable by the shareholders of record, to renounce the shares offered in favor of any other person;

the number of shares offered; and

the period of the offer, which may not be less than 15 days from the date of the offer. If the offer is not accepted, it is deemed to have been declined.

Our board of directors is permitted to distribute equity shares not accepted by existing shareholders in the manner it deems beneficial for us in accordance with our Articles. Holders of ADSs may not be able to participate in any such offer. See Description of American Depositary Shares Share Dividends and Other Distributions .

General Meetings of Shareholders

There are two types of general meetings of shareholders: annual general meetings and extraordinary general meetings. We are required to convene our annual general meeting within six months after the end of each fiscal year. We may convene an extraordinary general meeting when necessary or at the request of a shareholder or shareholders holding on the date of the request at least 10% of our paid up capital. A general meeting is generally convened by our company secretary in accordance with a resolution of the board of directors. Written notice stating the agenda of the meeting must be given at least 21 days prior to the date set for the general meeting to the shareholders whose names are in the register at the record date. Those shareholders who are not registered at the record date do not receive notice of this meeting and are not entitled to attend or vote at this meeting.

The annual general meeting is held in Mumbai, the city in which our registered office is located. General meetings other than the annual general meeting may be held at any location if so determined by a resolution of our board of directors.

Voting Rights

A shareholder has one vote for each equity share and voting may be by a show of hands or on a poll. However, under the Indian Banking Regulation Act, on poll, a shareholder cannot exercise voting rights in excess of 10% of the total voting rights of all shareholders. Unless a poll is demanded by a shareholder, resolutions are adopted at a general meeting by a majority of the shareholders having voting rights present or represented. The quorum for a general meeting is five members personally present. Generally, resolutions may be passed by simple majority of the shareholders present and voting at any general meeting. However, resolutions such as an amendment to the organizational documents, commencement of a new line of business, an issue of additional equity shares without preemptive rights and reductions of share capital, require that the votes cast in favor of the resolution (whether by show of hands or on a poll) are not less than three times the number of votes, if any, cast against the resolution. As provided in our Articles, a shareholder may exercise his voting rights by proxy to be given in the form prescribed by us. This proxy, however, is required to be lodged with us at least 48 hours before the time of the relevant meeting. A shareholder may, by a single power of attorney, grant general power of representation covering several general meetings. A corporate shareholder is also entitled to nominate a representative to attend and vote on its behalf at all general meetings. The Companies Act provides for the passing of resolutions in relation to certain matters specified by the government of India, by means of a postal ballot. ADS holders have no voting rights with respect to the deposited shares. See Description of American Depositary Shares Voting Rights .

Annual Report

At least 21 days before an annual general meeting, we must circulate either a detailed or abridged version of our Indian GAAP audited financial accounts, together with the Directors Report and the Auditor s Report, to the shareholders along with a notice convening the annual general meeting. We are also required under the Companies Act to make available upon the request of any shareholder our complete balance sheet and profit and loss account. Under the Companies Act, we must file with the Registrar of Companies our Indian GAAP balance sheet and profit and loss account within 30 days of the conclusion of the annual general meeting and our annual return within 60 days of the conclusion of that meeting.

Register of Shareholders, Record Dates and Transfer of Shares

The equity shares are in registered form. We maintain a register of our shareholders in Mumbai. We register transfers of equity shares on the register of shareholders upon presentation of certificates in respect of the transfer of equity shares held in physical form together with a transfer deed duly executed by the transferor and transferee. These transfer deeds are subject to stamp duty, which has been fixed at 0.25% of the transfer price.

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For the purpose of determining equity shares entitled to annual dividends, the register of shareholders is closed for a period prior to the annual general meeting. The Companies Act and our listing agreements with the stock exchanges permit us, pursuant to a resolution of our board of directors and upon at least 7 days advance notice to the stock exchanges, to set the record date and close the register of shareholders after seven days public notice for not more than 30 days at a time, and for not more than 45 days in a year, in order for us to determine which shareholders are entitled to certain rights pertaining to the equity shares. Trading of equity shares and delivery of certificates in respect of the equity shares may, however, continue after the register of shareholders is closed.

Transfer of Shares

Shares held through depositories are transferred in the form of book entries or in electronic form in accordance with the regulations laid down by the Securities Exchange Board of India (SEBI). These regulations provide the regime for the functioning of the depositories and the participants and set out the manner in which the records are to be kept and maintained and the safeguards to be followed in this system. Transfers of beneficial ownership of shares held through a depositary are exempt from stamp duty.

SEBI requires that our equity shares for trading and settlement purposes be in book-entry form for all investors, except for transactions that are not made on a stock exchange and transactions that are not required to be reported to the stock exchange. Transfers of equity shares in book-entry form require both the seller and the purchaser of the equity shares to establish accounts with depositary participants appointed by depositories established under the Depositaries Act, 1996. Charges for opening an account with a depositary participant, transaction charges for each trade and custodian charges for securities held in each account vary depending upon the practice of each depositary participant. Upon delivery, the equity shares shall be registered in the name of the relevant depositary on our books and this depositary shall enter the name of the investor in its records as the beneficial owner. The transfer of beneficial ownership shall be effected through the records of the depositary. The beneficial owner shall be entitled to all rights and benefits and subject to all liabilities in respect of his securities held by a depositary.

The requirement to hold the equity shares in book-entry form will apply to the ADS holders when the equity shares are withdrawn from the depositary facility upon surrender of the ADSs. In order to trade the equity shares in the Indian market, the withdrawing ADS holder will be required to comply with the procedures described above.

Our equity shares are freely transferable, subject only to the provisions of the Companies Act under which, if a transfer of equity shares contravenes the Securities and Exchange Board of India Act, 1992 or the regulations issued under it or the Sick Industrial Companies (Special Provisions) Act, 1985, or any other similar law, the Indian Company Law Board may, on application made by us, a depositary incorporated in India, an investor, SEBI or certain other parties, direct a rectification of the register of records. It is a condition of our listing that we transfer equity shares and deliver share certificates duly endorsed for the transfer within one month of the date of lodgment of transfer. If a company without sufficient cause refuses to register a transfer of equity shares within two months from the date on which the instrument of transfer is delivered to the company, the transferee may appeal to the Indian Company Law Board seeking to register the transfer of equity shares. The Indian Company Law Board may, in its discretion, issue an interim order suspending the voting rights attached to the relevant equity shares before completing its investigation of the alleged contravention. Our Articles provide for certain restrictions on the transfer of equity shares, including granting power to the board of directors in certain circumstances, to refuse to register or acknowledge transfer of equity shares or other securities issued by us. Furthermore, the RBI requires us to obtain its approval before registering a transfer of equity shares in favor of a person which together with equity shares already held by him represent more than 5.0% of our share capital.

Our transfer agent, Datamatics Financial Services Limited, is located in Mumbai. Certain foreign exchange control and security regulations apply to the transfer of equity shares by a non-resident or a foreigner. See Restrictions on Foreign Ownership of Indian Securities .

Disclosure of Ownership Interest

The provisions of the Companies Act generally require beneficial owners of equity shares of Indian companies that are not holders of record to declare to the company details of the holder of record and holders of record to declare details of the beneficial owner. While it is unclear whether these provisions apply to holders of an Indian company s ADSs, investors who exchange ADSs for equity shares are subject to this provision. Failure to comply with these provisions would not affect the obligation of a company to register a transfer of equity shares or to pay any dividends to the registered holder of any equity shares in respect of which this declaration has not been made, but any person who fails to make the required declaration may be liable for a fine of up to Rs. 1,000 for each day this failure continues. However, under the Indian Banking Regulation Act, a registered holder of any equity shares, except in certain conditions, shall not be liable to any suit or proceeding on the ground that the title to those equity shares vests in another person.

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Acquisition by the Issuer of Its Own Shares

Until recently, the Companies Act did not permit a company to acquire its own equity shares because of the resulting reduction in the company s capital. However, the government of India amended the Companies Act and consequently this reduction in capital is permitted in certain circumstances. The reduction of capital requires compliance with buy-back provisions specified in the Companies Act and by SEBI.

ADS holders will be eligible to participate in a buy-back in certain cases. An ADS holder may acquire equity shares by withdrawing them from the depositary facility and then sell those equity shares back to us. ADS holders should note that equity shares withdrawn from the depositary facility may only be redeposited into the depositary facility under certain circumstances. See Description of American Depositary Shares Deposit, Withdrawal and Cancellation.

There can be no assurance that the equity shares offered by an ADS investor in any buy-back of shares by us will be accepted by us. The position regarding regulatory approvals required for ADS holders to participate in a buy-back is not clear. ADS investors are advised to consult their Indian legal advisers prior to participating in any buy-back by us, including in relation to any regulatory approvals and tax issues relating to the buy-back.

Liquidation Rights

Subject to the rights of depositors, creditors and employees, in the event of our winding up, the holders of the equity shares are entitled to be repaid the amounts of capital paid up or credited as paid up on these equity shares. All surplus assets remaining belong to the holders of the equity shares in proportion to the amount paid up or credited as paid up on these equity shares, respectively, at the commencement of the winding up.

Acquisition of the Undertaking by the Government

Under the Indian Banking Regulation Act, the government may, after consultation with the RBI, in the interest of our depositors or banking policy or better provision of credit generally or to a particular community or area, acquire our banking business. The RBI may acquire our business if it is satisfied that we have failed to comply with the directions given to us by the RBI or that our business is being managed in a manner detrimental to the interest of our depositors. Similarly, the Government of India may also acquire our business based on a report by the RBI.

Takeover Code and Listing Agreements

Under the Securities and Exchange Board of India (Substantial Acquisitions of Shares & Takeovers) Regulations, 2011 (the Takeover Code as amended), upon the acquisition of shares which taken together with the shares/voting rights already held aggregates 5% or more of the outstanding shares or voting rights of a publicly listed Indian company, a purchaser is required to notify the company and all the stock exchanges on which the shares of such company are listed. Such notification is also required when a person holds 5% or more of the outstanding shares or voting rights in a target company and there is a change in his holding either due to purchase or disposal of shares of 2% or more of the outstanding shares/voting rights in the target company.

No acquisition of shares/voting rights by an acquirer in a target company which entitles the acquirer to 25% or more of such shares or voting rights is permissible unless the acquirer makes a public announcement of an open offer for acquiring the shares of the target company in the manner provided in the Takeover Code. The public announcement of an open offer is also mandatory where an acquirer who holds 25% of the shares/voting rights in the target company seeks to acquire an additional 5% or more of the shares/voting rights in the target company during any fiscal year. However, the Takeover Code applies only to shares or securities convertible into shares which carry a voting right. This provision will apply to an ADS holder only once he or she converts the ADSs into the underlying equity shares.

We have entered into listing agreements with each of the Indian stock exchanges on which our equity shares are listed. Each of the listing agreements provides that the acquirer or holder of shares/voting rights in a target company shall in terms of the Continual Disclosure requirements disclose to the target company and the stock exchanges the details of holdings of equity shares/voting rights if such holding of shares/voting rights is 25% or more of the outstanding shares/aggregate voting rights as at 31^{st} March every year. The promoter of every target company shall disclose the detail of holding of equity shares/voting rights in a target company as at 31^{st} March every year. The promoter of every company must also disclose details of shares encumbered by him in a target company as well as details of invocation of encumbered shares or any release of such encumbrance.

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DESCRIPTION OF AMERICAN DEPOSITARY SHARES

American Depositary Shares

JPMorgan Chase Bank, N.A., as depositary, issued the American Depositary Shares, or ADSs. Each ADS represents an ownership interest in three equity shares, which we have deposited with the custodian, as agent of the depositary, under the deposit agreement among ourselves, the depositary and each ADR holder. In the future, each ADS will also represent any securities, cash or other property deposited with the depositary but which it has not distributed directly to an ADR holder. The ADSs are evidenced by what is known as American Depositary Receipts or ADRs. The shareholders of the Bank at the 17th Annual General Meeting held on July 6, 2011 approved the sub division of one (1) equity share of the Bank having a nominal value of Rs. 10.0 each into five (5) equity shares with a nominal value of Rs. 2.0 each. As a result of the same, the Bank issued additional proportionate ADSs and each ADSs represents three (3) underlying equity shares of the Bank.

The depositary s office is located at 1 Chase Manhattan Plaza, Floor 58, New York, NY 10005.

Investors may hold ADSs either directly or indirectly through their broker or other financial institution. If an investor holds ADSs directly, by having an ADS registered in his name on the books of the depositary, he is an ADR holder. This description assumes that the investor holds his ADSs directly. If an investor holds the ADSs through his broker or financial institution nominee, he must rely on the procedures of such broker or financial institution to assert the rights of an ADR holder described in this section. Investors should consult with their broker or financial institution to find out what these procedures are.

Because the depositary s nominee will actually be the registered owner of the shares, investors must rely on it to exercise the rights of a shareholder on their behalf. The obligations of the depositary and its agents are set out in the deposit agreement. The deposit agreement and the ADSs are governed by New York law.

The following is a summary of the material terms of the deposit agreement. Because it is a summary, it does not contain all the information that may be important to investors. For more complete information, investors should read the entire deposit agreement and the form of ADR which contains the terms of the ADSs. Investors can read a copy of the deposit agreement which was filed as an exhibit to the registration statement on Form F-1 we filed on July 12, 2001. Investors may also obtain a copy of the deposit agreement at the Securities and Exchange Commission Office, Public Reference Room, which is located at 100 F Street, N.E., Washington, D.C. 20549. Investors may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330.

Share Dividends and Other Distributions

We may make various types of distributions with respect to our securities. The depositary has agreed to pay to the investor the cash dividends or other distributions it or the custodian receives on shares or other deposited securities, after deducting its expenses. The investor will receive these distributions in proportion to the number of underlying shares that the investor s ADSs represent. To the extent the depositary is legally permitted, the depositary will deliver such distributions to ADR holders in proportion to their interests in the following manner:

Cash

The depositary will distribute any U.S. dollars available to it resulting from a cash dividend or other cash distribution if this is practicable and can be done in a reasonable manner. The depositary will attempt to distribute this cash in a practicable manner, and may deduct any taxes required to be withheld, any expenses of converting foreign currency and transferring funds to the United States and other expenses and adjustments. If exchange rates fluctuate during a time when the depositary cannot convert a foreign currency, investors may lose some or all of the value of the distribution.

Shares

In the case of a distribution in shares, the depositary will issue additional ADRs to evidence the number of ADSs representing such shares. Only whole ADSs will be issued. The depositary will sell any shares which would result in fractional ADSs and distribute the net proceeds to the ADR holders entitled to them.

Rights to Receive Additional Shares

In the case of a distribution of rights to subscribe for additional shares or other rights, if we provide satisfactory evidence that the depositary may lawfully distribute the rights, the depositary may arrange for ADR holders to instruct the depositary as to the exercise of the rights. However, if we do not furnish that evidence or if the depositary determines it is not practical to distribute the rights, the depositary may:

- sell the rights, if practicable, and distribute the net proceeds as cash, or

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- allow the rights to lapse, in which case ADR holders will receive nothing.

We have no obligation to file a registration statement under the Securities Act in order to make any rights available to ADR holders.

Other Distributions

In the case of a distribution of securities or property other than those described above, the depositary may either:

- distribute such securities or property in any manner it deems equitable and practicable,
- to the extent the depositary deems distribution of such securities or property not to be equitable and practicable, sell such securities or property and distribute any net proceeds in the same way it distributes cash, or
- hold the distributed property, in which case the ADSs will also represent the distributed property.

Any U.S. dollars will be distributed by checks drawn on a bank in the United States for whole dollars and cents (fractional cents will be withheld without liability for interest and added to future cash distributions).

The depositary may choose any practical method of distribution for any specific ADR holder, including the distribution of foreign currency, securities or property, or it may retain those items, without paying interest on or investing them, on behalf of the ADR holder as deposited securities.

Total loans	$1,108	$165,660	100.00%	$854	$178,584	100.00%	$747	$174,038	100.00%

	2008			2007		
	Allowance for Loan Losses	**Loan Balances by Category**	**Loans in Each Category to Total Loans**	**Allowance for Loan Losses**	**Loan Balances by Category**	**Loans in Each Category to Total Loans**
	(Dollars in thousands)					
Real estate loans:						
One- to four-family	$ 199	80,454	48.34%	214	$ 84,925	51.59%
Multi-family	9	3,722	2.24	8	3,272	1.99
Commercial real estate	196	59,655	35.85	142	56,609	34.39
Construction	8	3,263	1.96	18	6,701	4.08
Total real estate loans	412	147,094	88.39	382	151,507	92.05
Commercial loans	17	6,592	3.96	3	1,414	0.86
Consumer loans:						
Home equity loans and lines of credit	20	7,321	4.40	12	5,539	3.37
Other consumer loans	13	5,411	3.25	15	6,141	3.73
Total consumer loans	33	12,732	7.65	27	11,680	7.10
Unallocated	10			18		
Total loans	$ 472	166,418	100.00%	430	$ 164,601	100.00%

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At December 31, 2011, our allowance for loan losses represented 0.67% of total loans. The allowance for loan losses increased to $1.1 million at December 31, 2011 from $854,000 at December 31, 2011, primarily due to the provision for loan losses of $407,000 less net charge-offs of $153,000.

Although we believe that we use the best information available to establish the allowance for loan losses, future adjustments to the allowance for loan losses may be necessary and results of operations could be adversely affected if circumstances differ substantially from the assumptions used in making the determinations. Furthermore, while we believe we have established our allowance for loan losses in conformity with accounting principles generally accepted in the United States of America, regulators, in reviewing our loan portfolio, may request us to increase our allowance for loan losses. In addition, because future events affecting borrowers and collateral cannot be predicted with certainty, the existing allowance for loan losses may not be adequate and increases may be necessary should the quality of any loan deteriorate as a result of the factors discussed above. Any material increase in the allowance for loan losses may adversely affect our financial condition and results of operations.

Investment Activities

General. The goals of our investment policy are to provide and maintain liquidity to meet deposit withdrawal and loan funding needs, to help mitigate our interest rate risk, and to generate a favorable return on idle funds within the context of our interest rate and credit risk objectives.

Our board of directors is responsible for adopting our investment policy. The investment policy is reviewed annually by management and any changes to the policy are recommended to and subject to the approval of the board of directors. Authority to make investments under the approved investment policy guidelines is delegated to our President and Chief Executive Officer and our Chief Financial Officer (all investment decisions require the approval of both investment officers). All investment transactions are reviewed at regularly scheduled quarterly meetings of the board of directors.

Our current investment policy permits investments in securities issued by the United States Government and its agencies or government sponsored enterprises. We also invest in mortgage-backed securities and, to a lesser extent, mutual funds that invest in mortgage-backed securities. Our investment policy also permits, with certain limitations, investments in bank-owned life insurance, collateralized mortgage obligations, asset-backed securities, real estate mortgage investment conduits, Alabama revenue bonds and municipal securities. While equity investments are generally not authorized by our investment policy, such investments are permitted on a case-by-case basis provided such investments are pre-authorized by action of our board of directors.

At December 31, 2011, we did not have an investment in the securities of any single non-government issuer that exceeded 10% of equity at that date.

Our current investment policy does not permit investment in stripped mortgage-backed securities, complex securities and derivatives as defined in federal banking regulations and other high-risk securities. As of December 31, 2011, we held no asset-backed securities other than mortgage-backed securities. Our current policies do not permit hedging activities, such as engaging in futures, options or swap transactions, or investing in high-risk mortgage derivatives, such as collateralized mortgage obligation residual interests, real estate mortgage investment conduit residual interests or stripped mortgage backed securities.

At December 31, 2011, none of the collateral underlying our securities portfolio was considered subprime or Alt-A, and we did not hold any common or preferred stock issued by Freddie Mac or Fannie Mae as of that date. However, in September 2008, the Federal Housing Finance Agency placed Freddie Mac and Fannie Mae into conservatorship. The U.S. Treasury Department has established financing agreements to ensure that Freddie Mac and Fannie Mae meet their obligations to holders of mortgage-backed securities that they have issued or guaranteed. These actions have not affected the markets for mortgage-backed securities issued by Freddie Mac or Fannie Mae. Accounting guidance requires that, at the time of purchase, we designate a security as either held to maturity, available-for-sale, or trading, based upon our ability and intent. Securities available-for-sale and trading securities are reported at fair value and securities held to maturity are reported at amortized cost. A periodic review and evaluation of our available-for-sale and held-to-maturity securities portfolios is conducted to determine if the fair value of any security has declined below its carrying value and whether such decline is other-than-temporary. If such decline is deemed to be other-than-temporary, the security is written down to a new cost basis and the resulting loss is charged against earnings. The fair values of our securities are based on published or securities dealers market values. At December 31, 2011, all of our securities were classified as available-for-sale.

U.S. Government Sponsored Agencies. At December 31, 2011, our U.S. Government sponsored agencies securities portfolio totaled $20.0 million, all of which was classified as available-for-sale. While these securities generally provide lower yields than other investments in our securities investment portfolio, we maintain these investments, to the extent appropriate, for liquidity purposes, as collateral for borrowings and for prepayment protection.

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Mortgage-Backed Securities. At December 31, 2011, our mortgage-backed securities portfolio totaled $2.7 million, all of which was classified as available-for-sale. Mortgage-backed securities are securities issued in the secondary market that are collateralized by pools of mortgages. Certain types of mortgage-backed securities are commonly referred to as pass-through certificates because the principal and interest of the underlying loans is passed through to investors, net of certain costs, including servicing and guarantee fees. Mortgage-backed securities typically are collateralized by pools of one- to four-family or multi-family mortgages, although we invest primarily in mortgage-backed securities backed by one-to-four family mortgages. The issuers of such securities pool and resell the participation interests in the form of securities to investors such as Cullman Savings Bank. The interest rate of the security is lower than the interest rates of the underlying loans to allow for payment of servicing and guaranty fees. Ginnie Mae, a United States Government agency, and government sponsored enterprises, such as Fannie Mae and Freddie Mac, either guarantee the payments or guarantee the timely payment of principal and interest to investors. Mortgage-backed securities are more liquid than individual mortgage loans since there is an active trading market for such securities. In addition, mortgage-backed securities may be used to collateralize our borrowings.

Investments in mortgage-backed securities involve a risk that actual payments will be greater or less than the prepayment rate estimated at the time of purchase, which may require adjustments to the amortization of any premium or accretion of any discount relating to such interests, thereby affecting the net yield on our securities. Current prepayment speeds determine whether prepayment estimates require modification that could cause amortization or accretion adjustments.

All of our mortgage-backed securities are issued by government-sponsored entities, except one, which had a fair value of approximately $631,000 at December 31, 2011. This security, issued by Wells Fargo, is AAA rated and is associated with the highest quality tranche of loans in the pool. Loans in this pool are all fully amortizing adjustable-rate mortgages secured by one-to-four family owner-occupied homes. Privately-issued mortgage-backed securities such as the security issued by Wells Fargo are subject to certain credit-related risks normally not associated with mortgage-backed securities that are issued by government-sponsored entities. However, management believes the higher yield available from the privately-issued mortgage-backed security offset the credit-related risk.

Mutual Funds. At December 31, 2011, our mutual fund portfolio totaled $1.5 million, all of which was classified as available-for-sale and all of which was invested in the AMF Ultra Short Mortgage Fund, a fund that invests primarily in mortgage-related securities.

Restricted Equity Securities. We invest in the common stock of the Federal Home Loan Bank of Atlanta, which is carried at cost and classified as restricted equity securities. We periodically evaluate the shares of common stock for impairment.

Bank-Owned Life Insurance. We invest in bank-owned life insurance to provide us with a funding source for our benefit plan obligations. Bank-owned life insurance also generally provides us non-interest income that is non-taxable. Federal regulations generally limit our investment in bank-owned life insurance to 25% of our Tier 1 capital plus our allowance for loan losses. At December 31, 2011, we had invested $2.5 million in bank-owned life insurance.

Securities Portfolio Composition. The following table sets forth the composition of our securities portfolio at the dates indicated.

	At December 31,					
	2011		2010		2009	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(Dollars in thousands)					
Securities available for sale:						
U.S. Government sponsored agencies	$ 19,989	19,993	13,997	13,532	9,745	9,710
Mutual fund	1,414	1,484	1,414	1,496	2,126	2,211
Municipal-taxable	5,146	5,473	5,154	5,055	506	484
Residential mortgage-backed, GSE	2,032	2,125	2,959	3,051	4,068	4,194
Residential mortgage-backed, private	623	631	961	983	1,531	1,481
Total	$ 29,204	29,706	24,485	24,117	17,976	18,080

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Securities Portfolio Maturities and Yields. The following table sets forth the contractual maturities and weighted average yields of our securities portfolio at December 31, 2011. Mortgage-backed securities are anticipated to be repaid in advance of their contractual maturities as a result of projected mortgage loan prepayments. The mutual fund does not have an actual maturity and can be redeemed by the Company at any time.

	One Year or Less		More than One Year to Five Years		More than Five Years to Ten Years	
	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield
	(Dollars in thousands)					
Securities available-for-sale:						
U.S. Government sponsored agencies	$	%	$	%	$ 9,999	2.70%
Mutual fund						
Municipal-taxable					504	4.89
Residential mortgage-backed -GSE			163	3.75	449	5.15
Residential mortgage-backed -private label						
Total	$	%	$ 163	3.75%	$ 10,952	2.90%

	More than Ten Years		Total	
	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield
	(Dollars in thousands)			
Securities available-for-sale:				
U.S. Government sponsored agencies	$ 9,991	2.76%	$ 19,989	2.73%
Mutual fund	1,414		1,414	
Municipal-taxable	4,642	5.53	5,146	5.47
Residential mortgage-backed -GSE	1,420	1.99	2,032	2.83
Residential mortgage-backed -private label	623	4.69	623	4.69
Total	$ 18,090	3.26%	$ 29,204	3.13%

Sources of Funds

General. Deposits have traditionally been our primary source of funds for use in lending and investment activities. We also use borrowings, primarily Federal Home Loan Bank of Atlanta advances, to supplement cash flow needs, lengthen the maturities of liabilities for interest rate risk purposes and to manage the cost of funds. In addition, we receive funds from scheduled loan payments, investment maturities, loan prepayments, retained earnings and income on earning assets. While scheduled loan payments and income on earning assets are relatively stable sources of funds, deposit inflows and outflows can vary widely and are influenced by prevailing interest rates, market conditions and levels of competition.

Deposits. Our deposits are generated primarily from residents within our primary market area. We offer a selection of deposit accounts, including demand accounts, NOW accounts, money market accounts, savings accounts and certificates of deposit. Deposit account terms vary, with the principal differences being the minimum balance required, the amount of time the funds must remain on deposit and the interest rate. We have not accepted brokered deposits in the past, although we have the authority to do so.

Interest rates, maturity terms, service fees and withdrawal penalties are established on a periodic basis. Deposit rates and terms are based primarily on current operating strategies and market rates, liquidity requirements, rates paid by competitors and growth goals. Personalized customer service, long-standing relationships with customers, and the favorable image of Cullman Savings Bank in the community are relied upon to attract and retain deposits.

The flow of deposits is influenced significantly by general economic conditions, changes in interest rates and competition. Our ability to gather deposits is impacted by the competitive market in which we operate which includes numerous financial institutions of varying sizes offering a wide range of products. We often use promotional rates to meet asset/liability and market segment goals.

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The variety of deposit accounts offered allows us to be competitive in obtaining funds and responding to changes in consumer demand. Based on our experience, we believe that statement savings, demand and NOW accounts may be somewhat more stable sources of deposits than certificates of deposits. However, it can be difficult to attract and maintain such deposits at favorable interest rates under current market conditions.

The following table sets forth the distribution of total deposits by account type, at the dates indicated.

	At December 31,								
	2011			2010			2009		
	Balance	Percent	Weighted Average Rate	Balance	Percent	Weighted Average Rate	Balance	Percent	Weighted Average Rate
	(Dollars in thousands)								
NOW and demand deposits	$ 37,423	27.09%	0.14%	$ 30,950	22.69%	0.43%	$ 30,289	24.21%	0.80%
Money market deposits	7,524	5.45	0.24	8,448	6.19	0.72	8,853	7.08	1.59
Regular savings and other deposits	16,620	12.03	0.24	17,099	12.54	0.65	13,296	10.62	1.17
Total transaction accounts	61,567	44.57	0.16	56,497	41.42	0.53	52,438	41.91	1.01
Certificates of deposit	76,580	55.43	1.41	79,902	58.58	1.94	72,681	58.09	3.19
Total deposits	$ 138,147	100.00%	0.82%	$ 136,399	100%	1.33%	$ 125,119	100%	2.28%

The following table sets forth our deposit activities for the years indicated.

	Years Ended December 31,	
	2011	2010
	(Dollars in thousands)	
Beginning balance	$ 136,399	$ 125,119
Net deposits (withdrawals) before interest credited	194	9,223
Interest credited	1,554	2,057
Net increase (decrease) in deposits	1,748	11,280
Ending balance	$ 138,147	$ 136,399

As of December 31, 2011, the aggregate amount of our outstanding certificates of deposit in amounts greater than or equal to $100,000 was approximately $41.5 million. The following table sets forth the maturity of these certificates as of December 31, 2011:

	At December 31, 2011 (Dollars in thousands)
Three months or less	$ 6,977
Over three through six months	4,806
Over six through twelve months	13,594
Over twelve months	16,091

Total	$	41,468

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The following table sets forth our time deposits classified by interest rate as of the dates indicated.

	At December 31, 2011	2010
	(Dollars in thousands)	
INTEREST RATE:		
Less than 1.00%	$ 26,640	$ 14,088
1.00% - 1.99%	43,856	46,348
2.00% - 2.99%	2,855	11,278
3.00% - 3.99%	414	1,929
4.00% - 4.99%	1,064	2,484
5.00% - 5.99%	1,751	3,775
Total	$ 76,580	$ 79,902

The following table sets forth the amount and maturities of our time deposits at December 31, 2011.

	Less Than One Year	Over One to Two Years	Over Two to Three Years	Over Three Years	Total	Percentage of Total Certificate of Deposit Accounts
			(Dollars in thousands)			
INTEREST RATE:						
Less than 2%	$ 43,943	$ 18,615	$ 510	$ 7,428	70,496	92.06%
2.00% - 2.99%	754	436	910	755	2,855	3.73
3.00% - 3.99%	14	400			414	0.54
4.00% - 4.99%	697	367			1,064	1.39
5.00% - 5.99%	1,751				1,751	2.29
Total	$ 47,159	$ 19,818	$ 1,420	$ 8,183	76,580	100.00%

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Borrowings

We may obtain advances from the Federal Home Loan Bank of Atlanta upon the security of our capital stock in the Federal Home Loan Bank of Atlanta and certain of our mortgage loans and mortgage-backed securities. Such advances may be made pursuant to several different credit programs, each of which has its own interest rate and range of maturities. To the extent such borrowings have different terms of repricing than our deposits, they can change our interest rate risk profile.

From time to time during recent years, we have utilized short-term borrowings to fund loan demand. To a limited extent, we have also used borrowings where market conditions permit to purchase securities of a similar duration in order to increase our net interest income by the amount of the spread between the asset yield and the borrowing cost. Finally, from time to time, we have obtained advances with terms of three years or more to extend the term of our liabilities.

Our borrowings currently consist primarily of advances from the Federal Home Loan Bank of Atlanta. At December 31, 2011, we had access to additional Federal Home Loan Bank advances of up to $51.0 million. The following table sets forth information concerning balances and interest rates on our Federal Home Loan Bank advances with terms of one year or less at the dates and for the periods indicated.

	Year Ended December 31,		
	2011	2010	2009
	(Dollars in thousands)		
Balance outstanding at end of period:			
FHLB advances	$ 42,000	$ 47,000	$ 51,107
Other borrowings	787	816	833
Average balance during the period:			
FHLB advances	$ 46,096	$ 46,809	$ 51,464
Other borrowings	802	825	847
Weighted average interest rate at end of period:			
FHLB advances	3.48%	3.61%	4.01%
Other borrowings	0.84	0.91	1.23
Weighted average interest rate during the period:			
FHLB advances	3.52%	4.25%	4.37%
Other borrowings	0.88	0.93	1.3

Subsidiary and Other Activities

Apart from Cullman Savings Bank, we have no subsidiaries. At December 31, 2011, we had a 99% limited partnership interest in Cullman Village Apartments of $596,000, which was acquired as an investment tax credit. The assets and liabilities of Cullman Village Apartments are consolidated into our financial statements.

Expense and Tax Allocation

Cullman Savings Bank has an agreement with Cullman Bancorp, Inc. and Cullman Savings Bank, MHC to provide them with certain administrative support services for compensation not less than the fair market value of the services provided. In addition, Cullman Savings Bank and Cullman Bancorp, Inc. have an agreement for allocating and for reimbursing the payment of their consolidated tax liability. During the year ended December 31, 2011, there were no expenses that were allocated between Cullman Savings Bank and Cullman Bancorp, Inc. and Cullman Savings Bank, MHC.

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Personnel

As of December 31, 2011, we had 36 full-time employees and four part-time employees. Our employees are not represented by any collective bargaining group. Management believes that we have good relations with our employees.

FEDERAL, STATE AND LOCAL TAXATION

Federal Taxation

General. Cullman Bancorp, Inc. and Cullman Savings Bank are subject to federal income taxation in the same general manner as other corporations, with some exceptions discussed below. Cullman Savings Bank s tax returns have not been audited during the past five years. The following discussion of federal taxation is intended only to summarize certain pertinent federal income tax matters and is not a comprehensive description of the tax rules applicable to Cullman Bancorp, Inc. or Cullman Savings Bank.

Method of Accounting. For federal income tax purposes, Cullman Savings Bank currently reports its income and expenses on the accrual method of accounting and uses a tax year ending December 31 for filing its federal income tax returns.

Bad Debt Reserves. Cullman Savings Bank is permitted to establish a reserve for bad debts and to make annual additions to the reserve. These additions, within specified formula limits, are deducted in arriving at our taxable income. Should Cullman Savings Bank s total assets exceed $500 million, it will be required to use the specific charge off method in computing its bad debt deduction.

Taxable Distributions and Recapture. Prior to the 1996 Act, federal tax bad debt reserves created prior to January 1, 1988 were subject to recapture into taxable income if the thrift institution failed to meet certain thrift asset and definitional tests. Federal legislation has eliminated these thrift-related recapture rules.

At December 31, 2011, our total federal and Alabama pre-1988 base year tax bad debt reserve was approximately $1.2 million. Under current law, pre-1988 federal base year reserves remain subject to recapture if a thrift institution makes certain non-dividend distributions, repurchases any of its stock, pays dividends in excess of tax earnings and profits, or ceases to maintain a thrift or bank charter.

Alternative Minimum Tax. The Internal Revenue Code of 1986, as amended imposes an alternative minimum tax (AMT) at a rate of 20% on a base of regular taxable income plus certain tax preferences (alternative minimum taxable income or AMTI). The AMT is payable to the extent such AMTI is in excess of an exemption amount and the AMT exceeds the regular income tax. Net operating losses can offset no more than 90% of AMTI. Certain payments of AMT may be used as credits against regular tax liabilities in future years. Cullman Savings Bank has not been subject to the AMT and has no such amounts available as credits for carryover.

Net Operating Loss Carryovers. A financial institution generally may carry back net operating losses to the preceding two taxable years and forward to the succeeding 20 taxable years, although legislation passed during 2011 allows a limited carry back of five years. At December 31, 2011, Cullman Savings Bank had no net operating loss carry forwards for federal and state income tax purposes.

Corporate Dividends-Received Deduction. Cullman Bancorp, Inc. may exclude from its income 100% of dividends received from Cullman Savings Bank as a member of the same affiliated group of corporations. The corporate dividends-received deduction is 80% in the case of dividends received from corporations with which a corporate recipient does not file a consolidated return, and owns more than 20% of the stock of a corporation distributing a dividend and only 70% in the case of dividends received from less-than-20% owned corporations.

State and Local Taxation

Alabama State Taxation. Cullman Bancorp, Inc., and Cullman Savings Bank will be required to file Alabama income tax returns and pay tax at a stated tax rate of 6.5% of Alabama taxable income. For these purposes, Alabama taxable income generally means federal taxable income subject to certain modifications, primarily the exclusion of interest income on United States obligations and the deduction of federal income taxes paid.

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SUPERVISION AND REGULATION

General

Cullman Savings Bank is examined and supervised by the Office of the Comptroller of the Currency (OCC). This regulation and supervision establishes a comprehensive framework of activities in which an institution may engage and is intended primarily for the protection of the FDIC s deposit insurance fund and depositors. Under this system of federal regulation, financial institutions are periodically examined to ensure that they satisfy applicable standards with respect to their capital adequacy, assets, management, earnings, liquidity and sensitivity to market interest rates. Cullman Savings Bank also is a member of and owns stock in the Federal Home Loan Bank of Atlanta, which is one of the twelve regional banks in the Federal Home Loan Bank System. Cullman Savings Bank also is regulated, to a lesser extent, by the FDIC with respect to insurance of deposit accounts and the Board of Governors of the Federal Reserve System (the Federal Reserve Board), with respect to reserves to be maintained against deposits and other matters. Cullman Savings Bank s relationship with its depositors and borrowers also is regulated to a great extent by both federal and state laws, especially in matters concerning the ownership of deposit accounts and the form and content of Cullman Savings Bank s mortgage documents.

Any change in these laws or regulations, whether by the OCC, FDIC or Congress, could have a material adverse impact on Cullman Bancorp, Inc. and Cullman Savings Bank, and their operations.

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the Dodd-Frank Act) made extensive changes in the regulation of federal savings banks such as the Bank. Under the Dodd-Frank Act, the Office of Thrift Supervision (OTS), Cullman Savings Banks former regulator, was eliminated. Responsibility for the supervision and regulation of federal savings banks was transferred to the OCC, which is the agency that is currently primarily responsible for the regulation and supervision of national banks, on July 21, 2011. The OCC assumed responsibility for implementing and enforcing many of the laws and regulations applicable to federal savings banks on that date. At the same time, responsibility for the regulation and supervision of savings and loan holding companies, such as the Company and Cullman Savings Bank, MHC was transferred from the OTS to the Federal Reserve Board, which also supervises bank holding companies.

Additionally, the Dodd-Frank Act created a new Consumer Financial Protection Bureau as an independent bureau of the Federal Reserve Board. The Consumer Financial Protection Bureau has assumed responsibility for the implementation of the federal financial consumer protection and fair lending laws and regulations, a function currently assigned to prudential regulators, and has authority to impose new requirements. However, institutions of less than $10 billion in assets, such as the Bank, will continue to be examined for compliance with consumer protection and fair lending laws and regulations by, and be subject to the primary enforcement authority of, their prudential regulator rather than the Consumer Financial Protection Bureau.

In addition to eliminating the OTS and creating the Consumer Financial Protection Bureau, the Dodd-Frank Act, among other things, directed changes in the way that institutions are assessed for deposit insurance, mandated the imposition of consolidated capital requirements on savings and loan holding companies, requires originators of securitized loans to retain a percentage of the risk for the transferred loans, required rate-setting for certain debit card interchange fees, repealed restrictions on the payment of interest on commercial demand deposits and contained a number of reforms related to mortgage originations. Many of the provisions of the Dodd-Frank Act are subject to delayed effective dates and/or require the issuance of implementing regulations. Their impact on our operations cannot yet be fully assessed. However, there is significant possibility that the Dodd-Frank Act will, at a minimum, result in increased regulatory burden, compliance costs and interest expense for the Company.

Certain of the regulatory requirements that are or will be applicable to Cullman Savings Bank, Cullman Bancorp, Inc. and Cullman Savings Bank, MHC are described below. This description of statutes and regulations is not intended to be a complete explanation of such statutes and regulations and their effect on Cullman Savings Bank, Cullman Bancorp, Inc. and Cullman Savings Bank, MHC and is qualified in its entirety by reference to the actual statutes and regulations.

Federal Banking Regulation

Business Activities. A federal savings bank derives its lending and investment powers from the Home Owners Loan Act, as amended, and federal regulations. Under these laws and regulations, Cullman Savings Bank may originate mortgage loans secured by residential and commercial real estate, commercial business loans and consumer loans, and it may invest in certain types of debt securities and certain other assets. Certain types of lending, such as commercial and consumer loans, are

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subject to an aggregate limit calculated as a specified percentage of Cullman Savings Bank s capital assets. Cullman Savings Bank also may establish subsidiaries that may engage in activities not otherwise permissible for Cullman Savings Bank, including real estate investment and securities and insurance brokerage.

The Dodd-Frank Act removed federal statutory restrictions on the payment of interest on commercial demand deposit accounts, effective July 21, 2011.

Capital Requirements. Federal regulations require savings banks to meet three minimum capital standards: a 1.5% tangible capital ratio, a 4% leverage ratio (3% for savings banks receiving the highest regulatory rating) and an 8% risk-based capital ratio. The prompt corrective action standards discussed below, in effect, establish a minimum 2% tangible capital standard.

The risk-based capital standard for savings banks requires the maintenance of Tier 1 (core) and total capital (which is defined as core capital and supplementary capital) to risk-weighted assets of at least 4% and 8%, respectively. In determining the amount of risk-weighted assets, all assets, including certain off-balance sheet assets, are multiplied by a risk-weight factor of 0% to 100% assigned by the regulation based on the risks believed inherent in the type of asset. Core capital is defined as common stockholders equity (including retained earnings but excluding accumulated other comprehensive income), certain noncumulative perpetual preferred stock and related surplus and minority interests in equity accounts of consolidated subsidiaries, less intangibles other than certain mortgage servicing rights and credit card relationships. The components of supplementary capital currently include cumulative preferred stock, long-term perpetual preferred stock, mandatory convertible securities, subordinated debt and intermediate preferred stock, the allowance for loan and lease losses limited to a maximum of 1.25% of risk-weighted assets and up to 45% of net unrealized gains on available-for-sale equity securities with readily determinable fair market values. Overall, the amount of supplementary capital included as part of total capital cannot exceed 100% of core capital. Additionally, a savings bank that retains credit risk in connection with an asset sale may be required to maintain additional regulatory capital because of the recourse back to the savings bank. In assessing an institution s capital adequacy, the OCC takes into consideration not only these numeric factors but also qualitative factors as well, and has the authority to establish higher capital requirements for individual associations where necessary.

At December 31, 2011, Cullman Savings Bank s capital exceeded all applicable requirements.

Loans to One Borrower. Generally, a federal savings bank generally may not make a loan or extend credit to a single or related group of borrowers in excess of 15% of unimpaired capital and surplus. An additional amount may be loaned, equal to 10% of unimpaired capital and surplus, if the loan is secured by readily marketable collateral, which generally does not include real estate. As of December 31, 2011, Cullman Savings Bank s largest lending relationship with a single or related group of borrowers totaled $3.5 million, which represented 10.6% of unimpaired capital and surplus; therefore, Cullman Savings Bank was in compliance with the loans-to-one borrower limitations.

Qualified Thrift Lender Test. As a federal savings bank, Cullman Savings Bank is subject to a qualified thrift lender, or QTL, test. Under the QTL test, Cullman Savings Bank must maintain at least 65% of its portfolio assets in qualified thrift investments in at least nine months of the most recent 12-month period. Portfolio assets generally means total assets of a savings institution, less the sum of specified liquid assets up to 20% of total assets, goodwill and other intangible assets, and the value of property used in the conduct of the savings bank s business.

Qualified thrift investments includes various types of loans made for residential housing purposes, investments related to such purposes, including certain mortgage-backed and related securities, and loans for personal, family, household and certain other purposes up to a limit of 20% of portfolio assets. Qualified thrift investments also include 100% of an institution s credit card loans, education loans and small business loans. Cullman Savings Bank also may satisfy the QTL test by qualifying as a domestic building and loan association as defined in the Internal Revenue Code.

A savings bank that fails the qualified thrift lender test must either convert to a commercial bank charter or operate under specified restrictions. The Dodd-Frank Act made noncompliance with the QTL Test potentially subject to agency enforcement action for violation of law. At December 31, 2011, Cullman Savings Bank maintained approximately 74.5% of its portfolio assets in qualified thrift investments and, therefore, satisfied the QTL test.

Capital Distributions. Federal regulations govern capital distributions by a federal savings bank, which include cash dividends, stock repurchases and other transactions charged to the capital account. A savings bank must file an application with the OCC for approval of a capital distribution if:

the total capital distributions for the applicable calendar year exceed the sum of the savings bank s net income for that year to date plus the savings bank s retained net income for the preceding two years;

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the savings bank would not be at least adequately capitalized following the distribution;

the distribution would violate any applicable statute, regulation, agreement or regulatory condition; or

the savings bank is not eligible for expedited treatment of its filings.

Even if an application is not otherwise required, every savings bank that is a subsidiary of a holding company must still file a notice with the Federal Reserve Board at least 30 days before the board of directors declares a dividend or approves a capital distribution.

The Federal Reserve Board may disapprove a notice or application if:

the savings bank would be undercapitalized following the distribution;

the proposed capital distribution raises safety and soundness concerns; or

the capital distribution would violate a prohibition contained in any statute, regulation or agreement.

In addition, the Federal Deposit Insurance Act provides that an insured depository institution shall not make any capital distribution if, after making such distribution, the institution would be undercapitalized.

Liquidity. A federal savings institution is required to maintain a sufficient amount of liquid assets to ensure its safe and sound operation. We seek to maintain a ratio of liquid assets not subject to pledge as a percentage of deposits and borrowings of 10% or greater. At December 31, 2011, this ratio was 21.2%.

Community Reinvestment Act and Fair Lending Laws. All savings banks have a responsibility under the Community Reinvestment Act and related regulations of the OCC to help meet the credit needs of their communities, including low- and moderate-income borrowers. In connection with its examination of a federal savings bank, the OCC is required to assess the savings bank s record of compliance with the Community Reinvestment Act. In addition, the Equal Credit Opportunity Act and the Fair Housing Act prohibit lenders from discriminating in their lending practices on the basis of characteristics specified in those statutes. A savings bank s failure to comply with the provisions of the Community Reinvestment Act could result in denial of certain corporate applications, such as branches or mergers, or in restrictions on its activities. The failure to comply with the Equal Credit Opportunity Act and the Fair Housing Act could result in enforcement actions by the OCC, as well as other federal regulatory agencies and the Department of Justice. Cullman Savings Bank received a satisfactory Community Reinvestment Act rating in its most recent federal examination.

Transactions with Related Parties. A federal savings bank s authority to engage in transactions with its affiliates is limited by federal regulations and by Sections 23A and 23B of the Federal Reserve Act and its implementing Regulation W promulgated by the Board of Governors of the Federal Reserve System. The term affiliate for these purposes generally means any company that controls or is under common control with an insured depository institution such as Cullman Savings Bank. Cullman Bancorp, Inc. is an affiliate of Cullman Savings Bank. In general, transactions with affiliates must be on terms that are as favorable to the savings bank as comparable transactions with non-affiliates. In addition, certain types of these transactions are restricted to an aggregate percentage of the savings bank s capital. Collateral in specified amounts must usually be provided by affiliates in order to receive loans from the savings bank. In addition, federal regulations prohibit a savings bank from lending to any of its affiliates that are engaged in activities that are not permissible for bank holding companies and from purchasing the securities of any affiliate, other than a subsidiary. Finally, transactions with affiliates must be consistent with safe and sound banking practices and may not involve low-quality assets. The OCC requires savings banks to maintain detailed records of all transactions with affiliates.

Cullman Savings Bank s authority to extend credit to its directors, executive officers and 10% shareholders, as well as to entities controlled by such persons, is currently governed by the requirements of Sections 22(g) and 22(h) of the Federal Reserve Act and Regulation O of the Federal Reserve Board. Among other things, these provisions require that extensions of credit to insiders (i) be made on terms that are substantially the same as, and follow credit underwriting procedures that are not less stringent than, those prevailing for comparable transactions with unaffiliated persons and that do not involve more than the normal risk of repayment or present other unfavorable features, and (ii) not exceed certain limitations on the amount of credit extended to such persons, individually and in the aggregate, which limits are based, in part, on the amount of

Cullman Savings Bank s capital. In addition, Cullman Savings Bank s board of directors must approve extensions of credit in excess of certain limits.

Cullman Savings Bank is in compliance with Regulation O.

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Enforcement. The OCC has primary enforcement responsibility over federal savings institutions and has the authority to bring enforcement action against all institution-affiliated parties, including stockholders, and attorneys, appraisers and accountants who knowingly or recklessly participate in wrongful action likely to have an adverse effect on an insured institution. Formal enforcement action may range from the issuance of a capital directive or cease and desist order to removal of officers and/or directors of the institution, receivership, conservatorship or the termination of deposit insurance. Civil penalties cover a wide range of violations and actions, and range up to $25,000 per day, unless a finding of reckless disregard is made, in which case penalties may be as high as $1.0 million per day. The FDIC also has the authority to recommend to the OCC that enforcement action be taken with respect to a particular savings institution. If the OCC does not take action, the FDIC has authority to take action under specified circumstances.

The OCC assumed the OTS enforcement authority over federal savings associations as part of the Dodd-Frank Act regulatory restructuring.

Standards for Safety and Soundness. Federal law requires each federal banking agency to prescribe certain standards for all insured depository institutions. These standards relate to, among other things, internal controls, information systems and audit systems, loan documentation, credit underwriting, interest rate risk exposure, asset growth, compensation, and other operational and managerial standards as the agency deems appropriate. The federal banking agencies adopted Interagency Guidelines Prescribing Standards for Safety and Soundness to implement the safety and soundness standards required under federal law. The guidelines set forth the safety and soundness standards that the federal banking agencies use to identify and address problems at insured depository institutions before capital becomes impaired. The guidelines address internal controls and information systems, internal audit systems, credit underwriting, loan documentation, interest rate risk exposure, asset growth, compensation, fees and benefits. If the appropriate federal banking agency determines that an institution fails to meet any standard prescribed by the guidelines, the agency may require the institution to submit to the agency an acceptable plan to achieve compliance with the standard. If an institution fails to meet these standards, the appropriate federal banking agency may require the institution to submit a compliance plan.

***Prompt Corrective Action Regulations*.** Under the prompt corrective action regulations, the OCC is authorized and, under certain circumstances, required to take supervisory actions against undercapitalized savings banks. For this purpose, a savings bank is placed in one of the following five categories based on the savings bank s capital:

- well-capitalized (at least 5% leverage capital, 6% Tier 1 risk-based capital and 10% total risk-based capital);
- adequately capitalized (at least 4% leverage capital, 4% Tier 1 risk-based capital and 8% total risk-based capital);
- undercapitalized (less than 8% total risk-based capital, 4% Tier 1 risk-based capital or 3% leverage capital);
- significantly undercapitalized (less than 6% total risk-based capital, 3% Tier 1 risk-based capital or 3% leverage capital); and
- critically undercapitalized (less than 2% tangible capital).

Generally, the OCC is required to appoint a receiver or conservator for a savings bank that is critically undercapitalized within specific time frames. The regulations also provide that a capital restoration plan must be filed with the OCC within 45 days of the date a savings bank receives notice that it is undercapitalized, significantly undercapitalized or critically undercapitalized. Any holding company for the savings bank required to submit a capital restoration plan must guarantee the lesser of an amount equal to 5% of the savings bank s assets at the time it was notified or deemed to be undercapitalized by the OCC, or the amount necessary to restore the savings bank to adequately capitalized status. This guarantee remains in place until the OCC notifies the savings bank that it has maintained adequately capitalized status for each of four consecutive calendar quarters, and the OCC has the authority to require payment and collect payment under the guarantee. Failure by a holding company to provide the required guarantee results in certain operating restrictions on the savings bank. Undercapitalized institutions are also subject to operating restrictions such as limitations on capital distributions and growth. The OCC may also take any one of a number of discretionary supervisory actions against undercapitalized savings banks, including the issuance of a capital directive and the replacement of senior executive officers and directors.

At December 31, 2011, Cullman Savings Bank met the criteria for being considered well-capitalized.

Insurance of Deposit Accounts. Cullman Savings Bank is a member of the Deposit Insurance Fund, which is administered by the FDIC. Deposit accounts in the Bank are insured by the FDIC. In view of the recent economic crisis, the FDIC temporarily increased the general individual deposit insurance available on deposit accounts from $100,000 to $250,000.

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The Dodd-Frank Act made that level of coverage permanent. In addition, pursuant to a provision of the Dodd-Frank Act, certain non-interest-bearing transaction accounts are fully insured regardless of the dollar amount until December 31, 2012.

The FDIC imposes an assessment for deposit insurance on all depository institutions. Under the FDIC s risk-based assessment system, insured institutions are assigned to risk categories based on supervisory evaluations, regulatory capital levels and certain other factors. An institution s assessment rate depends upon the category to which it is assigned and certain adjustments specified by FDIC regulations, with institutions deemed less risky paying lower rates. Assessment rates (inclusive of possible adjustments) currently range from 2 1/2 to 45 basis points of each institution s total assets less tangible capital. The FDIC may increase or decrease the scale uniformly, except that no adjustment can deviate more than two basis points from the base scale without notice and comment rulemaking. The FDIC s current system represents a change, required by the Dodd-Frank Act, from its prior practice of basing the assessment on an institution s volume of deposits.

In 2009, the FDIC, in response to pressures on the Deposit Insurance Fund caused by bank and savings association failures, required all insured depository institutions to prepay their estimated assessments for the fourth quarter of 2009, and for all of 2010, 2011 and 2012. The estimated assessments were based on assumptions established by the FDIC, including an assumed 5% annual growth rate and certain assumed assessment rate increases. That pre-payment, which was due on December 30, 2009, was recorded as a prepaid expense at December 31, 2009 and is being amortized to expense over three years. Any unused prepaid assessments would be returned to the institution in June 2013.

On May 22, 2009, the FDIC issued a final rule that imposed a special five basis point assessment on each FDIC-insured depository institution s assets, minus its Tier 1 capital on June 30, 2009. That was collected on September 30, 2009. The special assessment was capped at 10 basis points of an institution s domestic deposits.

The Dodd-Frank Act increased the minimum target Deposit Insurance Fund ratio from 1.15% of estimated insured deposits to 1.35% of estimated insured deposits. The FDIC must seek to achieve the 1.35% ratio by September 30, 2020. Insured institutions with assets of $10 billion or more are supposed to fund the increase. The Dodd-Frank Act eliminated the 1.5% maximum fund ratio, instead leaving it to the discretion of the FDIC and the FDIC has exercised that discretion by establishing a long term fund ratio of 2%.

The FDIC has authority to increase insurance assessments. Any significant increases would have an adverse effect on the operating expenses and results of operations of Cullman Savings Bank. Management cannot predict what assessment rates will be in the future.

Insurance of deposits may be terminated by the FDIC upon a finding that an 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. Management of Cullman Savings Bank does not know of any practice, condition or violation that may lead to termination of our deposit insurance.

In addition to the FDIC assessments, the Financing Corporation (FICO) is authorized to impose and collect, with the approval of the FDIC, assessments for anticipated payments, issuance costs and custodial fees on bonds issued by the FICO in the 1980s to recapitalize the former Federal Savings and Loan Insurance Corporation. The bonds issued by the FICO are due to mature in 2017 through 2019. For the quarter ended December 31, 2011, the FICO assessment was equal to 0.68 basis points of total assets less tangible capital.

Prohibitions Against Tying Arrangements. Federal savings banks are prohibited, subject to some exceptions, from extending credit to or offering any other service, or fixing or varying the consideration for such extension of credit or service, on the condition that the customer obtain some additional service from the institution or its affiliates or not obtain services of a competitor of the institution.

Federal Home Loan Bank System. Cullman Savings Bank is a member of the Federal Home Loan Bank System, which consists of twelve regional Federal Home Loan Banks. The Federal Home Loan Bank System provides a central credit facility primarily for member institutions. As a member of the Federal Home Loan Bank of Atlanta, Cullman Savings Bank is required to acquire and hold shares of capital stock in the Federal Home Loan Bank. As of December 31, 2011, Cullman Savings Bank was in compliance with this requirement.

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Other Regulations

Interest and other charges collected or contracted for by Cullman Savings Bank are subject to state usury laws and federal laws concerning interest rates. Cullman Savings Bank s operations are also subject to federal laws applicable to credit transactions, such as the:

Truth-In-Lending Act, governing disclosures of credit terms to consumer borrowers;

Home Mortgage Disclosure Act, requiring financial institutions to provide information to enable the public and public officials to determine whether a financial institution is fulfilling its obligation to help meet the housing needs of the community it serves;

Equal Credit Opportunity Act, prohibiting discrimination on the basis of race, creed or other prohibited factors in extending credit;

Fair Credit Reporting Act, governing the use and provision of information to credit reporting agencies;

Fair Debt Collection Act, governing the manner in which consumer debts may be collected by collection agencies;

Truth in Savings Act; and

Rules and regulations of the various federal agencies charged with the responsibility of implementing such federal laws.

The operations of Cullman Savings Bank also are subject to the:

Right to Financial Privacy Act, which imposes a duty to maintain confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records;

Electronic Funds Transfer Act and Regulation E promulgated thereunder, which govern automatic deposits to and withdrawals from deposit accounts and customers rights and liabilities arising from the use of automated teller machines and other electronic banking services;

Check Clearing for the 21st Century Act (also known as Check 21), which gives substitute checks, such as digital check images and copies made from that image, the same legal standing as the original paper check;

Title III of The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (referred to as the USA PATRIOT Act), which significantly expanded the responsibilities of financial institutions, including savings and loan associations, in preventing the use of the United States financial system to fund terrorist activities. Among other provisions, the USA PATRIOT Act and the related federal regulations require savings banks operating in the United States to, among other things, establish broadened anti-money laundering compliance programs, due diligence policies and controls to ensure the detection and reporting of money laundering. Such required compliance programs are intended to supplement existing compliance requirements, also applicable to financial institutions, under the

Bank Secrecy Act and the Office of Foreign Assets Control Regulations; and

The Gramm-Leach-Bliley Act, which places limitations on the sharing of consumer financial information by financial institutions with unaffiliated third parties. Specifically, the Gramm-Leach-Bliley Act requires all financial institutions offering financial products or services to retail customers to provide such customers with the financial institution s privacy policy and provide such customers the opportunity to opt out of the sharing of certain personal financial information with unaffiliated third parties.

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Holding Company Regulation

General. Cullman Savings Bank, MHC and Cullman Bancorp, Inc. are savings and loan holding companies within the meaning of the Home Owners Loan Act. As such, Cullman Savings Bank, MHC and Cullman Bancorp, Inc. are registered with the Federal Reserve Board and are subject to Federal Reserve Board regulations, examinations, supervision and reporting requirements. In addition, the Federal Reserve Board has enforcement authority over Cullman Savings Bank, MHC and Cullman Bancorp, Inc., and their subsidiaries. Among other things, this authority permits the Federal Reserve Board to restrict or prohibit activities that are determined to be a serious risk to the subsidiary savings institution. As federal corporations, Cullman Savings Bank, MHC and Cullman Bancorp, Inc. are generally not subject to state business organization laws.

The Dodd-Frank Act transferred to the Federal Reserve Board from the OTS the responsibility for regulating and supervising savings and loan holding companies. The transfer was effective July 21, 2011.

Permitted Activities. Pursuant to Section 10(o) of the Home Owners Loan Act and Federal Reserve Board regulations and policy, a mutual holding company and a federally chartered mid-tier holding company such as Cullman Bancorp, Inc. may engage in the following activities:

(i) investing in the stock of a savings institution;

(ii) acquiring a mutual savings bank through the merger of such savings institution into a savings institution subsidiary of such holding company or an interim savings bank subsidiary of such holding company;

(iii) merging with or acquiring another holding company, one of whose subsidiaries is a savings institution;

(iv) investing in a corporation, the capital stock of which is available for purchase by a savings institution under federal law or under the law of any state where the subsidiary savings institution or savings institutions share their home offices;

(v) furnishing or performing management services for a savings institution subsidiary of such company;

(vi) holding, managing or liquidating assets owned or acquired from a savings subsidiary of such company;

(vii) holding or managing properties used or occupied by a savings institution subsidiary of such company;

(viii) acting as trustee under deeds of trust;

(ix) any other activity (A) that the Federal Reserve Board, by regulation, has determined to be permissible for bank holding companies under Section 4(c) of the Bank Holding Company Act of 1956, unless the Federal Reserve Board, by regulation, prohibits or limits any such activity for savings and loan holding companies; or (B) in which multiple savings and loan holding companies were authorized (by regulation) to directly engage on March 5, 1987;

(x) any activity permissible for financial holding companies under Section 4(k) of the Bank Holding Company Act, including securities and insurance underwriting; and

(xi) purchasing, holding, or disposing of stock acquired in connection with a qualified stock issuance if the purchase of such stock by such savings and loan holding company is approved by the Federal Reserve Board. If a mutual holding company acquires or merges with another holding company, the holding company acquired or the holding company resulting from such merger or acquisition may only invest in assets and engage in activities listed in (i) through (xi) above, and has a period of two years to cease any nonconforming activities and divest of any nonconforming investments.

The Home Owners Loan Act prohibits a savings and loan holding company, including Cullman Bancorp, Inc. and Cullman Savings Bank, MHC, directly or indirectly, or through one or more subsidiaries, from acquiring more than 5% of another savings institution or holding company thereof, without prior written approval of the Federal Reserve Board. It also prohibits the acquisition or retention of, with certain exceptions, more than 5% of a nonsubsidiary company engaged in activities other than those permitted by the Home Owners Loan Act; or acquiring or retaining control of an institution that is not federally insured. In evaluating applications by holding companies to acquire savings institutions, the Federal Reserve Board must consider the financial and managerial resources, future prospects of the company and institution involved, the effect of the acquisition on the risk to the insurance fund, the convenience and needs of the community and competitive factors.

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The Federal Reserve Board is prohibited from approving any acquisition that would result in a multiple savings and loan holding company controlling savings institutions in more than one state, subject to two exceptions: (i) the approval of interstate supervisory acquisitions by savings and loan holding companies, and (ii) the acquisition of a savings institution in another state if the laws of the state of the target savings institution specifically permit such acquisitions.

The states vary in the extent to which they permit interstate savings and loan holding company acquisitions.

Capital. Savings and loan holding companies are not currently subject to specific regulatory capital requirements. The Dodd-Frank Act, however, requires the Federal Reserve Board to promulgate consolidated capital requirements for depository institution holding companies that are no less stringent, both quantitatively and in terms of components of capital, than those applicable to institutions themselves. That will eliminate from Tier 1 capital certain instruments that are currently includable for bank holding companies, such as trust preferred securities. There is a five-year transition period from the July 21, 2011 date of enactment of the Dodd-Frank Act before the capital requirements will apply to savings and loan holding companies.

Source of Strength. The Dodd-Frank Act also extends the source of strength doctrine to savings and loan holding companies. The regulatory agencies must promulgate regulations implementing the source of strength policy that requires holding companies act as a source of strength to their subsidiary depository institutions by providing capital, liquidity and other support in times of financial stress.

The Federal Reserve Board has also issued a policy statement regarding the payment of dividends by bank holding companies that it has made applicable to savings and loan holding companies as well. In general, the policy provides that dividends should be paid only out of current earnings and only if the prospective rate of earnings retention by the holding company appears consistent with the organization s capital needs, asset quality and overall financial condition. Regulatory guidance provides for prior regulatory review of capital distributions in certain circumstances such as where the company s net income for the past four quarters, net of dividends previously paid over that period, is insufficient to fully fund the dividend or the company s overall rate of earnings retention is inconsistent with the company s capital needs and overall financial condition. The ability of a holding company to pay dividends may be restricted if a subsidiary bank becomes undercapitalized. These regulatory policies could affect the ability of Cullman Bancorp, Inc. to pay dividends or otherwise engage in capital distributions.

Waivers of Dividends by Cullman Savings Bank, MHC. When Cullman Bancorp, Inc. pays dividends on its common stock to public shareholders, it is also required to pay dividends to Cullman Savings Bank, MHC, unless Cullman Savings Bank, MHC elects to waive the receipt of dividends. Under the Dodd-Frank Act, Cullman Savings Bank, MHC must receive the approval of the Federal Reserve Board before it may waive the receipt of any dividends from Cullman Bancorp, Inc., and there is no assurance that the Federal Reserve Board will approve future dividend waivers. In addition, any dividends waived by Cullman Savings Bank, MHC must be considered in determining an appropriate exchange ratio in the event of a conversion of the mutual holding company to stock form.

Conversion of Cullman Savings Bank, MHC to Stock Form. Federal regulations permit Cullman Savings Bank, MHC to convert from the mutual form of organization to the capital stock form of organization (a Conversion Transaction). There can be no assurance when, if ever, a Conversion Transaction will occur, and the board of directors has no current intention or plan to undertake a Conversion Transaction. In a Conversion Transaction, a new holding company would be formed as the successor to Cullman Bancorp, Inc. (the New Holding Company), Cullman Savings Bank, MHC s corporate existence would end, and certain depositors of Cullman Savings Bank would receive the right to subscribe for shares of the New Holding Company. Each share of common stock held by stockholders other than Cullman Savings Bank, MHC (Minority Stockholders) would be automatically converted into a number of shares of common stock of the New Holding Company determined pursuant to an exchange ratio that ensures that Minority Stockholders own the same percentage of common stock in the New Holding Company as they owned in Cullman Bancorp, Inc. immediately prior to the Conversion Transaction. The total number of shares of common stock held by Minority Stockholders after a Conversion Transaction also would be increased by any purchases by Minority Stockholders in the stock offering conducted as part of the Conversion Transaction.

Any Conversion Transaction would require the approval of a majority of the outstanding shares of common stock of Cullman Bancorp, Inc. held by Minority Stockholders. Any Conversion Transaction also would require the approval of a majority of the eligible votes of members of Cullman Savings Bank, MHC.

Liquidation Rights. Each depositor of Cullman Savings Bank has both a deposit account in Cullman Savings Bank and a pro rata ownership interest in the net worth of Cullman Savings Bank, MHC based upon the deposit balance in his or her account. This ownership interest is tied to the depositor s account and has no tangible market value separate from the deposit

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account. This interest may only be realized in the unlikely event of a complete liquidation of Cullman Savings Bank. Any depositor who opens a deposit account obtains a pro rata ownership interest in Cullman Savings Bank, MHC without any additional payment beyond the amount of the deposit. A depositor who reduces or closes his or her account (including reductions to pay for shares of common stock in the stock offering) receives a portion or all, respectively, of the balance in the deposit account but nothing for his or her ownership interest in the net worth of Cullman Savings Bank, MHC, which is lost to the extent that the balance in the account is reduced or closed.

In the unlikely event of a complete liquidation of Cullman Savings Bank, all claims of creditors of Cullman Savings Bank, including those of depositors of Cullman Savings Bank (to the extent of their deposit balances), would be paid first. Thereafter, if there were any assets of Cullman Savings Bank remaining, these assets would be distributed to Cullman Bancorp, Inc. as Cullman Savings Bank s sole stockholder. Then, if there were any assets of Cullman Bancorp, Inc. remaining, depositors of Cullman Savings Bank would receive those remaining assets, pro rata, based upon the deposit balances in their deposit account in Cullman Savings Bank immediately prior to liquidation.

Federal Securities Laws

Cullman Bancorp, Inc. common stock is registered with the Securities and Exchange Commission under the Securities Exchange Act of 1934, as amended. Cullman Bancorp, Inc. is subject to the information, proxy solicitation, insider trading restrictions and other requirements under the Securities Exchange Act of 1934.

The registration under the Securities Act of 1933 of shares of the common stock in the stock offering does not cover the resale of the shares. Shares of the common stock purchased by persons who are not affiliates of Cullman Bancorp, Inc. may be resold without registration. Shares purchased by an affiliate of Cullman Bancorp, Inc. will be subject to the resale restrictions of Rule 144 under the Securities Act of 1933. If Cullman Bancorp, Inc. meets the current public information requirements of Rule 144 under the Securities Act of 1933, each affiliate of Cullman Bancorp, Inc. who complies with the other conditions of Rule 144, including those that require the affiliate s sale to be aggregated with those of other persons, would be able to sell in the public market, without registration, a number of shares not to exceed, in any three month period, the greater of 1% of the outstanding shares of Cullman Bancorp, Inc., or the average weekly volume of trading in the shares during the preceding four calendar weeks. Provision may be made in the future by Cullman Bancorp, Inc. to permit affiliates to have their shares registered for sale under the Securities Act of 1933.

Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act of 2002 addresses, among other issues, corporate governance, auditing and accounting, executive compensation, and enhanced and timely disclosure of corporate information. As directed by the Sarbanes-Oxley Act, our Chief Executive Officer and Chief Financial Officer will be required to certify that our quarterly and annual reports do not contain any untrue statement of a material fact. The rules adopted by the Securities and Exchange Commission under the Sarbanes-Oxley Act have several requirements, including having these officers certify that: they are responsible for establishing, maintaining and regularly evaluating the effectiveness of our internal control over financial reporting; they have made certain disclosures to our auditors and the audit committee of the Board of Directors about our internal control over financial reporting; and they have included information in our quarterly and annual reports about their evaluation and whether there have been changes in our internal control over financial reporting or in other factors that could materially affect internal control over financial reporting.

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Item 1A. Risk Factors

Not applicable to a smaller reporting company.

Item 1B. Unresolved Staff Comments

Not applicable to a smaller reporting company.

Item 2. Properties

As of December 31, 2011, the net book value of our properties was $9.5 million. The following is a list of our offices:

Location	Leased or Owned	Year Acquired or Leased	Square Footage		Net Book Value of Real Property (In thousands)
Main Office:					
316 Second Avenue SW Cullman, Alabama	Owned	1970	44,000	$	6,839
Other Properties:					
101 Main Street SW Hanceville, Alabama	Owned	1979	1,524		172
3201 Alabama Highway 157 Cullman, Alabama	Owned	2002	6,000		1,494
Highway 278 West Cullman, Alabama	Owned	2008	**Land Only**		399
1652 Second Avenue SW Cullman, Alabama	Owned	2010	2,531		592
				$	9,496

We believe that current facilities are adequate to meet our present and foreseeable needs, subject to possible future expansion.

Item 3. Legal Proceedings

From time to time, we are involved as plaintiff or defendant in various legal proceedings arising in the ordinary course of business. At December 31, 2011, we were not involved in any legal proceedings, the outcome of which would be material to our financial condition or results of operations.

Item 4. Mine Safety Disclosures

Not applicable

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PART II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Our shares of common stock are traded on the OTC Bulletin Board under the symbol CULL . The approximate number of holders of record of Cullman Bancorp, Inc. s common stock as of December 31, 2011 was 240. Certain shares of Cullman Bancorp, Inc. are held in nominee or street name and accordingly, the number of beneficial owners of such shares is not known or included in the foregoing number. The following table presents quarterly market information for Cullman Bancorp, Inc. s common stock for each quarter for 2011 and 2010. The following information was provided by the OTC Bulletin Board:

Year ended December 31, 2011	High	Low	Cash Dividends Declared
First quarter	$ 11.00	$ 10.30	$
Second quarter	$ 13.75	$ 11.00	$ 0.08
Third quarter	$ 13.50	$ 11.50	$ 0.08
Fourth quarter	$ 13.50	$ 11.50	$ 0.08

Year ended December 31, 2010	High	Low	Cash Dividends Declared
First quarter	$ 10.35	$ 10.06	$
Second quarter	$ 10.40	$ 10.00	$
Third quarter	$ 10.65	$ 9.50	$
Fourth quarter	$ 10.60	$ 9.50	$

The Board of Directors has the authority to declare cash dividends on shares of common stock, subject to statutory and regulatory requirements. As of December 31, 2011, the Company was paying quarterly cash dividends of $0.08 per share. In determining whether and in what amount to pay a cash dividend, the Board is expected to take into account a number of factors, including capital requirements, our consolidated financial condition and results of operations, tax considerations, statutory and regulatory limitations and general economic conditions. No assurances can be given that any cash dividends will be paid or that, if paid, will not be reduced or eliminated in the future.

The available sources of funds for the payment of a cash dividend in the future are dividends from Cullman Savings Bank.

When Cullman Bancorp, Inc. pays dividends on its common stock to public shareholders, it will also be required to pay dividends to Cullman Savings Bank, MHC, unless Cullman Savings Bank, MHC elects to, and is permitted to, waive the receipt of dividends. The Dodd-Frank Act transferred the authority to review and approve mutual holding dividends waivers from the Office of Thrift Supervision to the Federal Reserve Board. The Federal Reserve Board historically has generally not allowed mutual holding companies to waive the receipt of dividends, and there can be no assurance that the Federal Reserve Board will approve dividend waiver requests by mutual holding companies such as Cullman Savings Bank, MHC.

In addition, our ability to pay dividends largely depends upon dividends we receive from Cullman Savings Bank, which are subject to regulatory restrictions on dividends. Applicable regulations limit dividends and other distributions from Cullman Savings Bank to us. See Item 1 Business Supervision and Regulation Capital Distributions. In addition, Cullman Savings Bank may not make a distribution that would constitute a return of capital during the three-year term of the business plan submitted in connection with the offering. No insured depository institution may make a capital distribution if, after making the distribution, the institution would be undercapitalized.

At December 31, 2011, there were no compensation plans under which equity securities of Cullman Bancorp, Inc. were authorized for issuance other than the Employee Stock Ownership Plan and the Equity Incentive Plan.

No shares were repurchased during 2011.

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Item 6. Selected Financial Data

The following information is derived from the audited consolidated financial statements of Cullman Bancorp, Inc. For additional information, reference is made to Management s Discussion and Analysis of Financial Condition and Results of Operations and the Consolidated Financial Statements of Cullman Bancorp, Inc. and related notes included elsewhere in this Annual Report.

	At or For the Year Ended December 31,		
	2011	2010	2009
		(In thousands)	
Financial Condition Data:			
Total assets	$ 222,951	$ 223,855	$ 214,579
Investment securities	29,706	24,117	18,080
Loans receivable, net	164,215	177,317	172,747
Deposits	138,147	136,399	125,119
Federal Home Loan Bank advances	42,000	47,000	51,107
Other borrowings	787	816	833
Total shareholders equity	40,393	38,270	36,514
Operating Data:			
Interest and dividend income	$ 11,736	$ 12,156	$ 12,140
Interest expense	3,237	4,046	5,339
Net interest income	8,499	8,110	6,801
Provision for loan losses	407	506	388
Net interest income after provision for loan losses	8,092	7,604	6,413
Non-interest income	831	964	(210)
Non-interest expenses	5,847	5,429	5,409
Income before income taxes	3,076	3,139	1,214
Income taxes	1,087	1,087	633
Net income	$ 1,989	$ 2,052	$ 581
Basic earnings per share (1)	$ 0.80	$ 0.85	$ 0.06
Dilutive earnings per share	$ 0.80	$ 0.85	$ 0.06

(1) Earnings per share for 2009 is based on earnings of Cullman Bancorp, Inc. for the period of October 8 to December 31, 2009.

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	At or For the Year Ended December 31,		
	2011	2010	2009
Performance Ratios:			
Return on average assets	0.88%	0.93%	0.27%
Return on average equity	4.86%	5.51%	2.08%
Interest rate spread (1)	3.78%	3.71%	3.22%
Net interest margin (2)	4.06%	4.00%	3.46%
Noninterest expense to average assets	2.58%	2.47%	2.53%
Efficiency ratio (3)	62.67%	60.08%	46.37%
Average interest-earning assets to average interest-bearing liabilities	1.18X	1.15X	1.09X
Average equity to average assets	18.03%	16.94%	13.12%
Capital Ratios:			
Total capital to risk weighted assets	22.25%	21.21%	22.03%
Tier I capital to risk weighted assets	21.75%	20.75%	21.53%
Tier I capital to average tangible assets	14.85%	14.71%	15.02%
Asset Quality Ratios:			
Allowance for loan losses as a percent of gross loans	0.67%	0.48%	0.43%
Allowance for loan losses as a percent of nonperforming loans	70.48%	386.43%	N/A%
Net (charge-offs) recoveries to average outstanding loans during the period	(0.09)%	(0.23)%	(0.07)%
Non-performing loans as a percent of gross loans	0.95%	0.12%	0.00%
Non-performing assets as a percent of total assets	1.40%	0.99%	0.43%
Total non-performing assets and troubled debt as a percentage of total assets	2.76%	3.43%	0.43%
Number of offices	3	3	3

(1) Represents the difference between the weighted average yield on average interest-earning assets and the weighted average cost of interest-bearing liabilities.

(2) Represents net interest income as a percent of average interest-earning assets.

(3) Represents noninterest expense divided by the sum of net interest income and noninterest income, excluding gains or losses on the sale of securities.

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

Overview

On October 8, 2009, the Bank completed its conversion and reorganization from a mutual savings bank into a two-tier mutual holding stock company. In accordance with the plan of reorganization, Cullman Bancorp, Inc. (of which Cullman Savings Bank became a wholly-owned subsidiary) issued and sold shares of capital stock to eligible depositors of Cullman Savings Bank.

Since the entities are under common control, the reorganization was accounted for at historical cost and presented as if the transaction occurred at the beginning of the earliest period shown. A total of 1,080,483 shares were sold in the conversion at $10 per share, raising $10.8 million of gross proceeds. Approximately $900,000 of conversion expenses were offset against the gross proceeds. Cullman Bancorp, Inc. s common stock began trading on the over-the-counter market under the symbol CULL on October 9, 2009. In addition, the Bank contributed $100,000 in cash and 50,255 shares of common stock to a charitable foundation that the Bank established in connection with the reorganization. The contribution of cash and shares of common stock totaled $603,000.

The combination of shares sold to the public and contributed to the charitable foundation represents 46% of the common stock of Cullman Bancorp, Inc. outstanding shares. Cullman Savings Bank, MHC owns 54% or 1,387,312 shares.

Our results of operations depend mainly on our net interest income, which is the difference between the interest income earned on our loan and investment portfolios and interest expense paid on our deposits and borrowed funds. Results of operations are also affected by fee income from banking operations, provisions for loan losses, gains (losses) on sales and other than temporary impairment charges of loans and securities and other miscellaneous income. Our noninterest expenses consist primarily of salaries and employee benefits, occupancy and equipment, data processing, advertising, bank examination fees, amortization of intangibles, general administrative expenses, deposit insurance fees and income tax expense. Our results of operations are also significantly affected by general economic and competitive conditions, particularly with respect to changes in interest rates, government policies and actions of regulatory authorities. Future changes in applicable laws, regulations or government policies may materially affect our financial condition and results of operations.

Critical Accounting Policies

We consider accounting policies that require management to exercise significant judgment or discretion or make significant assumptions that have, or could have, a material impact on the carrying value of certain assets or on income, to be critical accounting policies. We consider the following to be our critical accounting policies:

Allowance for Loan Losses. Our allowance for loan losses is the estimated amount considered necessary to reflect probable incurred credit losses in the loan portfolio at the balance sheet date. The allowance is established through the provision for loan losses, which is charged against income. In determining the allowance for loan losses, management makes significant estimates and has identified this policy as one of the most critical for Cullman Bancorp, Inc. The methodology for determining the allowance for loan losses is considered a critical accounting policy by management due to the high degree of judgment involved, the subjectivity of the assumptions utilized and the potential for changes in the economic environment that could result in changes to the amount of the recorded allowance for loan losses.

As a substantial amount of our loan portfolio is collateralized by real estate, appraisals of the underlying value of property securing loans and discounted cash flow valuations of properties are critical in determining the amount of the allowance required for specific loans. Assumptions for appraisals and discounted cash flow valuations are instrumental in determining the value of properties. Overly optimistic assumptions or negative changes to assumptions could significantly impact the valuation of a property securing a loan and the related allowance determined. The assumptions supporting such appraisals and discounted cash flow valuations are carefully reviewed by management to determine that the resulting values reasonably reflect amounts realizable on the related loans.

Management performs a quarterly evaluation of the allowance for loan losses. Consideration is given to a variety of factors in establishing this estimate including, but not limited to, current economic conditions, delinquency statistics, geographic and industry concentrations, the value of the underlying collateral, the financial strength of the borrower, results of internal loan reviews and other relevant factors. This evaluation is inherently subjective as it requires material estimates that may be susceptible to significant revision based on changes in economic and real estate market conditions.

The analysis of the allowance for loan losses has two components: specific and general allocations. Specific allocations are made for loans that are determined to be impaired. Impairment loss is measured by determining the present value of expected future cash flows or, for collateral-dependent loans, the fair value of the collateral adjusted for market conditions and selling expenses. The general allocation is determined by segregating classified loans from the remaining loans, and then categorizing each group by type of loan. Loans within each type exhibit common characteristics including terms, collateral type, and other risk characteristics. We also analyze historical loss experience for the preceding four quarters, delinquency trends, general economic conditions and geographic and industry concentrations. This analysis establishes factors that are applied to the loan groups to determine the amount of the general allocations. Actual loan losses may be significantly more than the allowance for loan losses we have established which could have a material negative effect on our financial results.

Deferred Income Taxes. We use the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. If current available information raises doubt as to the realization of the deferred tax assets, a valuation allowance is established. These judgments and estimates are reviewed on a continual basis as regulatory and business factors change.

Securities Impairment. Accounting standards require us to perform periodic reviews of individual securities in our investment portfolios to determine whether a decline in the value of a security is other than temporary. We conduct a quarterly review and evaluation of our securities portfolio to make this determination and consider many factors, including the severity and duration of the impairment; our intent and ability to hold the security for a period of time sufficient for a recovery in value; and for debt securities, external credit ratings and recent downgrades. Securities on which there is an unrealized loss that is deemed to be other-than-temporary are written down to fair value with the write-down recorded as a realized loss. If such decline is deemed other-than-temporary, we would adjust the cost basis on the credit loss portion of the security by writing down the security to estimated fair market value through a charge to current period operations.

Business Strategy

We have focused primarily on improving the execution of our community oriented retail banking strategy. Highlights of our current business strategy include the following:

Continue to Focus on Residential Lending. We have been and will continue to be primarily a one-to-four family residential mortgage lender for borrowers in our market area. As of December 31, 2011, $78.7 million, or 47.6% of our total loan portfolio consisted of one- to four-family residential mortgage loans. We have developed a secondary mortgage capacity so that we can offer loans, including long-term fixed-rate loans, to our customers that we do not wish to retain in our loan portfolio from an asset/liability management standpoint. We consider the current interest rate environment in making decisions as to whether to hold our originated mortgage loans for investment or to sell the loans to investors, choosing the strategy that is most advantageous to us from a profitability and risk management standpoint.

Increase Commercial Real Estate Lending. While we will continue to emphasize one- to four-family residential mortgage loans, we also have increased and, subject to market conditions, intend to continue to increase our origination of commercial real estate loans in order to increase the yield of, and reduce the term to repricing of, our total loan portfolio. At December 31, 2011, $63.3 million, or 38.2% of our total loan portfolio consisted of commercial real estate loans.

Manage Interest Rate Risk While Maintaining or Enhancing to the Extent Practicable our Net Interest Margin. Subject to market conditions, we have sought to enhance net interest income by emphasizing controls on the cost of funds rather than attempting to maximize asset yields, as loans with high yields often involve greater credit risk or may be repaid during periods of decreasing market interest rates. We try to promote core deposits such as passbook and statement savings accounts, money market accounts and regular and commercial checking accounts, which generally are lower-cost sources of funds than certificates of deposit, and which are less sensitive to withdrawal when interest rates fluctuate. At December 31, 2011, 44.6% of our deposits were core deposits. We attempt to attract and retain core deposits by offering competitive products that meet the full-service banking needs of our customers, by emphasizing quality customer service, and through our convenient locations and advertising and promotions programs.

Expand Banking Relationships to a Larger Base of Customers. Our banking subsidiary, Cullman Savings Bank was established in 1887 and has been operating continuously in Cullman County since that time. Our share of FDIC-insured deposits in Cullman County as of June 30, 2011 (the latest date for which such information is available) was 10.4%. We will seek to expand our customer base and offer our products and services to the new base of customers, by using our recognized brand name and the goodwill developed over years of providing timely, efficient banking services.

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Maintain Strong Asset Quality. We have emphasized maintaining strong asset quality by following conservative underwriting guidelines, sound loan administration, and focusing on loans secured by real estate located within our market area only. Our non-performing assets and troubled debt restructurings totaled $6.1 million, or 2.8% of total assets at December 31, 2011. Our total nonperforming loans to total loans ratio was 0.95% at December 31, 2011. Total loan delinquencies, greater than 30 days, as of December 31, 2011 were $2.7 million, or 1.6% of total loans

Comparison of Financial Condition at December 31, 2011 and December 31, 2010

Our total assets decreased $904,000, or 0.40%, to $222.9 million at December 31, 2011 from $223.9 million at December 31, 2010. The decrease was due to a decrease in loans of $13.1 million, or 7.4%, to $164.2 million at December 31, 2011 from $177.3 million at December 31, 2010. The decrease in total loans was partially offset by increases in cash and cash equivalents of $6.9 million to $9.5 million from $2.5 million and securities available for sales of $5.6 million to $29.7 million from $24.1 million at December 31, 2011 and 2010, respectively. The decrease in loans reflected the decreased demand for one-to-four family and real estate construction loans. Our portfolio of one-to-four family loans decreased $4.8 million to $78.9 million at December 31, 2011 from $83.7 million at December 31, 2010. Real estate construction loans decreased $7.3 million to $1.7 million from $8.9 million. Total real estate loans decreased $11.9 million to $149.1 at December 31, 2011 from $160.9 at December 31, 2010. Proceeds from loan repayments were used to fund purchases of securities available for sale and investment in federal funds sold.

Deposits increased to $138.1 million at December 31, 2011 from $136.4 million at December 31, 2010. The increase in deposits reflected a $6.5 million increase in NOW and demand accounts. This increase was offset partially by a decrease in certificates of deposit of $3.3 million to $76.6 million at December 31, 2011 from $79.9 million at December 31, 2010.

Federal Home Loan Bank of Atlanta advances decreased to $42.0 million at December 31, 2011 from $47.0 million at December 31, 2010. Our increase in deposits helped to offset the planned decrease in Federal Home Loan Bank advances.

Total equity increased to $40.4 million at December 31, 2011 from $38.3 million at December 31, 2010. The increase largely reflected net income of $2.0 million and an increase in accumulated other comprehensive income of $549,000, partially offset by dividends of $534,000.

Comparison of Operating Results for the Years Ended December 31, 2011 and December 31, 2010

General. Net income decreased to $2.0 million for the year ended December 31, 2011 from $2.1 million for the year ended December 31, 2010. The decrease reflected lower noninterest income and higher noninterest expenses. Noninterest income decreased by $134,000, or 13.9%, and noninterest expense increased by $399,000, or 7.4%, for the year ended December 31, 2011.

Interest Income. Interest income decreased $420,000, or 3.5%, to $11.7 million for the year ended December 31, 2011 from $12.1 million for the year ended December 31, 2010. The decrease reflected a decrease in the yields on interest earning assets to 5.6% during the year ended December 31, 2011 from 6.0% for the year ended December 31, 2010, which more than offset the modest increase in the average balances of interest earning assets of $6.8 million to $209.3 million from $202.5 million for the same periods ended.

Interest income on loans decreased $431,000 or 3.8%, to $10.8 million for the year ended December 31, 2011 from $11.2 million for the year ended December 31, 2010, reflecting a decrease in the average yield on loans to 6.2% from 6.4% and a decrease in the average balances of loans to $173.6 million from $174.5 million for the same periods ended. Interest income on investment securities decreased to $905,000 for the year ended December 31, 2011 from $911,000 for the year ended December 31, 2010, reflecting a decrease in the average yield of such securities to 3.6% in 2011 from 4.4% in 2010, which more than offset the increase in their average balances to $24.8 million from $20.8 million for the same periods ended.

Interest Expense. Interest expense decreased $809,000, or 20.2%, to $3.2 million for the year ended December 31, 2011 from $4.0 million for the year ended December 31, 2010. The decrease reflected a decrease in the yields on interest-bearing deposits to 1.20% for the year ended December 31, 2011 from 1.6% for the year ended December 31, 2010 and a decrease in the yield on Federal Home Loan Bank advances and other borrowings to 3.6% from 4.2% for the same periods ended. The decrease in the yields on interest-bearing deposits more than offset the increase in the average balances of deposits of $2.1 million to $130.9 million for the year ended December 31, 2011 from $128.8 million for the year ended December 31, 2010.

Interest expense on certificates of deposit decreased to $1.4 million for the year ended December 31, 2011 from $1.7 million for the year ended December 31, 2010. The decrease was due to a decrease in the yield on certificates of deposit to

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1.7% from 2.2%, which more than offset the increase in their average balances of $2.4 million. Interest expense on money market deposits and NOW and demand deposits decreased to $203,000 for the year ended December 31, 2011 from $370,000 for the year ended December 31, 2010, due to both a decrease in the average yields on such deposits to 0.40% for the year ended December 31, 2011 from 0.72% for the year ended December 31, 2010 and a decrease in the average balances of such deposits of $282,000 to $51.3 million from $51.7 million for the same periods ended.

Interest expense on borrowings, primarily advances from the Federal Home Loan Bank of Atlanta, decreased $312,000, or 15.7% to $1.7 million for the year ended December 31, 2011 from $2.0 million for the year ended December 31, 2010. The decrease reflected a decrease in the average balance of such borrowings of $1.5 million to $46.1 million for the year ended December 31, 2011 coupled with a lower average rate paid on such borrowings of 3.6% for the year ended December 31, 2011 compared to 4.2% for the year ended December 31, 2010.

Net Interest Income. Net interest income increased to $8.5 million for the year ended December 31, 2011 from $8.1 million for the year ended December 31, 2010. The increase resulted from an increase in our interest rate spread to 3.8% from 3.7% and an increase in the ratio of our average interest earning assets to average interest bearing liabilities to 1.18X from 1.15X. Our net interest margin increased to 4.1% from 4.0%. The increases in our interest rate spread and net interest margin reflected a lower interest rate environment.

Provision for Loan Losses. The provision for loan losses decreased by $99,000 to $407,000 for the year ended December 31, 2011 from $506,000 for the year ended December 31, 2010. Net charge offs were $153,000 for the year ended December 31, 2011 compared to $399,000 for the year ended December 31, 2010. The allowance for loan losses was $1.1 million, or 0.67% of total loans at December 31, 2011 compared to $854,000, or 0.48%, of total loans at December 31, 2010. Nonperforming loans at December 31, 2011 were $1.6 million compared to $221,000 at December 31, 2010. Our foreclosed real estate was $1.5 million at December 31, 2011 compared to $2.0 million at December 31, 2010. To the best of our knowledge, we have recorded all losses that are both probable and reasonably estimable for the years ended December 31, 2011 and 2010.

Noninterest Income. Noninterest income decreased to $831,000 for the year ended December 31, 2011 from $964,000 for the year ended December 31, 2010. The decrease in noninterest income was primarily attributable to the decrease in service charges on deposit accounts of $36,000, the decrease in the net gain on sales of mortgage loans of $80,000, and the decrease in the net gain on the sale of securities of $38,000 to $409,000, $241,000, and $0, respectively for the year ended December 31, 2011. The decrease in the gain on sale of mortgage loans is reflective of lower volume in originations of these types of loans due to lower demand.

Noninterest Expense. Noninterest expense increased by $399,000 for the year ended December 31, 2011 to $5.8 million for the year ended December 31, 2011 from $5.4 million for the year ended December 31, 2010. The increase is largely reflective of the increase in salaries and other employee benefits of $290,000 and net losses on foreclosed real estate of $126,000. The increase in salaries and employee benefits reflected the increase in our stock based compensation expenses related to our ESOP and restricted stock programs. The total of these stock based compensation programs was $198,000 for the year ended December 31, 2011 from $49,000 for the year ended December 31, 2010. These increases were offset partially by a decrease in occupancy and equipment expense of $69,000 to $623,000 for the year ended December 31, 2011 and a decrease in the FDIC deposit insurance premium of $27,000 to $127,000 for the year ended December 31, 2011.

Income Tax Expense. The provision for income taxes remained the same at $1.1 million for both years ended December 31, 2011 and 2010. Our effective tax rate was 35.3% for the year ended December 31, 2011 compared to 34.6% for the year ended December 31, 2010.

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Analysis of Net Interest Income

Net interest income represents the difference between the income we earn on interest-earning assets and the interest expense we pay on interest-bearing liabilities. Net interest income also depends upon the relative amounts of interest-earning assets and interest-bearing liabilities and the interest rates earned or paid on them.

The following tables set forth average balance sheets, average yields and costs, and certain other information for the periods indicated. All average balances are daily average balances. Non-accrual loans were included in the computation of average balances, but have been reflected in the tables as loans carrying a zero yield. The yields set forth below include the effect of deferred fees, discounts and premiums that are amortized or accreted to interest income.

	For The Year Ended December 31,								
	2011			2010			2009		
	Average Balance	Interest and Dividends	Yield Cost	Average Balance	Interest and Dividends	Yield Cost	Average Balance	Interest and Dividends	Yield Cost
	(Dollars in thousands)								
Assets:									
Interest-earning assets:									
Loans	$ 173,655	$ 10,799	6.22%	$ 174,881	$ 11,230	6.42%	$ 169,540	$ 11,080	6.54%
Securities available for sale	24,790	905	3.65	20,762	911	4.39	21,172	1,046	4.94
Other interest-earning assets	10,873	32	0.29	6,895	15	0.22	6,017	14	0.23
Total interest-earning assets	209,318	11,736	5.61	202,538	12,156	6.00	196,729	12,140	6.17
Noninterest earning assets	17,492			17,335			16,496		
Total average assets	$ 226,810			$ 219,873			$ 213,225		
Liabilities and equity:									
Interest-bearing liabilities:									
NOW and demand deposits	$ 26,228	98	0.37	$ 25,651	158	0.62	$ 30,601	278	0.91
Regular savings and other deposits	17,171	69	0.40	15,763	119	0.75	12,356	148	1.20
Money market deposits	7,990	36	0.45	10,257	93	0.91	9,060	150	1.66
Certificates of deposit	79,541	1,351	1.70	77,108	1,688	2.19	76,926	2,512	3.27
Total interest-bearing deposits	130,930	1,554	1.19	128,779	2,058	1.60	128,943	3,088	2.39
FHLB advances and other borrowings	46,096	1,683	3.65	47,634	1,988	4.17	52,311	2,251	4.30
Total interest-bearing liabilities	177,026	3,237	1.83	176,413	4,046	2.29	181,254	5,339	2.95
Noninterest-bearing demand deposits	7,349			4,227			2,756		
Other noninterest-bearing liabilities	1,548			1,986			1,235		
Total liabilities	185,923			182,626			185,245		
Equity	40,888			37,247			27,980		
Total liabilities and equity	$ 226,810			$ 219,873			$ 213,225		
Net interest income		$ 8,499			$ 8,110			$ 6,801	
Interest rate spread			3.78%			3.71%			3.22%
Net interest margin			4.06%			4.00%			3.46%
Average interest-earning assets to average interest-bearing liabilities	1.18X			1.15X			1.09X		

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Rate/Volume Analysis

The following table presents the dollar amount of changes in interest income and interest expense for the major categories of our interest-earning assets and interest-bearing liabilities. Information is provided for each category of interest-earning assets and interest-bearing liabilities with respect to (i) changes attributable to changes in volume (i.e., changes in average balances multiplied by the prior-period average rate) and (ii) changes attributable to rate (i.e., changes in average rate multiplied by prior-period average balances). For purposes of this table, changes attributable to both rate and volume, which cannot be segregated, have been allocated proportionately to the change due to volume and the change due to rate.

	Years Ended December 31, 2011 vs. 2010			Years Ended December 31, 2010 vs. 2009		
	Increase (Decrease) Due to		Total Increase	Increase (Decrease) Due to		Total Increase
	Volume	Rate	(Decrease)	Volume	Rate	(Decrease)
	(Dollars In thousands)			(Dollars In thousands)		
Interest-earning assets						
Loans receivable	$ (79)	$ (352)	$ (431)	$ 345	$ (195)	$ 150
Investment securities	177	(183)	(6)	(20)	(115)	(135)
Other interest-earning assets	9	8	17	(5)	6	1
Total interest earning	107	(527)	(420)	320	(304)	16
Interest-bearing liabilities						
NOW and demand deposits	4	(64)	(60)	(40)	(80)	(121)
Regular savings and other deposits	11	(61)	(50)	35	(64)	(29)
Money market deposits	(21)	(36)	(57)	18	(75)	(57)
Certificates of deposit	53	(390)	(337)	6	(830)	(824)
FHLB advances and other borrowings	(64)	(241)	(305)	(199)	(64)	(262)
Total interest-bearing liabilities	(17)	(792)	(809)	(180)	(1,113)	(1,293)
Increase in net interest income	$ 124	$ 265	$ 389	$ 500	$ 809	$ 1,309

Liquidity and Capital Resources

Our primary sources of funds are deposits and the proceeds from principal and interest payments on loans and investment securities. While maturities and scheduled amortization of loans and securities are predicable sources of funds, deposit flows and mortgage prepayments are greatly influenced by general interest rates, economic conditions and competition. We generally manage the pricing of our deposits to be competitive within our market and to increase core deposit relationships.

Our cash flows are comprised of three primary classifications: (i) cash flows provided by operating activities, (ii) investing activities, and (iii) financing activities. Net cash flows from operating activities were $3.2 million for the year ended December 31, 2011 and $3.3 million for the year ended December 31, 2010. Net cash from investing activities consisted primarily of disbursements for loan originations and the purchase of securities, offset by principal collections on loans, and proceeds from maturities and sales of securities. Net cash flows from investing activities were $7.6 million for year ended December 31, 2011 and net cash flows used in investing activities were $13.2 million for the year ended December 31, 2010. Net cash provided by financing activities consisted primarily of activity in deposits and borrowings. Net cash flows used in financing activities were $3.8 million for the year ended December 31, 2011 compared to net cash flows from financing activities were $7.2 million for the year ended December 31, 2010. The changes in net cash flows provided by financing activities over the periods were primarily related to the net change in deposits, net proceeds from the issuance of capital stock, and repayment of Federal Home Loan Bank advances.

Our most liquid assets are cash and short-term investments. The levels of these assets are dependent on our operating, financing, lending, and investing activities during any given period. At December 31, 2011 and 2010, cash and short-term investments totaled $9.5 million and $2.5 million, respectively. We may also utilize the sale of securities available-for-sale, federal funds purchased, Federal Home Loan Bank of Atlanta advances and other borrowings as sources of funds.

At December 31, 2011 and 2010, we had outstanding commitments to originate loans of $936,000 and $975,000, respectively, and unfunded commitments under lines of credit and standby letters of credit of $8.5 million and $8.6 million, respectively. We anticipate that we will have sufficient funds available to meet our current loan commitments. Loan commitments have, in recent periods, been funded through liquidity and normal deposit flows. Certificates of deposit scheduled to mature in one year or less from December 31, 2011 totaled $47.2 million. Management believes, based on past experience, that a significant portion of such deposits will remain with us. Based on the foregoing, in addition to our level of core deposits and capital, we consider our liquidity and capital resources sufficient to meet our outstanding short-term and long-term needs.

Liquidity management is both a daily and long-term responsibility of management. We adjust our investments in liquid assets based upon management s assessment of (i) expected loan demand, (ii) expected deposit flows, (iii) yields available on interest-earning deposits and investment securities, and (iv) the objectives of our asset/liability management program. Excess liquid assets are invested generally in interest-earning overnight deposits, federal funds sold, and short and intermediate-term U.S. Government sponsored agencies and mortgage-backed securities of short duration. If we require funds beyond our ability to generate them internally, we have additional borrowing capacity with the Federal Home Loan Bank of Atlanta. At December 31, 2011, we had $42.0 million in advances from the Federal Home Loan Bank of Atlanta and an available borrowing limit up to $51.0 million.

We are subject to various regulatory capital requirements. At December 31, 2011, we were in compliance with all applicable capital requirements. See Supervision and Regulation Federal Banking Regulation Capital Requirements and Note 11 of the Notes to our Consolidated Financial Statements.

Off-Balance Sheet Arrangements. In the normal course of operations, we engage in a variety of financial transactions that, in accordance with U.S. generally accepted accounting principles, are not recorded in our financial statements. These transactions involve, to varying degrees, elements of credit, interest rate and liquidity risk. Such transactions are used primarily to manage customers requests for funding and take the form of loan commitments and lines of credit. For information about our loan commitments and unused lines of credit, see Note 12 of the Notes to our Financial Statements.

For fiscal years ended December 31, 2011 and 2010, we did not engage in any off-balance-sheet transactions other than loan origination commitments in the normal course of our lending activities.

New Accounting Standards

ASU 2011-02, Receivables (Topic 310): A Creditor s Determination of Whether a Restructuring is a Troubled Debt Restructuring provides additional guidance to clarify when a loan modification or restructuring is considered a troubled debt restructuring (TDR) in order to address current diversity in practice and lead to more consistent application of U.S. GAAP for debt restructurings. In evaluating whether a restructuring constitutes a troubled debt restructuring, a creditor must separately conclude that both of the following exist: (1) the restructuring constitutes a concession, and (2) the debtor is experiencing financial difficulties. The amendments to Topic 310 clarify the guidance regarding the evaluation of both considerations above. Additionally, the amendments clarify that a creditor is precluded from using the effective interest rate test in the debtor s guidance on restructuring of payables (paragraph 470-60-55-10) when evaluating whether a restructuring constitutes a TDR. This amendment is effective for us July 1, 2011. Early adoption is permitted. Retrospective application to the beginning of the annual period of adoption for modifications occurring on or after the beginning of the annual adoption period is required. As a result of applying these amendments, the Company may identify receivables that are newly considered to be impaired. For purposes of measuring impairment of those receivables, an entity should apply the amendments prospectively for the first interim or annual period beginning on or after June 15, 2011. The Company has complied with this update and the changes are reflected in our financial statements. The effect of adopting this standard did not have a material affect on the Company s operating results or financial condition.

Newly Issued Not Yet Effective

In May 2011, the FASB issued ASU No. 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. This ASU represents the converged guidance of the FASB and the IASB (the Boards) on fair value measurement. The collective efforts of the Boards and their staffs, reflected in ASU 2011-04, have resulted in common requirements for measuring fair value and for disclosing information about fair value measurements, including a consistent meaning of the term fair value. The Boards have concluded the common requirements will result in greater comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with U.S. GAAP and IFRSs. The amendments to the FASB Accounting Standards Codification in this ASU are to be applied prospectively. For public entities, the amendments are effective during interim and annual periods beginning after December 15, 2011. Early application by public entities is not permitted. The Company is currently in the process of evaluating the impact that this ASU may have on the consolidated financial statements.

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In June 2011, the FASB issued ASU No. 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income. This ASU amends the FASB Accounting Standards Codification to allow an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. ASU 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of changes in shareholders equity. The amendments to the Codification in the ASU do not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. ASU 2011-05 should be applied retrospectively. For public entities, the amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. Early adoption is permitted. The Company is currently in the process of evaluating the impact this ASU may have on the consolidated financial statements.

Impact of Inflation and Changing Prices

The financial statements and related data presented herein have been prepared in accordance with generally accepted accounting principles in the United States of America which require the measurement of financial position and operating results in terms of historical dollars without considering changes in the relative purchasing power of money over time due to inflation. The primary impact of inflation on our operations is reflected in increased operating costs. Unlike most industrial companies, virtually all of the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates, generally, have a more significant impact on a financial institution s performance than does inflation. Interest rates do not necessarily move in the same direction or to the same extent as the prices of goods and services.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Not applicable to a smaller reporting company.

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Item 8. Financial Statements and Supplementary Data

CULLMAN BANCORP, INC.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors

Cullman Bancorp, Inc.

Cullman, Alabama

We have audited the accompanying consolidated balance sheets of Cullman Bancorp, Inc. as of December 31, 2011 and 2010, and the related consolidated statements of income and comprehensive income, shareholders equity and cash flows for the years then ended. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Cullman Bancorp, Inc. as of December 31, 2011 and 2010, and the results of its operations and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

/s/ Crowe Horwath LLP

Brentwood, Tennessee

March 9, 2012

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CULLMAN BANCORP, INC.

CONSOLIDATED BALANCE SHEETS

December 31, 2011 and 2010

(All amounts in thousands, except share and per share data)

	2011	2010
ASSETS		
Cash and cash equivalents	$ 1,997	$ 2,368
Federal funds sold	7,479	174
Cash and cash equivalents	9,476	2,542
Securities available for sale	29,706	24,117
Loans, net of allowance of $1,108 and $854, respectively	164,215	177,317
Loans held for sale	441	320
Premises and equipment, net	10,870	10,612
Foreclosed real estate	1,541	1,997
Accrued interest receivable	1,056	1,157
Restricted equity securities	2,410	2,595
Bank owned life insurance	2,455	2,349
Other assets	781	849
Total assets	$ 222,951	$ 223,855
LIABILITIES AND SHAREHOLDERS EQUITY		
Deposits		
Non-interest bearing	$ 9,906	$ 6,188
Interest bearing	128,241	130,211
Total deposits	138,147	136,399
Federal Home Loan Bank advances	42,000	47,000
Long-term debt	787	816
Accrued interest payable and other liabilities	1,624	1,370
Total liabilities	182,558	185,585
Commitments and contingencies (Note 12)		
Shareholders equity		
Common stock, $0.01 par value; 20,000,000 shares authorized; 2,561,996 and 2,512,750 shares outstanding at December 31, 2011 and December 31, 2010	26	25
Additional paid-in capital	10,461	10,330
Retained earnings	30,589	29,134
Accumulated other comprehensive income (loss)	317	(232)
Unearned ESOP shares, at cost	(821)	(887)
Amount reclassified on ESOP shares	(179)	(100)
Total shareholders equity	40,393	38,270

Total liabilities and shareholders equity	$ 222,951	$ 223,855

See accompanying notes to the consolidated financial statements

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CULLMAN BANCORP, INC.

CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

December 31, 2011 and 2010

(All amounts in thousands, except share and per share data)

	2011	2010
Interest and dividend income:		
Loans, including fees	$ 10,799	$ 11,230
Securities, taxable	905	911
Federal funds sold and other	32	15
Total interest income	11,736	12,156
Interest expense:		
Deposits	1,554	2,058
Federal Home Loan Bank advances and other borrowings	1,683	1,988
Total interest expense	3,237	4,046
Net interest income	8,499	8,110
Provision for loan losses	407	506
Net interest income after provision for loan losses	8,092	7,604
Noninterest income:		
Service charges on deposit accounts	409	445
Income on bank owned life insurance	106	108
Gain on sales of mortgage loans	241	321
Net gain (loss) on sales of securities		38
Other	75	52
Total noninterest income	831	964
Noninterest expense:		
Salaries and employee benefits	3,275	2,985
Occupancy and equipment	623	692
Data processing	504	507
Professional and supervisory fees	389	367
Office expense	134	119
Advertising	74	75
Charitable contributions	20	
FDIC deposit insurance	127	154
Net losses on foreclosed real estate	393	267
Other	308	263
Total noninterest expense	5,847	5,429
Income before income taxes	3,076	3,139
Income tax expense	1,087	1,087

Net income	$ 1,989	$ 2,052
Other comprehensive income, net of tax		
Unrealized (loss) gain on securities available for sale, net of tax	549	(272)
Reclassification adjustment for gains realized in income, net of tax		(24)
Other comprehensive (loss) income	549	(296)
Comprehensive income	$ 2,538	$ 1,756
Earnings per share: (Note 17)		
Basic	$ 0.80	$ 0.85
Dilutive	$ 0.80	$ 0.85

See accompanying notes to the consolidated financial statements

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CULLMAN BANCORP, INC.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

Years ended December 31, 2011 and 2010

(All amounts in thousands, except share and per share data)

	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (loss)	Unearned ESOP Shares	Amount Reclassified ESOP Shares	Total
Balance at January 1, 2010	$ 25	$ 10,330	$ 27,082	$ 64	$ (936)	$ (51)	$ 36,514
Net income			2,052				2,052
Net change in accumulated other comprehensive income				(296)			(296)
ESOP shares earned					49		49
Reclassification of common stock in ESOP subject to repurchase obligation						(49)	(49)
Balance at December 31, 2010	25	$ 10,330	$ 29,134	$ (232)	$ (887)	$ (100)	$ 38,270
Net income			1,989				1,989
Net change in accumulated other comprehensive income				549			549
ESOP shares earned		14			66		80
Stock based compensation expense		118					118
Dividends (1)			(534)				(534)
Issuance of 49,249 shares of restricted stock	1	(1)					
Reclassification of common stock in ESOP subject to repurchase obligation						(79)	(79)
Balance at December 31, 2011	$ 26	$ 10,461	$ 30,589	$ 317	$ (821)	$ (179)	$ 40,393

(1) Cash dividends were declared during the first, third and fourth quarters of 2011 of $0.08, $0.08, and $0.08 per share, respectively, on all shares outstanding as of the date of declaration. The Office of Thrift Supervision granted a dividend payment waiver to Cullman Savinsgs Bank, MHC for the March 15, 2011 dividend declaration for all, but 375,000 shares, of the Company s stock held by Cullman Savings Bank. No future dividend waivers are expected to be granted by the Federal Reserve Bank, the regulatory body now responsible for mutual holding companies.

See accompanying notes to the consolidated financial statements

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CULLMAN BANCORP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years Ended December 31, 2011 and 2010

(All amounts in thousands, except share and per share data)

	2011	2010
Cash Flows From Operating Activities		
Net income	$ 1,989	$ 2,052
Adjustments to reconcile net income to net cash from operating activities:		
Provision for loan losses	407	506
Depreciation and amortization, net	257	177
Deferred income tax expense (benefit)	(259)	(26)
Net (gain) loss on sale of securities		(38)
Losses from sales and impairment of foreclosed real estate	393	267
Income on bank owned life insurance	(106)	(108)
Gain on sale of mortgage loans	(241)	(321)
Mortgage loans originated for sale	(10,536)	(15,020)
Mortgage loans sold	10,656	15,466
ESOP compensation expense	80	49
Stock based compensation expense	118	
Net change in operating assets and liabilities		
Accrued interest receivable	101	(130)
Accrued interest payable	(24)	(50)
Other	204	557
Net cash from operating activities	3,039	3,381
Cash Flows From Investing Activities		
Purchases of premises and equipment	(629)	(674)
Purchases of securities	(16,990)	(24,398)
Proceeds from maturities, paydowns and calls of securities	12,267	17,186
Proceeds from sale of securities		750
Proceeds from sales of foreclosed real estate	459	240
Redemptions of restricted equity securities	185	116
Loan originations and payments, net	12,418	(6,447)
Net cash from (used in) investing activities	7,710	(13,227)
Cash Flows from Financing Activities		
Net change in deposits	1,748	11,280
Proceeds from Federal Home Loan Bank advances		6,000
Repayment of Federal Home Loan Bank advances	(5,000)	(10,107)
Repayment of long-term debt	(29)	(17)
Cash payment of dividends	(534)	
Net cash from (used in) financing activities	(3,815)	7,156
Change in cash and cash equivalents	6,934	(2,690)
Cash and cash equivalents, beginning of year	2,542	5,232

Cash and cash equivalents, end of period	$ 9,476	$ 2,542

See accompanying notes to the consolidated financial statements

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CULLMAN BANCORP, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2011 and 2010

(All amounts in thousands, except share and per share data)

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations and Principles of Consolidation: The consolidated financial statements of Cullman Bancorp, Inc. (the Bancorp) include the accounts of its wholly owned subsidiary, Cullman Savings Bank (the Bank) and its 99% ownership of Cullman Village Apartments, (together referred to as the Company). Intercompany transactions and balances are eliminated in the consolidation. The Company is majority owned (54%) by Cullman Savings Bank, MHC. These financial statements do not include the transactions and balances of Cullman Savings Bank, MHC.

The Company provides financial services through its offices in Cullman County, Alabama. Its primary deposit products are checking, savings, and term certificate accounts, and its primary lending products are residential mortgage, commercial, and installment loans. Substantially all loans are secured by specific items of collateral including business assets, consumer assets, and commercial and residential real estate. Commercial loans are expected to be repaid from cash flow from operations of businesses. There are no significant concentrations of loans to any one industry or customer. However, the customers ability to repay their loans is dependent on the real estate and general economic conditions in the area.

On October 8, 2009, the Bank completed its conversion and reorganization from a mutual savings bank into a two-tier mutual holding stock company. In accordance with the plan of reorganization, Cullman Bancorp, Inc. (of which Cullman Savings Bank became a wholly-owned subsidiary) issued and sold shares of capital stock to eligible depositors of Cullman Savings Bank.

Since the entities are under common control, the reorganization was accounted for at historical cost and presented as if the transaction occurred at the beginning of the earliest period shown. A total of 1,080,483 shares were sold in the conversion at $10 per share, raising $10.8 million of gross proceeds. Approximately $900 of conversion expenses were offset against the gross proceeds. Cullman Bancorp, Inc. s common stock began trading on the over-the-counter market under the symbol CULL on October 9, 2009. In addition, the Bank contributed $100 in cash and 50,255 shares of common stock to a charitable foundation that the Bank established in connection with the reorganization. The contribution of cash and shares of common stock totaled $603.

The combination of shares sold to the public and contributed to the charitable foundation represents 46% of the common stock of Cullman Bancorp, Inc. outstanding shares. Cullman Savings Bank, MHC owns 54% or 1,387,312 shares.

Use of Estimates: To prepare financial statements in conformity with U.S. generally accepted accounting principles, management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and the disclosures provided, and actual results could differ. The allowance for loan losses, carrying value of deferred tax assets and fair value of financial instruments are particularly subject to change.

Restrictions on Cash: Cash on hand or on deposit with the Federal Reserve Bank was required to meet regulatory reserve and clearing requirements. These balances do not earn interest.

Cash Flows: Cash and cash equivalents include cash, due from financial institutions, and federal funds sold. Due from financial institutions are deposits with other financial institutions with maturities under 90 days. Net cash flows are reported for customer loan and deposit transactions and due from financial institutions.

Securities: Debt securities are classified as available for sale when they might be sold before maturity. Securities available for sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income, net of tax.

Interest income includes amortization and accretion of purchase premiums and discounts. Premiums and discounts on securities are amortized and accreted using the level-yield method without anticipating prepayments, except for mortgage backed securities where prepayments are anticipated. Gains and losses on sales are recorded on the trade date and determined using the specific identification method.

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CULLMAN BANCORP, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2011 and 2010

(All amounts in thousands, except share and per share data)

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Management evaluates securities for other-than-temporary impairment (OTTI) at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. For securities in an unrealized loss position, management considers the extent and duration of the unrealized loss, and the financial condition and near-term prospects of the issuer. Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: (1) OTTI related to credit loss, which must be recognized in the income statement; and (2) OTTI related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis. For equity securities, the entire amount of impairment is recognized through earnings.

Loans: Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding, net of deferred loan fees and costs, and an allowance for loan losses. Interest income is accrued on the unpaid principal balance. Management defers any material loan fees net of certain direct costs and amortizes these deferred fees or costs into interest income using the level yield method without anticipating prepayments.

Interest income on loans is discontinued at the time the loan is 90 days delinquent unless the loan is well-secured and in process of collection. Past due status is based on the contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful. All interest accrued but not received for loans placed on nonaccrual is reversed against interest income. Interest received on such loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured. Nonaccrual loans and loans past due 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans. A loan is moved to non-accrual status in accordance with the Company s policy, typically after 90 days of non-payment.

Concentration of Credit Risk: Most of the Company s business activity is with current customers located within Cullman County. Therefore, the Company s exposure to credit risk is significantly affected by changes in the economy in the Cullman County area.

Allowance for Loan Losses: The allowance for loan losses is a valuation allowance for probable incurred credit losses. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. Management estimates the allowance balance required 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. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management s judgment, should be charged-off.

The allowance consists of specific and general components. The specific component consists of the amount of impairment related to loans that have been evaluated on an individual basis, and the general component consists of the amount of impairment related to loans that have been evaluated on a collective basis. Loans are considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Loans for which the terms have been modified resulting in a concession, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings.

Troubled debt restructurings are separately identified for impairment disclosures and are measured at the present value of estimated future cash flows using the loan s effective rate at inception. If a troubled debt restructuring is considered to be a collateral dependent loan, the loan is reported, net, at the fair value of the collateral. For troubled debt restructurings that subsequently default, the Company determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses.

The general component covers non-impaired loans and is based on historical loss experience adjusted for current factors. The historical loss experience is determined by portfolio segment and is based on the actual loss history experienced by the Company over the most recent 4 quarters. This actual loss experience is supplemented with other economic factors based on the risks present for each portfolio segment. These economic factors include consideration of the following: levels of and

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CULLMAN BANCORP, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2011 and 2010

(All amounts in thousands, except share and per share data)

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedures, and practices; experience, ability, and depth of lending management and other relevant staff; national and local economic trends and conditions; industry conditions; and effects of changes in credit concentrations.

Management utilizes an internal loan grading system and assigns each loan a grade of pass, special mention, substandard, or doubtful, which are more fully explained in Note 3. All loan relationships over $100 graded substandard and doubtful are evaluated for impairment. The amount of impairment, if any, is measured by a comparison of the loan s carrying value to the net present value of future cash flows using the loan s exiting rate or at the fair value of collateral if repayment is expected to solely from the collateral.

All loans graded pass, special mention, substandard and doubtful not specifically evaluated for impairment are collectively evaluated for impairment by portfolio segment. To develop and document a systematic methodology for determining the portion of the allowance for loan losses for loans evaluated collectively, the Company has divided the loan portfolio into six portfolio segments, each with different risk characteristics and methodologies for assessing risk. Those portfolio segments are discussed below:

One-to-four family: One-to-four family residential loans consist primarily of loans secured by first or second deeds of trust on primary residences. We originate adjustable-rate and fixed-rate, one-to-four-family residential real estate loans for the construction, purchase or refinancing of a mortgage. These loans are collateralized by owner-occupied properties located in the Company s market area. Loans on one-to-four-family residential real estate are generally originated in amounts of up to 90% for owner-occupied one-to-four family homes and up to 80% for non-owner occupied homes. Mortgage title insurance and hazard insurance are normally required. Construction loans have a unique risk, because they are secured by an incomplete dwelling. This risk is reduced through periodic site inspections, including one at each loan draw period.

Commercial real estate: Commercial real estate loans consist of loans to finance real estate purchases, refinancings, expansions and improvements to commercial properties. Commercial real estate loans are made to finance the purchases of real property, which generally consists of real estate with completed structures. These commercial real estate loans are secured by first liens on the real estate, which primarily include office buildings, farms, retail and mixed-use properties, churches, warehouses and restaurants located within the Company s market area. The Company s underwriting analysis includes credit verification, independent appraisals, a review of the borrower s financial condition, and a detailed analysis of the borrower s underlying cash flows.

Commercial real estate loans are larger than one-to-four family residential loans and involve greater credit risk. Often these loans are made to single borrowers or groups of related borrowers, and the repayment of these loans largely depends on the results of operations and management of these properties. Adverse economic conditions also affect the repayment ability to a greater extent than one-to-four real estate loans. These loans are typically originated in amounts of no more than 85% of the appraised value of the property.

Multi-family: Multi-family real estate loans generally have a maximum term of 20 years and are secured by apartment buildings in the Company s market area. The interest rates on these loans are generally fixed for an initial period of three to five years and then adjust every one to five years. These loans are generally made in amounts of up to 80% of the lesser of the appraised value or the purchase price of the property with an appropriate projected debt service coverage ratio. The Company s underwriting analysis includes considering the borrower s expertise and require verification of the borrower s credit history, income and financial statements, banking relationships, independent appraisals, references and income projections for the property. The Company generally obtains personal guarantees on these loans.

Multi-family real estate loans generally present a higher level of risk than loans secured by one-to-four family residences. This greater risk is due to 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 project.

Construction loans: Construction loans consist of loans to individuals for the construction of their primary residences and, to a limited extent, loans to builders and commercial borrowers for owner-occupied projects. Loans to individuals for the construction of their residences typically run for up to 12 months and then convert to permanent loans. These construction

CULLMAN BANCORP, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2011 and 2010

(All amounts in thousands, except share and per share data)

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

loans have rates and terms comparable to one-to-four family loans. During the construction phase, the borrower pays interest only. The maximum loan-to-value ratio of owner-occupied single-family construction loans is 85%. Residential construction loans are generally underwritten pursuant to the same guidelines used for originating permanent residential loans.

Construction loans generally are made for relatively short terms. However, to the extent construction loans are not made to owner-occupants of single-family homes, they are more vulnerable to changes in economic conditions and the concentration of credit with a limited number of borrowers. Further, the nature of these loans is such that they are more difficult to evaluate and monitor. The risk of loss on a construction loan is dependent largely upon the accuracy of the initial estimate of the property s value upon completion of the project and the estimated cost (including interest) of the project.

Commercial: Commercial business loans and lines of credit consist of loans to small- and medium-sized companies in the Company s market area. Commercial business loans are generally used for working capital purposes or for acquiring equipment, inventory or furniture. Interest rates on these loans are floating-rate indexed to the prime rate as published in *The Wall Street Journal* and fixed-rate loans generally for a one-year term. Primarily all of the Company s commercial loans are secured loans, along with a small amount of unsecured loans. The Company s underwriting analysis consists of a review of the financial statements of the borrower, the lending history of the borrower, the debt service capabilities of the borrower, the projected cash flows of the business, the value of the collateral, if any, and whether the loan is guaranteed by the principals of the borrower. Commercial business loans are generally secured by accounts receivable, inventory and equipment.

Commercial business loans are typically are made on the basis of the borrower s ability to make repayment from the cash flow of the borrower s business, which makes them of higher risk than one-to-four family residential loans and the collateral securing loans may depreciate over time, may be difficult to appraise and may fluctuate in value based on the success of the business. We seek to minimize these risks through our underwriting standards.

Consumer: Consumer loans mainly consist of variable-rate and fixed-rate home equity lines-of-credit secured by a lien on the borrower s primary residence. Home equity products are limited to 90% of the property value less any other mortgages. The Company uses the same underwriting standards for home equity lines-of-credit as it uses for one-to-four family residential mortgage loans. The variable-rate home equity line-of-credit product carries an interest rate tied to the prime rate published in *The Wall Street Journal* with a margin that ranges from (100) basis points to 250 basis points. Home equity lines-of-credit provide for an initial draw period of up to five years, with monthly payments of 1.5% of the outstanding balance or interest only payments calculated on the outstanding balance. At the end of the initial five years, the line may be paid in full or restructured through our then current home equity program. The Company has very minimal unsecured consumer loans, such as for automobiles. To that extent, most of our consumer loans share approximately the same level of risk as one-to-four family residential mortgages.

We calculate the amount of impairment or allowance collectively for each portfolio segment by applying internally derived loss factors that we have estimated based on various criteria affecting each segment. These loss factors are derived from both quantitative and qualitative considerations. Historical loss experience per portfolio segment factors significantly into our estimation and is based on our consideration of historical losses for the previous four quarters, including the quarter in which the allowance is calculated. In addition to historical loss factors, we evaluate internal trends in each segment such as delinquencies and foreclosures, and we evaluate external trends such as current economic conditions and demographic unemployment rates, population density, real estate values, and charge-off trends of other comparable institutions, taking into consideration how each of the factors influence the risk within each portfolio segment. For all portfolio segments, we also consider the results of any internal loan reviews; loan to value ratios; our historically conservative credit risk policy; the strength of our underwriting and ongoing credit monitoring function; and other relevant factors.

Loans Held for Sale: Mortgage loans originated and intended for sale in the secondary market are carried at the lower of aggregate cost or market, as determined by outstanding commitments from investors. Net unrealized losses, if any, are recorded as a valuation allowance and charged to earnings. Mortgage loans held for sale are generally sold with servicing rights released. Gains and losses on sales of mortgage loans are based on the difference between the selling price and the carrying value of the related loan sold.

Mortgage Banking Derivatives: Commitments to fund mortgage loans (interest rate locks) to be sold into the secondary market and forward commitments for the future delivery of these mortgage loans are accounted for as derivatives not qualifying for hedge accounting. The fair values of these derivatives have not been recognized at 2011 and 2010 because they are not significant.

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CULLMAN BANCORP, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2011 and 2010

(All amounts in thousands, except share and per share data)

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Premises and Equipment: Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation. Buildings and related components are depreciated using the straight-line method with useful lives ranging from 5 to 39 years. Furniture, fixtures and equipment are depreciated using the straight-line (or accelerated) method, with useful lives ranging from 5 to 7 years.

Foreclosed Real Estate: Real estate acquired through loan foreclosure is recorded at fair value less cost to sell at the date of foreclosure. Subsequently, these assets are accounted for at the lower of cost or fair value less costs to sell. Valuations are periodically performed and any reductions in fair value result in a write down of the carrying value and a charge to the income statement. Revenues and expenses from operations are recognized in the income statement as earned or incurred.

Restricted Equity Securities: The Company is a member of the FHLB system. Members are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. FHLB stock is carried at cost, classified as a restricted security, periodically evaluated for impairment based on ultimate recovery of par value. Both cash and stock dividends are reported as income.

Income Taxes: Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates. The principal differences relate to premises and equipment and the allowance for loan losses. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized.

A tax position is recognized as a benefit only if it is more likely than not that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the more likely than not test, no tax benefit is recorded.

The Company recognizes interest and/or penalties related to income tax matters in income tax expense.

Comprehensive Income: Comprehensive income consists of net income and other comprehensive income. Other comprehensive income includes unrealized gains and losses on securities available for sale which are also recognized as a separate component of equity.

Investment Tax Credit: During 1996, the Company invested $1,146 for a 99% interest as a limited partner in a 40-unit affordable housing project, Cullman Village Apartments. The Company is allocated tax credits and tax deductions for its investment in the project. The tax credits were for the first 10 years of the life of the project. However, the Company continues to receive tax benefits for the losses incurred in this project. The portion of losses for 2011 and 2010 were ($24) and $(33), respectively. The Company has determined that Cullman Village Apartments is a variable interest entity (VIE) and that the Company is the primary beneficiary of the VIE s activities and therefore consolidates the activities of the VIE into its financial statements. The total consolidated net assets of the VIE At December 31, 2011 and 2010 were approximately $596 and $612, respectively. Because of the immateriality of the balances, additional required disclosures have been omitted.

Loss Contingencies: Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Management does not believe there now are such matters that will have a material effect on the financial statements.

Stock-Based Compensation: Compensation cost is recognized for stock options and restricted stock awards issued to employees, based on the fair value of these awards at the date of grant. A Black-Scholes model is utilized to estimate the fair value of stock options, while the market price of the Company s common stock at the date of grant is used for restricted stock awards. Compensation cost is recognized over the required service period, generally defined as the vesting period. For awards with graded vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award.

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CULLMAN BANCORP, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2011 and 2010

(All amounts in thousands, except share and per share data)

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Loan Commitments and Related Financial Instruments: Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and commercial letters of credit, issued to meet customer financing needs. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded. The fair value of standby letters of credit at December 31, 2011 and 2010 were not significant and have not been recorded.

Fair Value of Financial Instruments: Fair values of financial instruments are estimated using relevant market information. Changes in market conditions could significantly affect the estimates. For financial instruments where there is little or no relevant market information due to limited or no market activity, the Company estimates the fair value of these instruments through the use of a discounted present value of estimated cash flows technique, which includes the Company s own assumptions as to the amounts and timing of cash flows, adjusted for risk factors related to nonperformance and liquidity. The Company s assumptions are based on an exit price strategy and take into consideration the assumptions that a willing market participant would use about nonperformance and liquidity risk.

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

Retirement Plans: Employee 401(k) and profit sharing plan expense is the amount of matching contributions. Deferred compensation and supplemental retirement plan expense allocates the benefits over years of service.

Company Owned Life Insurance: The Company has purchased life insurance policies on certain officers and directors. Accounting guidance requires Company owned life insurance to be recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

Operating Segments: While the chief decision makers monitor the revenue streams of the various products and services, operations are managed and financial performance is evaluated on a Company-wide basis. Operating segments are aggregated into one as operating results for all segments are similar. Accordingly, all of the financial service operations are considered by management to be aggregated into one operating segment.

Employee Stock Ownership Plan: The cost of shares issued to the ESOP, but not yet allocated to participants, is shown as a reduction of shareholders equity. Compensation expense is based on the market price of shares as they are committed to be released to participant accounts. Dividends, when paid, on allocated ESOP shares reduce retained earnings; dividends, when paid, on unearned ESOP shares reduce debt and accrued interest. Participants may put their ESOP shares back to the Company upon termination, and an amount of equity equal to the fair value of the shares is reclassified out of shareholders equity and into other liabilities.

Earnings Per Common Share: Basic earnings per common share is earnings allocated to common stock divided by the weighted average number of common shares outstanding during the period. ESOP shares are considered outstanding for this calculation unless unearned. Basic EPS is determined by dividing net earnings available to common shareholders by the weighted average number of common shares outstanding for the period. ESOP shares are considered outstanding for this calculation unless unearned. Diluted EPS is determined by dividing net earnings available to common shareholders by the weighted average number of common shares outstanding for the period, adjusted for the dilutive effect of common share equivalents

Dividend Restriction: Banking regulations require maintaining certain capital levels and may limit the dividends paid by the Bank to the Bancorp or by the Bancorp to shareholders.

New Accounting Standards: ASU 2011-02, Receivables (Topic 310): A Creditor s Determination of Whether a Restructuring is a Troubled Debt Restructuring provides additional guidance to clarify when a loan modification or restructuring is considered a troubled debt restructuring (TDR) in order to address current diversity in practice and lead to more consistent application of U.S. GAAP for debt restructurings. In evaluating whether a restructuring constitutes a troubled debt restructuring, a creditor must separately conclude that both of the following exist: (1) the restructuring constitutes a concession, and (2) the debtor is experiencing financial difficulties. The amendments to Topic 310 clarify the guidance regarding the evaluation of both considerations above. Additionally, the amendments clarify that a creditor is precluded from using the effective interest rate test in the debtor s guidance on restructuring of payables (paragraph 470-60-55-10) when evaluating whether a restructuring constitutes a TDR. This amendment is effective for us July 1, 2011. Early adoption is permitted.

CULLMAN BANCORP, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Retrospective application to the beginning of the annual period of adoption for modifications occurring on or after the beginning of the annual adoption period is required. As a result of applying these amendments, the Company may identify receivables that are newly considered to be impaired. For purposes of measuring impairment of those receivables, an entity should apply the amendments prospectively for the first interim or annual period beginning on or after June 15, 2011. The Company has complied with this update and the changes are reflected in our financial statements. The effect of adopting this standard did not have a material effect on the Company s operating results or financial condition.

Newly Issued Not Yet Effective

In May 2011, the FASB issued ASU No. 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. This ASU represents the converged guidance of the FASB and the IASB (the Boards) on fair value measurement. The collective efforts of the Boards and their staffs, reflected in ASU 2011-04, have resulted in common requirements for measuring fair value and for disclosing information about fair value measurements, including a consistent meaning of the term fair value. The Boards have concluded the common requirements will result in greater comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with U.S. GAAP and IFRSs. The amendments to the FASB Accounting Standards Codification in this ASU are to be applied prospectively. For public entities, the amendments are effective during interim and annual periods beginning after December 15, 2011. Early application by public entities is not permitted. The Company is currently in the process of evaluating the impact that this ASU may have on the consolidated financial statements.

In June 2011, the FASB issued ASU No. 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income. This ASU amends the FASB Accounting Standards Codification to allow an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. ASU 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of changes in shareholders equity. The amendments to the Codification in the ASU do not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. ASU 2011-05 should be applied retrospectively. For public entities, the amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. Early adoption is permitted. The Company is currently in the process of evaluating the impact that this ASU may have on the consolidated financial statements.

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NOTE 2 SECURITIES AVAILABLE FOR SALE

The fair value of available for sale securities and the related gross unrealized gains and losses recognized in accumulated other comprehensive income (loss) at December 31, 2011 and 2010 were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
2011				
U.S. Government sponsered agencies	$ 19,989	$ 29	$ (25)	$ 19,993
Municipal - taxable	5,146	327		5,473
Residential mortgage-backed, GSE	2,032	93		2,125
Residential mortgage-backed, private label	623	8		631
Ultra Short mortgage mutual fund	1,414	70		1,484
Total	$ 29,204	$ 527	$ (25)	$ 29,706
2010				
U.S. Government sponsered agencies	$ 13,997	$ 13	$ (478)	$ 13,532
Municipal - taxable	5,154	23	(122)	5,055
Residential mortgage-backed, GSE	2,959	92		3,051
Residential mortgage-backed, private label	961	22		983
Ultra Short mortgage mutual fund	1,414	82		1,496
Total	$ 24,485	$ 232	$ (600)	$ 24,117

The Company s mortgage-backed securities are primarily issued by government sponsored enterprises (GSEs) and agencies such as Fannie Mae and Ginnie Mae as denoted in the tables above and below as GSE. At December 31, 2011 and 2010, the Company had only one private label mortgage-backed security.

Sales of available for sale during the years ended December 31, 2011 and 2010 securities were as follows:

	2011	2010
Proceeds	$	$ 750
Gross gains		38
Gross losses		
Tax benefits (provision)		(15)

The amortized cost and fair value of the investment securities portfolio are shown below by expected maturity. Expected maturities may differ from contractual maturities if borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

	December 31, 2011		December 31, 2010	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due from one to five years	$	$	$	$
Due from five to ten years	10,502	10,555	4,004	3,885
Due after ten years	14,633	14,911	15,147	14,702
Mutual fund	1,414	1,484	1,414	1,496
Residential mortgage-backed	2,655	2,756	3,920	4,034
Total	$ 29,204	$ 29,706	$ 24,485	$ 24,117

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NOTE 2 SECURITIES AVAILABLE FOR SALE (Continued)

Carrying amounts of securities pledged to secure public deposits, repurchase agreements, and Federal Home Loan Bank advances as of December 31, 2011 and 2010 were $6,786 and $6,320, respectively. At December 31, 2011 and 2010, there were no holdings of securities of any one issuer, other than the U.S. Government and its agencies in an amount greater than 10% of shareholders equity.

Securities with unrealized losses at December 31, 2011 and 2010, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, are as follows:

	Less than 12 months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
2011						
U.S. Government sponsered agencies	$ 7,970	$ (25)	$	$	$ 7,970	$ (25)
Total temporarily impaired	$ 7,970	$ (25)			$ 7,970	$ (25)
2010						
U.S. Government sponsered agencies	$ 10,519	$ (478)	$	$	$ 10,519	$ (478)
Municipal - taxable	3,589	(122)			3,589	(122)
Total temporarily impaired	$ 14,108	$ (600)	$	$	$ 14,108	$ (600)

There were seven US Government sponsored agency securities with unrealized losses at December 31, 2011. None of the unrealized losses for these securities have been recognized into net income for the year ended December 31, 2011 because the issuer s bonds are of high credit quality, management does not intend to sell and it is likely that management will not be required to sell the securities prior to their anticipated recovery, and the decline in fair value is largely due to changes interest rates. The fair value is expected to recover as the bonds approach their maturity date or reset date.

The Company evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. The Company considers the length of time and the extent to which the fair value has been less than cost and the financial condition and near-term prospects of the issuer. Additionally, the Company considers its intent to sell or whether it will be more likely than not it will be required to sell the security prior to the security s anticipated recovery in fair value. In analyzing an issuer s financial condition, the Company may consider whether the securities are issued by the federal Government sponsored agencies, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer s financial condition.

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(All amounts in thousands, except share and per share data)

NOTE 3 LOANS

Loans at December 31, 2011 and 2010 were as follows:

	2011	2010
Real estate loans:		
One- to four-family	$ 78,869	$ 83,721
Multi-family	5,184	4,837
Commercial real estate	63,336	63,443
Construction	1,667	8,936
Total real estate loans	149,056	160,937
Commercial loans	7,221	7,371
Consumer loans:		
Home equity loans and lines of credit	5,286	6,165
Other consumer loans	4,097	4,111
Total loans	165,660	178,584
Net deferred loan fees	(337)	(413)
Allowance for loan losses	(1,108)	(854)
Loans, net	$ 164,215	$ 177,317

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CULLMAN BANCORP, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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NOTE 3 LOANS (Continued)

The following tables present the activity in the allowance for loan losses for the years ended December 31, 2011 and 2010. The recorded investment in loans in any of the following tables does not include accrued and unpaid interest or any deferred loan fees or costs, as amounts are not significant.

	Real estate						
December 31, 2011	**One-to-Four Family**	**Multi-family**	**Commercial**	**Construction**	**Commercial**	**Consumer**	**Total**
Allowance for loan losses:							
Beginning balance	$ 332	$ 9	$ 356	$ 9	$ 47	$ 101	$ 854
Charge-offs	(33)		(78)			(52)	(163)
Recoveries						10	10
Provisions	241	1	135	(7)	(29)	66	407
Ending balance	$ 540	$ 10	$ 413	$ 2	$ 18	$ 125	$ 1,108
Ending allowance attributed to loans:							
Individually evaluated for impairment	240		110				$ 350
Collectively evaluted for impairment	300	10	303	2	18	125	758
Total ending allowance balance:	$ 540	$ 10	$ 413	$ 2	$ 18	$ 125	$ 1,108
Loans:							
Loans individually evaluated for impairment:	$ 2,582	$ 1,910	$ 1,712	$	$ 99	$ 122	$ 6,425
Loans collectively evaluated for impairment:	76,287	3,274	61,624	1,667	7,122	9,261	159,235
Total ending loans balance	$ 78,869	$ 5,184	$ 63,336	$ 1,667	$ 7,221	$ 9,383	$ 165,660

December 31, 2010	**One-to-Four Family**	**Multi-family**	**Commercial**	**Construction**	**Commercial**	**Consumer**	**Total**
Allowance for loan losses:							
Ending allowance attributed to loans:							
Individually evaluated for impairment	$	$	$ 95	$	$ 25	$	$ 120
Collectively evaluted for impairment	332	9	261	9	22	101	734
Total ending allowance balance:	$ 332	$ 9	$ 356	$ 9	$ 47	$ 101	$ 854

Loans:							
Loans individually evaluated for impairment:	$ 2,713	$ 1,993	$ 3,724	$	$ 112	$ 165	$ 8,707
Loans collectively evaluated for impairment:	81,008	2,844	59,719	8,936	7,259	10,111	169,877
Total ending loans balance	$ 83,721	$ 4,837	$ 63,443	$ 8,936	$ 7,371	$ 10,276	$ 178,584

The following table presents the activity in the allowance for loan losses for the year ended December 31, 2010:

	2010
Beginning balance	$ 747
Charge-offs	(422)
Recoveries	23
Provisions	506
Ending balance	$ 854

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CULLMAN BANCORP, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2011 and 2010

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NOTE 3 LOANS (Continued)

The following table presents loans individually evaluated for impairment by portfolio class at December 31, 2011 and 2010:

	December 31, 2011					December 31, 2010		
	Unpaid principal balance	Recorded investment	Related allowance	Average Recorded Investment	Interest Income Recognized	Unpaid principal balance	Recorded investment	Related allowance
With no recorded allowance:								
Real estate loans:								
One- to four-family	$ 1,367	$ 1,367	$	$ 1,255	$ 88	$ 2,714	$ 2,714	$
Multi-family	1,910	1,910		1,939	138	1,993	1,993	
Commercial	1,515	1,515		3,030	167	3,445	3,445	
Contraction								
Total real estate loans	4,792	4,792		6,224	393	8,152	8,152	
Commercial	99	99		52	1	61	61	
Consumer:								
Home equity loans and lines of credit	122	122		131	3	165	165	
Other consumer loans								
Total	$ 5,013	$ 5,013	$	$ 6,407	$ 397	$ 8,378	$ 8,378	$
With recorded allowance:								
Real estate loans:								
One- to four-family	$ 1,215	$ 1,215	$ 240	$ 1,120	$ 34	$	$	$
Multi-family								
Commercial	197	197	110	179		280	280	95
Contraction								
Total real estate loans	1,412	1,412	350	1,299	34	280	280	95
Commercial				40		49	49	25
Consumer:								
Home equity loans and lines of credit								
Other consumer loans								
Total	$ 1,412	$ 1,412	$ 350	$ 1,338	$ 34	$ 329	$ 329	$ 120

The recorded investment amounts do not include accrued and unpaid interest or any deferred loan fees or costs due to immateriality. Interest income recognized during the impairment period in December 31, 2011 and 2010 was $431 and $197, respectively. The difference between interest income recognized and cash basis interest income recognized was not material. The average recorded investment of individually impaired loans during the year ended December 31, 2010 was $3,783.

CULLMAN BANCORP, INC.

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NOTE 3 LOANS (Continued)

The following table presents the aging of the recorded investment in past due loans at December 31, 2011and 2010 by portfolio class of loans:

December 31, 2011	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans	Accruing loans past due 90 days or more
Real estate loans:							
One- to four-family	$ 2,157	$ 130	$ 122	$ 2,409	$ 76,460	$ 78,869	$
Multi-family					5,184	5,184	
Commercial	32			32	63,304	63,336	
Construction					1,667	1,667	
Total real estate loans	2,189	130	122	2,441	146,615	149,056	
Commercial loans	150	25		175	7,046	7,221	
Consumer loans:							
Home equity loans and lines of credit					5,286	5,286	
Other consumer loans	84	2		86	4,011	4,097	
Total	$ 2,423	$ 157	$ 122	$ 2,702	$ 162,958	$ 165,660	$

December 31, 2010	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans	Accruing loans past due 90 days or more
Real estate loans:							
One- to four-family	$ 654	$ 118	$ 61	$ 833	$ 82,888	$ 83,721	$
Multi-family	613			613	4,224	4,837	
Commercial		107	156	263	63,180	63,443	
Construction					8,936	8,936	
Total real estate loans	1,267	225	217	1,709	159,228	160,937	
Commercial loans					7,371	7,371	

Consumer loans:							
Home equity loans and lines of credit	75	120	4	199	5,966	6,165	
Other consumer loans	7	1		8	4,103	4,111	
Total	$ 1,349	$ 346	$ 221	$ 1,916	$ 176,668	$ 178,584	$

Nonaccrual loans at December 31, 2011 and 2010 were $1,572 and $221, respectively. These loans are disclosed in one-to-four family class above at December 31, 2011. These loans are disclosed by portfolio class above in the 90 days or more past due column at December 31, 2010. Additional required disclosure by class was deemed immaterial to the financial statements. Non-performing loans and loans past due 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

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CULLMAN BANCORP, INC.

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NOTE 3 LOANS (Continued)

Troubled Debt Restructurings:

Troubled debt restructurings at December 31, 2011 and 2010 were $3,033 and $5,459, respectively. The amount of impairment allocated to loans whose loan terms have been modified in troubled debt restructurings at December 31, 2011 and 2010 was $260 and $35, respectively. The Company has committed to no additional amounts at December 31, 2011 to customers with outstanding loans that are classified as troubled debt restructurings.

During the year ended December 31, 2011, the terms of certain loans were modified as troubled debt restructurings. The modification of the terms of such loans included one or a combination of the following: a reduction of the stated interest rate of the loans; an extensions of the maturity date at a stated rate of the loan; an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risks.

The following table presents loans by class modified as troubled debt restructurings that occurred during year ended December 31, 2011:

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings:			
Real estate loans:			
One- to four-family	2	$ 193	$ 193
Multi-family			
Commercial real estate	1	73	73
Construction			
Total real estate loans	3	266	266
Commercial loans	1	50	50
Consumer loans			
Total	4	$ 316	$ 316

The troubled debt restructurings described above did not have a material effect on the allowance for loan losses and there were no charge offs during the year ended December 31, 2011.

There were two residential real estate loans with a recorded investment of $709 that were modified as troubled debt restructurings for which there was a payment default within twelve months following the modification during the year ended December 31, 2011. A loan is considered to be in payment default once it is 60 days contractually past due under the modified terms. The troubled debt restructurings that subsequently defaulted as described above did not increase the allowance for loans losses but resulted in charge offs of $31 during year ended December 31, 2011.

In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification. This evaluation is performed under the Company s internal underwriting policy.

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NOTE 3 LOANS (Continued)

Credit Quality Indicators:

The Company utilizes a grading system whereby all loans are assigned a grade based on the risk profile of each loan. Loan grades are determined based on an evaluation of relevant information about the ability of borrowers to service their debt such as current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. All loans, regardless of size, are analyzed and are given a grade based upon the management s assessment of the ability of borrowers to service their debts. The analysis is performed on a quarterly basis.

The Company uses the following definitions for loan grades:

Special Mention. Loans classified as special mention have a potential weakness that deserves management s close attention. If left uncorrected, these potential weaknesses may result in deterioration of repayment prospects for the loan or of the institution s credit position at some future date.

Substandard. Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Doubtful. Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Loans not meeting the criteria above are graded Pass. These loans are included within groups of homogenous pools of loans based upon portfolio segment and class for estimation of the allowance for loan losses on a collective basis. Loan relationships graded substandard and doubtful of $100 or more are individually evaluated for impairment.

At December 31, 2011 and 2010, based on the most recent analysis performed, the loan grade for each loan by portfolio class is as follows:

	Real estate							
	One-to-four Family		Multi-family		Commercial		Construction	
	2011	**2010**	**2011**	**2010**	**2011**	**2010**	**2011**	**2010**
Pass	$ 74,761	$ 78,909	$ 3,274	$ 2,844	$ 54,291	$ 51,184	$ 1,667	$ 8,936
Special mention	1,041	955			7,223	6,987		
Substandard	3,067	3,857	1,910	1,993	1,822	5,272		
Doubtful								

Total	$ 78,869	$ 83,721	$ 5,184	$ 4,837	$ 63,336	$ 63,443	$ 1,667	$ 8,936

	Commercial		Home Equity Loans and Lines of Credit		Other Consumer Loans		Totals	
	2011	2010	2011	2010	2011	2010	2011	2010
Pass	$ 7,122	$ 7,234	$ 5,164	$ 6,165	$ 4,066	$ 4,107	$ 150,345	$ 159,379
Special mention					25		8,289	7,942
Substandard	99	137	122		6	4	7,026	11,263
Doubtful								
Total	$ 7,221	$ 7,371	$ 5,286	$ 6,165	$ 4,097	$ 4,111	$ 165,660	$ 178,584

CULLMAN BANCORP, INC.

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NOTE 4 PREMISES AND EQUIPMENT

Premises and equipment at December 31, 2011 and 2010 were as follows:

	2011	2010
Land	$ 1,820	$ 1,820
Construction in progress		42
Buildings and improvements	13,857	13,345
Furniture, fixtures and equipment	1,999	1,840
	17,676	17,047
Less: Accumulated depreciation	(6,806)	(6,435)
	$ 10,870	$ 10,612

Depreciation expense for the years ended December 31, 2011 and 2010 was $371 and $386, respectively.

NOTE 5 DEPOSITS

Time deposits of $100 or more at December 31, 2011 and 2010 were $41,468 and $42,516, respectively. Scheduled maturities of time deposits at December 31, 2011 for the next five years were as follows:

	2011
2012	47,159
2013	19,818
2014	1,420
2015	7,501
2016	682

NOTE 6 FEDERAL HOME LOAN BANK ADVANCES

At December 31, 2011 and 2010, there were $42,000 and $47,000 in Federal Home Loan Bank advances, respectively. Interest rates on these advances ranged from 1.56 % to 5.03% during the periods ended December 31, 2011 and 2010, respectively. Maturity dates ranged from October 2013 to October 2025. The average rate on advances was 3.48% and 3.61% at December 31, 2011 and 2010, respectively.

Each advance is payable at its maturity date, with a prepayment penalty for fixed rate advances. The advances were collateralized by $90,050 and $97,834 of first mortgage loans under a blanket lien arrangement at December 31, 2011 and 2010, respectively. Based on this collateral and the Company s holdings of FHLB stock, the Company is eligible to borrow up to a total of $50,990 at year-end 2011.

The FHLB advances at December 31, 2011 mature over the next five years as follows:

	2011
2012	$
2013	5,000
2014	
2015	7,000
2016	5,000

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NOTE 6 FEDERAL HOME LOAN BANK ADVANCES (Continued)

Of the $42,000 outstanding FHLB advances at December 31, 2011, there are $25,000 in convertible rate advances that will convert to variable rate advances with interest rates based upon LIBOR. At the conversion date, the Company has the option to renew these advances or repay the balances without penalty.

Information related to the Company s convertible rate advances at December 31, 2011 is described in the following table:

Maturity Date	Next Option Date	Current Interest Rate	Balance
7/31/2017	1/31/2012	4.08%	$ 5,000
1/22/2018	1/22/2013	3.41%	5,000
5/14/2018	5/14/2013	3.64%	