

CITIZENS COMMUNITY BANCORP  
Form 10QSB  
May 11, 2006

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

**FORM 10-QSB**

**(Mark One)**

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

For the quarterly period ended **March 31, 2006**

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission file number \_\_\_\_\_

**CITIZENS COMMUNITY BANCORP**

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

**United States**

**20-0663325**

(State or other jurisdiction of incorporation or  
organization)

(IRS Employer Identification Number)

**2174 EastRidge Center, Eau Claire, WI 54701**

(Address of principal executive offices)

**715-836-9994**

Issuer's telephone number)

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

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

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

**APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY  
PROCEEDINGS DURING THE PRECEDING FIVE YEARS**

Check whether the registrant filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Exchange Act after the distribution of securities under a plan confirmed by a court. Yes / / No / /

**APPLICABLE ONLY TO CORPORATE ISSUERS**

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

**At April 30, 2006, there were 3,724,628 shares of the issuers' common stock outstanding**

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

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**CITIZENS COMMUNITY BANCORP**

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For the Six Months ended March 31, 2006 and 2005

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**CITIZENS COMMUNITY BANCORP**

**Consolidated Balance Sheets**

**March 31, 2006 unaudited, and September 30, 2005 derived from audited financial statements**

<i>Assets</i>	<i>March 31, 2006</i>	<i>September 30, 2005</i>
Cash and cash equivalents	\$4,296,325	\$9,265,477
Other interest-bearing deposits	\$1,152,900	\$1,444,233
Securities available-for-sale (at fair value)	\$1,839,081	\$2,088,349
Federal Home Loan Bank stock	\$1,826,480	\$2,094,900
Loans Receivable	\$235,131,410	\$218,733,884
Allowance for Loan Losses	(\$807,766)	(\$803,218)
Loans receivable - Net	\$234,323,644	\$217,930,666

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Office properties and equipment - Net	\$3,611,821	\$2,922,884
Accrued interest receivable - Loans	\$749,953	\$612,644
Intangible assets	\$1,980,170	\$2,130,949
Goodwill	\$5,465,619	\$5,465,619
Other assets	\$1,379,029	\$1,751,770
<b>TOTAL ASSETS</b>	<b>\$256,625,022</b>	<b>\$245,707,491</b>
Liabilities and Equity	March 31, 2006	September 30, 2005
Liabilities:		
Deposits	\$188,298,100	\$177,469,100
Federal Home Loan Bank Advances	\$36,200,000	\$36,200,000
Other Liabilities	\$2,312,833	\$2,484,991
Total Liabilities	<b>\$226,810,933</b>	<b>\$216,154,091</b>
Stockholders' Equity:		
Common Stock - 3,747,319 Shares issued	\$37,473	\$37,473
Additional Paid-in Capital	\$18,796,945	\$18,779,709
Retained Earnings	\$12,690,688	\$12,536,512
Unearned ESOP Shares	(\$953,820)	(\$1,013,460)
Unearned Compensation	(\$340,749)	(\$389,169)
Accumulated other comprehensive loss	(\$22,226)	(\$3,654)
Treasury Stock at cost, - 26,267 and 26,251 shares, respectively	(\$394,222)	(\$394,011)
Total Stockholders' Equity	<b>\$29,814,089</b>	<b>\$29,553,400</b>
<b>TOTAL LIABILITIES AND EQUITY</b>	<b>\$256,625,022</b>	<b>\$245,707,491</b>

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**CITIZENS COMMUNITY BANCORP**

**Consolidated Statements of Income - Unaudited  
For the Three and Six Months Ended March 31, 2006 and 2005**

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	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>March 31, 2006</b>	<b>March 31, 2005</b>	<b>March 31, 2006</b>	<b>March 31, 2005</b>
<b>Interest and Dividend Income:</b>				
Interest and fees on loans	\$3,697,102	\$2,718,624	\$7,304,728	\$5,353,499
Other interest and dividend income	\$84,966	\$21,090	\$219,072	\$43,378
<b>Total interest and dividend income</b>	<b>\$3,782,068</b>	<b>\$2,739,714</b>	<b>\$7,523,800</b>	<b>\$5,396,877</b>
<b>Interest expense:</b>				
Interest on deposits	\$1,240,964	\$797,412	\$2,367,794	\$1,455,950
Notes Payable Interest	\$393,620	\$64,752	\$772,884	\$192,871
<b>Total interest expense</b>	<b>\$1,634,584</b>	<b>\$862,164</b>	<b>\$3,140,678</b>	<b>\$1,648,821</b>
<b>Net Interest Income</b>	<b>\$2,147,484</b>	<b>\$1,877,550</b>	<b>\$4,383,122</b>	<b>\$3,748,056</b>
Provision for loan losses	\$38,400	\$102,133	\$108,451	\$202,136
<b>Net interest income after provision for loan losses</b>	<b>\$2,109,084</b>	<b>\$1,775,417</b>	<b>\$4,274,671</b>	<b>\$3,545,920</b>
<b>Noninterest Income:</b>				
Service charges on deposit accounts	\$230,083	\$176,370	\$475,265	\$370,433
Insurance commissions	\$88,087	\$97,905	\$165,477	\$196,660
Loan fees and service charges	\$95,246	\$80,715	\$194,534	\$148,508
Securities Gains	\$0	\$0	\$27,110	\$0
Other	\$3,696	\$388,572	\$7,805	\$392,899
<b>Total Noninterest Income</b>	<b>\$417,112</b>	<b>\$743,562</b>	<b>\$870,191</b>	<b>\$1,108,500</b>
<b>Noninterest expense:</b>				
Salaries and related benefits	\$1,405,767	\$1,121,223	\$2,771,676	\$2,183,639
Occupancy - Net	\$250,996	\$188,925	\$468,290	\$349,893
Office	\$215,633	\$147,289	\$428,457	\$299,869
Data processing	\$106,147	\$77,466	\$207,133	\$154,528
Other	\$408,458	\$341,465	\$843,460	\$684,215
<b>Total noninterest expense</b>	<b>\$2,387,001</b>	<b>\$1,876,368</b>	<b>\$4,719,016</b>	<b>\$3,672,144</b>
<b>Income before provision for income tax</b>	<b>\$139,195</b>	<b>\$642,611</b>	<b>\$425,846</b>	<b>\$982,276</b>
Provision for income taxes	\$56,744	\$258,705	\$176,252	\$398,286
<b>Net income</b>	<b>\$82,451</b>	<b>\$383,906</b>	<b>\$249,594</b>	<b>\$583,990</b>

## Per Share Information:

Basic Earnings	\$0.02	\$0.13	\$0.07	\$0.20
Diluted Earnings	\$0.02	\$0.13	\$0.07	\$0.20
Dividends Paid	\$0.05	\$0.05	\$0.10	\$0.10

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## CITIZENS COMMUNITY BANCORP

**Consolidated Statements of  
Changes in Stockholders' Equity - Unaudited  
For the Six Months ended March 31, 2006 and 2005**

	Shares	Common Stock	Additional Paid-In Capital	Retained Earnings	Unearned ESOP Shares	Unearned Compensation	Accumulated Other Comprehensive Loss	Treasury Stock	Total
Six Months Ended March 31, 2006									
Balance - Beginning of Period	3,747,319	\$37,473	\$18,779,709	\$12,536,512	(\$1,013,460)	(\$389,169)	(\$3,654)	(\$394,011)	<b>\$29,553,400</b>
Comprehensive Income:									
Net Income				\$249,594					\$249,594
Net Unrealized Loss on Available for Sale Securities							(\$18,572)		(\$18,572)
Total Comprehensive Income									<b>\$231,022</b>
Committed ESOP Shares					\$59,640				\$59,640
Appreciation in fair value of ESOP shares charged to expense			\$17,236						\$17,236
16 Shares of Common Stock Purchased from Employee 401K Retirement Plan								(\$211)	(\$211)
Amortization of Restricted Stock						\$48,420			\$48,420
Cash Dividends (\$0.10 per share)				(\$95,418)					(\$95,418)
Balance - End of Period	<b>3,747,319</b>	<b>\$37,473</b>	<b>\$18,796,945</b>	<b>\$12,690,688</b>	<b>(\$953,820)</b>	<b>(\$340,749)</b>	<b>(\$22,226)</b>	<b>(\$394,222)</b>	<b>\$29,814,089</b>

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	Shares	Common Stock	Additional Paid-In Capital	Retained Earnings	Unearned ESOP Shares	Unearned Compensation	Accumulated Other Comprehensive Loss	Treasury Stock	Total
Six Months Ended March 31, 2005									
Balance - Beginning of period	3,041,750	\$30,418	\$9,029,696	\$11,678,549	(\$1,132,740)	\$0	\$0	\$0	\$19,605,923
Comprehensive Income:									
Net Income				\$583,990					\$583,990
Other Comprehensive Income				\$0					\$0
Total Comprehensive Income				<b>\$583,990</b>					<b>\$583,990</b>
59,618 Shares of Common Stock purchased for									
Recognition and Retention Plan								(\$894,866)	(\$894,866)
Committed ESOP shares			\$25,327		\$59,640				\$84,967
33,386 Shares of Common Stock Awarded for									
Recognition and Retention Plan			(\$52,082)			(\$449,042)		\$501,124	\$0
Amortization of Restricted Stock						\$14,968			\$14,968
Cash dividends (\$0.10 per share)				(\$97,866)					(\$97,866)
Balance - End of Period	<b>3,041,750</b>	<b>\$30,418</b>	<b>\$9,002,941</b>	<b>\$12,164,673</b>	<b>(\$1,073,100)</b>	<b>(\$434,074)</b>	<b>\$0</b>	<b>(\$393,742)</b>	<b>\$19,297,116</b>

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**CITIZENS COMMUNITY BANCORP**

**Consolidated Statements of Cash Flows - Unaudited  
For the Six Months ended March 31, 2006 and 2005**

	<i>March 31, 2006</i>	<i>March 31, 2005</i>
Increase (decrease) in cash and cash equivalents:		
Cash flows from operating activities:		
Net Income	\$249,594	\$583,990

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Adjustments to reconcile net income to net cash provided  
by operating activities:

Provision for depreciation	\$181,276	\$123,051
Provision for loan losses	\$108,451	\$202,136
Amortization of core deposit intangible	\$150,779	\$12,765
Amortization of Restricted Stock	\$48,421	\$14,968
Federal Home Loan Bank stock dividends	(\$16,480)	(\$23,900)
ESOP contribution expense in excess of shares released	\$17,236	\$25,327
Increase (decrease) in accrued interest receivable and other assets	\$235,432	(\$299,979)
Increase (decrease) in other liabilities	(\$172,158)	\$291,105
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Total adjustments	\$552,957	\$345,473
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Net cash provided by operating activities	\$802,551	\$929,463
	<hr/>	<hr/>
Cash flows from investing activities:		
Proceeds from maturities of other interest bearing deposits	\$291,333	\$0
Proceeds from sale of securities available-for-sale	\$230,696	\$0
Sale (Purchase) of Federal Home Loan Bank stock	\$284,900	(\$348,400)
Net increase in loans	(\$16,501,429)	(\$17,533,499)
Capital expenditures	(\$870,213)	(\$142,474)
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Net cash used in investing activities	(\$16,564,713)	(\$18,024,373)
	<hr/>	<hr/>
Cash flows from financing activities:		
Increase in Borrowings	\$0	\$10,500,000
Increase in deposits	\$10,829,000	\$5,648,288
Purchase common stock	(\$211)	(\$894,866)
Reduction in unallocated shares held by ESOP	\$59,640	\$59,640
Cash dividends paid	(\$95,418)	(\$97,866)
	<hr/>	<hr/>
Net cash provided by financing activities	\$10,793,011	\$15,215,196
	<hr/>	<hr/>
Net increase (decrease) in cash and cash equivalents	(\$4,969,151)	(\$1,879,714)
Cash and cash equivalents at beginning	\$9,265,477	\$4,768,007
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Cash and cash equivalents at end	\$4,296,326	\$2,888,293
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**CITIZENS COMMUNITY BANCORP**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED)**

**NOTE 1 - Organization**

The financial statements of Citizens Community Federal (the "Bank") included herein have been included by Citizens Community Bancorp (the "Company") pursuant to the rules and regulations of the Securities and Exchange Commission. The Company is a successor to Citizens Community Federal as a result of a regulatory restructuring into the mutual holding company form, which was effective on March 29, 2004. The restructuring included the capitalization of the Company, the sale of 978,650 shares of its common stock, including 119,236 shares to the Company's employee stock ownership plan (ESOP), the issuance of 2,063,100 shares to the Citizens Community Mutual Holding Company and the acquisition by the Company of all of the shares of Citizens Community Federal. The ESOP borrowed \$1,192,360 from the Company to purchase 119,236 shares of the Company's stock.

Proceeds from the stock offering, net of the ESOP loan of \$1,192,360, totaled \$7,974,296. \$4,533,328 was used to purchase 100% (3,041,750 shares) of Citizens Community Federal stock and \$3,340,968 was retained by the Company for short-term investments and general corporate purposes. The restructuring included a series of transactions by which the corporate structure of Citizens Community Federal was converted from a mutual savings bank to the mutual holding company form of ownership. Upon completion, Citizens Community Federal became a federal stock savings bank subsidiary of Citizens Community Bancorp. Citizens Community Bancorp is a majority-owned subsidiary of Citizens Community MHC. Members of Citizens Community Federal became members of Citizens Community MHC and continue to have the same voting rights in Citizens Community MHC as they had in Citizens Community Federal after the restructuring. Citizens Community MHC owned 67.83% or 2,063,100 shares of the common stock of Citizens Community Bancorp and the remaining 32.17% of the stock was sold to the public.

On July 1, 2005, the Company acquired Community Plus Savings Bank, Rochester Hills, Michigan, through a merger with and into Citizens Community Federal. In accordance with the merger agreement, the Company issued 705,569 additional shares to Citizens Community MHC, based on the \$9.25 million independently appraised value of Community Plus Savings Bank. In addition to the shares issued to Citizens Community MHC, the members of Community Plus Savings Bank became members of Citizens Community MHC. At June 30, 2005, Community Plus Savings Bank had total assets of \$46.0 million and deposits and other liabilities of \$41.8 million, prior to purchase accounting adjustments.

The consolidated income of the Company is principally from the income of the Bank. The Bank originates residential and consumer loans and accepts deposits from customers primarily in Wisconsin, Minnesota and Michigan. The Bank acquired a branch in Mankato, Minnesota in November of 2003, opened a new branch office in Oakdale, Minnesota on October 1, 2004, and acquired Community Plus Savings Bank's Lake Orion and Rochester Hills, Michigan

branches on July 1, 2005. The Bank is subject to competition from other financial institutions and non-financial institutions providing financial products. Additionally, the Bank is subject to the regulations of certain regulatory agencies and undergoes periodic examination by those regulatory agencies.

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## **NOTE 2 -- PRINCIPLES OF CONSOLIDATION**

The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, Citizens Community Federal. All significant inter-company accounts and transactions have been eliminated.

The accompanying unaudited consolidated financial statements of Citizens Community Bancorp have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-QSB. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for the fair presentation have been included. Operating results for the three and six months ended March 31, 2006 are not necessarily indicative of the results that may be expected for the year ending September 30, 2006. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted.

## **NOTE 3 -- STOCK AWARD PLANS**

In February 2005, the Recognition and Retention Plan was approved by the Company's shareholders. The plan provides for the grant of up to 59,618 shares. As of March 31, 2006, 36,962 restricted shares had been granted under this plan. Restricted shares are issued at no cost to the employee and have a five-year vesting period. The fair value of the restricted shares on the date of issue was \$13.45 per share for 33,386 shares and \$11.80 for 3,576 shares. Compensation expense related to these awards was \$25,968 for the three months ended March 31, 2006, and \$48,421 for the six months ended March 31, 2006.

In February 2005, the 2004 Stock Option and Incentive Plan was approved by the Company's shareholders. The plan provides for the grant of nonqualified and incentive stock options, and stock appreciation rights. The total number of shares available for future grants at December 31, 2005 under the plan was 149,046. At March 31, 2006, 105,827 options had been granted under this plan at a weighted average exercise price of \$13.45 per share. Options vest over a five-year period. Unexercised nonqualified stock options expire in 15 years and unexercised incentive stock options expire in 10 years. None of the options granted were vested, exercised, or forfeited during the period and all options granted remain outstanding at March 31, 2006.

## **NOTE 4 - STOCK-BASED COMPENSATION**

The Company accounts for stock-based employee compensation using the intrinsic value method prescribed under Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" and related

Interpretations. Accordingly, the Company would record compensation expense if the quoted market price on the date of grant exceeds the exercise price. Compensation expense for stock options is calculated as the number of options granted multiplied by the amount the market price exceeds the exercise price. For options with a vesting period, the expense, if applicable, is recognized over the vesting period. Compensation expense is recognized immediately for options that are fully vested on the date of grant. The Company has not recognized any stock option related employee compensation expense during the three months or six months ended March 31, 2006.

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If the Company had elected to recognize compensation expense for its employee stock-based compensation plans based on the fair values at the grant dates, consistent with the methodology prescribed by SFAS No. 123, "Accounting for Stock-Based Compensation", net earnings and earnings per share would have been reported as follows:

	Three months ended		Six months ended	
	03/31/06	03/31/05	03/31/06	03/31/05
<b>Net income - as reported</b>	\$82,451	\$383,906	\$249,594	\$583,990
Deduct: Total stock-based employee compensation	\$16,716	\$0	\$33,432	\$0
Expense determined under a fair value based method				
For all awards granted, net of related tax effects				
Proforma net income	\$65,735	\$383,906	\$216,162	\$583,990
Basic earnings per share - as reported	\$ 0.02	\$ 0.13	\$ 0.07	\$ 0.20
Proforma basic earnings per share	\$ 0.02	\$ 0.13	\$ 0.06	\$ 0.20
Diluted Earnings Per Share - as reported	\$ 0.02	\$ 0.13	\$ 0.07	\$ 0.20
Pro forma diluted earnings per share	\$ 0.02	\$ 0.13	\$ 0.06	\$ 0.20

For purposes of the pro forma disclosures above, the weighted average fair value per stock option granted was \$3.66. The fair value was estimated using the Black-Scholes option-pricing model with the following weighted average assumptions: (1) annual volatility factor of 16%, (2) risk-free interest rate of 4.16%, (3) expected dividend yield of 1.5% and (4) expected option term of ten years.

#### **NOTE 5 -- EARNINGS PER SHARE**

Basic and diluted earnings per share represent income available to common shareholders divided by the weighted-average number of common shares outstanding during the period, excluding unallocated shares of the Employee Stock Ownership Plan (ESOP). The weighted average number of shares outstanding was 3,625,256 for the three months ended March 31, 2006, and 3,628,263 for the six months ended March 31, 2006. Basic and diluted earnings per share of \$0.02 were reported for the three months ended March 31, 2006, compared to \$0.13 per share reported for the three-month period ended March 31, 2005. Basic and diluted earnings per share of \$0.07 were

reported for the six-month period ended March 31, 2006, compared to \$0.20 for the prior six-month period.

#### **NOTE 6 -- NEW ACCOUNTING PRONOUNCEMENTS**

In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS 123(R), "Share-Based Payments." This Statement is a revision to SFAS 123, "Accounting for Stock-Based Compensation," and supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees." SFAS 123(R) requires the recognition of the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. The cost will be recognized over the period during which an employee is required to provide service in exchange for the award. No compensation cost is recognized for equity instruments for which employees are not required to render any service. The Statement is effective for the Company beginning October 1, 2006. While the Company is still in the process of evaluating the effect of SFAS No. 123(R) on the financial statements, Note 4 does disclose the effect SFAS No. 123(R) would have had on earnings if it had been adopted in prior periods. Since the statement will be adopted using the modified-prospective method, the effect the adoption will have on the financial statements can be materially impacted by the number of options granted in future periods.

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## **ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

### **GENERAL**

Citizens Community Bancorp (the "Company") was capitalized as a result of an initial public offering related to the mutual holding company reorganization as explained in Note 1 to the unaudited consolidated financial statements, effective March 29, 2004. The Company is the mid-tier holding company for Citizens Community Federal. The Company is chartered under federal law and owns 100% of the stock of Citizens Community Federal (the "Bank"). The Company directs Citizens Community Federal's business activities.

The following discussion focuses on the consolidated financial condition of the Company and the Bank as of March 31, 2006 and the consolidated results of operations for the three and six months ended March 31, 2006, compared to the same period in 2005. This discussion should be read in conjunction with the interim condensed consolidated financial statements and notes thereto included with this report.

Historically, we were a federal credit union. We accepted deposits and made loans to members, who were the people who lived, worked or worshiped in the Wisconsin counties of Chippewa and Eau Claire, and parts of Pepin, Buffalo and Trempealeau. In addition, this included businesses and other entities located in these counties, and members and employees of the Hocak Nation. In December 2001, we converted to a federal mutual savings bank in order to better serve our customers and the local community through the broader lending ability of a federal savings bank, and to expand our customer base beyond the limited field of membership permitted to credit unions. As a federal savings bank, we have expanded authority in structuring residential mortgage and consumer loans, and the ability to make commercial loans, although the Bank does not currently have any immediate plans to commence making commercial

loans.

We have utilized this expanded lending authority to significantly increase our ability to market one-to four-family residential lending. Most of these loans are originated through our internal marketing efforts and our existing and walk-in customers. We typically do not rely on real estate brokers and builders to help us generate loan originations.

In order to differentiate ourselves from our competitors, we have stressed the use of personalized branch-oriented customer service. With operations structured around a branch system staffed with knowledgeable and well-equipped employees, our on-going commitment to training at all levels of our staff remains a key to the Company's success.

On July 1, 2005, Citizens Community Federal successfully completed a merger with Michigan-based, Community Plus - a federally chartered mutual savings bank headquartered in Rochester Hills with an additional branch location in Lake Orion, Michigan. As a result of the merger 705,569 additional shares of common stock of Citizens Community Bancorp were issued to Citizens Community MHC.

On April 20, 2006, the Board of Directors of Citizens Community MHC adopted a Plan of Conversion and Reorganization whereby the Mutual Holding Company will offer for sale to depositors and others in a subscription and community offering the 74.3% stock interest it currently holds in Citizens Community Bancorp. The proposed Plan of Conversion and Reorganization is subject to approval by the Office of Thrift Supervision, the shareholders of Citizens Community Bancorp and the members of the Mutual Holding Company.

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## CRITICAL ACCOUNTING POLICIES

***Allowance for Loan Losses.*** The allowance for loan losses is established through a provision for loan losses charged to expense. Loans are charged against the allowance for loan losses when management believes the collectibility of the principal is unlikely. The Bank considers loans secured by real estate and all consumer loans to be large groups of smaller-balance homogeneous loans that are collectively evaluated for impairment. The allowance for credit losses attributed to these loans is established via a process that estimates the probable losses inherent in the portfolio, based upon various analyses. These include historical delinquency and credit loss experience and the current aging of the portfolio, together with analyses that reflect current trends and conditions. Management also considers overall portfolio indicators including historical credit losses, delinquent, non-performing and classified loans, and trends in volumes and term of loans, an evaluation of overall credit quality and the credit process, including lending policies and procedures, and economic, geographical, and other environmental factors. In management's judgment, the allowance for loan losses is maintained at a level that represents its best estimate of probable losses relating to specifically identified loans, as well as probable losses inherent in the balance of the loan portfolio.

### Financial Condition

***Total Assets.*** Total assets of the Company as of March 31, 2006 were \$256.6 million, compared to \$245.7 million as of September 30, 2005, an increase of \$10.9 million, or 4.4%. Assets increased primarily as a result of an increase in loans receivable. Contributing to the increase in loans was the continued growth of the Mankato and Oakdale,

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Minnesota branches.

**Cash and Cash Equivalents.** Cash and cash equivalents decreased from \$9.3 million on September 30, 2005 to \$4.3 million on March 31, 2006. The decrease was a result of using cash to fund loan growth in the period.

**Loans Receivable.** Loans increased by \$16.4 million, or 7.5%, from \$218.7 million as of September 30, 2005 to \$235.1 million as of March 31, 2006. At March 31, 2006, the loan portfolio was comprised of \$154.2 million of loans secured by real estate, or 65.6% of total loans, \$80.8 million of consumer loans, or 34.4% of total loans, and commercial loans of \$74,000, less than 1% of total loans.

At September 30, 2005, the loan portfolio mix included real estate loans of \$144.5 million or 66.1% of total loans, consumer loans of \$74.2 million or 33.9% of total loans and commercial loans of \$75,000, less than 1% of total loans. As noted above, a contributing factor to the loans receivable increase was the loan production at the Mankato and Oakdale, Minnesota branches. At March 31, 2006 loans receivable were \$15.2 million at Mankato and \$15.8 million at Oakdale, compared to \$11.2 million at Mankato and \$11.6 million at Oakdale at September 30, 2005.

**Allowance for Loan Losses.** The following table is an analysis of the activity in the allowance for loan losses for the three-and six-month periods ended March 31, 2006 and March 31, 2005.

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	Three months ended		Six months ended	
	March 31, 2006	March 31, 2005	March 31, 2006	March 31, 2005
<b>Balance at Beginning</b>	\$828,770	\$596,473	\$803,218	\$554,210
<b>Provisions Charged to Operating Expense</b>	38,400	102,133	108,451	202,136
<b>Loans Charged Off</b>	62,390	64,486	109,554	128,405
<b>Recoveries on Loans</b>	2,986	7,223	5,651	13,402
<b>Balance at End</b>	\$807,766	\$641,343	\$807,766	\$641,343

**Office Properties and Equipment.** Total investment in office properties and equipment was \$2.9 million on September 30, 2005, and \$3.6 million on March 31, 2006, an increase of \$700,000 or 24.1%. The increase came primarily from the purchase of computer equipment and software totaling \$800,000. As previously disclosed in an 8-K filing, on September 9, 2005, the Company entered into a series of purchase agreements and software user agreements with Information Technology, Inc. for computer equipment and software. The purchase was completed in March of 2006.

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**Deposits.** Deposits as of March 31, 2006 were \$188.3 million, compared to \$177.5 million as of September 30, 2005, an increase of \$10.8 million, or 6.1%. The majority of the deposit growth came from the two Minnesota branch offices, as management sought the most cost-effective markets to attract deposits.

**Borrowed Funds.** Federal Home Loan Bank advances were unchanged at \$36.2 million on September 30, 2005 and March 31, 2006.

**Liquidity and Asset / Liability Management.** The Company must maintain an adequate liquidity position in order to respond to the short-term demand for funds caused by withdrawals from deposit accounts, increased loan demand and extensions of credit and for payments of operating expenses. Maintaining this position of adequate liquidity is accomplished through the management of a combination of liquid assets; those which can be converted into cash and access to additional sources of funds. Primarily, liquid assets of the Company are cash and cash equivalents, other interest bearing deposits, investments held that are available for sale and maturing loans. Advances from the Federal Home Loan Bank system represent the Company's primary source of immediate additional liquidity, and are maintained at a level necessary to fulfill needs. Assets and liabilities are maintained to provide the proper balance between liquidity, safety and profitability. This monitoring process is done on a continuing basis. The Company manages its interest rate sensitive assets and liabilities on a regular basis to lessen the impact of interest rate changes. As part of managing liquidity, the Company monitors its maturing deposits and loans, loan to deposit ratio, competitors' rates and the cost of borrowing funds versus the ability to attract deposits. The Company manages its rate sensitivity position to avoid wide swings in margins and to minimize risk. The Company's management believes its liquidity sources are adequate to meet its operating needs. The Company's earnings were negatively impacted by the flat yield curve during the three-and six-month periods ended March 31, 2006. The flat yield curve contributed to a reduction in interest spread as interest rates on deposits continued to rise at a faster rate than interest rates on loans.

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**Off-Balance Sheet Liabilities.** The Company has financial instruments with off-balance sheet risk. These instruments include unused commitments for credit cards, lines of credit, overdraft protection and home equity lines of credit, as well as commitments to extend credit. As of March 31, 2006, the Company has \$8.2 million in unused commitments compared to \$8.1 million in unused commitments as of September 30, 2005.

**Capital Resources.** Capital ratios applicable to the Bank as of March 31, 2006 and September 30, 2005 were as follows:

Capital Ratios					
Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
Amount	Ratio	Amount	Ratio	Amount	Ratio

As of March 31, 2006

(Unaudited)

Total capital (to risk weighted assets)	\$19,879,000	12.1%	\$13,170,000	>= 8.0%	\$16,463,000	>= 10.0%
Tier 1 capital (to risk weighted assets)	\$19,251,000	11.7%	\$6,585,000	>= 4.0%	\$9,878,000	>= 6.0%
Tier 1 capital (to adjusted total assets)	\$19,251,000	7.7%	\$9,978,000	>= 4.0%	\$12,473,000	>= 5.0%
Tangible capital (to tangible assets)	\$19,251,000	7.7%	\$3,742,000	>= 1.5%	NA	NA

As of September 30, 2005

Total capital (to risk weighted assets)	\$19,318,000	12.6%	\$12,259,000	>= 8.0%	\$15,323,000	>= 10.0%
Tier 1 capital (to risk weighted assets)	\$18,693,000	12.2%	\$6,129,000	>= 4.0%	\$9,194,000	>= 6.0%
Tier 1 capital (to adjusted total assets)	\$18,693,000	7.9%	\$9,495,000	>= 4.0%	\$11,869,000	>= 5.0%
Tangible capital (to tangible assets)	\$18,693,000	7.9%	\$3,561,000	>= 1.5%	NA	NA

Management intends to maintain capital levels in the well-capitalized category established by regulatory authorities. The Bank was categorized as "well-capitalized" under the regulatory framework for capital adequacy as of March 31, 2006 and September 30, 2005.

## Results of Operation

**Overview.** For the quarter ended March 31, 2006, the Company continued to see strong loan demand with a leveling off of the rapid deposit growth from the previous quarter as management reduced its cash position to fund the loan demand. Loan quality remains good with low delinquency levels and a continued reduction in provision for loan loss. Interest rates on deposits continued to increase at a slightly faster pace than the rates on loans, but this increase was less evident than in the first quarter of fiscal 2006. The Company incurred increased operating expenses, primarily associated with the two Michigan offices acquired July 1, 2005, and with non-recurring costs associated with overtime, training and other non-interest expenses related to the computer conversion completed during the quarter. The Company anticipates continued strong loan growth and fee income that should help offset the decline in rate spread going forward.

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**Net Income.** For the three months ended March 31, 2006, the Company reported net income of \$82,451, a decrease of

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78.5%, compared to net income of \$383,906 for the three months ended March 31, 2005. Net income was \$249,594 for the six months ended March 31, 2006, as compared to net income of \$583,990 for the same period in 2005. The decrease for both periods was primarily a result of income generated from the January 12, 2005 merger of PULSE-EFT and Discover Financial Services. The Company was a stockholder and member of PULSE-EFT. As a result of the merger, the Company received \$384,467 in pre-tax income in the second quarter of fiscal 2005 from this one-time event. Both net interest margin and interest spread decreased from 4.33% and 4.29%, respectively, for the three months ended March 31, 2005 to 3.51% and 3.32% respectively, for the current three-month period; and net interest margin and interest spread decreased from 4.42% and 4.40%, respectively, for the prior six-month period to 3.53% and 3.47%, respectively, for the current six-month period. The decrease in both net interest margin and interest spread were a result of the increase in short-term interest rates and the flat yield curve that existed during the periods.

**Total Interest Income.** Total interest income increased by \$1.1 million for the three-month period ended March 31, 2006, to \$3.8 million from \$2.7 million for the same period in 2005. Total interest income increased by \$2.1 million for the six-month period ended March 31, 2006, to \$7.5 million from \$5.4 million for the six-month period ended March 31, 2006. The increase for both periods was a result of an increase in the average balance of loans receivable attributed to strong loan demand. The yield on loans receivable decreased in both periods, from 6.61% for the three-month period ended March 31, 2005, to 6.51% for the three-month period ended March 31, 2006, and from 6.59% for the six-month period ended March 31, 2005, to 6.47% for the six-month period ended March 31, 2006, reflecting the payments and payoffs on higher yielding loans being replaced by new loans with lower interest rates.

**Net Interest Income.** Net interest income before provision for loan losses increased by \$269,934 for the three-month period ended March 31, 2006, to \$2.1 million compared to \$1.9 million for the same period in 2005. Net interest income increased by \$635,066 for the six-month period ended March 31, 2006, from \$3.7 million to \$4.4 million. The increase in net interest income for both periods was due to an increase in the average balance of loans receivable, partially offset by a decrease in average loan yield and an increase in interest expense due to an increase in the average balance of deposits and an increase in the average rate paid on interest-bearing liabilities. The average cost of interest-bearing liabilities increased from 2.39% for the quarter ended March 31, 2005, to 3.21% for the quarter ended March 31, 2006. The average cost of interest-bearing liabilities increased from 2.35% for the six-month period ended March 31, 2005, to 3.08% for the current six-month period.

**Provision for Loan Losses.** We establish the provision for loan losses, which is charged to operations, at a level management believes will adjust the allowance for loan losses to reflect probable incurred credit losses in the loan portfolio. In evaluating the level of the allowance for loan losses, management considers the types of loans and the amount of loans in the loan portfolio, historical loss experience, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral, and prevailing economic conditions. Based on our evaluation of these factors, we made provisions of \$38,400 and \$102,133 for the three months ended March 31, 2006 and March 31, 2005, respectively. For the six-month period ended March 31, 2006, we made provisions of \$108,451 compared to provisions of \$202,136 for the prior six-month period. Non-performing assets were approximately \$1,112,000 at March 31, 2006, as compared to \$701,000 at September 30, 2005. Non-performing assets were 0.43% of total assets as compared to 0.29% of total assets as of September 30, 2005. The primary cause of the increase was a result of one borrower filing bankruptcy. The borrower owes \$293,000 on a loan secured by a 1-4 family home. Minimal loss is anticipated. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available, or as future events change. We used the same methodology and generally similar assumptions in assessing the loan allowance for both periods.

The level of the allowance is based on estimates and the ultimate losses may vary from the estimates. Management assesses the allowance for loan losses on a monthly basis and makes provisions for loan losses as necessary in order to maintain the allowance. While management uses available information to recognize losses on loans, future loan loss provisions may be necessary based on changes in economic conditions or changes in individual account conditions. In addition, various regulatory agencies, as an integral part in their examination process, periodically review the allowance for loan losses and may require us to recognize additional provisions based on their judgment of information available to them at the time of their examination.

**Non-Interest Income.** Non-interest income decreased to \$417,112 for the period ended March 31, 2006, compared to \$743,562 for the same period in 2005. For the six-month period ended March 31, 2006, non-interest income decreased to \$870,191 from \$1,108,500 for the six-month period ended March 31, 2005. The decrease for both periods came primarily as a result of non-recurring income generated from the previously discussed January 12, 2005 merger of PULSE-EFT and Discover Financial Services.

**Non-Interest Expense.** Non-interest expense increased from \$1.9 million to \$2.4 million for the three months ended March 31, 2006. Non-interest expense increased from \$3.7 million for the six-month period ended March 31, 2005 to \$4.7 million for the same period in 2006. The increase was due primarily to the additional operating costs associated with the two Michigan offices acquired July 1, 2005, located in Rochester Hills and Lake Orion. In addition, there were non-recurring costs in the current periods associated with the February 2006 computer conversion due to considerable time and effort involved with the project. The cost of overtime, training, travel expenses, customer mailings and form replacement totaled approximately \$50,000 during the quarter ended March 31, 2006.

**Forward-Looking Statements.** This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended. We intend such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Reform Act of 1995, and are including this statement for purposes of these safe harbor provisions. "Forward-looking statements", which are based on certain assumptions and describe future plans, strategies and expectations of Citizens Community Bancorp may be identified by the use of words such as "believe," "expect," "anticipate," "should," "planned," "estimated," and "potential". Examples of forward-looking statements include, but are not limited to, estimates with respect to our financial condition, results of operation and business that are subject to various factors which could cause actual results to differ materially from these estimates and most other statements that are not historical in nature. These factors include, but are not limited to, general and local economic conditions, changes in interest rates, deposit flows, demand for mortgage, consumer and other loans, real estate values, competition, changes in accounting principles, policies, or guidelines, changes in legislation or regulation, and other economic, competitive, governmental, regulatory and technological factors affecting our operations, pricing, products and services. These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. Further information concerning Citizens Community Bancorp and its business, including additional factors that could materially affect our financial results, is included in our filings with the Securities and Exchange Commission.

### ITEM 3. CONTROLS AND PROCEDURES

An evaluation of the Company's disclosure controls and procedures (as defined in Section 13(a)-15(e) under the Securities Exchange Act of 1934 (the "Act") as of March 31, 2006 was carried out under the supervision and with the participation of the Chief Executive Officer and Chief Financial Officer and several other members of our senior management. The Chief Executive Officer and Chief Financial Officer concluded that as of March 31, 2006, the Company's disclosure controls and procedures were effective in ensuring that the information required to be disclosed by the Company in the reports the Company files or submits under the Act is (i) accumulated and communicated to management (including the Chief Executive Officer and Chief Financial Officer) in a timely manner, and (ii) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. There have been no changes in our internal controls over financial reporting (as defined in Rule 13a-15(f) under the Act) that occurred during the quarter ended March 31, 2006 that have materially affected, or are reasonably likely to materially effect, our internal controls over financial reporting.

The Company does not expect that its disclosure controls and procedures will prevent all errors and all fraud. A control procedure, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control procedure are met. Because of the inherent limitations in all control procedures, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any control procedure is also based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies and procedures may deteriorate. Because of the inherent limitations in a cost-effective control procedure, misstatements due to error or fraud may occur and not be detected.

Section 404 of the Sarbanes-Oxley Act of 2002 requires that companies evaluate and annually report on their systems of internal control over financial reporting. In addition, our independent accountants must report on management's evaluation. We are in the process of evaluating, documenting and testing our system of internal control over financial reporting to provide the basis for our report that will, for the first time, be a required part of our annual report on Form 10-KSB for the fiscal year ending September 30, 2007. Due to the ongoing evaluation and testing of our internal controls, there can be no assurance that if any control deficiencies are identified they will be remediated before the end of the 2007 fiscal year, or that there may not be significant deficiencies or material weaknesses that would be required to be reported. In addition, we expect the evaluation process and any required remediation, if applicable, to increase our accounting, legal and other costs and divert management resources from core business operations.

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## PART II -- OTHER INFORMATION

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**Item 1. LEGAL PROCEEDINGS**

In the normal course of business, the Company occasionally becomes involved in various legal proceedings. In the opinion of management, any liability from such proceedings would not have a material adverse effect on the business or financial condition of the Company.

**Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.**

The following table summarizes our share repurchase activity during the three months ended March 31, 2006.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans	Maximum Number of Shares That May Yet be Purchased Under the Plan
January 1, 2006 through January 31, 2006	NA	NA	NA	NA
February 1, 2006 through February 28, 2006	NA	NA	NA	NA
March 1, 2006 through March 31, 2006	16	\$13.20	NA	NA
Total	16	\$13.20	NA	NA

**Item 3. DEFAULTS UPON SENIOR SECURITIES**

Not applicable

**Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

At the Annual Meeting of Shareholders, dated February 22, 2006, two items of business were voted upon: The nominees to serve on the Board of Directors for terms to expire in the year 2009 and the ratification of the appointment of Wipfli, LLP as independent auditors for the Company for the fiscal year ending September 30, 2006. Results of the voting were as follows:

	Election of Directors	
	FOR	WITHHOLD
Brian R. Schilling	99.8%	0.2%
David B. Westrate	99.8%	0.2%

**Ratification of Auditors**

<b>FOR</b>	<b>AGAINST</b>	<b>ABSTAIN</b>
99.8%	0.2%	0.0%

**Item 5. OTHER INFORMATION**

Not applicable

**Item 6. EXHIBITS**

(a) Exhibits

- 31.1 Rule 13a-15(e) Certification of the Company's President and Chief Executive Officer.
- 31.2 Rule 13a-15(e) Certification of the Company's Chief Financial Officer
- 32.0 Certification

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**SIGNATURES**

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

CITIZENS COMMUNITY BANCORP

Date: May 11, 2006

By: /s/ James G. Cooley

\_\_\_\_\_  
James G. Cooley  
President and Chief Executive Officer

Date: May 11, 2006

By: /s/ John D. Zettler

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John Zettler  
Chief Financial Officer

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Exhibits

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