

BROADWAY FINANCIAL CORP \DE\

Form 10-Q

August 12, 2004

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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 June 30, 2004

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

For transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 0-27464

**BROADWAY FINANCIAL CORPORATION**

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

Delaware  
(State or other jurisdiction of

Incorporation or organization)

95-4547287  
(I.R.S. Employer

Identification No.)

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4800 Wilshire Boulevard, Los Angeles, California  
(Address of principal executive offices)

90010  
(Zip Code)

(323) 634-1700

(Issuer's telephone number, including area code)

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

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: 1,500,073 shares of the Company's Common Stock, par value \$0.01 per share, were issued and outstanding as of July 30, 2004.

Transitional Small Business Disclosure Format (Check one):

Yes  No

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**Table of Contents****BROADWAY FINANCIAL CORPORATION AND SUBSIDIARIES****Consolidated Balance Sheets**

(Dollars in thousands)

(Unaudited)

	<b>June 30,</b>	<b>December 31,</b>
	<b>2004</b>	<b>2003</b>
	<u>          </u>	<u>          </u>
<b>Assets</b>		
Cash	\$ 3,327	\$ 5,029
Federal funds sold	900	2,600
Investment securities available for sale, at fair value	5,988	
Investment securities held to maturity (fair value of \$1,933,000 at June 30, 2004 and \$3,967,000 at December 31, 2003)	2,000	3,996
Mortgage-backed securities available for sale, at fair value		9,122
Mortgage-backed securities held to maturity (fair value of \$4,593,000 at June 30, 2004 and \$6,664,000 at December 31, 2003)	4,350	6,317
Loans receivable held for sale, at lower of cost or fair value		1,671
Loans receivable, net	227,661	192,116
Accrued interest receivable	917	883
Investments in capital stock of Federal Home Loan Bank, at cost	2,200	1,789
Office properties and equipment, net	5,492	5,603
Other assets	850	689
	<u>          </u>	<u>          </u>
Total assets	\$ 253,685	\$ 229,815
	<u>          </u>	<u>          </u>
<b>Liabilities and stockholders equity</b>		
Deposits	\$ 184,041	\$ 179,907
Advances from Federal Home Loan Bank	46,065	28,502
Junior subordinated debentures	6,000	
Advance payments by borrowers for taxes and insurance	418	324
Deferred income taxes	1,058	1,019
Other liabilities	1,838	1,872
	<u>          </u>	<u>          </u>
Total liabilities	239,420	211,624
<b>Stockholders Equity:</b>		
Preferred non-convertible, non-cumulative, and non-voting stock, \$.01 par value, authorized 1,000,000 shares; issued and outstanding 55,199 shares of Series A and 100,000 shares of Series B at June 30, 2004 and December 31, 2003	2	2
Common stock, \$.01 par value, authorized 3,000,000 shares; issued and outstanding 1,500,073 shares at June 30, 2004 and 1,832,507 shares at December 31, 2003	10	10
Additional paid-in capital	10,524	10,507
Accumulated other comprehensive loss, net of taxes	(7)	(68)
Retained earnings-substantially restricted	8,946	8,207
Treasury stock-at cost, 368,869 shares at June 30, 2004 and 36,435 shares at December 31, 2003	(5,142)	(375)
Unearned Employee Stock Ownership Plan shares	(68)	(92)
	<u>          </u>	<u>          </u>

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Total stockholders' equity	14,265	18,191
Total liabilities and stockholders' equity	\$ 253,685	\$ 229,815

*See accompanying notes to unaudited consolidated financial statements.*

**Table of Contents****BROADWAY FINANCIAL CORPORATION AND SUBSIDIARIES****Consolidated Statements of Operations and Comprehensive Earnings**

(Dollars in thousands, except per share amounts)

(Unaudited)

	<b>Three Months ended June 30,</b>		<b>Six Months ended June 30,</b>	
	<b>2004</b>	<b>2003</b>	<b>2004</b>	<b>2003</b>
Interest on loans receivable	\$ 3,285	\$ 2,569	\$ 6,397	\$ 5,113
Interest on investment securities	56	37	102	103
Interest on mortgage-backed securities	67	404	193	808
Other interest income	35	37	62	75
<b>Total interest income</b>	<b>3,443</b>	<b>3,047</b>	<b>6,754</b>	<b>6,099</b>
Interest on deposits	791	764	1,574	1,585
Interest on borrowings	287	186	470	362
<b>Total interest expense</b>	<b>1,078</b>	<b>950</b>	<b>2,044</b>	<b>1,947</b>
<b>Net interest income</b>	<b>2,365</b>	<b>2,097</b>	<b>4,710</b>	<b>4,152</b>
<b>Non-interest income:</b>				
Service charges	269	331	533	601
Net gains on sale of loans and securities available for sale	77	5	174	18
Other	19	10	39	16
<b>Total non-interest income</b>	<b>365</b>	<b>346</b>	<b>746</b>	<b>635</b>
<b>Non-interest expense:</b>				
Compensation and benefits	1,160	1,020	2,317	1,934
Occupancy expense, net	275	251	530	509
Information services	166	126	332	256
Professional services	124	107	246	268
Office services and supplies	94	108	199	210
Other	183	249	326	433
<b>Total non-interest expense</b>	<b>2,002</b>	<b>1,861</b>	<b>3,950</b>	<b>3,610</b>
<b>Earnings before income taxes</b>	<b>728</b>	<b>582</b>	<b>1,506</b>	<b>1,177</b>
Income taxes	291	226	602	457
<b>Net earnings</b>	<b>\$ 437</b>	<b>\$ 356</b>	<b>\$ 904</b>	<b>\$ 720</b>
<b>Other comprehensive income (loss), net of tax:</b>				
Unrealized gain (loss) on securities available for sale	\$ (12)	\$ 387	\$ 207	\$ 404

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Reclassification of realized net gains (loss) included in net earnings			(108)	
Income tax benefit (expense)	5	(153)	(38)	(154)
Other comprehensive income (loss), net of tax	(7)	234	61	250
Comprehensive earnings	\$ 430	\$ 590	\$ 965	\$ 970
Net earnings	\$ 437	\$ 356	\$ 904	\$ 720
Dividends paid on preferred stock	(19)	(19)	(38)	(38)
Earnings available to common shareholders	\$ 418	\$ 337	\$ 866	\$ 682
Earnings per share-basic	\$ 0.28	\$ 0.19	\$ 0.54	\$ 0.38
Earnings per share-diluted	\$ 0.27	\$ 0.18	\$ 0.51	\$ 0.36

*See accompanying notes to unaudited consolidated financial statements.*

**Table of Contents****BROADWAY FINANCIAL CORPORATION AND SUBSIDIARIES****Consolidated Statements of Cash Flows**

(Dollars in thousands)

(Unaudited)

	<b>Six Months ended June 30,</b>	
	<b>2004</b>	<b>2003</b>
<b>Cash flows from operating activities:</b>		
Net earnings	\$ 904	\$ 720
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation	177	183
Amortization of premiums and discounts on loans purchased	4	63
Amortization of net deferred loan origination fees	(138)	(29)
Amortization of premiums and discounts on investment and mortgage - backed securities	37	(28)
Amortization of deferred compensation	70	63
Loss on sale of securities available for sale	21	
Gain on sale of loans receivable held for sale	(195)	(18)
Loans originated for sale	(13,479)	(622)
Proceeds from sale of loans receivable held for sale	15,345	1,081
Changes in operating assets and liabilities:		
Accrued interest receivable	(34)	(413)
Other assets	(161)	(36)
Deferred income taxes		
Other liabilities	(34)	(174)
	<u>2,517</u>	<u>790</u>
Net cash provided by operating activities	2,517	790
<b>Cash flows from investing activities:</b>		
Loans originated, net of refinances	(54,922)	(18,615)
Principal repayment on loans	21,391	23,117
Purchase of loans	(1,880)	(14,175)
Purchases of investment securities available for sale	(28,000)	(21,000)
Purchases of mortgage-backed securities available for sale		(12,000)
Proceeds from maturities of interest bearing deposits		1,028
Proceeds from call /maturities of investment securities available for sale	2,000	
Proceeds from sale of investment securities available for sale	21,986	24,002
Proceeds from sale of mortgage-backed securities held to maturity	185	
Proceeds from sale of mortgage-backed securities available for sale	9,201	
Principal repayments on mortgage-backed securities held to maturity	1,757	2,300
Principal repayments on mortgage-backed securities available for sale	10	3,955
Purchase of Federal Home Loan Bank stock	(411)	(96)
Capital expenditures for office properties and equipment	(66)	(123)
	<u>(28,749)</u>	<u>(11,607)</u>
Net cash used in investing activities	(28,749)	(11,607)



*See accompanying notes to unaudited consolidated financial statements.*

**Table of Contents****BROADWAY FINANCIAL CORPORATION AND SUBSIDIARIES****Consolidated Statements of Cash Flows (Continued)**

(Dollars in thousands)

(Unaudited)

	<b>Six Months ended</b>	
	<b>June 30,</b>	
	<b>2004</b>	<b>2003</b>
	<u>          </u>	<u>          </u>
<b>Cash flows from financing activities:</b>		
Net increase in deposits	\$ 4,134	\$ 7,384
Increase (decrease) in advances from the Federal Home Loan Bank	17,563	3,406
Junior subordinated debentures issued	6,000	
Common and Preferred dividends paid	(165)	(173)
Reissuance of treasury stock	945	
Purchases of treasury stock	(5,851)	
Stock options exercised	110	24
Increase (decrease) in advances by borrowers for taxes and insurance	94	(67)
	<u>          </u>	<u>          </u>
Net cash provided by financing activities	22,830	10,574
	<u>          </u>	<u>          </u>
Net increase (decrease) in cash and cash equivalents	(3,402)	(243)
Cash and cash equivalents at beginning of period	7,629	5,359
	<u>          </u>	<u>          </u>
Cash and cash equivalents at end of period	\$ 4,227	\$ 5,116
	<u>          </u>	<u>          </u>
<b>Supplemental disclosures of cash flow information:</b>		
Cash paid for interest	\$ 2,089	\$ 1,932
	<u>          </u>	<u>          </u>
Cash paid for income taxes	\$ 380	\$ 377
	<u>          </u>	<u>          </u>
<b>Supplemental disclosure of non-cash investing and financing activities:</b>		
Transfers of loans from held for sale to held for investment	\$	\$ 3,184
	<u>          </u>	<u>          </u>

*See accompanying notes to unaudited consolidated financial statements.*

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**BROADWAY FINANCIAL CORPORATION AND SUBSIDIARIES**

**Notes to Unaudited Consolidated Financial Statements**

**June 30, 2004**

**NOTE (1) Basis of Financial Statement Presentation**

The unaudited consolidated financial statements included herein have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial statements and pursuant to the instructions for Form 10-QSB and the rules and regulations of the Securities and Exchange Commission. In the opinion of the management of Broadway Financial Corporation (the Company), the preceding unaudited consolidated financial statements contain all material adjustments, consisting solely of normal recurring accruals, necessary to present fairly the consolidated financial position of the Company and its subsidiaries at June 30, 2004 and December 31, 2003, the results of their operations and comprehensive earnings for the three and six months ended June 30, 2004 and 2003 and their cash flows for the six months ended June 30, 2004 and 2003. These unaudited consolidated financial statements do not include all disclosures associated with the Company's consolidated annual financial statements included in its annual report on Form 10-KSB for the year ended December 31, 2003 and, accordingly, should be read in conjunction with such audited financial statements. The results of operations for the three and six months ended June 30, 2004 are not necessarily indicative of the results to be expected for the full year.

**NOTE (2) Earnings Per Share**

Basic earnings per share is determined by dividing net earnings available to common shareholders by the weighted average number of shares of Common Stock outstanding for the period (1,470,702 and 1,794,153 shares for the three months ended June 30, 2004 and 2003, and 1,611,361 and 1,790,925 shares for the six months ended June 30, 2004 and 2003, respectively). Diluted earnings per share is determined by dividing net earnings available to common shareholders by the weighted average number of shares of Common Stock outstanding for the period, adjusted for the dilutive effect of Common Stock equivalents, (1,563,834 and 1,889,532 shares for the three months ended June 30, 2004 and 2003, and 1,708,699 and 1,884,063 shares for the six months ended June 30, 2004 and 2003, respectively).

**NOTE (3) Cash and Cash Equivalents**

For purposes of reporting cash flows in the Consolidated Statements of Cash Flows, cash and cash equivalents include cash and federal funds sold.

**NOTE (4) Current Accounting Pronouncements**

Financial Accounting Standards Board (FASB) Interpretation 46 (revised December 2003), Consolidation of Variable Interest Entities (FIN 46R), requires a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or is entitled to receive a majority of the entity's residual returns or both. Prior to FIN 46R, a company included another entity in its consolidated financial statements only if it controlled the entity through voting interests. FIN 46R also requires disclosures

about variable interest entities that the company is not required to consolidate but in which it has a significant variable interest. The consolidated requirements of FIN 46R apply to all Special Purpose Entities ( SPEs ) by the end of the first reporting period that ends after December 15, 2003. The provisions of FIN 46R for interests held by public entities in variable interest entities that are not SPEs are required to be applied by the first reporting period that ends after March 15, 2004. The implementation of FIN 46R has not had a material financial impact on us.

In accordance with Statement of Financial Accounting Standards No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities ( SFAS 149 ), expected interest rate lock commitments on mortgage loans that will be held for sale must be accounted for as derivatives and marked to market in accordance with Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities ( SFAS 133 ). All other interest rate lock commitments are excluded from SFAS 133, pursuant to SFAS 149. In October 2003, the FASB decided to add a project to its agenda that would clarify how fair value should be measured for interest rate lock derivatives. To our knowledge, no timetable has been established yet for the completion of this project.



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Stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects

Pro forma net income	\$ 402	\$ 332	\$ 836	\$ 664
Basic net income per share				
As reported	\$ 0.28	\$ 0.19	\$ 0.54	\$ 0.38
Pro forma	\$ 0.27	\$ 0.19	\$ 0.52	\$ 0.38
Diluted net income per share				
As reported	\$ 0.27	\$ 0.18	\$ 0.51	\$ 0.36
Pro forma	\$ 0.26	\$ 0.18	\$ 0.49	\$ 0.36

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**BROADWAY FINANCIAL CORPORATION AND SUBSIDIARIES**

**Notes to Unaudited Consolidated Financial Statements (continued)**

**NOTE (6) Junior Subordinated Debentures**

On March 17, 2004, the Company issued \$6.0 million of Floating Rate Junior Subordinated Debentures in a private placement to fund the purchase of shares from Hot Creek Ventures 1, L.P. and its affiliates ( Hot Creek ) as described in Note (7) below. The debentures mature in 10 years and interest is payable quarterly at a rate per annum equal to the 3-month LIBOR plus 2.54%. The initial interest rate is 3.65%.

**NOTE (7) Capital Transactions**

On March 18, 2004, the Company purchased the holdings of Hot Creek in the Company's Common Stock, consisting of 410,312 shares, at a price of \$14.00 per share and Hot Creek agreed, with certain exceptions, not to acquire shares of the Company's stock in the future. The Company also signed a stock purchase agreement with Cathay General Bancorp ( Cathay ) providing for the sale by the Company of up to 215,000 shares of the Company's Common Stock to Cathay at a price of \$13.50 per share, subject to the receipt by Cathay of required regulatory approval for the transaction. The Company also announced its intent to make a public tender offer for up to 183,251 shares of Common Stock, constituting 10% of the Company's Common Stock outstanding at December 31, 2003, at a price of \$14.00 per share upon completion of the stock sale to Cathay. The agreement with Cathay contains a standstill provision under which Cathay has agreed not to acquire additional shares of Broadway Financial Corporation stock. Cathay has informed the Company that its proposed investment in the Company is intended to support the Company in its role as a provider of banking services to the minority communities in the Company's market area, as part of Cathay's desire to be responsive to opportunities to serve under the Community Reinvestment Act.

Subsequent to entering into the Stock Purchase Agreement, Cathay withdrew its previously submitted regulatory application for approval of the transaction after discussion with its banking regulators. On June 11, 2004, Cathay purchased 70,000 shares of the contemplated total of up to 215,000 shares of the Company's Common Stock, which it could do without obtaining regulatory approval. Cathay has informed the Company that it will defer pursuing regulatory approval of the purchase of the remaining up to 145,000 shares of the Company's Common Stock until later this year. Based on discussions with Cathay, the Company currently believes that the remaining stock sale to Cathay, and the public tender will not occur before December 31, 2004.

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATIONS**

Certain statements under this caption may constitute forward-looking statements under the Private Securities Litigation Reform Act of 1995, which involve risks and uncertainties. Actual results may differ significantly from the results discussed in such forward-looking statements. Factors that may cause such a difference include, but are not limited to, economic conditions, competition in the geographic and business areas in which operations are conducted, fluctuations in market interest rates, credit quality and government regulation.

**General**

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Broadway Financial Corporation (the Company) is primarily engaged in the savings and loan business through its wholly owned subsidiary, Broadway Federal Bank, f.s.b. (Broadway Federal or the Bank). Broadway Federal is a community-oriented savings institution dedicated to serving the African-American, Hispanic and other communities of Mid-City and South Los Angeles, California. Broadway Federal's business is that of a financial intermediary and consists primarily of attracting deposits from the general public and using such deposits, together with borrowings and other funds, to make mortgage loans secured by residential real estate located in Southern California. At June 30, 2004, Broadway Federal operated four retail-banking offices in Mid-City and South Los Angeles. Broadway Federal is subject to significant competition from other financial institutions, and is also subject to regulation by federal agencies and undergoes periodic examinations by those regulatory agencies.

The accompanying consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, Broadway Federal, Broadway Financial Funding, LLC and BankSmart, Inc. (a dormant company). All significant inter-company balances and transactions have been eliminated in consolidation.



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The Company's principal business is serving as a holding company for Broadway Federal. The Company's results of operations are dependent primarily on Broadway Federal's net interest income, which is the difference between the interest income earned on its interest-earning assets, such as loans and investments, and the interest expense paid on its interest-bearing liabilities, such as deposits and borrowings. Broadway Federal also generates recurring non-interest income, such as transactional fees on its loan and deposit portfolios. The Company's operating results are affected by the amount of provisions for loan losses and the Bank's non-interest expenses, which consist principally of employee compensation and benefits, occupancy expenses, and technology and communication costs. More generally, the results of operations of thrift and banking institutions are also affected by prevailing economic conditions, competition, and the monetary and fiscal policies of governmental agencies.

## **Critical Accounting Policy**

Accounting for the allowance for loan losses involves significant judgments and assumptions by management, which have a material impact on the carrying value of net loans receivable. Management considers this accounting policy to be a critical accounting policy. The judgments and assumptions used by management are based on historical experience, current economic trends, the Company's assessment of the borrowers ability to repay and repayment performance, and other factors, which are believed to be reasonable under the circumstances as described under the heading "Loans Receivable and the Allowance for Loan Losses" in the Notes to Consolidated Financial Statements included in the Company's Annual Report on Form 10-KSB for the year ended December 31, 2003.

## **Comparison of Operating Results for the Three Months and Six Months ended June 30, 2004 and June 30, 2003**

### **General**

The Company recorded net earnings of \$437,000 and \$904,000, or \$0.27 and \$0.51 per diluted share, respectively, for the three and six months ended June 30, 2004, compared to \$356,000 and \$720,000, or \$0.18 and \$0.36 per diluted share, respectively, for the three and six months ended June 30, 2003. Compared to 2003, second quarter net earnings increased 22.75% and net earnings for the six months increased 25.56%.

### **Net Earnings**

The change in net earnings, comparing 2004 to 2003, was primarily attributable to the increase in net interest income and non-interest income, offset by an increase in non-interest expense. Net interest income increased \$268,000 and \$558,000, or 12.78% and 13.44%, respectively, for the three and six months ended June 30, 2004, compared to the same periods in 2003. Non-interest income increased \$19,000 and \$111,000, or 5.49% and 17.48%, respectively, for the three and six months ended June 30, 2004, compared to the same periods in 2003. Non-interest expense increased \$141,000 and \$340,000, or 7.58% and 9.42%, respectively, for the three and six months ended June 30, 2004, compared to the same periods in 2003.

### **Net Interest Income**

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Net interest income increased to \$2.4 million and \$4.7 million for the three and six months ended June 30, 2004, from \$2.1 million and \$4.2 million for the same periods in 2003. A six-month rate/volume analysis indicates that the \$558,000 increase in net interest income in the first six months of 2004 over 2003 was primarily attributable to the impact of the growth in average interest-earning assets of \$31.0 million, or 15.10%, and average interest-bearing liabilities of \$32.8 million, or 17.03%, which resulted in an increase in net interest income of \$856,000 (volume impact), offset by the impact of a decrease in the net interest rate spread of 2 basis points (rate impact), which resulted in a decrease in net interest income of \$298,000.

Gross loan originations were \$35.5 million and \$68.7 million for the three and six months ended June 30, 2004, compared to \$11.3 million and \$19.0 million for the same periods in 2003. Loans purchases totaled \$1.9 million for the three and six months ended June 30, 2004, compared to \$14.2 million in the first quarter of 2003. Loan prepayments amounted to \$10.9 million and \$21.4 million for the three and six months ended June 30, 2004, compared to \$14.4 million and \$23.1 million for the same periods in 2003. The drop in loan prepayments in the second quarter of 2004 reflects the effect of rising interest rates. If rates continue to rise during the remainder of the year, prepayments may be expected to continue to decrease. Loans receivable, net grew \$35.5 million, or 18.50%, to \$227.7 million at June 30, 2004 from \$192.1 million at December 31, 2003.

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Interest-bearing liabilities increased \$12.5 million during the second quarter of 2004. The increase was primarily attributable to the net effect of an increase in Federal Home Loan Bank ( FHLB ) advances of \$15.3 million, offset by a decrease in deposits of \$2.7 million. The decrease in deposits is primarily due to the withdrawal of \$3.0 million by a non-profit organization, which the Company anticipates will be redeposited before year-end 2004. For the six months ended June 30, 2004, interest-bearing liabilities increased \$27.7 million. This increase was comprised of an increase in deposits of \$4.1 million, an increase in FHLB advances of \$17.6 million and the issuance of junior subordinated debentures of \$6.0 million.

The net interest rate spread for the three and six months ended June 30, 2004 was 3.82% and 3.91%, respectively, compared 3.88% and 3.93%, respectively, for the same periods in 2003. The 6 and 2 basis points decreases in spread were attributable to the larger decline in the weighted average yield on interest-earning assets compared to the decline in the weighted average cost of funds on interest-bearing liabilities. The yield on interest-earning assets declined 15 and 23 basis points to 5.66% and 5.72%, respectively, for the three and six months ended June 30, 2004 from 5.81% and 5.95%, respectively, for the same periods in 2003. The weighted average cost of funds declined 9 and 21 basis points to 1.84% and 1.81%, respectively, for the three and six months ended June 30, 2004 compared to 1.93% and 2.02%, respectively, for the same periods in 2003. The primary spread (weighted average interest rate on loans minus weighted average interest rate on deposits) at June 30, 2004 was 4.07% compared to 4.73% at June 30, 2003, a decline of 66 basis points.

## **Non-interest Income**

Total non-interest income increased to \$365,000 and \$746,000 for the three and six months ended June 30, 2004, from \$346,000 and \$635,000 for the same periods in 2003. The \$19,000 increase for the second quarter was primarily attributable to an \$86,000 gain on sale of \$8.5 million of loans held for sale, offset by an \$8,000 loss on sale of securities and a \$62,000 decrease in service charges. The decrease in service charges was primarily attributable to the Bank exiting its cash delivery services to check cashing businesses.

## **Non-interest Expense**

Total non-interest expense increased to \$2.0 million and \$4.0 million for the three and six months ended June 30, 2004, from \$1.9 million and \$3.6 million for the same periods in 2003. The \$141,000 increase for the second quarter was primarily attributable to increases in compensation and benefits costs, principally higher performance bonus accruals.

## **Allowance for Loan Losses**

As of June 30, 2004, the Company's allowance for loan losses totaled \$1.3 million, unchanged from the balance at December 31, 2003. The allowance for loan losses represents 0.57% of gross loans at June 30, 2004 compared to 0.67% at December 31, 2003.

Total non-performing assets, consisting of non-accrual loans, decreased by \$1,000 to \$79,000 at June 30, 2004 from \$80,000 at December 31, 2003. Non-accrual loans at June 30, 2004 consisted of one loan totaling \$79,000 secured by a single-family dwelling. There was no REO as of June 30, 2004 and December 31, 2003. As a percentage of total assets, non-performing assets were 0.03% at June 30, 2004, compared to 0.03% at December 31, 2003.

Management believes that the allowance for loan losses is adequate to cover inherent losses in Broadway Federal's loan portfolio as of June 30, 2004, but there can be no assurance that actual losses will not exceed the estimated amounts. In addition, the Office of Thrift Supervision ( OTS ) and the Federal Deposit Insurance Corporation periodically review Broadway Federal's allowance for loan losses as an integral part of their examination process. These agencies may require Broadway Federal to increase the allowance for loan losses based on their judgments of the information available to them at the time of their examination.

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### **Deposits**

Total deposits increased \$4.1 million, or 2.30%, to \$184.0 million from \$179.9 million at December 31, 2003. Core deposits (NOW, demand, money market and passbook accounts) increased by \$5.9 million during the first six months of 2004. At June 30, 2004, core deposits represented 45.02% of total deposits, compared to 42.77% at December 31, 2003, and 44.59% at June 30, 2003. Management has focused on increasing core deposit customers, extending deposit maturities on time deposits, and closely managing the cost of deposits.

### **Capital**

Total capital at June 30, 2004 was \$14.3 million, compared to \$18.2 million at December 31, 2003. The \$3.9 million decrease was primarily due to the repurchase of the Company's common stock from Hot Creek Ventures 1, L.P. and its affiliates, offset by the sale of the Company's common stock to Cathay General Bancorp (Cathay) and net earnings for the period.

### **Performance Ratios**

For the three months ended June 30, 2004, the Company's return on average equity increased to 12.79%, compared to 8.03% for the same period in 2003. The return on average assets also increased to 0.69% for the three months ended June 30, 2004, compared to 0.65% for the same period in 2003. The ratio of non-interest expense to average assets improved to 3.18% for the three months ended June 30, 2004, compared to 3.41% for the same period in 2003. The efficiency ratio (total non-interest expense divided by the sum of net interest income and non-interest income) improved to 73.33% in second quarter 2004, compared to 76.18% in second quarter 2003.

### **Income Taxes**

The Company's effective tax rate was approximately 39.97% for the three and six months ended June 30, 2004, compared to 38.82% for the same periods in the prior year. Income taxes are computed by applying the statutory federal income tax rate of 34.00% and the California income tax rate of 10.84% to earnings before income taxes.

### **Liquidity, Capital Resources and Market Risk**

Sources of liquidity and capital for the Company on a stand-alone basis include distributions from the Bank and the issuance of equity and debt securities, such as the preferred stock issued in 2002, the junior subordinated debentures issued during the first quarter of 2004 and the sale of 70,000 shares of the Company's common stock to Cathay during the second quarter of 2004. Dividends and other capital distributions from the Bank are subject to regulatory restrictions. (See Note (7) of Notes to Unaudited Consolidated Financial Statements)

The Bank's primary sources of funds are deposits, principal and interest payments on loans, sales of loans, mortgage-backed securities and investments, and advances from the Federal Home Loan Bank of San Francisco. Other sources of liquidity include principal repayments on mortgage-backed securities and other investments, and contributions of capital by the Company.

Since December 31, 2003, there has been no material change in the Company's interest rate sensitivity. For a discussion on the Company's interest rate sensitivity and market risk, see the Company's annual report on Form 10-KSB for the year ended December 31, 2003, including the Company's audited financial statements and the notes thereto.

### **Regulatory Capital**

The OTS capital regulations include three separate minimum capital requirements for savings institutions that are subject to OTS supervision. First, the tangible capital requirement mandates that the Bank's stockholder's equity, less intangible assets, be at least 1.50% of adjusted total assets as defined in the capital regulations. Second, the core capital requirement currently mandates that core capital (tangible capital plus certain qualifying intangible assets) be at least 4.00% of adjusted total assets as defined in the capital regulations. Third, the risk-based capital requirement presently mandates that core capital plus supplemental capital (as defined by the OTS) be at least 8.00% of risk-weighted assets as prescribed in the capital regulations. The capital regulations assign specific risk weightings to all assets and off-balance sheet items for this purpose.

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Broadway Federal was in compliance with all capital requirements in effect at June 30, 2004, and met all standards necessary to be considered well-capitalized under the prompt corrective action regulations adopted by the OTS pursuant to the Federal Deposit Insurance Corporation Improvement Act of 1991 ( FDICIA ).

The following table reflects the required and actual regulatory capital ratios of Broadway Federal at the date indicated:

Regulatory Capital Ratios For Broadway Federal	FIRREA Minimum Requirement	FDICIA Well-capitalized Requirement	Actual at June 30, 2004
Tangible ratio	1.50%	N/A	7.28%
Leverage ratio	4.00%	5.00%	7.28%
Tier 1 Risk-based ratio	4.00%	6.00%	9.94%
Total Risk-based ratio	8.00%	10.00%	10.64%

**ITEM 3. CONTROLS AND PROCEDURES**

As of June 30, 2004, an evaluation was performed under the supervision of the Company's Chief Executive Officer ( CEO ) and Chief Financial Officer ( CFO ) of the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based on that evaluation, the Company's CEO and CFO concluded that the Company's disclosure controls and procedures were effective as of June 30, 2004. There have been no significant changes in the Company's internal controls over financial reporting or in other factors that could significantly affect these controls subsequent to June 30, 2004.

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**PART II. OTHER INFORMATION**

Item 1. LEGAL PROCEEDINGS

None

Item 2. CHANGES IN SECURITIES AND SMALL BUSINESS ISSUER PURCHASES OF EQUITY SECURITIES

See Note (7) to the accompanying financial statements for a description of the Company's issuance of common stock in June 2004 without registration under the Securities Act of 1933 in reliance on the exemption set forth in Section 4(2) thereof and a related repurchase of its common stock in March 2004.

Item 3. DEFAULTS UPON SENIOR SECURITIES

None

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

The Annual Meeting of Stockholders of the Company was held on June 16, 2004 for the following purposes:

(a) To elect three directors to serve until the Annual Meeting to be held in the year 2007 and until their successors are elected and have been qualified.

At the meeting, the stockholders re-elected Elbert T. Hudson, Robert C. Davidson, Jr. and Rosa M. Hill to serve as directors for three-year terms. The number of votes for each of the directors was as follows:

Mr. Elbert T. Hudson	
For	1,126,990
Against	500
Abstain	25

Mr. Robert C. Davidson, Jr.	
For	1,126,990
Against	500
Abstain	25

Ms. Rosa M. Hill



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For	1,121,141
Against	0
Abstain	6,374

(b) To ratify the appointment of KPMG LLP as the Company's independent auditors for 2004.

At the meeting, the stockholders ratified the appointment of KPMG LLP as the Company's independent auditors based upon 1,124,361 shares voting for, 2,900 shares voting against and 254 shares abstaining.

Item 5. OTHER INFORMATION

None

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Item 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

Exhibit 31 Certifications pursuant to Rules 13a-14 or 15d-14 of the Securities Exchange Act of 1934 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

Exhibit 32 Certifications pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(b) Reports on Form 8-K

Current Report on Form 8-K dated and filed June 21, 2004 Item 5

Current Report on Form 8-K dated and filed June 16, 2004 Item 5

Current Report on Form 8-K dated and furnished April 29, 2004 Item 12

Current Report on Form 8-K dated and filed March 19, 2004 Item 5

Current Report on Form 8-K dated and furnished February 9, 2004 Item 12

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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

Date: August 12, 2004

By: /s/ PAUL C. HUDSON

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Paul C. Hudson  
President and Chief Executive Officer

Broadway Financial Corporation

Date: August 12, 2004

By: /s/ ALVIN D. KANG

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Alvin D. Kang  
Chief Financial Officer

Broadway Financial Corporation