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PFS BANCORP INC
Form 10QSB
August 12, 2004

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

OR

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

For the transition period from _____ to _____

Commission File Number: 033233

PFS BANCORP, INC.

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

Indiana

35-2142534

(State or other jurisdiction of
incorporation or organization)

(IRS Employer Identification No.)

Second & Bridgeway Streets, Aurora, Indiana 47001

(Address of principal executive offices)

(812) 926-0631

(Issuer's telephone number)

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

Check whether the issuer (1) filed all reports required to be filed by
Sections 13 or 15(d) of the Securities Exchange Act of 1934 during the
past 12 months (or for such shorter period that the issuer was
required to file such reports) and (2) has been subject to such filing
requirements for the past 90 days.

Yes No

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APPLICABLE ONLY TO CORPORATE ISSUERS

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date:
August 11, 2004 - 1,473,728 shares of common stock

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

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PFS Bancorp, Inc.

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

(In thousands, except share data)

ASSETS	June 30, 2004	December 31, 2003
Cash and due from banks	\$ 814	\$ 855
Interest-bearing deposits in other financial institutions	3,815	4,332
	-----	-----
Cash and cash equivalents	4,629	5,187

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Investment securities designated as available for sale - at market	9,098	10,016
Investment securities held to maturity - at amortized cost, which approximates market	143	152
Loans receivable - net	108,437	100,293
Office premises and equipment - at depreciated cost	990	1,065
Real estate acquired through foreclosure	-	169
Federal Home Loan Bank stock - at cost	776	758
Accrued interest receivable	411	395
Prepaid expenses and other assets	125	126
Prepaid income taxes	89	20
Deferred income taxes	86	92
	-----	-----
Total assets	\$124,784	\$118,273
	=====	=====

LIABILITIES AND SHAREHOLDERS' EQUITY

Deposits	\$ 86,330	\$ 88,328
Advances from the Federal Home Loan Bank	10,000	2,000
Advances by borrowers for taxes and insurance	129	63
Accrued interest payable	10	12
Other liabilities	1,164	948
	-----	-----
Total liabilities	97,633	91,351
Commitments	-	-
Shareholders' equity		
Preferred stock, 5,000,000 shares authorized, \$.01 par value; no shares issued	-	-
Common stock - 10,000,000 shares authorized, \$.01 par value; 1,551,293 shares issued	16	16
Additional paid-in capital	15,029	15,029
Retained earnings - restricted	14,318	14,101
Less: 77,565 shares of treasury stock at June 30, 2004 and December 31, 2003	(1,282)	(1,282)
Shares acquired by stock benefit plans	(1,801)	(1,801)
Accumulated other comprehensive income - unrealized gains on securities designated as available for sale, net of related tax effects	871	859
	-----	-----
Total shareholders' equity	27,151	26,922
	-----	-----
Total liabilities and shareholders' equity	\$124,784	\$118,273
	=====	=====

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PFS Bancorp, Inc.

CONSOLIDATED STATEMENTS OF EARNINGS

(In thousands, except per share data)

	Six months ended		Three months ended	
	June 30,		June 30,	
	2004	2003	2004	2003
Interest income				
Loans	\$2,558	\$2,729	\$1,281	\$1,317

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Investment securities	165	218	80	102
Interest-bearing deposits and other	19	49	9	28
	-----	-----	-----	-----
Total interest income	2,742	2,996	1,370	1,447
Interest expense				
Deposits	709	1,068	340	506
Borrowings	56	2	33	-
	-----	-----	-----	-----
Total interest expense	765	1,070	373	506
	-----	-----	-----	-----
Net interest income	1,977	1,926	997	941
Provision for losses on loans	48	48	24	24
	-----	-----	-----	-----
Net interest income after provision for losses on loans	1,929	1,878	973	917
Other operating income				
Loss on sale of investment securities	-	(28)	-	-
Gain (loss) on sale of repossessed property	(5)	10	(5)	6
Other operating	247	193	129	106
	-----	-----	-----	-----
Total other income	242	175	124	112
General, administrative and other expense				
Employee compensation and benefits	829	777	402	390
Occupancy and equipment	163	167	79	84
Data processing	124	103	62	53
Federal deposit insurance premiums	25	26	12	13
Other operating	290	273	169	149
	-----	-----	-----	-----
Total general, administrative and other expense	1,431	1,346	724	689
	-----	-----	-----	-----
Earnings before income taxes	740	707	373	340
Income taxes				
Current	296	309	138	143
Deferred	6	(20)	14	-
	-----	-----	-----	-----
Total income taxes	302	289	152	143
	-----	-----	-----	-----
NET EARNINGS	\$ 438	\$ 418	\$ 221	\$ 197
	=====	=====	=====	=====
EARNINGS PER SHARE				
Basic	\$.32	\$.30	\$.16	\$.15
	===	===	===	===
Diluted	\$.31	\$.30	\$.15	\$.15
	===	===	===	===

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PFS Bancorp, Inc.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

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	Six months ended June 30,		Three mont June
	2004	2003	2004
Net earnings	\$438	\$418	\$221
Other comprehensive income (loss), net of tax:			
Unrealized holding gains (losses) on securities during the period, net of taxes (benefits) of \$6, \$(47), \$(2) and \$(6) for the respective periods	12	(91)	(4)
Reclassification adjustment for realized losses included in earnings, net of tax benefits of \$10 in 2003	-	18	-
Comprehensive income	\$450	\$345	\$217
	===	===	===
Accumulated comprehensive income	\$871	\$808	\$871
	===	===	===

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PFS Bancorp, Inc.

CONSOLIDATED STATEMENTS OF CASH FLOWS

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

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	2004	2003
Cash flows from operating activities:		
Net earnings for the period	\$ 438	\$ 418
Adjustments to reconcile net earnings to net cash provided by (used in) operating activities:		
Amortization of deferred loan origination fees	(21)	(33)
Amortization of premiums and discounts on investment securities - net	33	44
Federal Home Loan Bank stock dividends	(18)	(9)
Depreciation	79	87
Provision for losses on loans	48	48
Loss on sale of investment securities	-	28
(Gain) loss on sale of repossessed assets	5	(10)
Increase (decrease) in cash due to changes in:		
Accrued interest receivable	(16)	22
Prepaid expenses and other assets	1	(8)
Other liabilities	216	137
Accrued interest payable	(2)	(11)
Income taxes		
Current	(75)	(96)
Deferred	6	(20)
	-----	-----
Net cash provided by operating activities	694	597
Cash flows provided by (used in) investing activities:		
Purchase of investment securities designated as available for sale	(11,932)	(17,445)
Proceeds from maturities and repayment of investment securities	12,844	16,169
Proceeds from sale of investment securities	-	3,029
Loan principal repayments	12,542	17,521
Loan disbursements	(20,763)	(15,696)
Purchase of office premises and equipment	(4)	(3)
Proceeds from sale of real estate acquired through foreclosure	214	-
	-----	-----
Net cash provided by (used in) investing activities	(7,099)	3,575
Cash flows provided by (used in) financing activities:		
Net increase (decrease) in deposits	(1,998)	887
Proceeds from Federal Home Loan Bank advances	8,000	2,500
Repayment of Federal Home Loan Bank advances	-	(3,500)
Advances by borrowers for taxes and insurance	66	(13)
Purchase of treasury shares	-	(1,282)
Dividends on common shares	(221)	(228)
	-----	-----
Net cash provided by (used in) financing activities	5,847	(1,636)
	-----	-----
Net increase (decrease) in cash and cash equivalents	(558)	2,536
Cash and cash equivalents at beginning of period	5,187	5,225
	-----	-----
Cash and cash equivalents at end of period	\$ 4,629	\$ 7,761
	=====	=====

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(In thousands)

	2004	2003
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Income taxes	\$ 390 =====	\$ 343 =====
Interest on deposits and borrowings	\$ 767 =====	\$1,081 =====
Supplemental disclosure of noncash investing activities:		
Unrealized gains (losses) on securities designated as available for sale, net of related tax effects	\$ 12 =====	\$ (73) =====
Transfers from loans to real estate acquired through foreclosure	\$ 50 =====	\$ - =====

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PFS Bancorp, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the six and three months ended June 30, 2004 and 2003

Forward-Looking Statements

This Form 10-QSB contains certain forward-looking statements and information relating to the Company that are based on the beliefs of management as well as assumptions made by and information currently available to management. In addition, in those and other portions of this document, the words "anticipate," "believe," "estimate," "except," "intend," "should" and similar expressions, or the

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negative thereof, as they relate to the Company or the Company's management, are intended to identify forward-looking statements. Such statements reflect the current views of the Company with respect to future looking events and are subject to certain risks, uncertainties and assumptions. Should one or more of these risks or uncertainties materialize or should underlying assumptions prove incorrect, actual results may vary from those described herein as anticipated, believed, estimated, expected or intended. The Company does not intend to update these forward-looking statements.

1. Basis of Presentation

The accompanying unaudited consolidated financial statements were prepared in accordance with instructions for Form 10-QSB and, therefore, do not include information or footnotes necessary for a complete presentation of financial position, results of operations and cash flows in conformity with accounting principles generally accepted in the United States of America. Accordingly, these financial statements should be read in conjunction with the Consolidated Financial Statements and Notes thereto of the Company for the period ended December 31, 2003. However, in the opinion of management, all adjustments (consisting of only normal recurring accruals) which are necessary for a fair presentation of the consolidated financial statements have been included. The results of operations for the six and three month periods ended June 30, 2004, are not necessarily indicative of the results which may be expected for the entire year.

2. Principles of Consolidation

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

3. Earnings Per Share

Basic earnings per share is computed based upon the weighted-average common shares outstanding during the period less shares in the ESOP that are unallocated and not committed to be released. Weighted-average common shares deemed outstanding, which gives effect to 86,632 and 97,336 unallocated ESOP shares at June 30, 2004 and 2003, respectively. Diluted earnings per share is computed by taking into consideration common shares outstanding and the dilutive effect of additional potential common shares issuable under the Company's stock option plan. The computations are as follows:

	For the six months ended		For the three months ended	
	June 30,		June 30,	
	2004	2003	2004	2003
Weighted-average common shares outstanding (basic)	1,387,096	1,404,247	1,387,096	1,376,392
Dilutive effect of assumed exercise of stock options	9,325	-	9,218	-
	-----	-----	-----	-----
Weighted-average common shares outstanding (diluted)	1,396,421	1,404,247	1,396,314	1,376,392

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The Company had no dilutive or potentially dilutive securities during either the three or six month periods ended June 30, 2003.

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PFS Bancorp, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

For the six and three months ended June 30, 2004 and 2003

4. Stock Option Plan

The Board of Directors had previously adopted the PFS Bancorp, Inc. Stock Option Plan (the "Plan") which provides for the issuance of 152,088 shares of authorized but unissued shares of common stock at fair value at the date of grant. The initial options granted in June 2003 totaled 62,228 at an exercise price equal to fair value of \$16.85. The Plan provides that one-fifth of the options granted become exercisable on each of the first five anniversaries of the date of grant.

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

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

		Six months ended		Three months ended	
		June 30,		June 30,	
		2004	2003	2004	2003
Net earnings (In thousands)	As reported	\$438	\$418	\$221	\$197
	Stock-based compensation, net of tax	(14)	-	(7)	-
		---	---	---	---
	Pro-forma	\$424	\$418	\$214	\$197
		===	===	===	===

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Earnings per share					
Basic	As reported	\$.32	\$.30	\$.16	\$.15
	Stock-based compensation, net of tax	(.01)	-	(.01)	-
		---	---	---	---
	Pro-forma	\$.31	\$.30	\$.15	\$.15
		===	===	===	===
Diluted					
	As reported	\$.31	\$.30	\$.15	\$.15
	Stock-based compensation, net of tax	(.01)	-	-	-
		---	---	---	---
	Pro-forma	\$.30	\$.30	\$.15	\$.15
		===	===	===	===

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PFS Bancorp, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

For the six three months ended June 30, 2004 and 2003

4. Stock Option Plan (continued)

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

	Six months ended June 30, 2004		Year ended December 31, 2003	
	Shares	Weighted- average exercise price	Shares	Weighted- average exercise price
Outstanding at beginning of period	62,228	\$16.85	-	\$ -
Granted	-	-	62,228	16.85
Exercised	-	-	-	-
Forfeited	-	-	-	-
	-----	-----	-----	-----
Outstanding at end of period	62,228	\$16.85	62,228	\$16.85
	=====	=====	=====	=====
Options exercisable at period-end	12,446	\$16.85	-	\$ -
	=====	=====	=====	=====
Weighted-average fair value of options granted during the period		\$ -		\$ 3.82
		=====		=====

The following information applies to options outstanding at June 30, 2004:

Number outstanding	62,228
Range of exercise prices	\$16.85
Weighted-average exercise price	\$16.85

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Weighted-average remaining contractual life 9 years

5. Critical Accounting Policies

Certain of the Company's accounting policies are important to the portrayal of the Company's financial condition, since they require management to make difficult, complex or subjective judgments, some of which may relate to matters that are inherently uncertain. Estimates associated with these policies are susceptible to material changes as a result of changes in facts and circumstances. Facts and circumstances which could affect these judgments include, but without limitation, changes in interest rates, changes in the performance of the economy or changes in the financial condition of borrowers. Management believes that its critical accounting policies include determining the allowance for loan losses and determining the carrying value of mortgage servicing rights. The Company's critical accounting policies are discussed in detail in its Annual Report for the year ended December 31, 2003 (incorporated by reference into the Company's 10K filing) in Note A of the Notes to the Consolidated Financial Statements under "Allowance for Loan Losses." If management were to underestimate the allowance for loan losses, earnings could be reduced in the future as a result of greater than expected net loan losses. Overestimations of the required allowance could result in future increases in income, as loan loss recoveries increase or provisions for losses on loans decrease.

Mortgage servicing rights are accounted for pursuant to the provisions of SFAS No. 140. "Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities," which requires that the Company recognize as separate assets, rights to service mortgage loans for others, regardless of how those servicing rights are acquired. An institution that acquires mortgage servicing rights through either the purchase or origination of mortgage loans and sells those loans with servicing rights retained must allocate some of the cost of the loans to the mortgage servicing rights.

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PFS Bancorp, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

For the six three months ended June 30, 2004 and 2003

5. Critical Accounting Policies (continued)

SFAS No. 140 requires that capitalized mortgage servicing rights and capitalized excess servicing receivables be assessed for impairment. Impairment is measured based on fair value. The mortgage servicing rights recorded by the Company, calculated in accordance with the provisions of SFAS No. 140, were segregated into pools for valuation purposes, using as pooling criteria the loan term and coupon rate. Once pooled, each grouping of loans was evaluated on a discounted earnings basis to determine the present value of future earnings that a purchaser could expect to realize from each portfolio. Earnings were projected from a variety of sources including loan servicing fees, interest earned on float, net interest earned on

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escrows, miscellaneous income, and costs to service the loans. The present value of future earnings is the "economic" value of the pool, i.e., the net realizable present value to an acquiror of the acquired servicing. Fluctuations in the fair value of mortgage servicing rights may affect net earnings, as this asset is carried at the lower of amortized cost or fair value.

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PFS Bancorp, Inc.

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

Discussion of Financial Condition Changes from December 31, 2003 to
June 30, 2004

At June 30, 2004, the Company's assets totaled \$124.8 million, an increase of \$6.5 million, or 5.5%, compared to total assets at December 31, 2003. The increase in assets was comprised primarily of an \$8.1 million, or 8.1%, increase in loans receivable which was principally funded by additional advances from the Federal Home Loan Bank, which increased by \$8.0 million.

Liquid assets (i.e. cash and interest-bearing deposits) decreased by \$558,000, or 10.8%, from December 31, 2003 levels, to a total of \$4.6 million at June 30, 2004. Investment securities available for sale totaled \$9.1 million at June 30, 2004, a decrease of \$918,000, or 9.2%, from December 31, 2003 levels. The decrease resulted primarily from investment maturities of \$12.8 million, which were partially offset by security purchases totaling \$11.9 million during the six month period.

As previously stated, loans receivable increased by \$8.1 million, or 8.1%, during the six month period ended June 30, 2004, to a total of \$108.4 million. Loan disbursements amounted to \$20.8 million and were partially offset by principal repayments of \$12.5 million. During the six months ended June 30, 2004, loan originations were comprised of \$11.2 million in loans secured by one- to four-family residential real estate, \$1.1 million in loans secured by multifamily residential real

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estate, \$5.4 million in loans secured by commercial and nonresidential real estate and \$3.1 million in consumer and other loans.

The allowance for loan losses totaled \$782,000 and \$771,000 at June 30, 2004 and December 31, 2003, respectively. Nonperforming and impaired loans totaled \$477,000 and \$1.1 million at June 30, 2004 and December 31, 2003, respectively. The allowance for loan losses represented 163.9% and 67.7% of nonperforming and impaired loans as of June 30, 2004 and December 31, 2003, respectively. The allowance represented approximately .72% and .76% of the total loan portfolio at June 30, 2004 and December 31, 2003, respectively. At June 30, 2004, nonperforming and impaired loans were comprised of \$468,000 in loans secured by one- to four-family residential real estate and \$9,000 in commercial, consumer and other loans. Management believes such loans are adequately collateralized and does not presently expect to incur any material losses on such loans. Although management believes that its allowance for loan losses at June 30, 2004, was sufficient to cover known and inherent losses in the loan portfolio based upon the available facts and circumstances, there can be no assurance that additions to such allowance will not be necessary in future periods, which could adversely affect the Company's results of operations.

Deposits totaled \$86.3 million at June 30, 2004, a decrease of \$2.0 million, or 2.3%, compared to December 31, 2003 levels. While management generally strives to maintain a moderate level of growth in deposits through marketing and pricing strategies, the current low interest rate environment contributed to the reduction in deposits as depositors sought alternative investments. The decline in deposits was offset by an \$8.0 million increase in advances from the Federal Home Loan Bank.

Shareholders' equity amounted to \$27.2 million at June 30, 2004, an increase of \$229,000, or .9%, from December 31, 2003 levels. The increase resulted primarily from the net earnings of \$438,000 and a \$12,000 increase in unrealized gains on securities designated as available for sale, which were partially offset by the payment of dividends of \$221,000.

Peoples is required to meet minimum capital standards promulgated by the Office of Thrift Supervision ("OTS"). At June 30, 2004, Peoples' regulatory capital was well in excess of the minimum capital requirements.

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PFS Bancorp, Inc.

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

Comparison of Operating Results for the Three-Month Periods Ended June 30, 2004 and 2003

General

Net earnings for the three months ended June 30, 2004 amounted to \$221,000, an increase of \$24,000, or 12.2%, compared to the \$197,000 in net earnings reported for the three month period ended June 30, 2003. The increase in earnings was due primarily to a \$56,000, or

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6.0%, increase in net interest income and a \$12,000, or 10.7%, increase in other income which were partially offset by a \$35,000, or 5.1%, increase in general, administrative and other expense, and a \$9,000, or 6.3% increase in income taxes.

Net Interest Income

Total interest income amounted to \$1.4 million for the three-month period ended June 30, 2004, a decrease of \$77,000, or 5.3%, from the same period in 2003. Interest income on loans totaled \$1.3 million during the 2004 period, a decrease of \$36,000, or 2.7%, from the 2003 period. This decline was due primarily to a 74 basis point decrease in the weighted-average yield quarter to quarter, to 4.80% for the quarter ended June 30, 2004, which was partially offset by an \$11.6 million, or 12.2%, increase in the average balance of loans outstanding quarter to quarter.

Interest income on investment securities decreased by \$22,000, or 21.6%, for the three months ended June 30, 2004, compared to the same quarter in 2003. This decline was due primarily to a 5 basis point decrease in the weighted-average yield to 3.08% for the quarter ended June 30, 2004, coupled with a \$2.7 million, or 20.4%, decrease in the average balance outstanding. Interest income on other interest-bearing deposits decreased by \$19,000, or 67.9%, during the three months ended June 30, 2004, compared to the same period in 2003, due primarily to a 35 basis point decrease in the weighted-average yield, to .90% for the 2004 quarter and a \$5.0 million, or 55.4%, decrease in the average balance outstanding for the three month period. The decline in the average balance of interest-bearing deposits was primarily due to the use of such funds to fund loan growth.

Interest expense on deposits totaled \$340,000 for the three month period ended June 30, 2004, a decrease of \$166,000, or 32.8%, from the \$506,000 recorded for the same period in 2003. The reduction in interest on deposits was due primarily to a 65 basis point decline in the weighted-average cost of deposits in the 2004 period. Interest expense on borrowings increased by \$33,000, or 100%, for the three month period ended June 30, 2004 compared to no borrowing cost recorded for the same period in 2003. This increase was due to an increase in the average balance of borrowings which was used to fund loan growth.

The reduction in the level of yields on interest-earning assets and costs of interest-bearing liabilities was due primarily to the overall decline in interest rates in the general economy.

Provision for Losses on Loans

As a result of an analysis of historical experience, the volume and type of lending conducted by the Savings Bank, the status of past due principal and interest payments, general economic conditions, particularly as such conditions relate to the Savings Bank's market area, and other factors related to the collectibility of the Savings Bank's loan portfolio, management elected to record a provision for losses on loans totaling \$24,000 for each of the quarters ending June 30, 2004 and 2003. The current period provision was predicated primarily upon the continuing change in the loan portfolio mix, including an increase in loans secured by nonresidential real estate, as well as the general condition of the local economy. There can be no assurance that the loan loss allowance will be sufficient to cover

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losses on nonperforming assets in the future.

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PFS Bancorp, Inc.

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

Comparison of Operating Results for the Three-Month Periods Ended June 30, 2004 and 2003 (continued)

Other Income

Other income totaled \$124,000 for the three month period ended June 30, 2004, an increase of \$12,000, or 10.7%, over the same period in 2003. The increase in other income was due primarily to a \$23,000, or 21.7% increase in service fees and fee income. In addition, there was \$5,000 loss on the sale of real estate for the 2004 quarter compared to a \$6,000 gain on the sale of real estate in the 2003 quarter.

General, Administrative and Other Expense

General, administrative and other expense totaled \$724,000 for the three months ended June 30, 2004, an increase of \$35,000, or 5.1%, compared to the same quarter in 2003. This increase was due primarily to a \$12,000, or 3.1%, increase in employee compensation and benefits, a \$9,000, or 17.0%, increase in data processing expenses, and a \$20,000, or 13.4% increase in other operating expenses which were partially offset by a \$5,000, or 6.0% decrease in occupancy and equipment expense. The increase in employee compensation and benefits was attributable to increased costs associated with the Company's stock benefit plans, retirement plan and insurance premiums, as well as normal merit increases quarter to quarter. Of the \$20,000 increase in other operating expenses, \$9,000 is attributable to legal expense related to the on-going compliance costs of being a stock company.

Income Taxes

The income tax provision totaled \$152,000 for the three month period ended June 30, 2004, an increase of \$9,000, or 6.3%, compared to the same quarter in 2003. The income tax provision includes expense for federal and Indiana state income taxes. The combined effective tax rates were 40.8% and 42.1% for the three month periods ended June 30, 2004 and 2003, respectively.

Comparison of Operating Results for the Six-Month Periods Ended June 30, 2004 and 2003

General

Net earnings for the six months ended June 30, 2004 amounted to \$438,000, an increase of \$20,000, or 4.8%, compared to the \$418,000 in net earnings reported for the six month period ended June 30, 2003.

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The increase in earnings was due primarily to a \$51,000, or 2.6%, increase in net interest income, and a \$67,000, or 38.3%, increase in other income, which were partially offset by an \$85,000, or 6.3%, increase in general, administrative and other expense, and a \$13,000, or 4.5%, increase in income taxes.

Net Interest Income

Total interest income amounted to \$2.7 million for the six-month period ended June 30, 2004, a decrease of \$254,000, or 8.5%, from the same period in 2003. Interest income on loans totaled \$2.6 million during the 2004 period, a decrease of \$171,000, or 6.3%, from the 2003 period. This decline was due primarily to a 84 basis point decrease in the weighted-average yield period to period, to 4.87% for the six month period ended June 30, 2004, which was partially offset by a \$9.6 million, or 10.0%, increase in the average balance of loans outstanding period to period.

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PFS Bancorp, Inc.

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

Comparison of Operating Results for the Six-Month Periods Ended June 30, 2004 and 2003 (continued)

Net Interest Income (continued)

Interest income on investment securities decreased by \$53,000, or 24.3%, for the six months ended June 30, 2004, compared to the same period in 2003. This decline was due primarily to a 26 basis point increase in the weighted-average yield to 3.15% for the six month period ended June 30, 2004, coupled with a \$4.6 million, or 30.5%, decrease in the average balance outstanding. Interest income on other interest-bearing deposits decreased by \$30,000, or 61.2%, during the six months ended June 30, 2004, compared to the same period in 2003, due primarily to a 38 basis point decrease in the weighted-average yield, to .93% for the 2004 period and a \$3.4 million, or 45.4%, decrease in the average balance outstanding for the six month period. The decline in the average balance of interest-bearing deposits was primarily due to the use of such funds to fund loan growth.

Interest expense on deposits totaled \$709,000 for the six month period ended June 30, 2004, a decrease of \$359,000, or 33.6%, from the \$1.1 million recorded for the same period in 2003. The reduction in interest on deposits was due primarily to a 75 basis point decline in the weighted-average cost of deposits in the 2004 period. Interest expense on borrowings increased by \$54,000 to \$56,000 for the six month period ended June 30, 2004 compared to the \$2,000 borrowing cost recorded for the same period in 2003 as a result of an increase in the average borrowings outstanding period to period in order to fund loan growth.

The reduction in the level of yields on interest-earning assets and costs of interest-bearing liabilities was due primarily to the overall decline in interest rates in the general economy.

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Provision for Losses on Loans -----

As a result of an analysis of historical experience, the volume and type of lending conducted by the Savings Bank, the status of past due principal and interest payments, general economic conditions, particularly as such conditions relate to the Savings Bank's market area, and other factors related to the collectibility of the Savings Bank's loan portfolio, management elected to record a provision for losses on loans totaling \$48,000 for each of the six month periods ending June 30, 2004 and 2003. The current period provision was predicated primarily upon the continuing change in the loan portfolio mix, including an increase in loans secured by nonresidential real estate, as well as the general condition of the local economy. There can be no assurance that the loan loss allowance will be sufficient to cover losses on nonperforming assets in the future.

Other Income -----

Other income totaled \$242,000 for the six month period ended June 30, 2004, an increase of \$67,000, or 38.3%, over the same period in 2003. The increase in other income was due primarily to a \$54,000, or 28.0% increase in service fees and fee income. In addition, there was a \$5,000 loss on the sale of real estate for the six month period in 2004 compared to an \$18,000 net loss resulting from the sale of investment securities and gain on sale of real estate in the 2003 period.

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PFS Bancorp, Inc.

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

Comparison of Operating Results for the Six-Month Periods Ended June 30, 2004 and 2003 (continued) -----

General, Administrative and Other Expense -----

General, administrative and other expense totaled \$1.4 million for the six months ended June 30, 2004, an increase of \$85,000, or 6.3%, compared to the same period in 2003. This increase was due primarily to a \$52,000, or 6.7%, increase in employee compensation and benefits, a \$21,000, or 20.4%, increase in data processing expenses, and a \$17,000, or 6.2% increase in other operating expense. The increase in employee compensation and benefits was attributable to increased costs associated with the Company's stock benefit plans, retirement plan and insurance premiums, as well as normal merit increases period to period. Of the \$17,000 increase in other operating expenses, \$14,000 is attributable to legal expense related to the on-going compliance costs of being a stock company.

Income Taxes -----

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The income tax provision totaled \$302,000 for the six month period ended June 30, 2004, an increase of \$13,000, or 4.5%, compared to the same period in 2003. The income tax provision includes expense for federal and Indiana state income taxes. The combined effective tax rates were 40.8% and 40.9% for the six month periods ended June 30, 2004 and 2003, respectively.

Impact of Inflation and Changing Prices

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

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

ITEM 3: Controls and Procedures

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

No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934) occurred during the most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PFS Bancorp, Inc.
PART II

ITEM 1. Legal Proceedings

Not applicable

ITEM 2. Changes in Securities and Small Business Issuer Purchase of Equity Securities

Not applicable

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ITEM 3. Defaults Upon Senior Securities

Not applicable

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

Not applicable

ITEM 5. Other Information

None.

ITEM 6. Exhibits and Reports on Form 8-K

(a) Exhibits:

EX-31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a)
EX-31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a)
EX-32.1	Section 1350 Certification of the Chief Executive Officer
EX-32.2	Section 1350 Certification of the Chief Financial Officer

(b) Reports on Form 8-K:

Date ----	Items and Description -----
April 27, 2004	Item 9. On April 27, 2004 the issuer announced its results of operations for the quarter ended March 31, 2004 in a press release attached as Exhibit 99.1.

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PFS Bancorp, Inc.

SIGNATURES

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

Date: August 11, 2004

By: /s/Mel E. Green

Mel E. Green

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President and Chief Executive Officer

Date: August 11, 2004

By: /s/Stuart M. Suggs

Stuart M. Suggs
Chief Financial Officer, Vice President
and Corporate Treasurer