

META FINANCIAL GROUP INC  
Form 10-K  
December 21, 2006

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended September 30, 2006

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

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

Commission file number 0-22140.

**META FINANCIAL GROUP, INC.**  
(Name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of  
incorporation or organization)

42-1406262  
(I.R.S. Employer  
Identification No.)

121 East Fifth Street, Storm Lake, Iowa  
(Address of principal executive offices)

50588  
(Zip Code)

Registrant's telephone number: (712) 732-4117

Securities Registered Pursuant to Section 12(b) of the Act:

None

Securities Registered Pursuant to Section 12(g) of the Act:

Common Stock, par value \$0.01 per share

(Title of Class)

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

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Indicate by check mark if the registrant is not required to file reports pursuant Section 13 and Section 15(d) of the Act. YES  NO

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES  NO

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12-b2 of the Exchange Act. (Check one): Large accelerated filer  Accelerated filer  Non-accelerated filer

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

As of November 27, 2006, there were outstanding 2,534,367 shares of the Registrant's Common Stock.

As of March 31, 2006, the aggregate market value of the voting stock held by non-affiliates of the Registrant, computed by reference to the average of the closing bid and asked prices of such stock on the Nasdaq System as of such date, was \$40.4 million.

**DOCUMENTS INCORPORATED BY REFERENCE**

PARTS II and IV of Form 10-K Portions of the Annual Report to Shareholders for the fiscal year ended September 30, 2006.

PART III of Form 10-K Portions of the Proxy Statement for the Annual Meeting of Shareholders to be held January 22, 2007.

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## Forward-Looking Statements

Meta Financial Group, Inc. <sup>®</sup> ( Meta Financial or the Company ) and its wholly-owned subsidiaries, MetaBank, MetaBank West Central ( MetaBank WC ) and Meta Trust, may from time to time make written or oral forward-looking statements, including statements contained in its filings with the Securities and Exchange Commission, in its reports to shareholders, and in other communications, which are made in good faith pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995.

These forward-looking statements include statements with respect to the Company's beliefs, expectations, estimates and intentions that are subject to significant risks and uncertainties, and are subject to change based on various factors, some of which are beyond the Company's control. Such statements address the following subjects: future operating results; customer growth and retention; loan and other product demand; earnings growth and expectations; new products and services, such as those offered by the MetaBank's Meta Payment Systems<sup>®</sup> Division of MetaBank; credit quality and adequacy of the allowance for loan losses; technology; and our employees. The following factors, among others, could cause the Company's financial performance to differ materially from the expectations, estimates, and intentions expressed in such forward-looking statements: the strength of the United States economy in general and the strength of the local economies in which the Company conducts its operations; the effects of, and changes in, trade, monetary, and fiscal policies and laws, including interest rate policies of the Federal Reserve Board; inflation, interest rate, market, and monetary fluctuations; the timely development of and acceptance of new products and services offered by the Company as well as risks (including litigation) attendant thereto and the perceived overall value of these products and services by users; the impact of changes in financial services laws and regulations; technological changes; acquisitions; changes in consumer spending and saving habits; and the success of the Company at managing and collecting assets of borrowers in default and managing the risks (including litigation) involved in the foregoing.

The foregoing list of factors is not exclusive. Additional discussion of factors affecting the Company's business and prospects is contained in the Company's periodic filings with the SEC. The Company does not undertake, and expressly disclaims any intent or obligation, to update any forward-looking statement, whether written or oral, that may be made from time to time by or on behalf of the Company.

## Available Information

The Company's website address is [www.metacash.com](http://www.metacash.com). The Company makes available, through a link with the SEC's EDGAR database, free of charge, its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (the Exchange Act ), and beneficial ownership reports on Forms 3, 4, and 5 as soon as reasonably practicable after electronically filing such material with, or furnishing it to, the SEC. The information found on the Company's website is not incorporated by reference in this or any other report the Company files or furnishes to the SEC.

**PART I**

**Item 1. Description of Business**  
**General**

Meta Financial is a Delaware corporation, the principal assets of which are all the issued and outstanding shares of MetaBank and MetaBank WC. Meta Financial, on September 20, 1993, acquired all of the capital stock of MetaBank in connection with its conversion from the mutual to stock form ownership (the Conversion). On September 30, 1996, Meta Financial became a bank holding company for regulatory purposes upon its acquisition of MetaBank WC as discussed below. Unless the context otherwise requires, references herein to the Company include Meta Financial, MetaBank WC and MetaBank, and all subsidiaries on a consolidated basis. MetaBank and MetaBank WC may sometimes collectively be referred to as the Banks.

Since the Conversion, the Company has acquired several financial institutions. On March 28, 1994, Meta Financial acquired Brookings Federal Bank in Brookings, South Dakota ( Brookings Federal ). On December 29, 1995, Meta Financial acquired Iowa Savings Bank, FSB in Des Moines, Iowa ( Iowa Savings ). Brookings Federal and Iowa Savings were both merged with, and now operate as market areas of, MetaBank. On September 30, 1996, Meta Financial completed the acquisition of Central West Bancorporation ( CWB ), the holding company for MetaBank WC, which upon the merger of CWB into Meta Financial resulted in MetaBank WC becoming a stand-alone banking subsidiary of Meta Financial.

MetaBank and MetaBank WC are the only direct, active full service banking subsidiaries of Meta Financial. The Banks are community-oriented financial institutions offering a variety of financial services to meet the needs of the communities they serve. The Company, through the Banks, provides a full range of financial services. The principal business of MetaBank has consisted of attracting retail deposits from the general public and investing those funds primarily in one- to four-family residential mortgage loans, commercial and multi-family real estate, agricultural operating and real estate, construction, consumer and commercial business loans primarily in MetaBank's market area. MetaBank's lending activities have expanded in recent years to include an increased emphasis on originations of commercial and multi-family real estate loans and commercial business loans. MetaBank also purchases loan participations from time to time from other financial institutions. These loans typically are collateralized by commercial real estate and commercial businesses. In 2004, MetaBank created a division known as Meta Payment Systems ( MPS ), which issues reloadable, non-reloadable and benefit cards, sponsors non-bank owned ATMs into various debit networks, provides ACH services for corporate clients, and provides related electronic banking services. MPS also generates low- and no-cost deposits for MetaBank through its activities. The principal business of MetaBank WC has been and continues to be attracting retail deposits from the general public and investing those funds in commercial and multi-family real estate and commercial operating loans and, to a lesser extent, one- to four-family residential, consumer and agriculture loans. The Banks also purchase mortgage-backed securities and other investments permissible under applicable regulations. Meta Financial also owns Meta Trust Company (the Trust Company ), a South Dakota trust corporation. At September 30, 2006, the Company had total assets of \$741.1 million, deposits of \$565.7 million, and shareholders' equity of \$45.3 million.

The Company's revenues are derived primarily from interest on commercial and residential mortgage loans, mortgage-backed securities, commercial business loans, other investments, consumer loans, agricultural operating loans, commercial business loans, income from service charges, loan

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origination fees, fees generated through the activities of Meta Payment Systems, and loan servicing fee income.

The Trust Company, established in April 2002 as a South Dakota corporation and a wholly-owned subsidiary of Meta Financial, provides a full range of trust services. First Midwest Financial Capital Trust, also a wholly-owned subsidiary of Meta Financial, was established in July 2001 for the purpose of issuing trust preferred securities.

Meta Financial, the Banks and the Trust Company are subject to comprehensive regulation. See Regulation herein.

The home office of the Company is located at 121 East Fifth Street, Storm Lake, Iowa 50588. Its telephone number at that address is (712) 732-4117.

### Market Area

MetaBank has four market areas and the Meta Payments Systems Division: Northwest Iowa ( NWI ), Brookings, Central Iowa ( CI ), and Sioux Empire ( SE ). MetaBank's headquarters is located at 121 East Fifth Street in Storm Lake, Iowa. NWI operates a total of six offices in Storm Lake (2), Lake View, Laurens, Odebolt and Sac City, Iowa. Brookings operates one office in Brookings, South Dakota. CI operates five offices in Des Moines (2), West Des Moines (2), and Urbandale, Iowa. SE operates four offices in Sioux Falls and one administrative office. The Meta Payment Systems Division of MetaBank, which provides stored value card services, ATM sponsorship services and ACH services, operates out of Sioux Falls, South Dakota. See Meta Payment Systems Division.

MetaBank WC operates its business through three full-service offices in Casey, Menlo and Stuart, Iowa.

The Company's primary market area includes the Iowa counties of Adair, Buena Vista, Dallas, Guthrie, Pocahontas, Polk and Sac, and the South Dakota counties of Brookings, Lincoln and Minnehaha.

Iowa ranks sixth lowest nationally in business costs (Economy.com Inc. 2003), among the top ten states for technology sophistication in K-12 schools (Market Data Retrieval), third most favorable business liability climate in the nation (Harris Interactive Survey, U.S. Chamber of Commerce, 2003), second most livable state in the nation (Morgan Qullno State Rankings, 2003), and has low corporate income and franchise taxes.

South Dakota ranks first in entrepreneurial friendliness (Small Business Survival Foundation, 2002), first in students per computer (Technology Courts 2002), is the second safest state (FBI, 2001), and has no corporate income tax, personal income tax, personal property tax, business inventory tax, or inheritance tax.

Storm Lake is located in Iowa's Buena Vista County approximately 150 miles northwest of Des Moines and 200 miles southwest of Minneapolis. Like much of the state of Iowa, Storm Lake and the surrounding market area are highly dependent upon farming and agricultural markets. Major employers in the area include Buena Vista Regional Medical Center, Tyson Foods, Sara Lee Foods, and Buena Vista University, which currently enrolls 1,118 full-time students at its Storm Lake campus and employs 83 full-time faculty members. The Northwest Iowa market operates two offices in Storm Lake with additional offices in Laurens, Sac City, Lake View and Odebolt.

Brookings is located in east central Brookings County, South Dakota, approximately 50 miles north of Sioux Falls and 200 miles west of Minneapolis. The Bank's market area encompasses approximately a 30-mile radius of Brookings. The area is generally rural, and agriculture is a significant industry in the community. South Dakota State University is the largest employer in Brookings. The University had 11,377 students enrolled for the 2006 fall term and employs 1,020 full-time faculty members. The community also has several manufacturing companies, including 3M, Larson Manufacturing, Daktronics, Falcon Plastics, Twin City Fan, and Rainbow Play Systems, Inc. The Brookings market operates from an office located in downtown Brookings.

Des Moines, Iowa's capital, is located in central Iowa. The Des Moines market area encompasses Polk County and surrounding counties. MetaBank's Central Iowa main office is located in a high growth area just off I-80 at the intersection of two major streets in Urbandale. The West Des Moines office operates near a high-traffic intersection, across from a major shopping mall. The Ingersoll office is located near the heart of Des Moines, on a major thoroughfare, in a densely populated area. The Highland Park facility is located in a historical district approximately five minutes north of downtown Des Moines. The Jordan Creek office is located in near Jordan Creek Town Center in West Des Moines, one of the fastest growing communities in the State of Iowa and the Greater Des Moines area. The Des Moines metro area is one of the top three insurance centers in the world, with sixty-seven insurance company headquarters and over one hundred regional insurance offices. Major employers include Principal Life Insurance Company, Des Moines Community Schools, Central Iowa Hospital Corporation, Mercy Hospital Medical Center, Hy-Vee Food Stores, Inc., Wells Fargo Home Mortgage Inc., Pioneer Hi Bred International Inc., Bridgestone/Firestone, Communications Data Services Inc., and Meredith Corporation. Universities and colleges in the area include Des Moines Area Community College, Drake University, Simpson College, Des Moines University Osteopathic Medical Center, Grand View College, AIB College of Business, and Upper Iowa University. The unemployment rate in the Des Moines metro area was 3.4% as of September 2006.

Sioux Falls is located at the crossroads of Interstates 29 and 90 in southeast South Dakota, 270 miles southwest of Minneapolis. The Sioux Falls market area encompasses Minnehaha and Lincoln counties. Sioux Falls ranks third in a national list of top cities to start a company according to a report by Cognetics, Inc. (Kiplinger Report, April 2001). Sioux Falls received an A+ on Zero Population Growth's 2001 Kid-Friendly Cities Report Card, excelling in health, public safety, education, economics, environment, and community life; ranking third out of 140 cities. The city was called a Diamond in the Rough as a great smaller market for businesses to make a move. The magazine cited the community's growth rates as a huge opportunity and recognized the state's friendly tax laws. (Sales & Marketing Management April 2002.) The main branch is located at the high growth area of 57<sup>th</sup> and Western. Other branches are located at 33<sup>rd</sup> and Minnesota, the intersection of 12<sup>th</sup> and Elmwood, and on North Minnesota Avenue just north of Russell Road. Major employers in the area include Sioux Valley Hospital, Avera McKennan Hospital, John Morrell & Company, Citibank (South Dakota) NA, and Hy-Vee Food Stores. Sioux Falls is home to Augustana College with 2006 fall enrollment of 1,768 and The University of Sioux Falls with 2005 fall enrollment of 1,674. The unemployment rate in Sioux Falls was 2.4% as of September 2006.

MetaBank WC's main office operates in Stuart, which is located in west-central Iowa on the border of Adair and Guthrie counties, approximately 40 miles west of Des Moines. MetaBank WC's market area is highly dependent on farming and agriculture. Local businesses include Agri-Drain Corporation, Cardinal Glass, Rose Acre Farms, Wausau Supply and Schafer Systems, Inc. In addition, a large number of area residents commute to the Des Moines metro area for work. In recent years, efforts of the Midwest Partnership Corporation have resulted in significant development of new service-related businesses in the area, associated with the westward expansion of Des Moines and direct interstate

highway access. Seven industrial parks exist in these two counties with rail access recently added to the Stuart area. This development provides economic diversity to MetaBank WC's market area.

Several of the Company's market areas are dependant on agriculture-related businesses, which are exposed to exogenous risk factors such as weather conditions and commodity prices. Presently, economic conditions in the agricultural sector of the Company's market area are relatively strong. Recent rises in agricultural commodity prices will serve to offset more modest yields this year. The agricultural economy is accustomed to commodity price fluctuations and is generally able to handle such fluctuations without significant problems. Although there has been minimal effect observed to date, an extended period of low commodity prices or poor weather conditions could result in a reduced demand for goods and services provided by agriculture-related businesses, which could also affect other businesses in the Company's market area.

### **Lending Activities**

*General.* Historically, the Company originated fixed-rate, one- to four-family mortgage loans. In the early 1980s, the Company began to focus on the origination of adjustable-rate mortgage ( ARM ) loans and short-term loans for retention in its portfolio in order to increase the percentage of loans in its portfolio with more frequent repricing or shorter maturities, and in some cases higher yields, than fixed-rate residential mortgage loans. The Company, however, has continued to originate fixed-rate residential mortgage loans in response to consumer demand, although most such loans are generally sold in the secondary market. See Management's Discussion and Analysis -- Asset/Liability Management in the Annual Report.

More recently, the Company has focused its lending activities on the origination of commercial and multi-family real estate loans, commercial business loans, and, to a lesser extent, commercial construction loans. The Company has increased its emphasis, both in absolute dollars and as a percentage of its gross loan portfolio, on all types of commercial lending. The Company also continues to originate one-to-four family mortgage loans, consumer loans and agriculturally related loans. The Company originates most of its loans in its primary market area. At September 30, 2006, the Company's net loan portfolio totaled \$388.8 million, or 52.5% of the Company's total assets.

Loan applications are initially considered and approved at various levels of authority, depending on the type and amount of the loan. The Company has a loan committee consisting of senior lenders and Market Presidents, and is led by the Chief Lending Officer. Loans in excess of certain amounts require approval by at least two members of the loan committee, or by the Bank's Board of Directors, which has responsibility for the overall supervision of the loan portfolio. The Company reserves the right to discontinue, adjust or create new lending programs to respond to its needs and to competitive factors.

At September 30, 2006, the Company's largest lending relationship to a single borrower or group of related borrowers totaled \$9.1 million, none of which has been sold to other participants. The Company had 24 other lending relationships in excess of \$3.0 million as of September 30, 2006 with the average outstanding balance of such loans equal to \$4.4 million. At September 30, 2006, one of these loans, with a balance of \$3.6 million, was classified as Substandard, and another, with a balance of \$4.0 million, was classified as Special Mention.

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**Loan Portfolio Composition.** The following table provides information about the composition of the Company's loan portfolio in dollar amounts and in percentages (before deductions for loans in process, deferred fees and discounts and allowances for losses) as of the dates indicated.

|                                    | September 30,     |               |                   |               |                   |               |                   |               |                   |               |
|------------------------------------|-------------------|---------------|-------------------|---------------|-------------------|---------------|-------------------|---------------|-------------------|---------------|
|                                    | 2006              |               | 2005              |               | 2004              |               | 2003              |               | 2002              |               |
|                                    | Amount            | Percent       | Amount            | Percent       | Amount            | Percent       | Amount            | Percent       | Amount            | Percent       |
| (Dollars in Thousands)             |                   |               |                   |               |                   |               |                   |               |                   |               |
| <b>Real Estate Loans</b>           |                   |               |                   |               |                   |               |                   |               |                   |               |
| One- to four-family                | \$ 59,330         | 15.0%         | \$ 70,165         | 15.3%         | \$ 75,364         | 18.1%         | \$ 71,628         | 19.7%         | \$ 98,423         | 27.8%         |
| Commercial and multi-family        | 167,590           | 42.2          | 214,049           | 46.9          | 196,774           | 47.2          | 171,791           | 47.2          | 151,806           | 42.9          |
| Agricultural                       | 16,147            | 4.1           | 15,246            | 3.3           | 12,880            | 3.0           | 11,639            | 3.2           | 12,067            | 3.4           |
| <b>Total real estate loans</b>     | <b>243,067</b>    | <b>61.3</b>   | <b>299,460</b>    | <b>65.5</b>   | <b>285,018</b>    | <b>68.3</b>   | <b>255,058</b>    | <b>70.1</b>   | <b>262,296</b>    | <b>74.1</b>   |
| <b>Other Loans :</b>               |                   |               |                   |               |                   |               |                   |               |                   |               |
| <b>Consumer Loans:</b>             |                   |               |                   |               |                   |               |                   |               |                   |               |
| Home equity                        | 25,247            | 6.4           | 24,685            | 5.4           | 21,993            | 5.3           | 18,126            | 5.0           | 14,669            | 4.2           |
| Automobile                         | 1,930             | 0.5           | 2,497             | 0.5           | 2,975             | 0.7           | 3,271             | 0.9           | 3,287             | 0.9           |
| Other(1)                           | 3,988             | 1.0           | 4,481             | 1.0           | 5,387             | 1.3           | 5,237             | 1.4           | 5,637             | 1.6           |
| <b>Total consumer loans</b>        | <b>31,165</b>     | <b>7.9</b>    | <b>31,663</b>     | <b>6.9</b>    | <b>30,355</b>     | <b>7.3</b>    | <b>26,634</b>     | <b>7.3</b>    | <b>23,593</b>     | <b>6.7</b>    |
| Agricultural operating             | 30,064            | 7.6           | 24,529            | 5.4           | 21,148            | 5.1           | 22,599            | 6.2           | 25,308            | 7.1           |
| Commercial business                | 92,385            | 23.2          | 101,772           | 22.2          | 80,515            | 19.3          | 59,468            | 16.4          | 42,844            | 12.1          |
| <b>Total other loans</b>           | <b>153,614</b>    | <b>38.7</b>   | <b>157,964</b>    | <b>34.5</b>   | <b>132,018</b>    | <b>31.7</b>   | <b>108,701</b>    | <b>29.9</b>   | <b>91,745</b>     | <b>25.9</b>   |
| <b>Total loans</b>                 | <b>396,681</b>    | <b>100.0%</b> | <b>457,424</b>    | <b>100.0%</b> | <b>417,036</b>    | <b>100.0%</b> | <b>363,759</b>    | <b>100.0%</b> | <b>354,041</b>    | <b>100.0%</b> |
| <b>Less:</b>                       |                   |               |                   |               |                   |               |                   |               |                   |               |
| Loans in process                   | 1,773             |               | 9,733             |               | 7,342             |               | 8,895             |               | 7,155             |               |
| Deferred fees and discounts        | 178               |               | 279               |               | 272               |               | 210               |               | 256               |               |
| Allowance for losses               | 5,968             |               | 7,222             |               | 5,371             |               | 4,962             |               | 4,693             |               |
| <b>Total loans receivable, net</b> | <b>\$ 388,762</b> |               | <b>\$ 440,190</b> |               | <b>\$ 404,051</b> |               | <b>\$ 349,692</b> |               | <b>\$ 341,937</b> |               |

(1) Consist generally of various types of secured and unsecured consumer loans.





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The following table shows the composition of the Company's loan portfolio by fixed and adjustable rate at the dates indicated.

|   | September 30, |         |           |         |           |         |           |         |           |         |
|---|---------------|---------|-----------|---------|-----------|---------|-----------|---------|-----------|---------|
|   | 2006          |         | 2005      |         | 2004      |         | 2003      |         | 2002      |         |
|   | Amount        | Percent | Amount    | Percent | Amount    | Percent | Amount    | Percent | Amount    | Percent |
| (Dollars in Thousands)                  |               |         |           |         |           |         |           |         |           |         |
| <b>Fixed Rate Loans</b>                 |               |         |           |         |           |         |           |         |           |         |
| Real estate:                            |               |         |           |         |           |         |           |         |           |         |
| One- to four-family                     | \$ 46,620     | 11.8%   | \$ 40,703 | 8.9%    | \$ 49,138 | 11.7%   | \$ 48,183 | 13.2%   | \$ 48,175 | 13.6%   |
| Commercial and multi-family             | 115,573       | 29.1    | 131,273   | 28.7    | 105,001   | 25.2    | 95,976    | 26.4    | 72,658    | 20.5    |
| Agricultural                            | 9,566         | 2.4     | 7,708     | 1.7     | 5,306     | 1.3     | 5,311     | 1.5     | 5,498     | 1.6     |
| Total fixed-rate real estate loans      | 171,759       | 43.3    | 179,684   | 39.3    | 159,445   | 38.2    | 149,470   | 41.1    | 126,331   | 35.7    |
| Consumer                                | 22,063        | 5.6     | 18,058    | 3.9     | 15,583    | 3.7     | 17,889    | 4.9     | 20,282    | 5.7     |
| Agricultural operating                  | 16,232        | 4.1     | 8,032     | 1.8     | 5,987     | 1.4     | 5,238     | 1.4     | 9,339     | 2.6     |
| Commercial business                     | 38,115        | 9.6     | 36,188    | 8.0     | 23,946    | 5.8     | 27,967    | 7.7     | 14,455    | 4.1     |
| Total fixed-rate loans                  | 248,169       | 62.6    | 241,962   | 52.9    | 204,961   | 49.1    | 200,564   | 55.1    | 170,407   | 48.1    |
| <b>Adjustable Rate Loans:</b>           |               |         |           |         |           |         |           |         |           |         |
| Real estate:                            |               |         |           |         |           |         |           |         |           |         |
| One- to four-family                     | 12,710        | 3.2     | 29,462    | 6.5     | 26,226    | 6.3     | 23,445    | 6.5     | 50,248    | 14.2    |
| Commercial and multi-family             | 52,018        | 13.1    | 82,776    | 18.1    | 91,773    | 22.0    | 75,815    | 20.8    | 79,148    | 22.4    |
| Agricultural                            | 6,580         | 1.7     | 7,538     | 1.6     | 7,574     | 1.8     | 6,328     | 1.7     | 6,569     | 1.9     |
| Total adjustable-rate real estate loans | 71,308        | 18.0    | 119,776   | 26.2    | 125,573   | 30.1    | 105,588   | 29.0    | 135,965   | 38.5    |
| Consumer                                | 9,102         | 2.3     | 13,605    | 3.0     | 14,772    | 3.5     | 8,745     | 2.4     | 3,311     | 0.9     |
| Agricultural operating                  | 13,832        | 3.5     | 16,497    | 3.6     | 15,161    | 3.6     | 17,361    | 4.8     | 15,969    | 4.5     |
| Commercial business                     | 54,270        | 13.6    | 65,584    | 14.4    | 56,569    | 13.7    | 31,501    | 8.7     | 28,389    | 8.0     |
| Total adjustable rate loans             | 148,512       | 37.4    | 215,462   | 47.1    | 212,075   | 50.9    | 163,195   | 44.9    | 183,634   | 51.9    |
| Total loans                             | 396,681       | 100.0   | 457,424   | 100.0%  | 417,036   | 100.0%  | 363,759   | 100.0%  | 354,041   | 100.0%  |
| <b>Less:</b>                            |               |         |           |         |           |         |           |         |           |         |
| Loans in process                        | 1,773         |         | 9,733     |         | 7,342     |         | 8,895     |         | 7,155     |         |
| Deferred fees and discounts             | 178           |         | 279       |         | 272       |         | 210       |         | 256       |         |
| Allowance for losses                    | 5,968         |         | 7,222     |         | 5,371     |         | 4,962     |         | 4,693     |         |
| Total loans receivable, net             | \$388,762     |         | \$440,190 |         | \$404,051 |         | \$349,602 |         | \$341,937 |         |



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The following table illustrates the interest rate sensitivity of the Company's loan portfolio at September 30, 2006. Mortgages which have adjustable or renegotiable interest rates are shown as maturing in the period during which the contract reprices. The table reflects management's estimate of the effects of loan prepayments or curtailments based on data from the Company's historical experiences and other third party sources.

|   | <u>Real Estate(1)</u> |                              | <u>Consumer</u> |                              | <u>Commercial Business</u> |                              | <u>Agricultural Operating</u> |                              | <u>Total</u>  |                              |
|---|-----------------------|------------------------------|-----------------|------------------------------|----------------------------|------------------------------|-------------------------------|------------------------------|---------------|------------------------------|
|   | <u>Amount</u>         | <u>Weighted Average Rate</u> | <u>Amount</u>   | <u>Weighted Average Rate</u> | <u>Amount</u>              | <u>Weighted Average Rate</u> | <u>Amount</u>                 | <u>Weighted Average Rate</u> | <u>Amount</u> | <u>Weighted Average Rate</u> |
| (Dollars in Thousands)                      |                       |                              |                 |                              |                            |                              |                               |                              |               |                              |
| <u>Due During Years Ending September 30</u> |                       |                              |                 |                              |                            |                              |                               |                              |               |                              |
| 2007(2)                                     | \$ 133,021            | 7.14%                        | \$ 16,528       | 7.60%                        | \$ 72,198                  | 8.78%                        | \$ 24,302                     | 8.04%                        | \$ 246,049    | 7.74%                        |
| 2008-2009                                   | 59,506                | 6.31                         | 11,566          | 7.26                         | 15,121                     | 6.73                         | 4,349                         | 6.85                         | 90,542        | 6.53                         |
| 2010 and following                          | 50,541                | 6.36                         | 3,071           | 7.09                         | 5,065                      | 6.54                         | 1,412                         | 6.79                         | 60,089        | 6.43                         |

(1) Includes one- to four-family, multi-family, commercial and agricultural real estate loans.

(2) Includes demand loans, loans having no stated maturity and overdraft loans.

*One- to Four-Family Residential Mortgage Lending.* One- to four-family residential mortgage loan originations are generated by the Company's marketing efforts, its present customers, walk-in customers and referrals from real estate agents and builders. At September 30, 2006, the Company's one- to four-family residential mortgage loan portfolio totaled \$59.3 million, or 15% of the Company's total gross loan portfolio. See Originations, Purchases, Sales and Servicing of Loans and Mortgage-Backed Securities. At September 30, 2006, the average outstanding principal balance of a one- to four-family residential mortgage loan was approximately \$65,000.

The Company offers fixed-rate and ARM loans for both permanent structures and those under construction. During the year ended September 30, 2006, the Company originated \$1.55 million of adjustable-rate loans and \$20.0 million of fixed-rate loans secured by one- to four-family residential real estate, of which approximately \$6.2 million was held in portfolio. The Company's one- to four-family residential mortgage originations are secured primarily by properties located in its primary market area and surrounding areas.

The Company originates one- to four-family residential mortgage loans with terms up to a maximum of 30-years and with loan-to-value ratios up to 100% of the lesser of the appraised value of the security property or the contract price. The Company generally requires that private mortgage insurance be obtained in an amount sufficient to reduce the Company's exposure to at or below the 80% loan-to-value level. Residential loans generally do not include prepayment penalties.

The Company currently offers one, three, five, seven and ten year ARM loans. These loans have a fixed-rate for the stated period and, thereafter, such loans adjust annually. These loans generally provide for an annual cap of up to a 200 basis points and a lifetime cap of 600 basis points over the initial rate. As a consequence of using an initial fixed-rate and caps, the interest rates on these loans may not be as rate sensitive as is the Company's cost of funds. The Company's ARMs do not permit negative amortization of principal and are not convertible into a fixed rate loan. The Company's delinquency experience on its ARM loans has generally been similar to its experience on fixed rate residential loans.

Due to consumer demand, the Company also offers fixed-rate mortgage loans with terms up to 30 years, most of which conform to secondary market, *i.e.*, Fannie Mae, Ginnie Mae, and Freddie Mac standards. Interest rates charged on these fixed-rate loans are competitively priced according to market conditions. The Company currently sells most, but not all, of its fixed-rate loans with terms greater than 15 years.

In underwriting one- to four-family residential real estate loans, the Company evaluates both the borrower's ability to make monthly payments and the value of the property securing the loan. Most properties securing real estate loans made by the Company are appraised by independent fee appraisers approved by the Board of Directors. The Company generally requires borrowers to obtain an attorney's title opinion or title insurance, and fire and property insurance (including flood insurance, if necessary) in an amount not less than the amount of the loan. Real estate loans originated by the Company generally contain a due on sale clause allowing the Company to declare the unpaid principal balance due and payable upon the sale of the security property.

*Commercial and Multi-Family Real Estate Lending.* The Company engages in commercial and multi-family real estate lending in its primary market area and surrounding areas and has purchased whole loan and participation interests in loans from other financial institutions. At September 30, 2006, the Company's commercial and multi-family real estate loan portfolio totaled \$167.6 million, or 42% of the Company's total gross loan portfolio. The purchased loans and loan participation interests are generally secured by properties located in the Midwest and West. See Originations, Purchases, Sales and Servicing of Loans and Mortgage-Backed Securities. The Company, in order to supplement its loan

portfolio and consistent with management's objectives to expand the Company's commercial and multi-family loan portfolio, purchased \$14.8 million, \$13.0 million, and \$25.7 million, of such loans during fiscal 2006, 2005 and 2004, respectively. At September 30, 2006, none of the Company's commercial and multi-family real estate loans were non-performing. See Non-Performing Assets, Other Loans of Concern and Classified Assets.

The Company's commercial and multi-family real estate loan portfolio is secured primarily by apartment buildings, office buildings, and hotels. Commercial and multi-family real estate loans generally have terms that do not exceed 20 years, have loan-to-value ratios of up to 80% of the appraised value of the security property, and are typically secured by personal guarantees of the borrowers. The Company has a variety of rate adjustment features and other terms in its commercial and multi-family real estate loan portfolio. Commercial and multi-family real estate loans provide for a margin over a number of different indices. In underwriting these loans, the Company currently analyzes the financial condition of the borrower, the borrower's credit history, and the reliability and predictability of the cash flow generated by the property securing the loan. Appraisals on properties securing commercial real estate loans originated by the Company are performed by independent appraisers.

At September 30, 2006, the Company's largest commercial and multi-family real estate loan was a \$4.7 million loan secured by residential housing developments. At September 30, 2006, the average outstanding principal balance of a commercial or multi-family real estate loan held by the Company was approximately \$341,000.

Multi-family and commercial real estate loans generally present a higher level of risk than loans secured by one- to four-family residences. This greater risk is due to several factors, including the concentration of principal in a limited number of loans and borrowers, the effect of general economic conditions on income producing properties and the increased difficulty of evaluating and monitoring these types of loans. Furthermore, the repayment of loans secured by multi-family and commercial real estate is typically dependent upon the successful operation of the related real estate project. If the cash flow from the project is reduced (for example, if leases are not obtained or renewed, or a bankruptcy court modifies a lease term, or a major tenant is unable to fulfill its lease obligations), the borrower's ability to repay the loan may be impaired. MetaBank believes that it may eventually exceed its 400 percent total capital limitation for nonresidential real estate loans and accordingly, has submitted a waiver request requesting OTS to grant an increase in its regulatory limit. At September 30, 2006, MetaBank's nonresidential real estate loans totaled 268 percent of total capital.

*Agricultural Lending.* The Company originates loans to finance the purchase of farmland, livestock, farm machinery and equipment, seed, fertilizer and for other farm related products. At September 30, 2006, the Company had agricultural real estate loans secured by farmland of \$16.1 million or 4% of the Company's gross loan portfolio. At the same date, \$30.1 million, or 8% of the Company's gross loan portfolio, consisted of secured loans related to agricultural operations.

Agricultural operating loans are originated at either an adjustable or fixed rate of interest for up to a one year term or, in the case of livestock, upon sale. Most agricultural operating loans have terms of one year or less. Such loans provide for payments of principal and interest at least annually, or a lump sum payment upon maturity if the original term is less than one year. Loans secured by agricultural machinery are generally originated as fixed-rate loans with terms of up to seven years. At September 30, 2006, the average outstanding principal balance of an agricultural operating loan held by the Company was \$72,000. At September 30, 2006, \$182,000, or 0.6%, of the Company's agricultural operating loans were non-performing.

Agricultural real estate loans are frequently originated with adjustable rates of interest. Generally, such loans provide for a fixed rate of interest for the first one to five years, which then balloon or adjust annually thereafter. In addition, such loans generally amortize over a period of ten to 20 years. Adjustable-rate agricultural real estate loans provide for a margin over the yields on the corresponding U.S. Treasury security or prime rate. Fixed-rate agricultural real estate loans generally have terms up to five years. Agricultural real estate loans are generally limited to 75% of the value of the property securing the loan. At September 30, 2006, none of the Company's agricultural real estate portfolio was non-performing.

Agricultural lending affords the Company the opportunity to earn yields higher than those obtainable on one- to four-family residential lending. Nevertheless, agricultural lending involves a greater degree of risk than one- to four-family residential mortgage loans because of the typically larger loan amount. In addition, payments on loans are dependent on the successful operation or management of the farm property securing the loan or for which an operating loan is utilized. The success of the loan may also be affected by many factors outside the control of the farm borrower.

Weather presents one of the greatest risks as hail, drought, floods, or other conditions, can severely limit crop yields and thus impair loan repayments and the value of the underlying collateral. This risk can be reduced by the farmer with a variety of insurance coverages which can help to ensure loan repayment. Government support programs and the Company generally require that farmers procure crop insurance coverage. Grain and livestock prices also present a risk as prices may decline prior to sale resulting in a failure to cover production costs. These risks may be reduced by the farmer with the use of futures contracts or options to mitigate price risk. The Company frequently requires borrowers to use future contracts or options to reduce price risk and help ensure loan repayment. Another risk is the uncertainty of government programs and other regulations. During periods of low commodity prices, the income from government programs can be a significant source of cash to make loan payments and if these programs are discontinued or significantly changed, cash flow problems or defaults could result. Finally, many farms are dependent on a limited number of key individuals upon whose injury or death may result in an inability to successfully operate the farm.

*Consumer Lending* . The Company offers a variety of secured consumer loans, including home equity, home improvement, automobile, boat and loans secured by savings deposits. In addition, the Company offers other secured and unsecured consumer loans. The Company currently originates substantially all of its consumer loans in its primary market area and surrounding areas. The Company originates consumer loans on both a direct and indirect basis. At September 30, 2006, the Company's consumer loan portfolio totaled \$31.2 million, or 8% of its total gross loan portfolio. Of the consumer loan portfolio at September 30, 2006, \$22.1 million were short- and intermediate-term, fixed-rate loans, while \$9.1 million were adjustable-rate loans.

The largest component of the Company's consumer loan portfolio consists of home equity loans and lines of credit. Substantially all of the Company's home equity loans and lines of credit are secured by second mortgages on principal residences. The Company will lend amounts which, together with all prior liens, typically may be up to 100% of the appraised value of the property securing the loan. Home equity loans and lines of credit generally have maximum terms of five years.

The Company primarily originates automobile loans on a direct basis, but also originates indirect automobile loans on a very limited basis. Direct loans are loans made when the Company extends credit directly to the borrower, as opposed to indirect loans, which are made when the Company purchases loan contracts, often at a discount, from automobile dealers which have extended credit to their customers. The Company's automobile loans typically are originated at fixed interest rates with terms up to 60

months for new and used vehicles. Loans secured by automobiles are generally originated for up to 80% of the N.A.D.A. book value of the automobile securing the loan.

Consumer loan terms vary according to the type and value of collateral, length of contract and creditworthiness of the borrower. The underwriting standards employed by the Company for consumer loans include an application, a determination of the applicant's payment history on other debts and an assessment of ability to meet existing obligations and payments on the proposed loan. Although creditworthiness of the applicant is a primary consideration, the underwriting process also includes a comparison of the value of the security, if any, in relation to the proposed loan amount.

Consumer loans may entail greater credit risk than do residential mortgage loans, particularly in the case of consumer loans which are unsecured or are secured by rapidly depreciable assets, such as automobiles or recreational equipment. In such cases, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment of the outstanding loan balance as a result of the greater likelihood of damage, loss or depreciation. In addition, consumer loan collections are dependent on the borrower's continuing financial stability, and thus are more likely to be affected by adverse personal circumstances. Furthermore, the application of various federal and state laws, including bankruptcy and insolvency laws, may limit the amount which can be recovered on such loans. At September 30, 2006, none of the Company's consumer loan portfolio was non-performing.

*Commercial Business Lending.* The Company also originates commercial business loans. Most of the Company's commercial business loans have been extended to finance local and regional businesses and include short-term loans to finance machinery and equipment purchases, inventory and accounts receivable. Commercial loans also involve the extension of revolving credit for a combination of equipment acquisitions and working capital in expanding companies. At September 30, 2006, \$92.4 million, or 23% of the Company's total gross loan portfolio was comprised of commercial business loans.

The maximum term for loans extended on machinery and equipment is based on the projected useful life of such machinery and equipment. Generally, the maximum term on non-mortgage lines of credit is one year. The loan-to-value ratio on such loans and lines of credit generally may not exceed 80% of the value of the collateral securing the loan. The Company's commercial business lending policy includes credit file documentation and analysis of the borrower's character, capacity to repay the loan, the adequacy of the borrower's capital and collateral as well as an evaluation of conditions affecting the borrower. Analysis of the borrower's past, present and future cash flows is also an important aspect of the Company's current credit analysis. Nonetheless, such loans are believed to carry higher credit risk than more traditional investments.

The largest commercial business loan outstanding at September 30, 2006 was a \$9.1 million secured by accounts receivables. The next largest commercial business loan outstanding at September 30, 2006 was a \$9.0 million loan secured by all of the assets of the borrower. These loans are currently performing in accordance with their terms. At September 30, 2006, the average outstanding principal balance of a commercial business loan held by the Company was approximately \$229,000.

Unlike residential mortgage loans, which generally are made on the basis of the borrower's ability to make repayment from his or her employment and other income and which are secured by real property whose value tends to be more easily ascertainable, commercial business loans typically are made on the basis of the borrower's ability to make repayment from the cash flow of the borrower's business. As a result, the availability of funds for the repayment of commercial business loans may be substantially dependent on the success of the business itself (which, in turn, is likely to be dependent upon the general economic environment). The Company's commercial business loans are usually, but not always, secured by business assets and personal guarantees. However, the collateral securing the loans may depreciate



over time, may be difficult to appraise and may fluctuate in value based on the success of the business. At September 30, 2006, \$3.6 million, or 3.9%, of the Company's commercial business loan portfolio was non-performing.

**Originations, Purchases, Sales and Servicing of Loans and Mortgage-Backed Securities**

Loans are generally originated by the Company's staff of salaried loan officers. Loan applications are taken and processed in the branches and the main office of the Company. While the Company originates both adjustable-rate and fixed-rate loans, its ability to originate loans is dependent upon the relative customer demand for loans in its market. Demand is affected by the interest rate and economic environment.

The Company, from time to time, sells whole loans and loan participations generally without recourse. At September 30, 2006, there were no loans outstanding sold with recourse. When loans are sold the Company sometimes retains the responsibility for collecting and remitting loan payments, making certain that real estate tax payments are made on behalf of borrowers, and otherwise servicing the loans. The servicing fee is recognized as income over the life of the loans. The Company services loans that it originated and sold totaling \$47.5 million at September 30, 2006, of which \$22.9 million were sold to Fannie Mae and \$24.6 million were sold to others.

In periods of economic uncertainty, the Company's ability to originate large dollar volumes of loans may be substantially reduced or restricted, with a resultant decrease in related loan origination fees, other fee income and operating earnings. In addition, the Company's ability to sell loans may substantially decrease as potential buyers (principally government agencies) reduce their purchasing activities.

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The following table shows the loan origination (including undisbursed portions of loans in process), purchases and advances on purchased loans, and repayment activities of the Company for the periods indicated.

|                                 | September 30,  |                |                |
|---------------------------------|----------------|----------------|----------------|
|                                 | 2006           | 2005           | 2004           |
| (Dollars in Thousands)          |                |                |                |
| <b>Originations by type:</b>    |                |                |                |
| Adjustable rate:                |                |                |                |
| Real estate one- to four-family | \$ 9,268       | \$ 13,584      | \$ 4,084       |
| - commercial and multi-family   | 33,300         | 39,710         | 35,289         |
| - agricultural real estate      | 565            | 4,500          | 5,418          |
| Non-real estate consumer        | 1,584          | 10,186         | 14,669         |
| - commercial business           | 121,137        | 150,519        | 103,864        |
| - agricultural operating        | 33,328         | 36,252         | 29,847         |
| <b>Total adjustable-rate</b>    | <b>199,182</b> | <b>254,751</b> | <b>193,171</b> |
| Fixed rate:                     |                |                |                |
| Real estate one- to four-family | 29,869         | 18,028         | 22,969         |
| - commercial and multi-family   | 37,025         | 48,174         | 43,875         |
| - agricultural real estate      | 7,625          |                | 40             |
| Non-real estate consumer        | 2,978          | 12,704         | 8,288          |
| - commercial business           | 63,006         | 41,521         | 21,324         |
| - agricultural operating        | 17,475         | 7,343          | 5,839          |
| <b>Total fixed-rate</b>         | <b>157,978</b> | <b>127,770</b> | <b>102,335</b> |
| <b>Total loans originated</b>   | <b>357,160</b> | <b>382,521</b> | <b>295,506</b> |

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Purchases:

|                                     |                   |                   |                   |
|-------------------------------------|-------------------|-------------------|-------------------|
| Real estate one-to-four-family      | 599               |                   |                   |
| - commercial and multi-family       | 14,814            | 12,987            | 25,732            |
| Non-real estate commercial business | 52,881            | 26,710            | 13,810            |
|                                     | <u>          </u> | <u>          </u> | <u>          </u> |
| Total loans                         | 68,294            | 39,697            | 39,542            |
| Total mortgage-backed securities    |                   | 15,173            | 46,004            |
|                                     | <u>          </u> | <u>          </u> | <u>          </u> |
| Total purchased                     | 68,294            | 54,870            | 85,546            |
|                                     | <u>          </u> | <u>          </u> | <u>          </u> |

Sales and Repayments:

Sales:

|                                     |                   |                   |                   |
|-------------------------------------|-------------------|-------------------|-------------------|
| Real estate one- to four family     | 1,737             | 16,272            | 18,043            |
| Non-real estate commercial business |                   |                   |                   |
|                                     | <u>          </u> | <u>          </u> | <u>          </u> |
| Total loans                         | 1,737             | 16,272            | 18,043            |
| Mortgaged-backed securities         |                   | 25,863            |                   |
|                                     | <u>          </u> | <u>          </u> | <u>          </u> |
| Total sales                         | 1,737             | 42,135            | 18,043            |
|                                     | <u>          </u> | <u>          </u> | <u>          </u> |

Repayments:

|                                       |                   |                   |                   |
|---------------------------------------|-------------------|-------------------|-------------------|
| Loan principal repayments             | 474,976           | 366,867           | 265,934           |
| Mortgage-backed securities repayments | 40,533            | 75,101            | 88,588            |
|                                       | <u>          </u> | <u>          </u> | <u>          </u> |
| Total principal repayments            | 515,509           | 441,968           | 354,792           |
|                                       | <u>          </u> | <u>          </u> | <u>          </u> |
| Total reductions                      | 517,246           | 484,103           | 372,835           |
|                                       | <u>          </u> | <u>          </u> | <u>          </u> |
| (Decrease) in other items, net        | (3,856)           | (4,071)           | (1,133)           |
|                                       | <u>          </u> | <u>          </u> | <u>          </u> |
| Net increase (decrease)               | \$ (95,648)       | \$ (50,783)       | \$ 7,084          |
|                                       | <u>          </u> | <u>          </u> | <u>          </u> |

At September 30, 2006, approximately \$50.8 million, or 12.8%, of the Company's gross loan portfolio consisted of purchased loans. The Company believes that purchasing loans outside of its market area assists the Company in diversifying its portfolio and may lessen the adverse affects on the Company's business or operations which could result in the event of a downturn or weakening of the local economy in which the Company conducts its operations. However, additional risks are associated with purchasing loans outside of the Company's market area, including the lack of knowledge of the local market and difficulty in monitoring and inspecting the property securing the loans.

The following table provides information regarding the Company's balance of wholly purchased real estate and business loans and participations for each state in which the balance of such loans exceeded \$1.0 million at September 30, 2006.

| Location                  | One- to four-<br>Family Loans |                       | Commercial and<br>Multi-Family |                       | Total Purchased<br>Loans |                       |
|---------------------------|-------------------------------|-----------------------|--------------------------------|-----------------------|--------------------------|-----------------------|
|                           | Balance                       | Number<br>of<br>Loans | Balance                        | Number<br>of<br>Loans | Balance                  | Number<br>of<br>Loans |
|                           | (Dollars in<br>Thousands)     |                       |                                |                       |                          |                       |
| Arizona                   | \$                            |                       | \$ 7,650                       | 3                     | \$ 7,650                 | 3                     |
| California                |                               |                       | 3,545                          | 2                     | 3,545                    | 2                     |
| Florida                   |                               |                       | 4,526                          | 3                     | 4,526                    | 3                     |
| Iowa                      | 14                            | 2                     | 16,388                         | 25                    | 16,402                   | 27                    |
| Minnesota                 |                               |                       | 5,377                          | 5                     | 5,377                    | 5                     |
| North Carolina            | 1,006                         | 5                     |                                |                       | 1,006                    | 5                     |
| South Dakota              | 9                             | 2                     | 4,285                          | 4                     | 4,294                    | 6                     |
| Washington                | 275                           | 1                     | 2,501                          | 4                     | 2,776                    | 5                     |
| Other states              | 632                           | 30                    | 4,544                          | 6                     | 5,176                    | 36                    |
| Total                     | \$ 1,936                      | 40                    | 48,816                         | 52                    | 50,752                   | 92                    |
| Percent of loan portfolio | 0.05%                         |                       | 12.3%                          |                       | 12.8%                    |                       |

#### Non-Performing Assets, Other Loans of Concern, and Classified Assets

When a borrower fails to make a required payment on real estate secured loans and consumer loans within 16 days after the payment is due, the Company generally initiates collection procedures by mailing a delinquency notice. The customer is contacted again, by written notice or telephone, before the payment is 30 days past due and again before 60 days past due. In most cases, delinquencies are cured promptly; however, if a loan has been delinquent for more than 90 days, satisfactory payment arrangements must be adhered to or the Company will initiate foreclosure or repossession.

Generally, when a loan becomes delinquent 90 days or more or when the collection of principal or interest becomes doubtful, the Company will place the loan on a non-accrual status and, as a result, previously accrued interest income on the loan is taken out of current income. The loan will remain on a non-accrual status until the loan becomes current.

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The following table sets forth the Company's loan delinquencies by type, before allowance for loan losses, by amount and by percentage of type at September 30, 2006.

|                             | Loans Delinquent For: |        |                     |            |        |                     |                  |          |                     |
|-----------------------------|-----------------------|--------|---------------------|------------|--------|---------------------|------------------|----------|---------------------|
|                             | 30-59 Days            |        |                     | 60-89 Days |        |                     | 90 Days and Over |          |                     |
|                             | Number                | Amount | Percent of Category | Number     | Amount | Percent of Category | Number           | Amount   | Percent of Category |
| (Dollars in Thousands)      |                       |        |                     |            |        |                     |                  |          |                     |
| Real Estate:                |                       |        |                     |            |        |                     |                  |          |                     |
| One- to four-family         | 2                     | \$ 186 | 21%                 |            | \$     | %                   | 1                | \$ 31    | 1%                  |
| Commercial and multi-family |                       |        |                     |            |        |                     |                  |          |                     |
| Agricultural real estate    |                       |        |                     |            |        |                     |                  |          |                     |
| Consumer                    | 3                     | 15     | 2                   | 2          | 9      | 2                   |                  |          |                     |
| Agricultural operating      | 2                     | 19     | 2                   |            |        |                     | 1                | 182      | 4                   |
| Commercial business         | 7                     | 673    | 75                  | 1          | 500    | 98                  | 5                | 3,887    | 95                  |
| Total                       | 14                    | \$ 893 | 100%                | 3          | \$ 509 | 100%                | 7                | \$ 4,100 | 100%                |

Delinquencies 90 days and over constituted 1.09% of total gross loans and 0.58% of total assets.

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The table below sets forth the amounts and categories of non-performing assets in the Company's loan portfolio. Loans, with some exceptions, are typically placed on non-accrual status when the loan becomes 90 days or more delinquent or when the collection of principal and/or interest become doubtful. For all years presented, the Company's troubled debt restructurings (which involved forgiving a portion of interest or principal on any loans or making loans at a rate materially less than that of market rates) are included in the table and were performing as agreed.

|  | September 30,   |                 |               |                 |                 |
|--|-----------------|-----------------|---------------|-----------------|-----------------|
|  | 2006            | 2005            | 2004          | 2003            | 2002            |
| (Dollars in Thousands)                       |                 |                 |               |                 |                 |
| Non-accruing loans:                          |                 |                 |               |                 |                 |
| One- to four-family                          | \$ 31           | \$ 54           | \$            | \$ 156          | \$ 51           |
| Commercial and multi-family                  |                 |                 | 399           | 417             | 417             |
| Agricultural real estate                     |                 |                 |               |                 | 41              |
| Consumer                                     |                 | 1               | 59            | 17              |                 |
| Agricultural operating                       | 182             | 218             | 254           | 291             | 394             |
| Commercial business                          | 3,887           | 404             |               | 126             | 408             |
| <b>Total non-accruing loans</b>              | <b>4,100</b>    | <b>677</b>      | <b>712</b>    | <b>1,007</b>    | <b>1,311</b>    |
| Accruing loans delinquent 90 days or more    |                 |                 |               |                 |                 |
|  |                 |                 |               |                 | 819             |
| <b>Total non-performing loans</b>            | <b>4,100</b>    | <b>677</b>      | <b>712</b>    | <b>1,007</b>    | <b>2,130</b>    |
| Restructured Loans:                          |                 |                 |               |                 |                 |
| Consumer                                     |                 |                 |               |                 |                 |
| Agricultural operating                       |                 | 7               | 9             | 28              | 9               |
| Commercial business                          |                 |                 | 8             | 31              | 71              |
| <b>Total restructured loans</b>              |                 | <b>7</b>        | <b>17</b>     | <b>59</b>       | <b>80</b>       |
| Foreclosed assets:                           |                 |                 |               |                 |                 |
| One- to four-family                          | 15              |                 |               |                 |                 |
| Commercial real estate                       | 35              | 1,841           |               | 912             | 1,310           |
| Consumer                                     |                 |                 |               | 4               | 18              |
| Commercial business                          |                 | 2,865           |               | 193             |                 |
| <b>Total</b>                                 | <b>50</b>       | <b>4,706</b>    |               | <b>1,109</b>    | <b>1,328</b>    |
| <b>Total non-performing assets</b>           | <b>\$ 4,150</b> | <b>\$ 5,390</b> | <b>\$ 729</b> | <b>\$ 2,175</b> | <b>\$ 3,538</b> |
| <b>Total as a percentage of total assets</b> | <b>0.56%</b>    | <b>0.69%</b>    | <b>0.09%</b>  | <b>0.28%</b>    | <b>0.58%</b>    |

For the year ended September 30, 2006, gross interest income which would have been recorded had the non-accruing loans been current in accordance with their original terms amounted to approximately \$635,000, of which none was included in interest income.

*Non-accruing Loans* . At September 30, 2006, the Company had \$4,100 in non-accruing loans, which constituted 1.03% of the Company's gross loan portfolio. Included in this total was a single commercial business loan, with an outstanding balance of \$3.6 million, which is secured by

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assets of a road paving company.

*Accruing Loans Delinquent 90 Days or More.* At September 30, 2006, the Company has no accruing loans delinquent 90 days or more.

*Other Loans of Concern.* At September 30, 2006, there were loans totaling \$1.3 million not included in the table above where known information about the possible credit problems of borrowers

caused management to have concern as to the ability of the borrower to comply with the present loan repayment terms. This amount consisted of two one- to four-family residential mortgage loans totaling \$39,000, two commercial real estate loans totaling \$333,000, five commercial business loans totaling \$842,000, and three consumer loans totaling \$44,000 .

*Classified Assets.* Federal regulations provide for the classification of loans and other assets such as debt and equity securities considered by the Office of Thrift Supervision (the OTS ) to be of lesser quality as substandard, doubtful or loss. An asset is considered substandard if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Substandard assets include those characterized by the distinct possibility that the savings association will sustain some loss if the deficiencies are not corrected. Assets classified as doubtful have all of the weaknesses inherent in those classified substandard, with the added characteristic that the weaknesses present make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. Assets classified as loss are those considered uncollectible and of such minimal value that their continuance as assets without the establishment of a specific loss reserve is not warranted. The loans held by MetaBank WC are subject to similar classification by its regulatory authorities.

When assets are classified as either substandard or doubtful, the Banks may establish general allowances for loan losses in an amount deemed prudent by management. General allowances represent loss allowances which have been established to recognize the inherent risk associated with lending activities, but which, unlike specific allowances, have not been allocated to particular problem assets. When assets are classified as loss, the Bank is required either to establish a specific allowance for losses equal to 100% of that portion of the asset so classified or to charge-off such amount. The Banks' determinations as to the classification of their assets and the amount of their valuation allowances are subject to review by their regulatory authorities, who may order the establishment of additional general or specific loss allowances.

On the basis of management's review of its assets, at September 30, 2006, the Company had classified a total of \$4.96 million of its assets as substandard, \$447,000 as doubtful and none as loss. Included in the assets classified as substandard is \$50,000 of real estate owned and other foreclosed assets.

*Allowance for Loan Losses.* The allowance for loan losses is established through a provision for loan losses based on management's evaluation of the risk inherent in its loan portfolio and changes in the nature and volume of its loan activity, including those loans which are being specifically monitored by management. Such evaluation, which includes a review of loans for which full collectibility may not be reasonably assured, considers among other matters, the estimated fair value of the underlying collateral, economic conditions, historical loan loss experience and other factors that warrant recognition in providing for an adequate loan loss allowance.

Current economic conditions in the Company's market area are generally stable. Unemployment rates remain at levels lower than the national average, and corporate profits have been firm. Over the last year, residential and commercial real estate prices have remained steady, but national trends in these areas, particularly on the East and West coasts, could eventually dampen real estate price appreciation or lead to price declines in the Company's market area. Many economists have forecasted a slowdown in economic growth during calendar 2007. Generally, economic growth in the Company's market area is not prone to fluctuations as great as those experienced on the national level; however a prolonged economic slowdown may affect the financial conditions and repayment capacities of the Company's commercial and consumer borrowers. The agricultural sector in the Company's market area is also generally stable. The agricultural economy is accustomed to commodity price fluctuations and is



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generally able to handle such fluctuations without significant problem. A prolonged decline in commodity prices, or a prolonged period of unfavorable weather conditions, however, could affect the financial conditions and repayment capacities of the Company's agricultural borrowers. Weakness in any of the Company's loan portfolios could create a need for the Company to increase its allowance for loan losses through increased charges to provision for loan losses.

Real estate properties acquired through foreclosure are recorded at the lower of cost or fair value. If fair value at the date of foreclosure is lower than the balance of the related loan, the difference will be charged-off to the allowance for loan losses at the time of transfer. Valuations are periodically updated by management and if the value declines, a specific provision for losses on such property is established by a charge to operations.

Although management believes that it uses the best information available to determine the allowances, unforeseen market conditions could result in adjustments and net earnings could be significantly affected if circumstances differ substantially from the assumptions used in making the final determination. Future additions to the Company's allowances will be the result of periodic loan, property and collateral reviews and thus cannot be predicted in advance.

The following table sets forth an analysis of the Company's allowance for loan losses.

|   | September 30           |          |          |          |          |
|---|------------------------|----------|----------|----------|----------|
|   | 2006                   | 2005     | 2004     | 2003     | 2002     |
|   | (Dollars in Thousands) |          |          |          |          |
| Balance at beginning of period  | \$ 7,222               | \$ 5,371 | \$ 4,962 | \$ 4,693 | \$ 3,869 |
| Charge-offs:  |                        |          |          |          |          |
| One-to four family  | (8)                    |          | (7)      | (4)      | (11)     |
| Agricultural operating  |                        |          |          |          | (84)     |
| Commercial and multi-family   |                        | (141)    |          | (31)     |          |
| Consumer  | (6)                    | (13)     | (19)     | (49)     | (139)    |
| Commercial business   | (1,115)                | (3,623)  | (83)     | (29)     | (86)     |
| Total charge-offs   | (1,129)                | (3,777)  | (109)    | (113)    | (320)    |
| Recoveries:   |                        |          |          |          |          |
| One-to-four family  |                        |          | 2        | 2        | 2        |
| Consumer  | 5                      | 32       | 25       | 13       | 39       |
| Commercial business   | 324                    |          | 2        | 10       | 4        |
| Commercial and multi-family   |                        | 114      |          |          |          |
| Agricultural operating  |                        |          |          | 7        | 9        |
| Total recoveries  | 329                    | 146      | 29       | 32       | 54       |
| Net charge-offs   | (800)                  | (3,631)  | (80)     | (81)     | (266)    |
| Additions charged (credited) to operations  | (454)                  | 5,482    | 489      | 350      | 1,090    |
| Balance at end of period  | \$ 5,968               | \$ 7,222 | \$ 5,371 | \$ 4,962 | \$ 4,693 |
| Ratio of net charge-offs during the period to average loans outstanding during the period | 0.19%                  | 0.83%    | 0.02%    | .02%     | .08%     |

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September 30

| Ratio of net charge-offs during the period<br>to<br>average non-performing assets | 13.56% | 118.0% | 2.26% | 2.50% | 4.54% |
|---|--------|--------|-------|-------|-------|

For more information on the provision for loan losses, see Management's Discussion and Analysis - Results of Operations in the Annual Report.

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The distribution of the Company's allowance for losses on loans at the dates indicated is summarized as follows:

|   | September 30,          |  |         |  |         |  |         |  |         |  |
|---|------------------------|--|---------|--|---------|--|---------|--|---------|--|
|   | 2006                   |  | 2005    |  | 2004    |  | 2003    |  | 2002    |  |
|   | Amount                 | Percent of Loans in Each Category to Total Loans | Amount  | Percent of Loans in Each Category to Total Loans | Amount  | Percent of Loans in Each Category to Total Loans | Amount  | Percent of Loans in Each Category to Total Loans | Amount  | Percent of Loans in Each Category to Total Loans |
|   | (Dollars in Thousands) |  |         |  |         |  |         |  |         |  |
| One- to four-family                     | \$ 130                 | 14.96%   | \$ 110  | 10.40%   | \$ 97   | 10.94%   | \$ 135  | 14.35%   | \$ 170  | 20.53%   |
| Commercial and multi-family real estate | 1,482                  | 42.25  | 2,370   | 51.74  | 2,834   | 50.27  | 2,512   | 52.57  | 2,665   | 50.15  |
| Agricultural real estate                | 115                    | 4.07   | 152     | 3.33   | 178     | 7.13   | 116     | 3.20   | 131     | 3.41   |
| Consumer                                | 120                    | 7.86   | 422     | 6.92   | 376     | 7.28   | 344     | 7.32   | 317     | 6.66   |
| Agricultural operating                  | 219                    | 7.58   | 476     | 5.36   | 478     | 5.07   | 628     | 6.21   | 639     | 7.15   |
| Commercial business                     | 3,544                  | 23.28  | 3,439   | 22.25  | 1,338   | 19.31  | 1,027   | 16.35  | 663     | 12.10  |
| Unallocated                             | 358                    |  | 253     |  | 70      |  | 200     |  | 108     |  |
| Total                                   | \$5,968                | 100.00%  | \$7,222 | 100.00%  | \$5,371 | 100.00%  | \$4,962 | 100.00%  | \$4,693 | 100.00%  |

## Investment Activities

*General.* The investment policy of the Company generally is to invest funds among various categories of investments and maturities based upon the Company's need for liquidity, to achieve the proper balance between its desire to minimize risk and maximize yield, to provide collateral for borrowings, and to fulfill the Company's asset/liability management policies. The Company's investment and mortgage-backed securities portfolios are managed in accordance with a written investment policy adopted by the Board of Directors, which is implemented by members of the Bank's Investment Committee. The Company is aware that, due to higher levels of concentration risk, the low- and no-cost checking deposits generated through MPS may carry a greater degree of liquidity risk than traditional consumer checking deposits. As a result, the Company closely monitors balances in these accounts, and maintains a portfolio of highly liquid assets to fund potential deposit outflows. To date, the Company has not experienced any inordinate or unusual outflows related to MPS, though no assurance can be given that this will continue to be the case.

As of September 30, 2006, the Company's entire investment and mortgage-backed securities portfolios were classified as available for sale. For additional information regarding the Company's investment and mortgage-backed securities portfolios, see Notes 1 and 4 of the Notes to Consolidated Financial Statements in the Annual Report.

As of September 30, 2006, investment and mortgage-backed securities with fair values of approximately \$75.1 million were pledged as collateral for FHLB advances and reverse repurchase agreements. For additional information regarding the Company's collateralization of borrowings, see Notes 9 and 10 of the Notes to Consolidated Financial Statement in the Annual Report.

*Securities Purchased Under Agreements to Resell.* In September 2005, Meta Payment Systems entered into a contract to assume the processing of a gift card portfolio. As part of the contract, the funds supporting the outstanding balances of the portfolio were invested in securities purchased under an agreement to resell through Bank of America. The agreement matures every seven days and the securities purchased under the agreement are comprised of U. S. Government agency securities.

*Investment Securities.* It is the Company's general policy to purchase investment securities which are U.S. Government securities and federal agency obligations, state and local government obligations, commercial paper, corporate debt securities and overnight federal funds.

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The following table sets forth the carrying value of the Company's investment security portfolio, excluding mortgage-backed securities, at the dates indicated.

|  | September 30, |           |           |
|--|---------------|-----------|-----------|
|  | 2006          | 2005      | 2004      |
| (Dollars in Thousands)   |               |           |           |
| <b>Investment Securities:</b>  |               |           |           |
| Trust preferred and corporate securities(1)  | 26,279        | \$ 25,637 | \$ 25,992 |
| Municipal bonds  | 145           | 441       | 482       |
| Equity investments   | 568           | 567       | 514       |
| Freddie Mac common stock   | 262           | 226       | 264       |
| Fannie Mae common stock  | 112           | 90        | 127       |
| Other  | 109           | 1,013     | 1,053     |
| Subtotal   | 27,475        | 27,971    | 28,432    |
| FHLB and FRB stock   | 5,768         | 8,287     | 11,179    |
| Total investment securities and FHLB and FRB stock                                   | 33,243        | \$ 36,258 | \$ 39,611 |
| <b>Other Interest-Earning Assets:</b>  |               |           |           |
| Interest bearing deposits in other financial institutions and Federal Funds sold (2) | 101,948       | \$ 8,979  | \$ 7,345  |

(1) Within the trust preferred securities presented above, there are securities from individual issuers that exceed 10% of the Company's total equity. The name and the aggregate market value of securities of each individual issuer are as follows, as of September 30, 2006: Key Corp Capital I, \$4.94 million; Bank Boston Capital Trust IV, \$4.86 million; BankAmerica Capital III, \$4.66 million; PNC Capital Trust, \$4.86 million; Huntington Capital Trust II, \$4.83 million.

(2) The Company at times maintains balances in excess of insured limits at various financial institutions including the Federal Home Loan Bank of Des Moines, the Federal Reserve Bank, and other private institutions. At September 30, 2006 the Company had \$79.8 million of interest bearing deposits held at the Federal Home Loan Bank of Des Moines. The Company does not believe these deposits carry a significant risk of loss, but cannot provide assurances that no losses could occur if these institutions were to become insolvent.

The composition and maturities of the Company's investment securities portfolio, excluding equity securities, FHLB stock and mortgage-backed securities, are indicated in the following table.

| September 30, 2006 |                              |                                |                |                             |
|--------------------|------------------------------|--------------------------------|----------------|-----------------------------|
| 1 Year or Less     | After 1 Year Through 5 Years | After 5 Years Through 10 Years | After 10 Years | Total Investment Securities |
|                    |                              |                                |                |                             |

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September 30, 2006

|  | <u>Carrying Value</u>  | <u>Carrying Value</u> | <u>Carrying Value</u> | <u>Carrying Value</u> | <u>Amortized Cost</u> | <u>Market Value</u> |
|--|------------------------|-----------------------|-----------------------|-----------------------|-----------------------|---------------------|
|  | (Dollars in Thousands) |                       |                       |                       |                       |                     |
| Trust preferred and corporate securities | \$                     | \$ 1,003              | \$                    | \$ 25,276             | \$ 26,773             | \$ 26,279           |
| Municipal bonds                          | 145                    |                       |                       |                       | 146                   | 145                 |
| Other                                    | 109                    |                       |                       |                       | 110                   | 109                 |
|  | <u>          </u>      | <u>          </u>     | <u>          </u>     | <u>          </u>     | <u>          </u>     | <u>          </u>   |
| Total investment securities              | \$ 254                 | \$ 1,003              | \$                    | \$ 25,276             | \$ 27,029             | \$ 26,533           |
|  | <u>          </u>      | <u>          </u>     | <u>          </u>     | <u>          </u>     | <u>          </u>     | <u>          </u>   |
| Weighted average yield (1)               | 4.37%                  | 5.70%                 | %                     | 6.31%                 | 6.25%                 | 6.27%               |

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<sup>(1)</sup> Yields on tax-exempt obligations have not been computed on a tax-equivalent basis.

*Mortgage-Backed Securities.* The Company's mortgage-backed and related securities portfolio consists primarily of securities issued under government-sponsored agency programs, including those of Ginnie Mae, Fannie Mae and Freddie Mac. The Company historically has held Collateralized Mortgage Obligations (CMOs), as well as a limited amount of privately issued mortgage pass-through certificates. The Ginnie Mae, Fannie Mae and Freddie Mac certificates are modified pass-through mortgage-backed securities that represent undivided interests in underlying pools of fixed-rate, or certain types of adjustable-rate, predominantly single-family and, to a lesser extent, multi-family residential mortgages issued by these government-sponsored entities. Fannie Mae and Freddie Mac generally provide the certificate holder a guarantee of timely payments of interest, whether or not collected. Ginnie Mae's guarantee to the holder is timely payments of principal and interest, backed by the full faith and credit of the U.S. Government. Privately issued mortgage pass-through certificates generally provide no guarantee as to timely payment of interest or principal, and reliance is placed on the creditworthiness of the issuer, which the Company monitors on a regular basis.

At September 30, 2006, the Company had mortgage-backed securities with a carrying value of \$147.9 million, representing 93% of the total portfolio, which had fixed rates of interest and \$10.8 million, representing 7% of the total portfolio, which had adjustable rates of interest.

Mortgage-backed securities generally increase the quality of the Company's assets by virtue of the insurance or guarantees that back them, are more liquid than individual mortgage loans and may be used to collateralize borrowings or other obligations of the Company. At September 30, 2006, \$85 million or 51% of the Company's mortgage-backed securities were pledged to secure various obligations of the Company.

While mortgage-backed securities carry a reduced credit risk as compared to whole loans, such securities remain subject to the risk that a fluctuating interest rate environment, along with other factors such as the geographic distribution of the underlying mortgage loans, may alter the prepayment rate of such mortgage loans and so affect both the prepayment speed, and value, of such securities. The prepayment risk associated with mortgage-backed securities is monitored periodically, and prepayment rate assumptions adjusted as appropriate to update the Company's mortgage-backed securities accounting and asset/liability reports.

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The following table sets forth the carrying value of the Company's mortgage-backed securities at the dates indicated.

|   | September 30,          |                   |                   |
|---|------------------------|-------------------|-------------------|
|   | 2006                   | 2005              | 2004              |
|   | (Dollars in Thousands) |                   |                   |
| Ginnie Mae  | \$                     | \$ 3              | \$ 6,727          |
| CMO   | 6                      | 7                 | 1,606             |
| Freddie Mac   | 98,328                 | 125,770           | 164,003           |
| Fannie Mae  | 60,295                 | 77,056            | 121,627           |
| Privately Issued Mortgage Pass-Through Certificates | 73                     | 85                | 129               |
| <b>Total</b>  | <b>\$ 158,702</b>      | <b>\$ 202,921</b> | <b>\$ 294,092</b> |

The following table sets forth the contractual maturities of the Company's mortgage-backed securities at September 30, 2006. Not considered in the preparation of the table below is the effect of prepayments, periodic principal repayments and the adjustable-rate nature of these instruments.

|  | September 30, 2006     |                              |                                |                |                                  |                |
|--|------------------------|------------------------------|--------------------------------|----------------|----------------------------------|----------------|
|  | 1 Year or Less         | After 1 Year Through 5 Years | After 5 Years Through 10 Years | After 10 Years | Total Mortgage-Backed Securities |                |
|  | Carrying Value         | Carrying Value               | Carrying Value                 | Carrying Value | Amortized Cost                   | Market Value   |
|  | (Dollars in Thousands) |                              |                                |                |                                  |                |
| CMO  | \$                     | \$                           | \$                             | \$ 6           | \$ 6                             | \$ 6           |
| Freddie Mac  |                        | 87,714                       |                                | 10,615         | 102,145                          | 98,328         |
| Fannie Mae   |                        | 59,421                       |                                | 873            | 63,581                           | 60,295         |
| Privately Issued Mortgage Pass-Through Certificates <sup>(1)</sup> |                        |                              |                                | 73             | 66                               | 73             |
| <b>Total investment securities</b>                                 |                        | <b>147,135</b>               |                                | <b>11,567</b>  | <b>165,798</b>                   | <b>158,702</b> |
| <b>Weighted average yield</b>                                      |                        | <b>% 4.14%</b>               |                                | <b>% 4.55%</b> | <b>4.16%</b>                     | <b>4.16%</b>   |

<sup>(1)</sup> This security is rated Aaa by a nationally recognized rating agency.

At September 30, 2006, the contractual maturity of 7.3% of all of the Company's mortgage-backed securities was in excess of ten years. The actual maturity of a mortgage-backed security is typically less than its stated maturity due to scheduled principal payments and prepayments of the underlying mortgages. Prepayments that are different than anticipated will affect the yield to maturity. The yield is based upon the interest income and the amortization of any premium or discount related to the mortgage-backed security. In accordance with generally accepted



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accounting principles, premiums and discounts are amortized over the estimated lives of the loans, which decrease and increase interest income, respectively. The prepayment assumptions used to determine the amortization period for premiums and discounts can significantly affect the yield of the mortgage-backed security, and these assumptions are reviewed periodically to reflect actual prepayments. Although prepayments of underlying mortgages depend on many factors, including the type of mortgages, the coupon rate, the age of mortgages, the geographical location of the underlying real estate collateralizing the mortgages and general levels of market interest rates, the difference between the interest rates on the underlying mortgages and the prevailing mortgage interest rates generally is the most significant determinant of the rate of prepayments. During periods of falling mortgage interest rates, if the coupon rate of the underlying mortgages exceeds the prevailing market interest rates offered for mortgage loans, refinancing generally increases and accelerates the prepayment of the underlying mortgages and the related security. Under such circumstances, the Company may be subject to reinvestment risk because, to the extent that

the Company's mortgage-backed securities amortize or prepay faster than anticipated, the Company may not be able to reinvest the proceeds of such repayments and prepayments at a comparable rate.

### **Sources of Funds**

*General.* The Company's sources of funds are deposits, borrowings, amortization and repayment of loan principal, interest earned on or maturation of investment securities and short-term investments, and funds provided from operations.

Borrowings, including Federal Home Loan Bank ( FHLB ) of Des Moines advances, and repurchase agreements, may be used at times to compensate for seasonal reductions in deposits or deposit inflows at less than projected levels, may be used on a longer-term basis to support expanded lending activities, and may also be used to match the funding of a corresponding asset.

*Deposits.* The Company offers a variety of deposit accounts having a wide range of interest rates and terms. The Company's deposits consist of passbook savings accounts, money market savings accounts, NOW and regular checking accounts, and certificate accounts currently ranging in terms from fourteen days to 60 months. The Company only solicits deposits from its primary market area and does not currently use brokers to obtain deposits. The Company relies primarily on competitive pricing policies, advertising and high-quality customer service to attract and retain these deposits. The Company has no brokered deposits.

The flow of deposits is influenced significantly by general economic conditions, changes in money market and prevailing interest rates, and competition.

The variety of deposit accounts offered by the Company has allowed it to be competitive in obtaining funds and to respond with flexibility to changes in consumer demand. The Company endeavors to manage the pricing of its deposits in keeping with its asset/liability management and profitability objectives. Based on its experience, the Company believes that its passbook savings, money market savings accounts, NOW and regular checking accounts are relatively stable sources of deposits. However, the ability of the Company to attract and maintain certificates of deposit and the rates paid on these deposits has been and will continue to be significantly affected by market conditions.

\$163.1 million of the Company's deposit portfolio is attributable to MPS. The majority of these deposits represent un-spent funds on prepaid debit cards and other stored value products and are included with non-interest-bearing demand deposits on the Company's Consolidated Statement of Financial Condition. Generally, these deposits do not earn interest. Meta Payment Systems originates debit card programs through outside sales agents and other financial institutions. As such, these deposits carry a somewhat higher degree of liquidity risk than traditional consumer products. If a major client or card program were to leave the Bank, deposit outflows would be more significant than if the bank were to lose a more traditional customer. The Company takes this additional risk into account when planning its investment and liquidity strategies. The increase in deposits arising from MPS has also allowed the bank to reduce its reliance on higher costing certificates of deposits and public funds.

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The following table sets forth the savings flows at the Company during the periods indicated.

|                   | September 30,          |             |             |
|-------------------|------------------------|-------------|-------------|
|                   | 2006                   | 2005        | 2004        |
|                   | (Dollars in Thousands) |             |             |
| Opening balance   | \$ 541,042             | \$ 461,797  | \$ 435,821  |
| Deposits          | 11,887,997             | 3,255,395   | 2,065,429   |
| Withdrawals       | (11,871,317)           | (3,185,592) | (2,031,501) |
| Sale of deposit   |                        |             | (16,103)    |
| Interest credited | 7,988                  | 9,442       | 8,151       |
| Ending balance    | \$ 565,710             | \$ 541,042  | \$ 461,797  |
| Net increase      | \$ 24,668              | \$ 79,245   | \$ 25,976   |
| Percent increase  | 4.56%                  | 17.16%      | 5.96%       |

The following table sets forth the dollar amount of savings deposits in the various types of deposit programs offered by the Company for the periods indicated.

|   | September 30,          |                  |            |                  |           |                  |
|---|------------------------|------------------|------------|------------------|-----------|------------------|
|   | 2006                   |                  | 2005       |                  | 2004      |                  |
|   | Amount                 | Percent of Total | Amount     | Percent of Total | Amount    | Percent of Total |
|   | (Dollars in Thousands) |                  |            |                  |           |                  |
| <b>Transactions and Savings Deposits:</b> |                        |                  |            |                  |           |                  |
| Non-interest bearing Demand Accounts      | \$ 189,506             | 33.50%           | \$ 102,436 | 18.92%           | \$ 19,753 | 4.28%            |
| Interest bearing Demand Accounts          | 26,828                 | 4.74             | 33,481     | 6.19             | 27,657    | 5.99             |
| Passbook Savings Accounts                 | 29,869                 | 5.28             | 62,371     | 11.52            | 45,666    | 9.89             |
| Money Market Accounts                     | 103,290                | 18.26            | 74,632     | 13.79            | 103,966   | 22.51            |
| Total Non-Certificate                     | 349,493                | 61.78            | 272,920    | 50.42            | 197,042   | 42.67            |
| <b>Certificates :</b>                     |                        |                  |            |                  |           |                  |
| Variable                                  | 2,908                  | 0.51             | 2,216      | 0.41             | 2,053     | 0.44             |
| 0.00 - 1.99%                              | 1,379                  | 0.24             | 18,791     | 3.47             | 89,602    | 19.40            |

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|                           | September 30,     |                |                   |                |                   |                |
|---------------------------|-------------------|----------------|-------------------|----------------|-------------------|----------------|
| 2.00 - 3.99%              | 69,494            | 12.28          | 190,189           | 35.17          | 129,447           | 28.04          |
| 4.00 - 5.99%              | 142,426           | 25.19          | 52,347            | 9.68           | 32,225            | 6.98           |
| 6.00 - 7.99%              | 10                | 0.00           | 4,579             | 0.85           | 11,428            | 2.47           |
| <b>Total Certificates</b> | <b>216,217</b>    | <b>38.22</b>   | <b>268,122</b>    | <b>49.58</b>   | <b>264,755</b>    | <b>57.33</b>   |
| <b>Total Deposits</b>     | <b>\$ 565,710</b> | <b>100.00%</b> | <b>\$ 541,042</b> | <b>100.00%</b> | <b>\$ 461,797</b> | <b>100.00%</b> |

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The following table shows rate and maturity information for the Company's certificates of deposit as of September 30, 2006.

|   | <u>Variable</u> | <u>0.00 -<br/>1.99%</u> | <u>2.00-<br/>3.99%</u> | <u>4.00-<br/>5.99%</u> | <u>6.00-<br/>7.99%</u> | <u>Total</u>      | <u>Percent<br/>of Total</u> |
|---|-----------------|-------------------------|------------------------|------------------------|------------------------|-------------------|-----------------------------|
| (Dollars in Thousands)                              |                 |                         |                        |                        |                        |                   |                             |
| Certificate accounts maturing<br>in quarter ending: |                 |                         |                        |                        |                        |                   |                             |
| December 31, 2006                                   | \$ 907          | \$ 1,193                | \$ 11,431              | \$ 19,357              | \$                     | \$ 32,888         | 15.2%                       |
| March 31, 2007                                      | 400             | 46                      | 22,592                 | 33,449                 |                        | 56,487            | 26.1                        |
| June 30, 2007                                       | 353             | 122                     | 8,588                  | 30,813                 |                        | 39,876            | 18.4                        |
| September 30, 2007                                  | 565             |                         | 4,554                  | 17,626                 |                        | 22,745            | 10.5                        |
| December 31, 2007                                   | 470             | 18                      | 3,198                  | 6,377                  |                        | 10,063            | 4.7                         |
| March 31, 2008                                      | 213             |                         | 2,336                  | 1,236                  |                        | 3,785             | 1.9                         |
| June 30, 2008                                       |                 |                         | 3,824                  | 6,648                  |                        | 10,472            | 4.8                         |
| September 30, 2008                                  |                 |                         | 6,990                  | 4,094                  |                        | 11,084            | 5.2                         |
| December 31, 2008                                   |                 |                         | 2,191                  | 2,676                  |                        | 4,867             | 2.2                         |
| March 31, 2009                                      |                 |                         | 1,592                  | 2,592                  |                        | 4,184             | 1.9                         |
| June 30, 2009                                       |                 |                         | 684                    | 2,968                  |                        | 3,652             | 1.7                         |
| September 30, 2009                                  |                 |                         | 336                    | 1,474                  |                        | 1,810             | 0.8                         |
| Thereafter  |                 |                         | 1,178                  | 13,116                 | 10                     | 14,304            | 6.6                         |
| <b>Total</b>  | <b>\$ 2,908</b> | <b>\$ 1,379</b>         | <b>\$ 69,494</b>       | <b>\$ 142,426</b>      | <b>\$ 10</b>           | <b>\$ 216,217</b> | <b>100.0%</b>               |
| Percent of total                                    | 1.3%            | 0.6%                    | 32.1%                  | 66.0%                  | 0.0%                   | 100.0%            |                             |

The following table indicates the amount of the Company's certificates of deposit and other deposits by time remaining until maturity as of September 30, 2006.

|  | Maturity                        |                                    |                                     |                            |                   |
|--|---------------------------------|------------------------------------|-------------------------------------|----------------------------|-------------------|
|  | <u>3<br/>Months<br/>or Less</u> | <u>After<br/>3 to 6<br/>Months</u> | <u>After<br/>6 to 12<br/>Months</u> | <u>After<br/>12 Months</u> | <u>Total</u>      |
| (In Thousands)                               |                                 |                                    |                                     |                            |                   |
| Certificates of deposit less than \$100,000  | \$ 24,561                       | \$ 45,258                          | \$ 49,711                           | \$ 52,420                  | \$ 171,950        |
| Certificates of deposit of \$100,000 or more | 8,327                           | 11,229                             | 12,910                              | 11,801                     | 44,267            |
| <b>Total certificates of deposit(1)</b>      | <b>\$ 32,888</b>                | <b>\$ 56,487</b>                   | <b>\$ 62,621</b>                    | <b>\$ 64,221</b>           | <b>\$ 216,217</b> |

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<sup>(1)</sup> Includes deposits from governmental and other public entities totaling \$3.9 million.

*Borrowings.* Although deposits are the Company's primary source of funds, the Company's policy has been to utilize borrowings when they are a less costly source of funds, can be invested at a positive interest rate spread, or when the Company desires additional capacity to fund loan demand.

The Company's borrowings historically have consisted primarily of advances from the FHLB of Des Moines upon the security of a blanket collateral agreement of a percentage of unencumbered loans and the pledge of specific investment securities. Such advances can be made pursuant to several different credit programs, each of which has its own interest rate and range of maturities. At September 30, 2006, the Company had \$99.6 million of advances from the FHLB of Des Moines and the ability to borrow up to an approximate additional \$82.2 million. At September 30, 2006, advances totaling \$25.3 million had terms to maturity of one year or less. The remaining \$74.3 million had maturities ranging up to 13 years.

On July 16, 2001, the Company issued all of the 10,000 authorized shares of Company Obligated Mandatorily Redeemable Preferred Securities of First Midwest Financial Capital Trust I (preferred securities of subsidiary trust) holding solely subordinated debt securities. Distributions are paid semi-annually. Cumulative cash distributions are calculated at a variable rate of LIBOR (as defined) plus 3.75%, not to exceed 12.5%. The Company may, at one or more times, defer interest payments on the capital securities for up to 10 consecutive semi-annual periods, but not beyond July 25, 2031. At the end of any deferral period, all accumulated and unpaid distributions will be paid. The capital securities will be redeemed on July 25, 2031; however, the Company has a semi-annual option to shorten the maturity date to a date not earlier than July 25, 2006. The redemption price is \$1,000 per capital security plus any accrued and unpaid distributions to the date of redemption plus, if redeemed prior to July 25, 2011, a redemption premium as defined in the Indenture Agreement. Holders of the capital securities have no voting rights, are unsecured and rank junior in priority of payment to all of the Company's indebtedness and senior to the Company's common stock. The trust preferred securities have been includable in the Company's capital calculations on a limited basis since they were issued.

From time to time, the Company has offered retail repurchase agreements to its customers. These agreements typically range from 14 days to five years in term, and typically have been offered in minimum amounts of \$100,000. The proceeds of these transactions are used to meet cash flow needs of the Company. At September 30, 2006, the Company had \$179,000 of retail repurchase agreements outstanding.

Historically, the Company has entered into wholesale repurchase agreements through nationally recognized broker-dealer firms. These agreements are accounted for as borrowings by the Company and are secured by certain of the Company's investment and mortgage-backed securities. The broker-dealer takes possession of the securities during the period that the reverse repurchase agreement is outstanding. The terms of the agreements have usually ranged from 7 days to six months, but on occasion longer term agreements have been entered into. At September 30, 2006, the Company had \$15.0 million of wholesale repurchase agreements outstanding.

The following table sets forth the maximum month-end balance and average balance of FHLB advances, retail and reverse repurchase agreements and Subordinated Debentures for the periods indicated.

|  | September 30,          |            |            |
|--|------------------------|------------|------------|
|  | 2006                   | 2005       | 2004       |
|  | (Dollars in Thousands) |            |            |
| <b>Maximum Balance:</b>                  |                        |            |            |
| FHLB advances                            | \$ 159,705             | \$ 229,300 | \$ 226,250 |
| Repurchase agreements                    | 20,369                 | 33,077     | 58,500     |
| Subordinated debentures                  | 9,831                  | 9,800      | 9,769      |
| <b>Average Balance:</b>                  |                        |            |            |
| FHLB advances                            | \$ 126,573             | \$ 209,618 | \$ 203,135 |
| Retail and reverse repurchase agreements | 16,616                 | 28,067     | 38,977     |
| Subordinated debentures                  | 9,816                  | 9,784      | 9,754      |

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The following table sets forth certain information as to the Company's FHLB advances and other borrowings at the dates indicated.

|   | September 30, |            |            |
|---|---------------|------------|------------|
|   | 2006          | 2005       | 2004       |
| (Dollars in Thousands)                                    |               |            |            |
| FHLB advances   | \$ 99,565     | \$ 159,705 | \$ 226,250 |
| Repurchase agreements                                     | 15,179        | 20,507     | 32,549     |
| Subordinated debentures                                   | 9,831         | 9,800      | 9,769      |
|   | \$ 124,575    | \$ 190,012 | \$ 268,568 |
| Weighted average interest rate of FHLB advances           | 4.97%         | 4.56%      | 3.62%      |
| Weighted average interest rate of repurchase agreements   | 3.13%         | 2.89%      | 2.49%      |
| Weighted average interest rate of subordinated debentures | 9.30%         | 7.67%      | 5.74%      |

### Subsidiary Activities

The subsidiaries of the Company are MetaBank, MetaBank WC, Meta Trust Company and First Midwest Financial Capital Trust I. MetaBank has one service corporation subsidiary, First Services Financial Limited ( First Services ). At September 30, 2006, the net book value of MetaBank's investment in First Services was approximately \$90,000. MetaBank WC does not have any subsidiaries. MetaBank organized First Services, its sole service corporation, in 1983. First Services currently has no active operations.

### Meta Payment Systems Division

Meta Financial, through its subsidiary MetaBank, operating under the divisional name of Meta Payment Systems, offers stored value and debit card programs. The programs target banks, card processors and third party marketers to distribute the cards. Stored value products are segregated into three categories: reloadable cards for applications such as payroll and personal use; non-reloadable cards for one-time uses such as gifts or promotions; and benefit cards for applications such as transportation and flexible-spending accounts. Stored value card programs are subject to certain fraud risks, including but not limited to, collusion between bank and merchant employees, and merchant employees and cardholders, counterfeiting, improper authorization, and system failure. Taking on prepaid funds from customers also subjects the Company to somewhat increased liquidity and interest rate risk.

While the Company believes that it has adopted policies and procedures to manage and monitor the risks attendant to this line of business, and while the executives who manage the Company's program have years of experience, no guarantee can be made that the Company will not experience losses in this division.

### Regulation

*Recent Legislation - The Financial Services Modernization Act.* On November 12, 1999, the Gramm-Leach-Bliley Financial Services Modernization Act of 1999 ( GLBA ) was signed into law. The purpose of this legislation was to modernize the financial services industry by establishing a





comprehensive framework to permit affiliations among commercial banks, insurance companies, securities firms and other financial service providers. Generally, the Act:

- (a) repealed the historical restrictions and eliminates many federal and state law barriers to affiliations among banks, securities firms, insurance companies and other financial service providers;
- (b) provided a uniform framework for the functional regulation of the activities of banks, savings institutions and their holding companies;
- (c) broadened the activities that may be conducted by national banks, banking subsidiaries of bank holding companies and their financial subsidiaries;
- (d) provided an enhanced framework for protecting the privacy of consumer information; and
- (e) addressed a variety of other legal and regulatory issues affecting day-to-day operations and long-term activities of financial institutions.

The GLBA also imposes certain obligations on financial institutions to develop privacy policies, restrict the sharing of nonpublic customer data with nonaffiliated parties at the customer's request, and establish procedures and practices to protect and secure customer data. These privacy provisions were implemented by regulations that were effective on November 12, 2000. Compliance with the privacy provisions was required by July 1, 2001.

*USA Patriot Act of 2001*. In October 2001, the USA Patriot Act of 2001 was enacted in response to the terrorist attacks in New York, Pennsylvania and Washington, D.C. which occurred on September 11, 2001. The Patriot Act is intended to strengthen U.S. law enforcement's and the intelligence communities' abilities to work cohesively to combat terrorism on a variety of fronts. The potential impact of the Patriot Act on financial institutions of all kinds is significant and wide ranging. The Patriot Act contains sweeping anti-money laundering and financial transparency laws and imposes various regulations, including standards for verifying client identification at account opening, and rules to promote cooperation among financial institutions, regulators and law enforcement entities in identifying parties that may be involved in terrorism or money laundering.

Among other requirements, Title III of the USA Patriot Act imposes the following requirements:

All financial institutions must establish anti-money laundering programs that include (i) internal policies, procedures and controls, (ii) specific designation of an anti-money laundering compliance officer, (iii) ongoing employee training programs and (iv) an independent audit function to test the anti-money laundering program.

Financial institutions that establish, maintain, administer, or manage private banking accounts or correspondent accounts in the United States for non-United States persons or their representatives must establish appropriate, specific, and, where necessary, enhanced due diligence policies, procedures, and controls designed to detect and report money laundering.

Financial institutions are prohibited from establishing, maintaining, administering or managing correspondent accounts for foreign shell banks that do not have a physical presence in any country, and will be subject to certain record keeping obligations with respect to correspondent accounts of foreign banks.

Bank regulators are directed to consider a holding company's effectiveness in combating money laundering when ruling on Federal Reserve Act and Bank Merger Act applications.

The Company's policies and procedures have been updated to reflect the requirements of the USA Patriot Act.

*Sarbanes-Oxley Act of 2002*. On July 30, 2002, President Bush signed into law the Sarbanes-Oxley Act of 2002, or the SOA. The SOA is the most far-reaching U.S. securities legislation enacted in many years, and includes many substantive and disclosure-based requirements. The stated goals of the SOA are to increase corporate responsibility, to provide for enhanced penalties for accounting and auditing improprieties at publicly traded companies and to protect investors by improving the accuracy and reliability of corporate disclosures pursuant to the securities laws. The SOA generally applies to all companies, both U.S. and non-U.S., that file or are required to file periodic reports with the Securities and Exchange Commission under the Exchange Act.

*Federal Deposit Insurance Reform Act of 2005*. The Federal Deposit Insurance Reform Act of 2005 (the FDIRA), signed into law on February 8, 2006, amended current laws regarding the federal deposit insurance system. Pursuant to the FDIRA, the FDIC merged the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF) into one deposit insurance fund, the Deposit Insurance Fund (DIF), on March 31, 2006. The new legislation also abolishes the prior minimum 1.25% reserve ratio and the mandatory assessments when the ratio falls below 1.25%. Under the FDIRA, the FDIC, at the beginning of each year, has the flexibility to adjust the DIF's reserve ratio between 1.15% and 1.50% depending upon a variety of factors, including projected losses, economic considerations and assessment rates.

Deposit insurance coverage limits are raised under the FDIRA from \$100,000 to \$250,000 for certain types of Individual Retirement Accounts, 401(k) plans and other retirement savings accounts (including Keough accounts and 457 plan accounts, among others). The current \$100,000 limit continues to apply to individual accounts and municipal deposits; however, Congress included in the FDIRA the authority for the FDIC to review all levels of insurance coverage after March 31, 2010, and index such insurance coverage to inflation. Additionally, the FDIRA states that undercapitalized financial institutions cannot accept employee benefit plan deposits.

On October 10, 2006, the FDIC announced its final rule with respect to implementing the \$4.7 billion dividend requirements of the FDIRA. The rule will take effect on January 1, 2007 and sunset on December 31, 2008, after which the FDIC intends to have in place a more comprehensive rulemaking on dividends. The dividend will take the form of a credit, to be calculated by the FDIC, that may be applied against future deposit insurance premiums due. Generally, to be eligible for the credit, an institution must have been in existence prior to December 31, 1996 and paid insurance premiums before such date or meet the agency's definition of a successor to such institution.

*Financial Services Regulatory Relief Act of 2006*. On October 13, 2006, President Bush signed into law the Financial Services Regulatory Relief Act of 2006. The legislation includes language important to all financial institutions, and the specific provisions applicable to federal savings associations include the following:

providing savings and loan trust departments with the same exemption from the investment adviser and broker-dealer regulatory requirements to the same extent previously enjoyed by bank trust departments with respect to the Investment Advisers Act of 1940 and the Securities Exchange Act of 1934;

requiring the Securities and Exchange Commission and the Federal Reserve Board, in consultation with the other federal banking regulators, including the Office of Thrift Supervision, to formally resolve regulatory issues with respect to the regulation of securities activities by banks and federal savings associations (final rules are required to be proposed by early April 2007);

providing that a federal savings association is only a citizen of the state in which its home office is located for purposes of determining diversity jurisdiction (a provision that previously had been applicable to national banks only);

increasing to \$500 million the applicable asset size for an 18-month examination cycle;

requiring the federal banking agencies to develop a succinct model privacy notice with respect to Gramm-Leach-Bliley privacy provisions and mandating that a regulatory safe harbor be provided to financial institutions that use such model privacy policy;

extending the powers of federal banking agencies to take enforcement actions against persons for conduct that occurred during their affiliation with the financial institution regardless of whether the person remains employed by the institution;

repealing certain requirements governing purchased mortgage servicing rights found in the Home Owners Loan Act.

*General.* Bank holding companies, such as Meta Financial, are subject to comprehensive regulation by the Board of Governors of the Federal Reserve System ( FRB ) under the Bank Holding Company Act of 1956, as amended ( BHCA ) and the regulations of the FRB. As a bank holding company, Meta Financial is required to file reports with the FRB and such additional information as the FRB may require, and is subject to regular inspections by the FRB. The FRB also has extensive enforcement authority over bank holding companies, including, among other things, the ability to assess civil money penalties, to issue cease and desist or removal orders and to require that a holding company divest subsidiaries (including its bank subsidiaries). In general, enforcement actions may be initiated for violations of law and regulations and unsafe or unsound practices.

Under FRB policy, a bank holding company must serve as a source of strength for its subsidiary banks. Under this policy the FRB may require a holding company to contribute additional capital to an undercapitalized subsidiary bank.

Under the Bank Holding Company Act of 1956, as amended (the BHCA ), a bank holding company must obtain FRB approval before: (i) acquiring, directly or indirectly, ownership or control of any voting shares of another bank or bank holding company if, after such acquisition, it would own or control more than 5% of such shares (unless it already owns or controls the majority of such shares); (ii) acquiring all or substantially all of the assets of another bank or bank holding company; or (iii) merging or consolidating with another bank holding company.

The BHCA prohibits a bank holding company, with certain exceptions, from acquiring direct or indirect ownership or control of more than 5% of the voting shares of any company which is not a bank or bank holding company, or from engaging directly or indirectly in activities other than those of banking, managing or controlling banks, or providing services for its subsidiaries. The principal exceptions to these prohibitions involve certain non-bank activities which, by statute or by FRB regulation or order, have been identified as activities closely related to the business of banking or managing or controlling banks. The list of activities permitted by the FRB includes, among other things, operating a savings

institution (such as MetaBank), mortgage company, finance company, credit card company or factoring company; performing certain data processing operations; providing certain investment and financial advice; underwriting and acting as an insurance agent for certain types of credit-related insurance; leasing property on a full-payout, non-operating basis; real estate and personal property appraising; and, subject to certain limitations, providing securities brokerage services for customers. The scope of permissible activities may be expanded from time to time by the FRB. Such activities may also be affected by federal legislation.

Meta Financial currently has four wholly-owned subsidiaries, MetaBank, a federally-chartered thrift institution, MetaBank WC, an Iowa-chartered commercial bank, First Midwest Financial Capital Trust I, a statutory business trust organized under the Delaware Business Trust Act and Meta Trust Company, a South Dakota corporation that provides trust services. MetaBank is subject to extensive regulation, supervision and examination by the OTS, as its chartering authority and primary federal regulator, and by the FDIC, which insures its deposits up to applicable limits. MetaBank is a member of the FHLB System and is subject to certain limited regulation by the FRB. Such regulation and supervision governs the activities in which an institution can engage and the manner in which such activities are conducted, and is intended primarily for the protection of the insurance fund and depositors. MetaBank WC is subject to extensive regulation, supervision and examination by the Iowa Superintendent of Banking (the Superintendent) and the FRB, which are its state and primary federal regulators, respectively. It is also subject to regulation by the FDIC, which insures its deposits up to applicable limits. As with MetaBank, such regulation and supervision governs the activities in which MetaBank WC can engage and the manner in which such activities are conducted and is intended primarily for the protection of the insurance fund and depositors.

Meta Financial is regulated as a bank holding company by the FRB. Bank holding companies are subject to comprehensive regulation and supervision by the FRB under the BHCA and the regulations of the FRB. As a bank holding company, Meta Financial must file reports with the FRB and such additional information as the FRB may require, and is subject to regular inspections by the FRB. Meta Financial is subject to the activity limitations imposed under the BHCA and in general may engage in only those activities that the FRB has determined to be closely related to banking.

Regulatory authorities have been granted extensive discretion in connection with their supervisory and enforcement activities which are intended to strengthen the financial condition of the banking industry, including the imposition of restrictions on the operation of an institution, the classification of assets by the institution and the adequacy of an institution's allowance for loan losses. Any change in the nature of such regulation and oversight, whether by the OTS, the FDIC, the FRB or legislatively by Congress, could have a material impact on Meta Financial, MetaBank or MetaBank WC and their respective operations.

Certain of these regulatory requirements and restrictions are discussed below or elsewhere in this document.

*Federal Regulation of Financial Institutions.* The OTS has extensive supervisory and regulatory authority over the operations of savings associations. As part of this authority, MetaBank is required to file periodic reports with the OTS and is subject to periodic examination by the OTS and the FDIC. The last regular OTS examination of Meta Financial was as of August 8, 2005. MetaBank WC is subject to similar regulation and oversight by the Superintendent and the FRB and was last examined as of September 20, 2005.

Each federal and state banking regulator also has extensive enforcement authority over its regulated institutions. This enforcement authority includes, among other things, the power to compel

higher reserves, the ability to assess civil money penalties, to issue cease-and-desist or removal orders and to initiate injunctive actions. In general, these enforcement actions may be initiated for violations of laws and regulations and unsafe or unsound practices. Other actions or inactions may provide the basis for enforcement action, including misleading or untimely reports. Except under certain circumstances, public disclosure of final enforcement actions by the regulator is required. The federal banking agencies have adopted guidelines establishing safety and soundness standards on such matters as loan underwriting and documentation, asset quality, earnings standards, internal controls and audit systems, interest rate risk exposure and compensation and other employee benefits. Any institution which fails to comply with these standards must submit a compliance plan.

In addition, the investment, lending and branching authority of MetaBank is prescribed by federal laws and it is prohibited from engaging in any activities not permitted by such laws. MetaBank WC is subject to such restrictions under state law as administered by the Iowa Superintendent. Federal savings associations are generally authorized to branch nationwide, whereas Iowa chartered banks, such as MetaBank WC, are generally limited to establishing branches within the State of Iowa.

Both MetaBank s and MetaBank WC s general permissible lending limit to one borrower is equal to the greater of \$500,000 or 15% of unimpaired capital and surplus (except for loans fully secured by certain readily marketable collateral, in which case this limit is increased to 25% of unimpaired capital and surplus). MetaBank WC is subject to similar restrictions. At September 30, 2006, MetaBank s and MetaBank WC s lending limit under these restrictions was \$8.16 million and \$935,000, respectively. MetaBank and MetaBank WC are in compliance with their lending limits.

*Insurance of Accounts and Regulation by the FDIC.* MetaBank and MetaBank WC are members of the Deposit Insurance Fund (the DIF ), each of which is administered by the FDIC. Deposits are insured up to applicable limits by the FDIC and such insurance is backed by the full faith and credit of the United States Government. As insurer, the FDIC imposes deposit insurance premiums and is authorized to conduct examinations of and to require reporting by FDIC-insured institutions. It also may prohibit any FDIC-insured institution from engaging in any activity the FDIC determines by regulation or order to pose a serious risk to the DIF. The FDIC also has the authority to initiate enforcement actions against any FDIC insured institution after giving its primary federal regulator the opportunity to take such action, and may terminate the deposit insurance if it determines that the institution has engaged in unsafe or unsound practices or is in an unsafe or unsound condition.

The FDIC s deposit insurance premiums are assessed through a risk-based system under which all insured depository institutions are placed into one of nine categories and assessed insurance premiums based upon their level of capital and supervisory evaluation. The current assessment rates range from zero to .27% per \$100 of assessable deposits. Risk classification of all insured institutions will be made by the FDIC for each semi-annual assessment period. Institutions that are well-capitalized and have a high supervisory rating are subject to the lowest assessment rate. At September 30, 2006, both MetaBank and MetaBank WC met the capital requirements of a well capitalized institution and were not subject to any assessment. See Note 15 of Notes to Consolidated Financial Statements in the Annual Report.

DIF-insured institutions pay a Financing Corporation (FICO) assessment in order to fund the interest on bonds issued to resolve thrift failures in the 1980s. For the quarter ended September 30, 2006, the FICO assessment was equal to 1.26 basis points for each \$100 in domestic deposits. These assessments will continue until the bonds mature in years 2017 through 2019.

Under the Federal Deposit Insurance Act ( FDIA ), the FDIC may terminate deposit insurance upon a finding that the institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or condition

imposed by the FDIC or the OTS. Management of the Banks does not know of any practice, condition or violation that might lead to termination of deposit insurance.

*Regulatory Capital Requirements.* Federally insured financial institutions, such as MetaBank and MetaBank WC, are required to maintain a minimum level of regulatory capital. These capital requirements mandate that an institution maintain at least the following ratios: (1) a core (or Tier 1) capital to adjusted total assets ratio of 4% (which can be reduced to 3% for highly rated institutions); (2) a Tier 1 capital to risk-weighted assets ratio of 4%, and (3) a risk-based capital to risk-weighted assets ratio of 8%. Capital requirements in excess of these standards may be imposed on individual institutions on a case-by-case basis. As of September 30, 2006, both Banks were in compliance with all capital standards applicable to them and were designated a well-capitalized under federal guidelines. See Note 15 of Notes to Consolidated Financial Statements in the Annual Report.

*Prompt Corrective Action.* Federal banking regulators are authorized and, under certain circumstances required, to take certain actions against banks that fail to meet their capital requirements. Effective December 19, 1992, the federal banking agencies were given additional enforcement authority with respect to undercapitalized depository institutions. They are generally required to take action to restrict the activities of an undercapitalized bank (generally defined to be one with less than either a four percent core capital ratio, a four percent Tier 1 risk-based capital ratio or an eight percent risk-based capital ratio). Any such bank must submit a capital restoration plan and until such plan is approved may not increase its assets, acquire another institution, establish a branch or engage in any new activities, and generally may not make capital distributions. The banking regulators are authorized to impose the additional restrictions, discussed below, that are applicable to significantly undercapitalized institutions.

Any institution that fails to comply with its capital plan or is significantly undercapitalized (*i.e.* Tier 1 risk-based or core capital ratios of less than three percent or a risk-based capital ratio of less than six percent) must be made subject to one or more of additional specified actions and operating restrictions mandated by FDICIA. These actions and restrictions include requiring the issuance of additional voting securities; limitations on asset growth; mandated asset reduction; changes in senior management; divestiture, merger or acquisition of the association; restrictions on executive compensation; and any other action the OTS deems appropriate. An institution that becomes critically undercapitalized (*i.e.* .., a tangible capital ratio of two percent or less) is subject to further mandatory restrictions on its activities in addition to those applicable to significantly undercapitalized associations. In addition, the appropriate banking regulator must appoint a receiver (or conservator with the concurrence of the FDIC) for an institution, with certain limited exceptions, within 90 days after it becomes critically undercapitalized. Any undercapitalized institution is also subject to other possible enforcement actions, including the appointment of a receiver or conservator. The appropriate regulator is also generally authorized to reclassify an institution into a lower capital category and impose restrictions applicable to such category if the institution is engaged in unsafe or unsound practices or is in an unsafe or unsound condition.

Though not expected, the imposition of any of these measures on the Banks may have a substantial adverse effect on them and on the Company's operations and profitability. Meta Financial shareholders do not have preemptive rights, and therefore, if Meta Financial is directed by the OTS, the FRB or the FDIC to issue additional shares of Common Stock, such issuance may result in the dilution in shareholders percentage of ownership of Meta Financial.

*Limitations on Dividends and Other Capital Distributions.* The OTS imposes various restrictions on savings associations with respect to their ability to make distributions of capital, which include dividends, stock redemptions or repurchases, cash-out mergers and other transactions charged to the capital account. The OTS also prohibits a savings association from declaring or paying any dividends or from repurchasing any of its stock if, as a result of such action, the regulatory capital of the association

would be reduced below the amount required to be maintained for the liquidation account established in connection with the association's mutual to stock conversion.

Savings institutions such as MetaBank may make a capital distribution without the approval of the OTS, provided they notify the OTS 30-days before they declare the capital distribution and they meet the following requirements: (i) have a regulatory rating in one of the two top examination categories, (ii) are not of supervisory concern, and will remain adequately- or well-capitalized, as defined in the OTS prompt corrective action regulations, following the proposed distribution, and (iii) the distribution does not exceed their net income for the calendar year-to-date plus retained net income for the previous two calendar years (less any dividends previously paid). If a savings institution does not meet the above stated requirements, it must obtain the prior approval of the OTS before declaring any proposed distributions.

MetaBank WC may pay dividends, in cash or property, only out of its undivided profits. In addition, FRB regulations prohibit the payment of dividends by a state member bank if losses have at any time been sustained by such bank that equal or exceed its undivided profits then on hand, unless (i) the prior approval of the FRB has been obtained, and (ii) at least two-thirds of the shares of each class of stock outstanding have approved the dividend payment. FRB regulations also prohibit the payment of any dividend by a state member bank without the prior approval of the FRB if the total of all dividends declared by the bank in any calendar year exceeds the total of its net profits for that year combined with its retained net profits of the previous two calendar years (minus any required transfers to a surplus or to a fund for the retirement of any preferred stock).

*Qualified Thrift Lender Test.* All savings associations, including MetaBank, are required to meet a qualified thrift lender ( QTL ) test to avoid certain restrictions on their operations. This test requires a savings association to have at least 65% of its portfolio assets (as defined by regulation) in qualified thrift investments on a monthly average for nine out of every 12 months on a rolling basis or meet the requirements for a domestic building and loan association under the Internal Revenue Code. Under either test, the required assets primarily consist of residential housing related loans and investments. At September 30, 2006, MetaBank met the test and has always met the test since its effectiveness.

Any savings association that fails to meet the QTL test must convert to a national bank charter, unless it requalifies as a QTL within one year and thereafter remains a QTL, or limits its new investments and activities to those permissible for both a savings association and a national bank. In addition, the association is subject to national bank limits for payment of dividends and branching authority. If such association has not requalified or converted to a national bank within three years after the failure, it must divest of all investments and cease all activities not permissible for a national bank.

*Community Reinvestment Act.* Under the Community Reinvestment Act ( CRA ), every FDIC insured institution has a continuing and affirmative obligation consistent with safe and sound banking practices to help meet the credit needs of its entire community, including low- and moderate-income neighborhoods. The CRA does not establish specific lending requirements or programs for financial institutions nor does it limit an institution's discretion to develop the types of products and services that it believes are best suited to its particular community. The CRA requires the OTS and the FRB, in connection with the examination of MetaBank and MetaBank WC, respectively, to assess the institution's record of meeting the credit needs of its community and to take such record into account in its evaluation of certain applications, such as a merger or the establishment of a branch, by the institution. An unsatisfactory rating may be used as the basis for the denial of such an application. MetaBank and MetaBank WC were examined for CRA compliance in August 2004.



*Interstate Banking and Branching.* The FRB may approve an application of an adequately capitalized and adequately managed bank holding company to acquire control of, or acquire all or substantially all of the assets of, a bank located in a state other than such holding company's home state, without regard to whether the transaction is prohibited by the laws of any state. In general, the FRB may not approve the acquisition of a bank that has not been in existence for the minimum time period (not exceeding five years) specified by the statutory law of the host state or if the applicant (and its depository institution affiliates) controls or would control more than 10% of the insured deposits in the United States or 30% or more of the deposits in the target bank's home state or in any state in which the target bank maintains a branch. Iowa has adopted a five year minimum existence requirement.

The federal banking agencies are also generally authorized to approve interstate merger transactions without regard to whether such transaction is prohibited by the law of any state. Interstate acquisitions of branches or the establishment of a new branch is permitted only if the law of the state in which the branch is located permits such acquisitions. Interstate mergers and branch acquisitions are also subject to the nationwide and statewide insured deposit concentration amounts described above. Iowa permits interstate branching only by merger.

*Holding Company Dividends.* The FRB has issued a policy statement on the payment of cash dividends by bank holding companies, which expresses the FRB's view that a bank holding company should pay cash dividends only to the extent that its net income for the past year is sufficient to cover both the cash dividends and a rate of earning retention that is consistent with the holding company's capital needs, asset quality and overall financial condition. The FRB also indicated that it would be inappropriate for a company experiencing serious financial problems to borrow funds to pay dividends. Furthermore, under the prompt corrective action regulations adopted by the FRB, the FRB may prohibit a bank holding company from paying any dividends if the holding company's bank subsidiary is classified as undercapitalized.

Bank holding companies are required to give the FRB prior written notice of any purchase or redemption of its outstanding equity securities if the gross consideration for the purchase or redemption, when combined with the net consideration paid for all such purchases or redemptions during the preceding 12 months, is equal to 10% or more of their consolidated net worth. The FRB may disapprove such a purchase or redemption if it determines that the proposal would constitute an unsafe or unsound practice or would violate any law, regulation, FRB order, or any condition imposed by, or written agreement with, the FRB. This notification requirement does not apply to any company that meets the well-capitalized standard for commercial banks, has a safety and soundness examination rating of at least a 2 and is not subject to any unresolved supervisory issues.

*Holding Company Capital Requirements.* The FRB has established capital requirements for bank holding companies that generally parallel the capital requirements for federal thrift institutions and commercial banks such as MetaBank and MetaBank WC. Meta Financial is in compliance with these requirements.

*Transactions with Affiliates.* The Banks must comply with Sections 23A and 23B of the Federal Reserve Act relative to transactions with affiliates. Generally, transactions between an institution or its subsidiaries and its affiliates are required to be on terms as favorable to the bank as transactions with non-affiliates. In addition, certain of these transactions, such as loans to an affiliate, are restricted to a percentage of the institutions' capital. Affiliates of the Banks include the Corporation and any company that is under common control with the Banks. In addition, a savings institution may not lend to any affiliate engaged in activities not permissible for a savings and loan holding company or acquire the securities of most affiliates. The OTS has the discretion to treat subsidiaries of savings institutions as affiliates on a case-by-case basis.

On April 1, 2003, the Federal Reserve's Regulation W, which comprehensively amends sections 23A and 23B of the Federal Reserve Act, became effective. The Federal Reserve Act and Regulation W are applicable to the Banks. The Regulation unifies and updates staff interpretations issued over the years, incorporates several new interpretative proposals (such as to clarify when transactions with an unrelated third party will be attributed to an affiliate) and addresses new issues arising as a result of the expanded scope of non-banking activities engaged in by banks and bank holding companies in recent years and authorized for financial holding companies under the Financial Services Modernization Act of 1999.

Certain transactions with directors, officers or controlling persons are also subject to conflict of interest regulations. These conflict of interest regulations and other statutes also impose restrictions on loans to such persons and their related interests. Among other things, such loans must be made on terms substantially the same as for loans to unaffiliated individuals.

*Federal Home Loan Bank System.* MetaBank and MetaBank WC are both members of the FHLB of Des Moines, which is one of 12 regional FHLBs that administers the home financing credit function of savings associations. Each FHLB serves as a reserve or central bank for its members within its assigned region. It makes loans to members (i.e., advances) in accordance with policies and procedures established by the board of directors of the FHLB. These policies and procedures are subject to the regulation and oversight of the Federal Housing Finance Board. All advances from the FHLB are required to be fully secured by sufficient collateral as determined by the FHLB. In addition, all long-term advances must be used for residential home financing.

As members of the FHLB System, MetaBank and MetaBank WC are required to purchase and maintain stock in the FHLB of Des Moines. At September 30, 2006, the Banks had in the aggregate \$5.64 million in FHLB stock, which was in compliance with this requirement. For the fiscal year ended September 30, 2006, dividends paid by the FHLB of Des Moines to MetaBank and MetaBank WC totaled \$240,712.

Under federal law, the FHLBs are required to provide funds for the resolution of troubled savings associations and to contribute to low- and moderately priced housing programs through direct loans or interest subsidies on advances targeted for community investment and low- and moderate-income housing projects. These contributions have affected adversely the level of FHLB dividends paid and could continue to do so in the future. These contributions could also have an adverse effect on the value of FHLB stock in the future. A reduction in value of the Banks' FHLB stock may result in a corresponding reduction in the Banks' capital. Recent legislative changes have required the FHLB to change the characteristics and amount of FHLB stock held by its members. It is also anticipated that these changes will restrict the ability of FHLB members to redeem their shares of FHLB stock. In addition, the federal agency that regulates the FHLBs has required each FHLB to register its stock with the SEC, which will increase the costs of each FHLB and may have other effects that are not possible to predict at this time.

*Federal Securities Law.* The common stock of Meta Financial is registered with the SEC under the Exchange Act, as amended. Meta Financial is subject to the information, proxy solicitation, insider trading restrictions and other requirements under the Exchange Act.

Meta Financial's stock held by persons who are affiliates (generally officers, directors and principal stockholders) of the Company may not be resold without registration unless sold in accordance with certain resale restrictions. If Meta Financial meets specified current public information requirements, each affiliate of the Company, subject to certain requirements, will be able to sell, in the public market, without registration, a limited number of shares in any three-month period.

## Federal and State Taxation

*Federal Taxation.* Meta Financial and its subsidiaries file consolidated federal income tax returns on a fiscal year basis using the accrual method of accounting. In addition to the regular income tax, corporations, including savings banks such as MetaBank, generally are subject to a minimum tax. An alternative minimum tax is imposed at a minimum tax rate of 20% on alternative minimum taxable income, which is the sum of a corporation's regular taxable income (with certain adjustments) and tax preference items, less any available exemption. The alternative minimum tax is imposed to the extent it exceeds the corporation's regular income tax and net operating losses can offset no more than 90% of alternative minimum taxable income.

To the extent earnings appropriated to a savings bank's bad debt reserves and deducted for federal income tax purposes exceed the allowable amount of such reserves computed under the experience method and to the extent of the bank's supplemental reserves for losses on loans (Excess), such Excess may not, without adverse tax consequences, be utilized for the payment of cash dividends or other distributions to a shareholder (including distributions on redemption, dissolution or liquidation) or for any other purpose (except to absorb bad debt losses). As of September 30, 2006, MetaBank's Excess for tax purposes totaled approximately \$6.7 million.

Meta Financial and its consolidated subsidiaries have not been audited by the IRS within the past ten years. In the opinion of management, any examination of still open returns (including returns of subsidiaries and predecessors of, or entities merged into, Meta Financial) would not result in a deficiency which could have a material adverse effect on the financial condition of Meta Financial and its subsidiaries.

*Iowa Taxation.* MetaBank and MetaBank WC file Iowa franchise tax returns. Meta Financial and MetaBank's Iowa subsidiary file a consolidated Iowa corporation tax return on a fiscal year-end basis.

Iowa imposes a franchise tax on the taxable income of mutual and stock savings banks and commercial banks. The tax rate is 5%, which may effectively be increased, in individual cases, by application of a minimum tax provision. Taxable income under the franchise tax is generally similar to taxable income under the federal corporate income tax, except that, under the Iowa franchise tax, no deduction is allowed for Iowa franchise tax payments and taxable income includes interest on state and municipal obligations. Interest on U.S. obligations is taxable under the Iowa franchise tax and under the federal corporate income tax. The taxable income for Iowa franchise tax purposes is apportioned to Iowa through the use of a one-factor formula consisting of gross receipts only.

Taxable income under the Iowa corporate income tax is generally similar to taxable income under the federal corporate income tax, except that, under the Iowa tax, no deduction is allowed for Iowa income tax payments; interest from state and municipal obligations is included in income; interest from U.S. obligations is excluded from income; and 50% of federal corporate income tax payments are deductible from income. The Iowa corporate income tax rates range from 6% to 12% and may be effectively increased, in individual cases, by application of a minimum tax provision.

*South Dakota Taxation.* MetaBank and Meta Trust Company file a consolidated South Dakota franchise tax return due to their operations in Sioux Falls and Brookings. The South Dakota franchise tax is imposed on depository institutions and trust companies. Meta Financial, MetaBank WC and MetaBank's subsidiaries are therefore not subject to the South Dakota franchise tax.

South Dakota imposes a franchise tax on the taxable income of depository institutions and trust companies at the rate of 6%. Taxable income under the franchise tax is generally similar to taxable income under the federal corporate income tax, except that, under the South Dakota franchise tax, no deduction is allowed for state income and franchise taxes, income from municipal obligations exempt from federal taxes are included in the franchise taxable income, and there is a deduction allowed for federal income taxes accrued for the fiscal year. The taxable income for South Dakota franchise tax purposes is apportioned to South Dakota through the use of a three-factor formula consisting of tangible real and personal property, payroll and gross receipts.

*Delaware Taxation.* As a Delaware holding company, Meta Financial is exempted from Delaware corporate income tax but is required to file an annual report with and pay an annual fee to the State of Delaware. Meta Financial is also subject to an annual franchise tax imposed by the State of Delaware.

### **Competition**

The Company faces strong competition, both in originating real estate and other loans and in attracting deposits. Competition in originating real estate loans comes primarily from commercial banks, savings banks, credit unions, captive finance companies, insurance companies, and mortgage bankers making loans secured by real estate located in the Company's market area. Commercial banks and credit unions provide vigorous competition in consumer lending. The Company competes for real estate and other loans principally on the basis of the quality of services it provides to borrowers, interest rates and loan fees it charges, and the types of loans it originates.

The Company attracts all of its deposits through its retail banking offices, primarily from the communities in which those retail banking offices are located; therefore, competition for those deposits is principally from other commercial banks, savings banks, credit unions and brokerage offices located in the same communities. The Company competes for these deposits by offering a variety of deposit accounts at competitive rates, convenient business hours, and convenient branch locations with interbranch deposit and withdrawal privileges at each.

The Company serves Adair, Buena Vista, Dallas, Guthrie, Pocahontas, Polk and Sac counties in Iowa and Brookings, Lincoln and Minnehaha counties in South Dakota. There are twenty-three commercial banks, one savings bank other than MetaBank, and two credit unions which compete for deposits and loans in MetaBank's primary market area in northwest Iowa and ten commercial banks, one savings bank other than MetaBank, and two credit unions which compete for deposits and loans in MetaBank's market area in Brookings, South Dakota. In addition, there are twelve commercial banks in MetaBank WC's primary market area in west central Iowa. The Banks compete for deposits and loans with numerous financial institutions located throughout the metropolitan market areas of Des Moines, Iowa and Sioux Falls, South Dakota.

### **Employees**

At September 30, 2006, the Company and its subsidiaries had a total of 257 employees, including 28 part-time employees.

### **Executive Officers of the Company Who Are Not Directors**

The following information as to the business experience during the past five years is supplied with respect to the executive officers of the Company who do not serve on the Company's Board of

Directors. There are no arrangements or understandings between such persons named and any persons pursuant to which such officers were selected.

On June 27, 2005, Mr. Troy Moore III was named Executive Vice President and Chief Operating Officer of the Company and MetaBank. Additionally, Mr. Moore became a member of the Executive Committees of both the Company and MetaBank. Previously, Mr. Moore, age 38, had been the president of the Central Iowa Market of MetaBank, a position he had held since 1998. He joined MetaBank in 1997 as a Vice President in the Central Iowa Market. Mr. Moore received a Bachelor of Business Administration degree from Iowa State University, Ames, Iowa. Mr. Moore is the son-in-law of James S. Haahr, the Company's Chairman of the Board, and the brother-in-law of J. Tyler Haahr, the Company's President and Chief Executive Officer.

Mr. Jonathan M. Gaiser, age 39, joined Meta Financial as Senior Vice President, Secretary, Treasurer, and Chief Financial Officer in January 2006. Mr. Gaiser was previously First Vice President and Assistant Treasurer at Commercial Federal Bank in Omaha, Nebraska. Mr. Gaiser received a Bachelor of Arts degree from St. Olaf College in Northfield, Minnesota, and a Master of Business Administration degree from George Washington University in Washington, D.C. Mr. Gaiser also holds a Chartered Financial Analyst professional designation.

**Item 1A. Risk Factors**

The Company's business could be harmed by any of the risks noted below. The trading price of the Company's common stock could decline due to any of these risks, and you may lose all or part of your investment. In assessing these risks you should also refer to the other information contained in this annual report on Form 10-K, including the Company's financial statements and related notes.

**Risks Related to the Banking Industry**

*Changes in economic and political conditions could adversely affect the Company's earnings, as the Company's borrowers' ability to repay loans and the value of the collateral securing the Company's loans decline.*

The Company's success depends, to a certain extent, upon economic and political conditions, local and national, as well as governmental monetary policies. Conditions such as inflation, recession, unemployment, changes in interest rates, money supply and other factors beyond the Company's control may adversely affect the Company's asset quality, deposit levels and loan demand and, therefore, the Company's earnings. Because the Company has a significant amount of real estate loans, decreases in real estate values could adversely affect the value of property used as collateral. Adverse changes in the economy may also have a negative effect on the ability of the Company's borrowers to make timely repayments of their loans, which would have an adverse impact on the Company's earnings. In addition, substantially all of the Company's loans are to individuals and businesses in the Company's market area. Consequently, any economic decline in the Company's market area could have an adverse impact on the Company's earnings.

***Changes in interest rates could adversely affect the Company's results of operations and financial condition.***

The Company's earnings depend substantially on the Company's interest rate spread, which is the difference between (i) the rates we earn on loans, securities and other earning assets, and (ii) the interest rates we pay on deposits and other borrowings. These rates are highly sensitive to many factors beyond the Company's control, including general economic conditions and the policies of various governmental and regulatory authorities. As market interest rates rise, we will have competitive pressures to increase the rates we pay on deposits, which may result in a decrease of the Company's net interest income. Conversely, if interest rates fall, yields on loans and investments may fall. Because a significant portion of the Company's deposit portfolio is in non-interest bearing accounts, such a change in rates would likely result in a decrease in the Company's net interest income. For additional information, see Item 7A, herein.

***The Company operates in a highly regulated environment, and changes in laws and regulations to which we are subject may adversely affect the Company's results of operations.***

MetaBank and MetaBank WC (collectively, the Banks) and the Company operate in a highly regulated environment and are subject to extensive regulation, supervision and examination by the Office of Thrift Supervision (OTS), the State of Iowa, the Federal Deposit Insurance Corporation (FDIC), and the Board of Governors of the Federal Reserve System (the Federal Reserve). See Business Regulation herein. Applicable laws and regulations may change, and there is no assurance that such changes will not adversely affect the Company's business. Such regulation and supervision govern the activities in which an institution may engage, including the activities of MetaBank's Meta Payment Systems Division, and are intended primarily for the protection of the Banks and their depositors. Regulatory authorities have extensive discretion in connection with their supervisory and enforcement activities, including but not limited to the imposition of restrictions on the operation of an institution, the classification of assets by the institution and the adequacy of an institution's allowance for loan losses. Any change in such regulation and oversight, whether in the form of restrictions on activities, regulatory policy, regulations, or legislation, including but not limited to changes in the regulations governing savings banks, could have a material impact on the bank and the Company's operations.

***Changes in technology could be costly.***

The banking industry is undergoing technological innovation at a fast pace. To keep up with its competition, the Company needs to stay abreast of innovations and evaluate those technologies that will enable it to compete on a cost-effective basis. This is especially true with respect to MetaBank's Meta Payment Systems Division. The cost of such technology, including personnel, can be high in both absolute and relative terms. There can be no assurance, given the fast pace of change and innovation, that the Company's technology, either purchased or developed internally, will meet or continue to meet the needs of the Company.

**Risks Related to the Company's Business**

***The Company operates in an extremely competitive market, and the Company's business will suffer if it is unable to compete effectively.***

In the Company's market area, the Banks encounter significant competition from other commercial banks, savings and loan associations, credit unions, mortgage banking firms, consumer finance companies, securities brokerage firms, insurance companies, money market mutual funds and

other financial intermediaries. Many of the Banks' competitors have substantially greater resources and lending limits and may offer services that the Bank does not or cannot provide. The Company's profitability depends upon the Company's continued ability to compete successfully in the Company's market area. The Meta Payment Systems Division operates on a national scale against competitors with substantially greater resources and limited barriers to entry. The Division's success depends upon its ability to compete in such an environment.

*The loss of key members of the Company's senior management team could adversely affect the Company's business.*

We believe that the Company's success depends largely on the efforts and abilities of the Company's senior management. Their experience and industry contacts significantly benefit us. The competition for qualified personnel in the financial services industry is intense, and the loss of any of the Company's key personnel or an inability to continue to attract, retain and motivate key personnel could adversely affect the Company's business.

*The Company's loan portfolio includes loans with a higher risk of loss.*

The Banks originate commercial mortgage loans, commercial loans, consumer loans, agricultural mortgage loans, agricultural loans and residential mortgage loans primarily within the Company's market areas. Commercial mortgage, commercial, and consumer loans may expose a lender to greater credit risk than loans secured by residential real estate because the collateral securing these loans may not be sold as easily as residential real estate. These loans also have greater credit risk than residential real estate for the following reasons:

*Commercial Mortgage Loans.* Repayment is dependent upon income being generated in amounts sufficient to cover operating expenses and debt service.

*Commercial Loans.* Repayment is dependent upon the successful operation of the borrower's business.

*Consumer Loans.* Consumer loans (such as personal lines of credit) are collateralized, if at all, with assets that may not provide an adequate source of payment of the loan due to depreciation, damage, or loss.

*Agricultural Loans.* Repayment is dependent upon the successful operation of the business, which are greatly dependent on many things outside the control of either the Banks or the borrowers. These factors include weather, commodity prices, and interest rates among others.

***If the Company's actual loan losses exceed the Company's allowance for loan losses, the Company's net income will decrease.***

The Company makes various assumptions and judgments about the collectibility of the Company's loan portfolio, including the creditworthiness of the Company's borrowers and the value of the real estate and other assets serving as collateral for the repayment of the Company's loans. Despite the Company's underwriting and monitoring practices, the Company's loan customers may not repay their loans according to their terms, and the collateral securing the payment of these loans may be insufficient to pay any remaining loan balance. The Company may experience significant loan losses, which could have a material adverse effect on its operating results. Because the Company must use assumptions regarding individual loans and the economy, the current allowance for loan losses may not be sufficient to cover actual loan losses, and increases in the allowance may be necessary. The Company may need to significantly increase the Company's provision for losses on loans if one or more of the Company's larger loans or credit relationships becomes delinquent or if we continue to expand the Company's commercial real estate and commercial lending. In addition, federal and state regulators periodically review the Company's allowance for loan losses and may require the Company to increase the Company's provision for loan losses or recognize loan charge-offs. Material additions to the Company's allowance would materially decrease the Company's net income. The Company cannot assure you that its monitoring procedures and policies will reduce certain lending risks or that the Company's allowance for loan losses will be adequate to cover actual losses.

***If the Company forecloses on and takes ownership of real estate collateral property, it may be subject to the increased costs associated with the ownership of real property, resulting in reduced revenues.***

The Company may have to foreclose on collateral property to protect its investment and may thereafter own and operate such property. In such case the Company will be exposed to the risks inherent in the ownership of real estate. The amount that the Company, as a mortgagee, may realize after a default is dependent upon factors outside of the Company's control, including, but not limited to: (i) general or local economic conditions; (ii) neighborhood values; (iii) interest rates; (iv) real estate tax rates; (v) operating expenses of the mortgaged properties; (vi) supply of and demand for rental units or properties; (vii) ability to obtain and maintain adequate occupancy of the properties; (viii) zoning laws; (ix) governmental rules, regulations and fiscal policies; and (x) acts of God. Certain expenditures associated with the ownership of real estate, principally real estate taxes and maintenance costs, may adversely affect the income from the real estate. Therefore, the cost of operating a real property may exceed the rental income earned from such property, and the Company may have to advance funds in order to protect the Company's investment, or may be required to dispose of the real property at a loss. The foregoing expenditures and costs could adversely affect the Company's ability to generate revenues, resulting in reduced levels of profitability.

***Environmental liability associated with commercial lending could have a material adverse effect on the Company's business, financial condition and results of operations.***

In the course of the Company's business, it may acquire, through foreclosure, commercial properties securing loans that are in default. There is a risk that hazardous substances could be discovered on those properties. In this event, the Company could be required to remove the substances from and remediate the properties at its own cost and expense. The cost of removal and environmental remediation could be substantial. The Company may not have adequate remedies against the owners of the properties or other responsible parties and could find it difficult or impossible to sell the affected properties. These



events could have a material adverse effect on the Company's business, financial condition and operating results.

*If the Company fails to maintain an effective system of internal control over financial reporting, it may not be able to accurately report the Company's financial results or prevent fraud, and, as a result, investors and depositors could lose confidence in the Company's financial reporting, which could adversely affect the Company's business, the trading price of the Company's stock and the Company's ability to attract additional deposits.*

Unless it further delays or curtails its proposed rule, beginning with the Company's annual report for the fiscal year ending September 30, 2007, the Company will have to include in its annual reports filed with the Securities and Exchange Commission (the Commission) a report of the Company's management regarding internal control over financial reporting. As a result, and although it is unclear whether, or to what extent, smaller companies will be exempted from its requirements, we recently have begun to document and evaluate the Company's internal control over financial reporting in order to satisfy the requirements of Section 404 of the Sarbanes-Oxley Act of 2002 (the Sarbanes-Oxley Act) and Commission rules and regulations, which require an annual management report on the Company's internal control over financial reporting, including, among other matters, management's assessment of the effectiveness of internal control over financial reporting and an attestation report by the Company's independent auditors addressing these assessments. Accordingly, management has retained outside consultants to assist the Company in (i) assessing and documenting the adequacy of the Company's internal control over financial reporting, (ii) improving control processes, where appropriate, and (iii) verifying through testing that controls are functioning as documented. If the Company fails to identify and correct any significant deficiencies in the design or operating effectiveness of the Company's internal control over financial reporting or fails to prevent fraud, current and potential stockholders and depositors could lose confidence in the Company's financial reporting, which could adversely affect the Company's business, financial condition and results of operations, the trading price of the Company's stock, and the Company's ability to attract additional deposits.

*A breach of information security or compliance breach by one of the Company's agents or vendors could negatively affect the Company's reputation and business.*

The Banks, including the Meta Payment Systems Division of MetaBank, depend on data processing, communication and information exchange on a variety of computing platforms and networks and over the internet. The Company cannot be certain all of its systems are entirely free from vulnerability to attack, despite safeguards it has installed. Additionally, the Company relies on and does business with a variety of third-party service providers, agents and vendors with respect to the Company's business, data and communications needs. If information security is breached, or one of the Company's agents or vendors breaches compliance procedures, information could be lost or misappropriated, resulting in financial loss or costs to the Company or damages to others. These costs or losses could materially exceed the Company's amount of insurance coverage, if any, which would adversely affect the Company's business.

#### **Risks Related to the Company's Stock**

*The Company's common stock is thinly traded, and thus your ability to sell shares or purchase additional shares of the Company's common stock will be limited, and the market price at any time may not reflect true value.*

Your ability to sell shares of the Company's common stock or purchase additional shares largely depends upon the existence of an active market for the common stock. The Company's common stock is quoted on NASDAQ Stock Market, but the volume of trades on any given day is light, and you may be unable to find a buyer for shares you wish to sell or a seller of additional shares you wish to purchase. In addition, a fair valuation of the purchase or sales price of a share of common stock also depends upon active trading, and thus the price you receive for a thinly traded stock, such as the Company's common stock, may not reflect its true value.

***Future sales or additional issuances of the Company's capital stock may depress prices of shares of the Company's common stock or otherwise dilute the book value of shares then outstanding.***

Sales of a substantial amount of the Company's capital stock in the public market or the issuance of a significant number of shares could adversely affect the market price for shares of the Company's common stock. As of September 30, 2006, the Company was authorized to issue up to 5,200,000 shares of common stock, of which 2,534,367 shares were outstanding, and 423,632 shares were held as treasury stock. The Company was also authorized to issue up to 800,000 shares of preferred stock, none of which is outstanding or reserved for issuance. Accordingly, and although it has no plans to do so, without further stockholder approval, the Company may issue up to 2,242,001 additional shares of common stock and up to 800,000 shares of preferred stock, which obviously may affect the market price for shares of the Company's common stock.

***The price of the Company's common stock may be volatile, which may result in losses for investors.***

The market price for shares of the Company's common stock has been volatile in the past, and several factors could cause the price to fluctuate substantially in the future. These factors include:

- announcements of developments related to the Company's business,
- fluctuations in the Company's results of operations,
- sales of substantial amounts of the Company's securities into the marketplace,
- general conditions in the Company's banking niche or the worldwide economy,
- a shortfall in revenues or earnings compared to securities analysts' expectations,
- lack of an active trading market for the common stock,
- changes in analysts' recommendations or projections, and
- the Company's announcement of new acquisitions or other projects.

The market price of the Company's common stock may fluctuate significantly in the future, and these fluctuations may be unrelated to the Company's performance. General market price declines or market volatility in the future could adversely affect the price of the Company's common stock, and the current market price may not be indicative of future market prices.

*Federal regulations may inhibit a takeover, prevent a transaction you may favor or limit the Company's growth opportunities, which could cause the market price of the Company's common stock to decline.*

Certain provisions of the Company's charter documents and federal regulations could have the effect of making it more difficult for a third party to acquire, or of discouraging a third party from attempting to acquire, control of the company. In addition, the Company must obtain approval from regulatory authorities before it can acquire control of any other company.

*The Company may not be able to pay dividends in the future in accordance with past practice.*

The Company pays a quarterly dividend to stockholders. The payment of dividends is subject to legal and regulatory restrictions. Any payment of dividends in the future will depend, in large part, on the Bank's earnings, capital requirements, financial condition and other factors considered relevant by the Company's Board of Directors.

**Item 1B. Unresolved Staff Comments**

Not Applicable.

**Item 2. Properties**

The Company conducts its business at its main office and branch office in Storm Lake, Iowa, and four other locations in its primary market area in Northwest Iowa. The Company also operates one office in Brookings, South Dakota; five offices in Des Moines, Iowa.; four offices in Sioux Falls, South Dakota.; and three offices in West Central Iowa through the Company's MetaBank WC State Bank subsidiary. In addition, the Company leases space at another facility in Sioux Falls, which houses general corporate functions.

The Company owns all of its offices, except for the branch offices located in Storm Lake Plaza, Storm Lake, Iowa, on Westown Parkway, West Des Moines, Iowa, on North Minnesota Avenue, Sioux Falls, South Dakota, on South Western Avenue, Sioux Falls, South Dakota, on West 12th Street, Sioux Falls, South Dakota, and the administrative offices located on 69<sup>th</sup> and Minnesota in Sioux Falls. In regard to the South Western and West 12<sup>th</sup> Street locations in Sioux Falls, South Dakota, the land on which the buildings were constructed is leased. The total net book value of the Company's premises and equipment (including land, building and leasehold improvements and furniture, fixtures and equipment) at September 30, 2006 was \$17.6 million. See Note 7 of Notes to Consolidated Financial Statements in the Annual Report.

The Company is experiencing rapid growth, particularly as a result of growth of the Meta Payment Systems Division. While current facilities are adequate to meet its present needs, the Company will likely continue to add additional branches in the future, and may be required to expand capacity for administrative support functions.

The Bank maintains an on-line data base with a service bureau, whose primary business is providing such services to financial institutions. The net book value of the data processing and computer equipment utilized by the Company at September 30, 2006 was approximately \$1.3 million.

**Item 3. Legal Proceedings**

On June 11, 2004, the Sioux Falls School District filed suit in the Second Judicial Circuit Court alleging that MetaBank, a wholly-owned subsidiary of the Company, improperly allowed funds, which belonged to the school district, to be deposited into, and subsequently withdrawn from, a corporate account established by an employee of the school district. The school district is seeking in excess of \$600,000. MetaBank has submitted the claim to its insurance carrier, and is working with counsel to vigorously contest the suit.

On or about March 10, 2006, plaintiffs filed five class-action suits on behalf of themselves and all other purchasers of vehicles from Prairie Auto Group, Inc., Dan Nelson Automotive Group, Inc.'s Rapid City, South Dakota location, and other not-yet-identified auto sales entities owned or operated by defendants. The complaints are styled as follows: Ronald Archullea, et al. v. Prairie Auto Group, Inc., et al. - In the Tribal Court for the Oglala Sioux Tribe, Pine Ridge Indian Reservation; Cedar Around Him, et al. v. Prairie Auto Group, Inc., et al. - In the Tribal Court for the Rosebud Sioux Tribe, Rosebud Indian Reservation; Chris Dengler, et al. v. Prairie Auto Group, Inc. - Circuit Court of the Second Judicial Circuit, Minnehaha County, South Dakota; Lucinda Janis, et al. v. Prairie Auto Group, Inc., et al. - File No. C-157-04; In the Tribal Court for the Cheyenne River Sioux Indian Reservation, Eagle Butte, South Dakota; and Kali Treetop, et al. v. Prairie Auto Group, Inc., et al. - File No. 01-970; Circuit Court for the Seventh Judicial Circuit, Pennington County, South Dakota. Except for the named plaintiffs, each of the complaints is essentially identical to the others. The nature of the allegations are the same, and the same fourteen legal claims are sought to be pled in each.

Each complaint states that it is a companion to the other four and names the same defendants (approximately twenty-five) including the Registrant and affiliates thereof (the MetaBank Defendants). None of these complaints has yet been served on any of the MetaBank Defendants. The thrust of the complaints is that plaintiffs allegedly suffered damages as a result of a scheme by defendants to use fraudulent statements, misrepresentations and omissions to sell vehicles and extended warranties to plaintiffs. Plaintiffs claim that they and other similarly situated purchasers paid too much for their vehicles and were induced to buy warranties that were not honored and otherwise proved worthless. Plaintiffs allege that defendants reaped considerable profits through fraudulent sales methods; by refusing to make warranted repairs; and by engaging in usurious repossession and resale practices. Plaintiffs allege that these practices were part of a business plan that originated with the franchisor-defendants and was purchased and employed by the franchisee-defendants. It appears that the principal basis for naming the MetaBank Defendants is that they loaned money to finance some of the defendants' business operations, purportedly with some degree of knowledge about the defendants' allegedly abusive consumer practices.

The complaints allege that the described transactions are typical of defendants' business and were part of a deliberate scheme directed primarily at Native American customers. The complaints allege that the franchisee-defendants engaged in coercive, fraudulent and other illegal activities in connection with the automobile sales, and each seeks to state claims for: (1) breach of express warranty; (2) breach of implied warranty of merchantability; (3) deceit/fraud; (4) violation of applicable deceptive trade laws; (5) breach of the implied covenant of good faith and fair dealing; (6) conversion; (7) civil conspiracy under tribal and state common law; (8) negligent hiring, training and supervision of employees; (9) violation of the Federal Equal Credit Opportunity Act; (10) invasion of privacy; (11) violation of the Racketeer Influenced and Corrupt Organizations Act (RICO); (12) violation of the Magnuson-Moss Act; (13) violation of the Federal Truth and Lending Act's (TILA) Three Day Rescission Period; and (14) violation of TILA's Disclosure of Finance Cost Requirement.

In addition to seeking certification as a class, plaintiffs seek cancellation of the automobile purchase contracts; monetary damages including the initial purchase price warranty charges, finance costs and related repossession and other charges; costs of allegedly warranted repairs that were not

made by defendants; consequential damages relating to the alleged wrongful repossession of vehicles and deficiency judgments associated therewith; damages for emotional and mental suffering; punitive and treble damages; and attorneys' fees. The amount of the alleged damages is not specified in the complaints.

Each participation agreement with the ten participant banks provides that the participant bank shall own a specified percentage of the outstanding loan balance at any given time. Each agreement also recites the maximum amount that can be loaned by MetaBank on that particular loan. MetaBank allocated to some participants an ownership in the outstanding loan balance in excess of the percentage specified in the participation agreement. MetaBank believes that in each instance this was done with the full knowledge and consent of the participant. Several participants have demanded that their participations be adjusted to match the percentage specified in the participant agreement. Based on the total loan recoveries projected as of March 31, 2006, MetaBank calculated that it would cost approximately \$953,000 to adjust these participations as the participants would have them adjusted. A few participants have more recently asserted that MetaBank owes them additional monies based on additional legal theories. MetaBank denies any obligation to make the requested adjustments on these or related claims. Other than as disclosed below, MetaBank cannot predict at this time whether any of these claims will be the subject of litigation.

During the third and fourth quarters of fiscal 2006, four lawsuits were filed against the Company's MetaBank subsidiary. Three of the complaints are related to the Company's alleged actions in connection with its activities as lead lender to three companies involved in auto sales, service, and financing and their owner. The fourth complaint alleges patent infringement. All four actions are in their infancy and materiality cannot be determined at this time. The Company intends, however, to vigorously defend its actions.

First Midwest Bank-Deerfield Branches and Mid-Country Bank v. MetaBank (Civ. No. 06-2241). On June 28, 2006, First Midwest Bank-Deerfield Branches and Mid-Country Bank filed suit against MetaBank in South Dakota's Second Judicial Circuit Court, Minnehaha County, in the above titled action. The complaint alleges that plaintiff banks, who were participating lenders with MetaBank on a series of loans made to Dan Nelson Automotive Group (DNAG) and South Dakota Acceptance Corporation (SDAC), suffered damages exceeding \$1 million as a result of MetaBank's placement and administration of the loans that were the subject of the loan participation agreements. The complaint sounds in breach of contract, negligence, gross negligence, negligent misrepresentation, fraud in the inducement, unjust enrichment and breach of fiduciary duty. On July 17, 2006, MetaBank removed the case from state court to the United States District Court for the District of South Dakota, where the action has been assigned case no. Civ. 06-4114.

First Premier Bank v. MetaBank (Civ. No. 06-2277). On July 5, 2006, First Premier Bank filed suit against MetaBank in South Dakota's Second Judicial Circuit Court, Minnehaha County in the above titled action. The complaint alleges that First Premier, a participating lender with MetaBank on a series of loans made to SDAC, has suffered damages in an as yet undetermined amount as a result of MetaBank's actions in selling to First Premier a participation in a loan made to SDAC and MetaBank's actions in administering that loan. The complaint sounds in breach of contract, breach of covenant of good faith and fair dealing, fraudulent inducement, fraud, deceit, negligent misrepresentation, fraudulent misrepresentation, conversion, negligence, gross negligence, breach of fiduciary duty and unjust enrichment. On July 17, 2006, MetaBank removed the case from state court to the United States District Court for the District of South Dakota, where the action has been assigned case no. Civ. 06-4115.

Home Federal Bank v. J. Tyler Haahr, Daniel A. Nelson and MetaBank (Civ. No. 06-2230). On June 26, 2006, Home Federal Bank filed suit against MetaBank and two individuals, J. Tyler Haahr and

Daniel A. Nelson, in South Dakota's Second Judicial Circuit Court, Minnehaha County in the above titled action. The complaint alleges that Home Federal, a participating lender with MetaBank on a series of loans made to DNAG and SDAC, suffered damages exceeding \$3.8 million as a result of failure to make disclosures regarding an investigation of Nelson, DNAG and SDAC by the Iowa Attorney General at the time Home Federal agreed to an extension of the loan participation agreements. The complaint sounds in fraud, negligent misrepresentation, breach of fiduciary duty, conspiracy and breach of duty of good faith and fair dealing. Subject to a reservation of rights, our insurance carrier has agreed to cover the three claims described above.

Meridian Enterprises Corporation v. Bank of America Corporation et al. (Case No. 4:06-cv-01117CDP). On July 21, 2006, Meridian Enterprises Corporation ( Meridian ) filed suit against Meta Financial Group, Inc. (Meta Payment Systems division) ( Meta ) and other banks and financial institutions in the U.S. District Court for the Eastern District of Missouri in the above-titled action. Meridian is the owner of U.S. Patent No. 5,025,372 (the 372 Patent ). The complaint alleges that Meta and the co-defendants each sell, administer, process and/or sponsor an incentive program where cards are provided to participants in the incentive program that can be presented to retailers to make a purchase. The complaint further alleges, inter alia, that Meta and the co-defendants each use a computer to determine whether or not a participant's performance under the incentive program entitles the participant to an award, in which the computer also determines the amount of the award, and the amount of the award is based upon the level of the participant's performance in the incentive program. Accordingly, the complaint sounds in infringement, inducement of infringement, and contributory infringement of one or more claims of the 372 Patent.

There are no other material pending legal proceedings to which the Company or its subsidiaries is a party other than ordinary routine litigation incidental to their respective businesses.

**Item 4. Submission of Matters to a Vote of Security Holders**

No matter was submitted to a vote of security holders, through the solicitation of proxies or otherwise, during the quarter ended September 30, 2006.

**PART II**

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

Page 36 of the attached 2006 Annual Report to Shareholders is herein incorporated by reference.

There have been no purchases by the Company during the quarter ended September 30, 2006 of equity securities that are registered by the Company pursuant to Section 12 of the Exchange Act.

**Item 6. Selected Financial Data**

Page 2 of the attached 2006 Annual Report to Shareholders is herein incorporated by reference.

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

Pages 3 through 10 of the attached 2006 Annual Report to Shareholders are herein incorporated by reference.

**Item 7A. Quantitative and Qualitative Disclosure About Market Risk**

Pages 7 through 8 of the attached 2006 Annual Report to Shareholders are herein incorporated by reference.

**Item 8. Consolidated Financial Statements and Supplementary Data**

Pages 11 through 34 of the attached 2006 Annual Report to Shareholders are herein incorporated by reference.

**Item 9. Changes In and Disagreements With Accountants on Accounting and Financial Disclosure**

Not applicable.

**Item 9A. Controls and Procedures**

Any control system, no matter how well designed and operated, can provide only reasonable (not absolute) assurance that its objectives will be met. Furthermore, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected.

The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures, as such term is defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act as of the end of the period covered by the report.

Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that as of September 30, 2006 our disclosure controls and procedures were effective to provide reasonable assurance that (i) the information required to be disclosed by us in this Report was recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and

(ii) information required to be disclosed by us in our reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15(d)-15(f) under the Exchange Act) occurred during the fourth fiscal quarter of fiscal 2006 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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. 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-K 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 corrected 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.

**Item 9B. Other Information**

None.

**PART III**

**Item 10. Directors and Executive Officers of the Registrant**

Directors

Information concerning directors of the Company is incorporated herein by reference from the Company's definitive Proxy Statement for the Annual Meeting of Shareholders to be held in January 2007 filed on December 19, 2006.

Executive Officers

Information concerning the executive officers of the Company is incorporated herein by reference from the Company's definitive Proxy Statement for the Annual Meeting of Shareholders to be held in January 2007, filed on December 19, 2006 and from the information set forth under the caption Executive Officers of the Company Who Are Not Directors contained in Part I of this Form 10-K.

Compliance with Section 16(a)

Section 16(a) of the Exchange Act requires the Company's directors and executive officers, and persons who own more than 10% of a registered class of the Company's equity securities, to file with the SEC reports of ownership and reports of changes in ownership of common stock and other equity securities of the Company. Officers, directors and greater than 10% shareholders are required by SEC regulation to furnish the Company with copies of all Section 16(a) forms they file.



To the Company's knowledge, based solely on a review of the copies of such reports furnished to the Company and written representations that no other reports were required during the fiscal year ended September 30, 2006, all Section 16(a) filing requirements applicable to its officers, directors and greater than 10 percent beneficial owners were complied with.

#### **Audit Committee Financial Expert**

Information regarding the audit committee of the Company's Board of Directors, including information regarding Jeanne Partlow, the audit committee financial expert serving on the audit committee for fiscal 2005 and the first quarter of fiscal 2007, is presented under the headings Meetings and Committees, Audit Committee matters and under Election of Directors which contains Ms. Partlow's biography, in the Company's definitive Proxy Statement for the 2006 Annual Meeting of Stockholders to be held on January 22, 2007, which was filed with the SEC on December 19, 2006, and is incorporated herein by reference.

#### **Code of Ethics**

We have adopted a written code of ethics within the meaning of Item 406 of SEC Regulation S-K that applies to our principal executive officer and senior financial officers, a copy of which is available free of charge by contacting Lisa Binder, our Investor Relations Officer, at 800.792.6815 or from our internet website ([www.metacash.com](http://www.metacash.com)).

#### **Item 11. Executive Compensation**

Information concerning executive compensation is incorporated herein by reference from the Company's definitive Proxy Statement for the Annual Meeting of Shareholders to be held in January 2007, filed on December 19, 2006.

#### **Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

##### **(a) Security Ownership of Certain Beneficial Owners**

The information required by this item under the sections captioned Voting Rights; Vote Required, Voting of Proxies; Revocability of Proxies; Proxy Solicitation Costs and Stock Ownership on pages 2 through 5 of the Proxy Statement filed with the SEC on December 19, 2006 is incorporated herein by reference.

##### **(b) Security Ownership of Management**

The information required by this item under the section captioned Stock Ownership on pages 4 through 5 of the Proxy Statement filed with the SEC on December 19, 2006 is incorporated herein by reference.

##### **(c) Changes in Control**

Management of the Company knows of no arrangements, including any pledge by any persons of securities of the Company, the operation of which may, at a subsequent date, result in a change in control of the Registrant.

(d) Equity Compensation Plan Information

The Company maintains the 2002 Omnibus Incentive Plan for purposes of issuing stock based compensation to employees and directors. An amendment to this plan, authorizing an additional 200,000 shares to be issued under this plan, was approved by the Board of Directors on August 28, 2006, and will be submitted for shareholder approval at the annual meeting of shareholders on January 22, 2007. The Company also has unexercised options outstanding under a previous stock option plan. The following table provides information about the Company's common stock that may be issued under the Company's omnibus incentive plans.

| Plan Category  | Number of securities to be issued upon exercise of outstanding options, warrants and rights | Weighted-average exercise price of outstanding options, warrants and rights | Number of securities remaining available for future issuance under equity compensation plan (excluding securities reflected in (a)) |
|--|---|---|---|
| Equity compensation plans approved by shareholders     | 357,724   | \$19.42   | 0   |
| Equity Compensation plans not approved by shareholders | 28,701  | \$24.43   | 171,299   |

**Item 13. Certain Relationships and Related Transactions**

Information concerning certain relationships and transactions is incorporated herein by reference from the Company's definitive Proxy Statement for the Annual Meeting of Shareholders to be held in January 2007, filed on December 19, 2006.

**Item 14. Principal Accountant Fees and Services**

Audit Fees

Fees paid to McGladrey & Pullen, LLP and its associated entity, RSM McGladrey, Inc., for each of the last two fiscal years are set forth below.

| Fiscal Year | Audit Fees | Audit-Related Fees | Tax Fees | All Other Fees |
|-------------|------------|--------------------|----------|----------------|
| 2006        | \$114,000  | \$32,000           | \$21,000 | \$4,000        |
| 2005        | \$121,000  | \$20,000           | \$17,000 | \$             |

Audit fees consist of fees for audit of the Company's annual financial statements, review of financial statements included in the Company's quarterly reports on Form 10-Q and services normally provided by the independent auditor in connection with statutory and regulatory filings or engagements.

Audit related fees primarily consist of fees for audits of financial statements of the employee benefit plan maintained by the Company and assistance with accounting research matters.

All other fees consist of fees for an independence consultation regarding the hiring of an employee.

Tax fees consist of fees for tax consultation and tax compliance services for the Company and the employee benefit plan maintained by the Company.

The Company's Audit Committee has considered and concluded that the provision of all non-auditing services (and the aggregate fees billed for such services) in the fiscal year ended September 30, 2007 by McGladrey & Pullen, LLP, the principal independent public accountants, and RSM McGladrey, Inc. is compatible with maintaining the principal auditors' independence.

*Pre-Approval Policy* . The Audit Committee pre-approves all audit and permissible non-audit services provided by the independent auditors. The non-audit services include audit-related services and tax services. The Audit Committee's policy is to pre-approve all services and fees for up to one year, which approval includes the appropriate detail with regard to each particular service and its related fees. In addition, the Audit Committee can be convened on a case-by-case basis to approve any services not anticipated or services whose costs exceed the pre-approved amounts.

During the fiscal year ended September 30, 2006, 100% of all audit and permissible non-audit services were pre-approved by the Audit Committee.

**PART IV**

**Item 15. Exhibits, Financial Statement Schedules, and Reports on Form 8-K**

**The following is a list of documents filed as part of this report:**

**(a) Financial Statements:**

The following financial statements are incorporated by reference under Part II, Item 8 of this Form 10-K:

1. Report of Independent Registered Public Accounting Firm.
2. Consolidated Statements of Financial Condition as of September 30, 2006 and 2005.
3. Consolidated Statements of Operations for the Years Ended September 30, 2006, 2005, and 2004.
4. Consolidated Statements of Comprehensive Income (Loss) for the Years ended September 30, 2006, 2005, and 2004.
5. Consolidated Statements of Changes in Shareholders' Equity for the Years Ended September 30, 2006, 2005, and 2004.
6. Consolidated Statements of Cash Flows for the Years Ended September 30, 2006, 2005, and 2004.
7. Notes to Consolidated Financial Statements.

**(b) Exhibits:**

See Index of Exhibits.

**(c) Financial Statement Schedules:**

All financial statement schedules have been omitted as the information is not required under the related instructions or is inapplicable.

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) 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.

META FINANCIAL GROUP, INC.

Date: December 20, 2006

By: /s/ J. Tyler Haahr  
J. Tyler Haahr  
*(Duly Authorized Representative)*

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

By: /s/ J. Tyler Haahr  
J. Tyler Haahr, President

Date: December 20, 2006

and Chief Executive Officer

*(Principal Executive Officer)*

By: /s/ James S. Haahr  
James S. Haahr, Chairman of the Board

Date: December 20, 2006

By: /s/ E. Wayne Cooley  
E. Wayne Cooley, Director

Date: December 20, 2006

By: /s/ E. Thurman Gaskill  
E. Thurman Gaskill, Director

Date: December 20, 2006

By: /s/ Brad Hanson  
Bradley C. Hanson, Director

Date: December 20, 2006

By: /s/ Frederick V. Moore  
Frederick V. Moore, Director

Date: December 20, 2006

By: /s/ Rodney G. Muilenburg  
Rodney G. Muilenburg, Director

Date: December 20, 2006

By: /s/ Jeanne Partlow  
Jeanne Partlow, Director

Date: December 20, 2006

By: /s/ Jonathan M. Gaiser  
Jonathan M. Gaiser, Senior Vice

Date: December 20, 2006

President, Secretary, Treasurer and

Chief Financial Officer

*(Principal Financial and Accounting Officer)*

**INDEX TO EXHIBITS**

| Exhibit<br>Number | Description  |
|-------------------|--|
| 3(i)              | Registrant's Articles of Incorporation as currently in effect, filed on June 17, 1993 as an exhibit to the Registrant's registration statement on Form S-1 (Commission File No. 33-64654), are incorporated herein by reference.   |
| 3(ii)             | Registrant's Bylaws, as amended and restated, filed as Exhibit 3(ii) to Registrant's Report on Form 10-K for the fiscal year ended September 30, 1998 (Commission File No. 0-22140), is incorporated herein by reference.          |
| 4                 | Registrant's Specimen Stock Certificate, filed on June 17, 1993 as an exhibit to the Registrant's registration statement on Form S-1 (Commission File No. 33-64654), is incorporated herein by reference.                          |
| 10.1              | Registrant's 1995 Stock Option and Incentive Plan, filed as Exhibit 10.1 to Registrant's Report on Form 10-KSB for the fiscal year ended September 30, 1996 (Commission File No. 0-22140), is incorporated herein by reference.    |
| 10.2              | Registrant's 1993 Stock Option and Incentive Plan, filed on June 17, 1993 as an exhibit to the Registrant's registration statement on Form S-1 (Commission File No. 33-64654), is incorporated herein by reference.                |
| 10.3              | Registrant's Recognition and Retention Plan, filed on June 17, 1993 as an exhibit to the Registrant's registration statement on Form S-1 (Commission File No. 33-64654), is incorporated herein by reference.                      |
| 10.4              | Employment agreement between MetaBank and J. Tyler Haahr, filed as an exhibit to Registrant's Report on Form 10-K for the fiscal year ended September 30, 1997 (Commission File No. 0-22140), is incorporated herein by reference. |
| 10.5              | Registrant's Supplemental Employees' Investment Plan, filed as an exhibit to Registrant's Report on Form 10-KSB for the fiscal year ended September 30, 1994 (Commission File No. 0-22140), is incorporated herein by reference.   |
| 10.6              | Employment agreements between MetaBank and James S. Haahr, filed on June 17, 1993 as an exhibit to the Registrant's registration statement on Form S-1 (Commission File No. 33-64654), is incorporated herein by reference.        |
| 10.7              | Registrant's Executive Officer Compensation Program, filed as Exhibit 10.6 to Registrant's Report on Form 10-K for the fiscal year ended September 30, 1998 (Commission File No. 0-22140), is incorporated herein by reference.    |
| 10.8              | Registrant's Executive Officer Incentive Stock Option Plan for Mergers and Acquisitions, filed as Exhibit 10.7 to Registrant's Report on Form 10-K for the fiscal year   |

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ended September 30, 1998 (Commission File No. 0-22140), is incorporated herein by reference.

- 10.9 Registrant's 2002 Omnibus Incentive Plan, filed as Exhibit 10.9 to Registrant's Report on Form 10-K for the fiscal year ended September 30, 2003 (Commission File No. 0-22140), is incorporated herein by reference.
- 10.10 The First Amendment to Registrant's 2002 Omnibus Incentive Plan, adopted by the Registrant on August 28, 2006, and filed on December 19, 2006 as Exhibit A to Registrant's Schedule 14A (DEF 14A) Proxy Statement (Commission File No. 0-22140), is incorporated herein by reference.
- 10.11 Settlement Agreement by and between First Indiana Bank, N.A. and MetaBank dated March 13, 2006, filed as Exhibit 10.12 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2006 (Commission File No. 0-22140), is incorporated herein by reference.
- 11 Statement re: computation of per share earnings (included under Note 2 of Notes to Consolidated Financial Statements in the Annual Report to Shareholders attached hereto as Exhibit 13).
- 13 Annual Report to Shareholders.
- 21 Subsidiaries of the Registrant.
- 23 Consent of McGladrey & Pullen, LLP.
- 31.1 Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of the CEO pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of the CFO pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.