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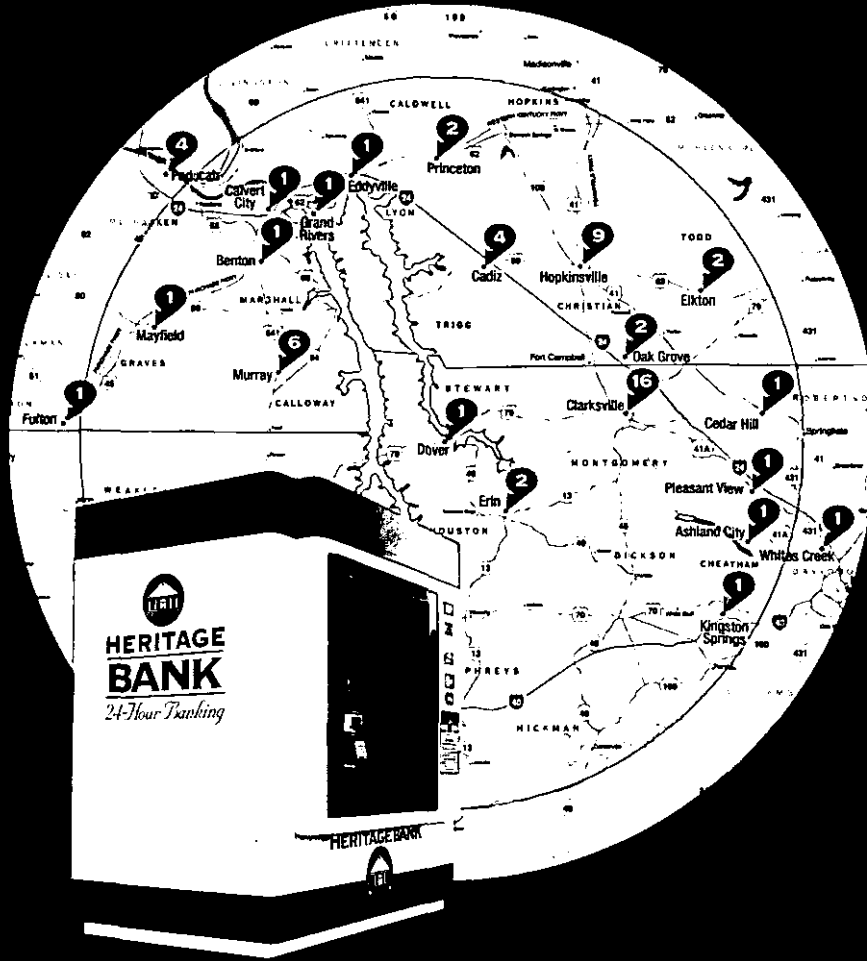
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2007 ANNUAL REPORT

HOPFED BANCORP, INC.

o o o



ON THE ROAD TO SUCCESS!

We live in a pick-up-and-deliver, drive through, automated world. Heritage Bank knows how its customers live and we know how they want to bank—on their terms. Consumers want convenient access, user friendly products, efficient technologies, and services which accommodate their needs.

To remain competitive in an industry that grows ever more crowded on a regular basis, we are well aware that we must identify the mechanisms which most conveniently deliver our products and services in the most effective manner and in the most cost-effective way. We must be creative in our approach to product development. We must be diligent in our incorporation of new tactics. And we must always keep an eye on the future.

In 2007, Heritage Bank reached a NUMBER of new heights. Here and on the following pages, we invite you to explore the countless ways in which we have, once again, added to our corporation's net worth.

4

INVESTMENT/INSURANCE OFFICES

18

BANKING CENTERS

64

ATM SITES

AVERAGE ANNUAL ACTIVITY

66,000 ELECTRONIC BILL PAYMENTS

113,760 CASH MANAGEMENT TRANSACTIONS

480,000 TELEPHONE TELLER TRANSACTIONS

492,000 ONLINE BANKING TRANSACTIONS

876,000 ATM TRANSACTIONS

1,056,000 DEBIT CARD TRANSACTIONS

1,452,000 LIVE TELLER TRANSACTIONS

At Heritage Bank, we know how our customers live and we know how they want to bank.



A few years ago a surgeon in New York removed the gallbladder of a patient in France—made possible by robotic surgical tools. Our society's demand for information has become immense. Internet users can tap into more than 110 million web sites. Brainpower and communications mark our modern economy. The more we communi-

cate, the more we gain from the world and the better we can compete both globally AND in our own backyard.

Today at Heritage Bank, clients and customers can make deposits, move money from one account to another, withdraw funds, pay bills and reconcile their checking accounts without ever leaving their living room Lazy Boy. Heritage Bank may operate amidst tobacco barns and amber waves of grain, but there is nothing uncultivated about our technological operations. In fact, Heritage Bank was recently recognized as the Showcase Bank in Automation by Metavante Corporation, a major processor of data for financial institutions. The award was presented for creativity in business approach, precision in process and procedures, strength in leadership and excellence in service.

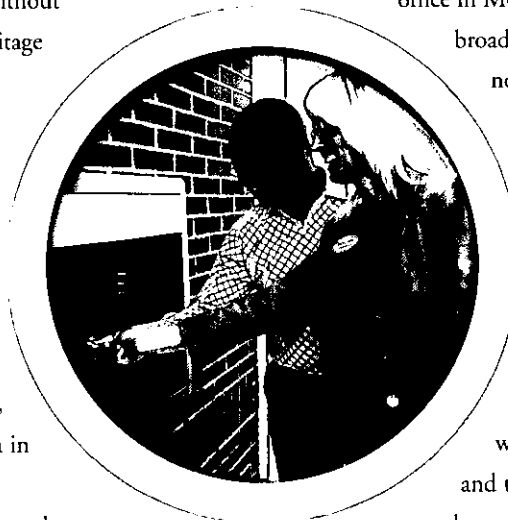
We live in a pick-up-and-deliver, drive through, serve-yourself, automated world. At Heritage Bank, we know how our customers live and we know how they want to bank. It has everything to do with convenience and placing ourselves in the right place with the right products.

STRENGTH IN NUMBERS

We also believe that potential customers and prospective relationships are still built on the time-honored elements of reliability, integrity and commitment. I think we've seen that proven at Heritage Bank year after year as we've watched the bank expand in every aspect of its multi-faceted product options.

This past year was no exception. In the past 12 months, Heritage Bank has taken new steps forward in our ever-widening geographic coverage of western Kentucky and Tennessee. From its humble beginnings, Heritage Bank has emerged as a leading financial company across two states and multiple neighborhoods—resulting from a faithfulness to high quality staffing, creative product definition, superior provision of service technologies, professional and productive marketing tactics and loyalties to the communities we serve.

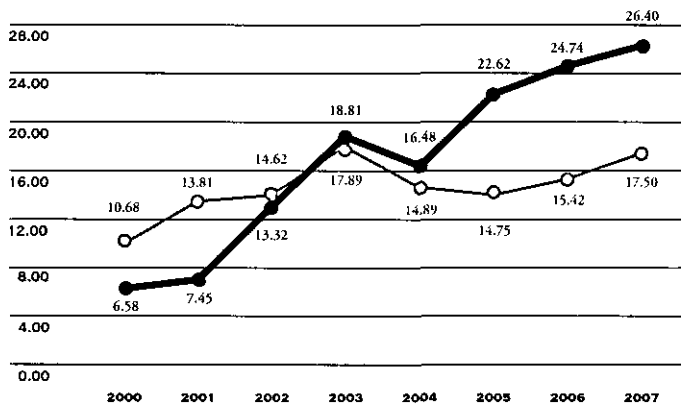
In 2007, Heritage Bank added banking centers in Clarksville, Tennessee (Madison Street and Main Street) as well as a second office in Murray, Kentucky. With the acquisition of a broad system of regional ATMs, Heritage Bank now offers the convenience of more than 60 ATMs around the two-state area supported by 18 neighborhood banks.



NEW MARKETS IN NEW NEIGHBORHOODS

In addition to our new physical sites, we have invested much of our intellectual capital as well into new and profitable ways to cross-sell our products and services and to develop new relationships with greater numbers of customers in each of our existing and newly added markets. Through enticements based on competitive rate structures as well as innovative ideas to draw new clients into our system, we have seen strong growth in our ability to tap new targeted market segments.

**MEDIAN NONINTEREST INCOME/
OPERATING REVENUE %**



○ THRIFTS ● HFBC

SOURCE: SNL FINANCIAL, LC

Heritage Bank has also continued to capitalize on non-interest income possibilities with the continued success of our consumer service divisions: Heritage Solutions and Heritage Mortgage Services. Heritage Solutions is a full-service financial company offering a wide range of investment portfolio products and services as well as a variety of insurance products. Offices are located in Murray, Kentucky; Dickson, Tennessee and Pleasant View, Tennessee.

In 2006, Heritage Bank opened Heritage Mortgage Services in Clarksville, Tennessee, offering home financing and mortgage products, adding yet another new dimension to the corporation's array of financial subsidiaries. We now offer our secondary mortgage products through all 18 Heritage Bank offices.

Fall & Fall Insurance in Fulton provides full-service insurance products, again providing valuable non-interest revenue to the company's corporate balance sheet.

OVERCOMING OBSTACLES

Record oil prices, a plunging real estate market, rising loan defaults

and tighter credit conditions are threatening to push the US economy into a recession. The uncertainty of the moment has caused the banking industry to become extremely volatile and has taken back many of the market's gains from the past few years.

Despite the negativity that has most recently been associated with the banking industry, Heritage Bank takes great pride in reporting another solid year of financial progress and asset strength. In financial times such as these, we believe that both our sound strategies and our array of peripheral businesses provides a diversity of transactions that works to insulate HopFed Bancorp from the threats of economic recession.

FAVORABLE OUTCOMES

As a result of these new developments and the sustained profitability of our existing financial network, we are pleased to present to you, our esteemed investors, this report of our financial growth in 2007. I am proud to report that as of December 31, 2007 total assets increased to \$808.4 million compared to \$770.9 million in 2006. Deposits increased to \$598.8 million compared to \$569.4 million last year. Loans receivable reached a total of \$576.3 million in 2007 from \$495.0 million in the previous year. The company's net income was reported as \$4.1 million in 2007 compared to 2006's total of \$3.9 million.

It has been both personally and professionally gratifying for me to be a part of this respected, perpetually advancing corporation for the past eight years. I know I speak for every individual who plays a part in the day-to-day operations of Heritage Bank and HopFed Bancorp when I say that each of us is proud to be a part of this organization. We would like to take this opportunity to thank you for your belief in our abilities and to pledge to you our unparalleled commitment to continued success in the year ahead.

John E. Peck

• SELECTED FINANCIAL DATA •

EARNINGS SUMMARY

DOLLARS IN THOUSANDS, EXCEPT PER SHARE DATA

YEAR ENDED DECEMBER 31,

	2007	2006	2005	2004
Interest income	\$49,033	\$40,668	\$29,666	\$26,381
Interest expense	\$28,891	\$23,288	\$15,474	\$12,537
Net interest income after provision for loan losses	\$19,166	\$16,357	\$12,942	\$12,644
Net income	\$4,116	\$3,908	\$4,130	\$3,991
Earnings per share (fully diluted)	1.14	1.07	1.13	1.09

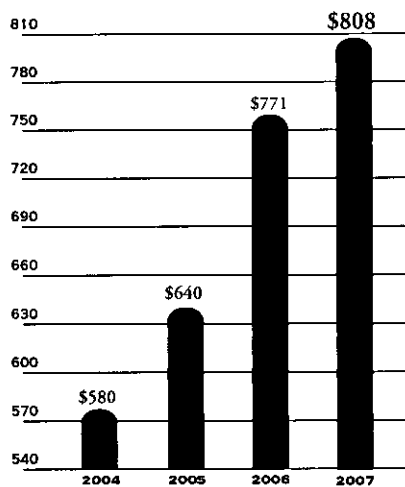
BALANCE SHEET DATA

DOLLARS IN THOUSANDS, EXCEPT PER SHARE DATA

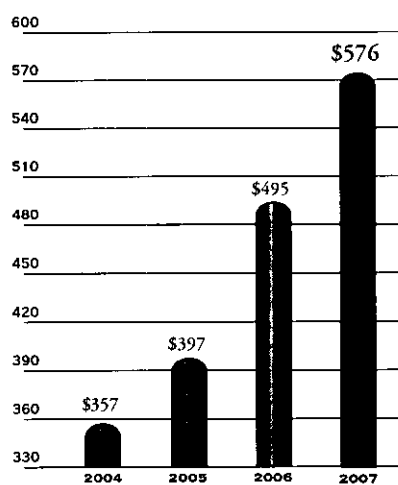
YEAR ENDED DECEMBER 31,

	2007	2006	2005	2004
Total assets	\$808,352	\$770,888	\$639,589	\$579,731
Loans receivable, net	\$576,252	\$494,968	\$397,310	\$356,825
Total deposits	\$598,753	\$569,433	\$482,728	\$436,195
Shareholders' equity	\$55,803	\$52,270	\$49,842	\$49,373
Book value per share	15.54	14.41	13.66	13.57

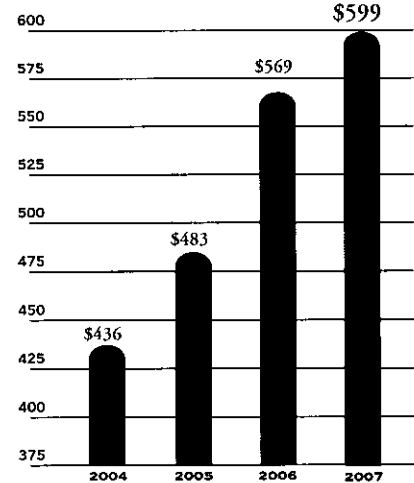
TOTAL ASSETS*



LOANS RECEIVABLE, NET*



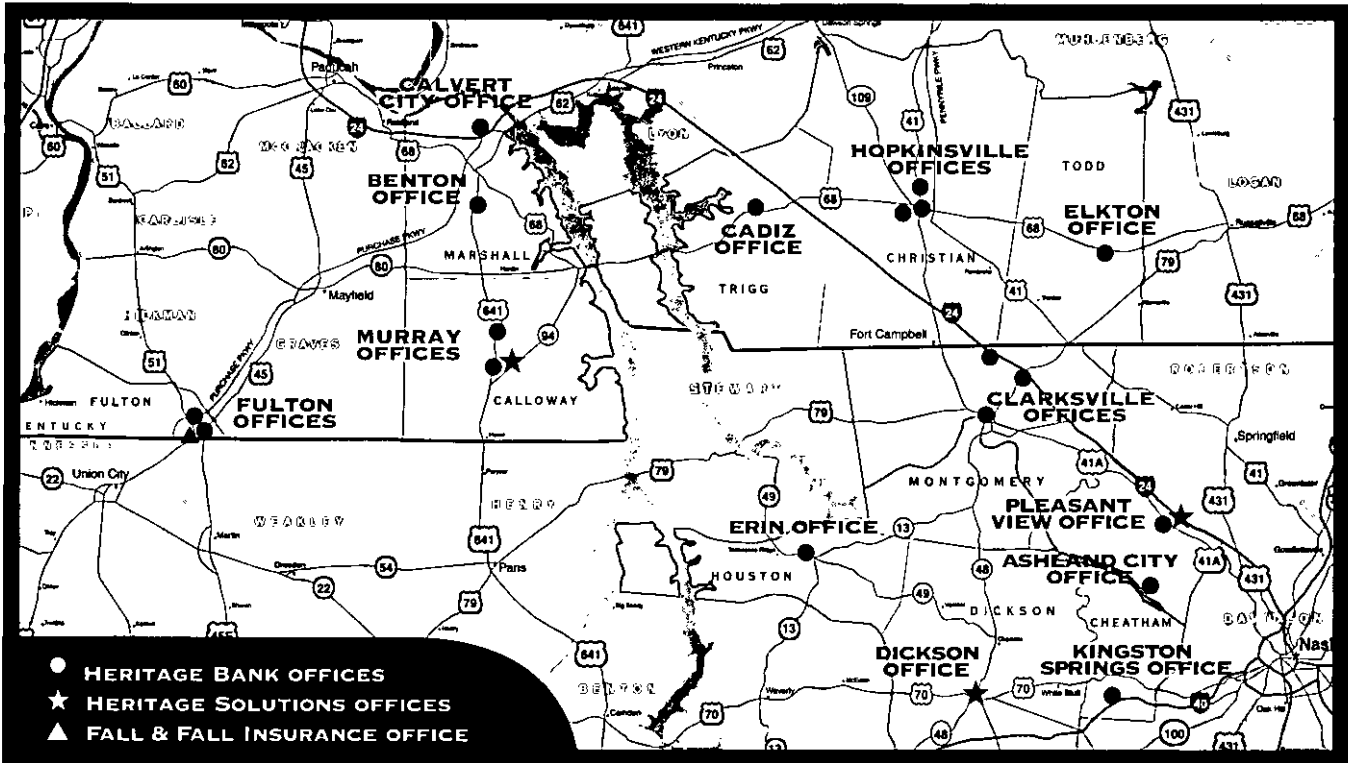
TOTAL DEPOSITS*



* DOLLARS IN MILLIONS, NUMBERS ROUNDED TO NEAREST SUM

• OFFICE LOCATIONS •

2007
 1/17/08
 1/17/08



CHRISTIAN COUNTY

Corporate Office
 4155 Lafayette Road
 Hopkinsville, KY 42240
 270-885-1171

2700 Fort Campbell Boulevard
 Hopkinsville, KY 42240
 270-885-1171

605 South Virginia Street
 Hopkinsville, KY 42240
 270-885-2628

CALLOWAY COUNTY

210 North 12th Street
 Murray, KY 42071
 270-753-7921

1601 North 12th Street
 Murray, KY 42071
 270-767-2000

TRIGG COUNTY

352 Main Street
 Cadiz, KY 42211
 270-522-6638

TODD COUNTY

536 West Main Street
 Elkton, KY 42220
 270-265-5628

MARSHALL COUNTY

105 West 5th Street
 Benton, KY 42025
 270-527-4353

20 Oak Plaza Drive
 Calvert City, KY 42029
 270-395-0781

FULTON COUNTY

306 Lake Street
 Fulton, KY 42041
 270-472-3300

Carr Plaza
 607 North Highland Drive
 Fulton, KY 42041
 270-472-4410

MONTGOMERY COUNTY

3845 Trenton Road
 Clarksville, TN 37040
 931-920-7100

2185 Madison Street
 Clarksville, TN 37040
 931-221-4700

322 Main Street
 Clarksville, TN 37040
 391-552-5627

HOUSTON COUNTY

1102 West Main Street
 Erin, TN 37061
 931-289-5000

CHEATHAM COUNTY

108 Cumberland Street
 Ashland City, TN 37015
 615-792-4337

104 West Kingston Springs Road
 Kingston Springs, TN 37082
 615-952-9143

2556 Highway 49 East
 Pleasant View, TN 37146
 615-746-2111

**HOPPED
BANCORP, INC.**

BOARD OF DIRECTORS

W D Kelley

*Chairman of the Board and Retired
Superintendent—Christian County Schools*

Gilbert E. Lee

*Vice-Chairman of the Board and
Co-owner—C & L Rentals, L.L.C.*

John E. Peck

President and Chief Executive Officer

Boyd M. Clark

Senior Vice President and Secretary

H. Joseph Dempsey, M.D.

Anesthesiologist

Walton G. Ezell

Farmer

Ted Kinsey

Owner—Parkway Chrysler

Dr. Thomas I. Miller, C.P.A.

*Professor of Accounting—Murray State
University and Executive Director—Murray
State University Foundation*

CORPORATE OFFICERS

John E. Peck

President and Chief Executive Officer

Michael L. Woolfolk

*Chief Operating Officer and
Executive Vice President*

Boyd M. Clark

Senior Vice President and Secretary

Billy C. Duvall, C.P.A.

*Vice President, Chief Financial Officer
and Treasurer*

Michael F. Stalls

Vice President and Chief Credit Officer

HERITAGE BANK

BOARD OF DIRECTORS

W D Kelley

*Chairman of the Board and Retired
Superintendent—Christian County Schools*

Gilbert E. Lee

*Vice Chairman of the Board and
Co-owner—C & L Rentals, L.L.C.*

John E. Peck

President and Chief Executive Officer

Boyd M. Clark

Senior Vice President—Loan Administration

H. Joseph Dempsey, M.D.

Anesthesiologist

Walton G. Ezell

Farmer

Ted Kinsey

Owner—Parkway Chrysler

Dr. Thomas I. Miller, C.P.A.

*Professor of Accounting—Murray State
University and Executive Director—Murray
State University Foundation*

Kenneth E. Crews

Retired—Banking

Johnny Piper

Mayor of Clarksville

EXECUTIVE MANAGEMENT

John E. Peck

President and Chief Executive Officer

Michael L. Woolfolk

*Chief Operating Officer and
Executive Vice President*

Boyd M. Clark

Senior Vice President—Loan Administration

Billy C. Duvall, C.P.A.

*Vice President, Chief Financial Officer
and Treasurer*

Michael F. Stalls

Vice President and Chief Credit Officer

**BANKING CENTER
MANAGEMENT**

Robert K. Burrow

*Market President
Fulton County*

Paul Thurman
Market President
Marshall County

Dan Dickerson
Market Manager
Trigg County

Tim Little
Market Manager
Todd County

Doug Lawson
Market President
Calloway County

Keith Bennett
Market President
Montgomery and Houston County

Paige McVity
Market President
Cheatham County

FALL & FALL INSURANCE, INC.
Roger D. Kephart, CPCU
Vice President and Manager

HERITAGE SOLUTIONS
Mark Vinson
Vice President

Charlene Martin
Vice President

Ty Watts
Vice President

HERITAGE MORTGAGE
Kathy Slack
Manager

COMMUNITY BOARD MEMBERS
CALLOWAY COUNTY
Marc Peebles
Owner—Innovative Printing & Graphics, Inc.

Dr. Thomas I. Miller, C.P.A.
Professor of Accounting—Murray State
University and Executive Director—Murray
State University Foundation

J.D. Outland, D.M.D.
Dentist

Dr. Joseph A. Morgan
School of Agriculture—Murray State University

MARSHALL COUNTY
Ted Kinsey
Owner—Parkway Chrysler

Greg Carter
Attorney at Law and Partner—Owen,
Harvey and Carter

Jim Wiseman
Owner—J & R Pharmacy

Gary Shemwell
Administration Manager—Westlake
Chemical Corp.

Gayle Hall
Owner and President—Calvert City
Insurance Agency

Donald R. Hise
Retired—Westlake Monomers Corp.

FULTON COUNTY
Robert K. Burrow
Market President—Heritage Bank Fulton

Kenneth E. Crews
Retired—Banking

L. M. McBride
Retired—Banking

R. Ward Bushart, II
Public School Administrator

Kent A. Hutchins
President—Hornbeak Funeral Chapel, Inc.

Roger Kephart, CPCU
Vice President and Manager—Fall & Fall
Insurance, Inc.; A Heritage Bank Company

MONTGOMERY /
HOUSTON COUNTY
Johnny Piper
Mayor of Clarksville

Albert P. Marks
Attorney at Law

Gary Mathews
President—Gary Mathews Automotive Group

INDEPENDENT AUDITORS

Rayburn, Bates & Fitzgerald, P.C.
5200 Maryland Way, Suite 300
Brentwood, TN 37027

GENERAL COUNSEL

Deatherage, Myers & Lackey
701 South Main Street
Hopkinsville, KY 42241

SPECIAL COUNSEL

Jones Walker
2600 Virginia, NW Suite 1113
Washington, D.C. 20037

TRANSFER AGENT

Registrar and Transfer Company
10 Commerce Drive
Cranford, NJ 07016

ANNUAL MEETING

The 2008 Annual Meeting of Stockholders will be held on May 21, 2008; at 3:00 p.m. at Heritage Bank; 4155 Lafayette Road; Hopkinsville, Kentucky 42240.

ANNUAL REPORT ON FORM 10-K

A copy of the Company's 2007 Annual Report on Form 10-K will be furnished without charge to stockholders as of the record date for the 2008 Annual Meeting upon written request to the Secretary; HopFed Bancorp, Inc.; P.O. Box 537; Hopkinsville, Kentucky 42241. Information on the company's filings can also be found on their website by visiting www.bankwithheritage.com.

MARKET AND DIVIDEND INFORMATION

Since February 9, 1998 the Common Stock has been quoted on the Nasdaq Stock Exchange under the symbol "HFBC." As of March 20, 2008, there were approximately 2,600 stockholders of the Company's Common Stock, with approximately 1,070 held in the name of the owner and the remainder held in street name. Below are the high and low stock prices of the Common Stock for the periods indicated.

A dividend of \$0.12 per share was declared in each of the four quarters of 2006 and 2007.

Dividends, when and if paid, are subject to determination and declaration by the Board of Directors at its discretion, which will take into account the Company's consolidated financial condition and results of operations, the Bank's regulatory capital requirements, tax considerations, economic conditions, regulatory restrictions, and other factors; and there can be no assurance that dividends will be paid or, if paid, will continue to be paid in the future. The payment of future dividends by the Company will depend in large part upon the receipt of dividends from the Bank, which is subject to various tax and regulatory restrictions on the payment of dividends.

PRICE RANGE OF COMMON STOCK

	YEAR ENDED DECEMBER 31, 2006		YEAR ENDED DECEMBER 31, 2007	
	HIGH	LOW	HIGH	LOW
First Quarter	\$17.00	\$14.91	\$16.44	\$15.20
Second Quarter	\$17.10	\$15.16	\$16.20	\$15.45
Third Quarter	\$16.80	\$15.41	\$16.35	\$14.39
Fourth Quarter	\$16.66	\$15.90	\$15.46	\$14.01

SELECTED FINANCIAL INFORMATION AND OTHER DATA

The following summary of selected financial information and other data does not purport to be complete and is qualified in its entirety by reference to the detailed information and Consolidated Financial Statements and accompanying Notes appearing elsewhere in this Report.

Financial Condition and Other Data

	At December 31,				
	<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>
Total amount of:	(Dollars in thousands)				
Assets.....	\$808,352	\$770,888	\$639,589	\$579,731	\$531,465
Loans receivable, net	576,252	494,968	397,310	356,825	334,740
Cash and due from banks.....	17,343	14,423	13,487	17,357	12,958
Interest-bearing deposits in Federal Home Loan Bank (FHLB)	931	4,190	424	42	35
Federal funds sold.....	3,755	3,270	2,250	850	2,185
Federal Home Loan Bank stock	3,836	3,639	3,211	3,015	2,917
Securities available for sale ...	142,310	183,339	172,890	155,151	140,597
Securities held to maturity:					
U.S. Government agency securities	13,541	17,318	17,292	21,546	13,339
Mortgage-backed Securities	554	700	891	1,222	1,769
Deposits	598,753	569,433	482,728	436,195	417,488
FHLB advances	101,882	113,621	93,172	81,319	54,353
Subordinated debentures.....	10,310	10,310	10,310	10,310	10,310
Total stockholders' equity.....	55,803	52,270	49,842	49,373	47,238

Number of:					
Real estate loans outstanding	6,211	5,316	5,076	4,805	4,048
Deposit accounts.....	76,823	67,252	51,635	48,071	43,069
Offices open.....	18	15	9	9	9

	Year Ended December 31,				
	<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>
	(Dollars in thousands)				
Interest and dividend income...	\$ 49,033	\$ 40,668	\$ 29,666	\$ 26,381	\$ 24,743
Interest expense	<u>28,891</u>	<u>23,288</u>	<u>15,474</u>	<u>12,537</u>	<u>12,379</u>
Net interest income before provision for loan losses	20,142	17,380	14,192	13,844	12,364
Provision for loan losses.....	<u>976</u>	<u>1,023</u>	<u>1,250</u>	<u>1,200</u>	<u>1,750</u>
Net interest income.....	19,166	16,357	12,942	12,644	10,614
Non-interest income	7,231	5,765	4,532	3,038	3,499
Non-interest expense	<u>20,553</u>	<u>16,514</u>	<u>11,600</u>	<u>10,008</u>	<u>9,044</u>
Income before income taxes....	5,844	5,608	5,874	5,674	5,069
Provision for income taxes	<u>1,728</u>	<u>1,700</u>	<u>1,744</u>	<u>1,683</u>	<u>1,574</u>
Net income	<u>\$ 4,116</u>	<u>\$ 3,908</u>	<u>\$ 4,130</u>	<u>\$ 3,991</u>	<u>\$ 3,495</u>

Selected Quarterly Information (Unaudited)

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	(Dollars in thousands)			
Year Ended December 31, 2007:				
Interest and dividend income	\$ 11,780	\$ 12,283	\$ 12,391	\$ 12,579
Net interest income after provision for losses on loans	4,684	4,967	4,792	4,723
Noninterest income	1,741	1,766	1,877	1,847
Noninterest expense	4,988	5,153	5,234	5,178
Net income	1,022	1,108	1,025	961
Year Ended December 31, 2006:				
Interest and dividend income	\$ 8,779	\$ 9,382	\$ 10,975	\$ 11,532
Net interest income after provision for losses on loans	3,870	3,814	4,348	4,325
Noninterest income	1,047	1,261	1,703	1,754
Noninterest expense	3,169	3,887	4,621	4,837
Net income	1,201	849	1,012	846

Key Operating Ratios

	At or for the Year Ended December 31,		
	2007	2006	2005
Performance Ratios			
Return on average assets (net income divided by average total assets).....	0.53%	0.56%	0.69%
Return on average equity (net income divided by average total equity).....	7.84%	7.65%	8.33%
Interest rate spread (combined weighted average interest rate earned less combined weighted average interest rate cost).....	2.65%	2.45%	2.39%
Ratio of average interest-earning assets to average interest-bearing liabilities.....	106.14%	107.14%	108.03%
Ratio of non-interest expense to average total assets.....	2.63%	2.35%	1.93%
Ratio of net interest income after provision for loan losses to non-interest expense.....	95.82%	100.51%	111.57%
Efficiency ratio (non-interest expense divided by sum of net interest income plus non-interest income).....	73.66%	70.66%	61.95%
Asset Quality Ratios			
Non-performing assets to total assets at end of period	0.12%	0.16%	0.19%
Non-performing loans to total loans at end of period	0.10%	0.17%	0.25%
Allowance for loan losses to total loans at end of period..	0.83%	0.90%	1.00%
Allowance for loan losses to non-performing loans at end of period	816.53%	517.96%	402.01%
Provision for loan losses to total loans receivable, net	0.17%	0.20%	0.31%
Net charge-offs to average loans outstanding	0.11%	0.16%	0.14%
Capital Ratios			
Total equity to total assets at end of period	6.90%	6.78%	7.79%
Average total equity to average assets	6.73%	7.26%	8.27%

Regulatory Capital

December 31, 2007
(Dollars in thousands)

	Bank	Company
Tangible capital.....	\$ 55,698	\$ 58,727
Less: Tangible capital requirement	<u>11,979</u>	<u>12,014</u>
Excess.....	<u>43,719</u>	<u>46,713</u>
Core capital	\$ 55,698	\$ 58,727
Less: Core capital requirement.....	<u>31,943</u>	<u>32,039</u>
Excess.....	<u>23,755</u>	<u>26,688</u>
Total risk-based capital	\$ 60,540	\$ 63,569
Less: Risk-based capital requirement.....	<u>46,249</u>	<u>46,315</u>
Excess.....	<u>14,291</u>	<u>17,254</u>

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

General

This discussion relates to the financial condition and results of operations of the Company, which became the holding company for the Bank in February 1998. The principal business of the Bank consists of accepting deposits from the general public and investing these funds primarily in loans and in investment securities and mortgage-backed securities. The Bank's loan portfolio consists primarily of loans secured by residential real estate located in its market area.

For the year ended December 31, 2007, the Company recorded net income of \$4.1 million, a return on average assets of 0.53% and a return on average equity of 7.84%. For the year ended December 31, 2006, the Company recorded net income of \$3.9 million, a return on average assets of 0.56% and a return on average equity of 7.65%. For the year ended December 31, 2005 the Company recorded net income of \$4.1 million, a return on average assets of 0.69% and a return on average equity of 8.33%.

The Company's net income is dependent primarily on its net interest income, which is the difference between interest income earned on its loan, investment securities and mortgage-backed securities portfolios and interest paid on interest-bearing liabilities. Net interest income is determined by (i) the difference between yields earned on interest-earning assets and rates paid on interest-bearing liabilities (interest rate spread) and (ii) the relative amounts of interest-earning assets and interest-bearing liabilities. The Company's interest rate spread is affected by regulatory, economic and competitive factors that influence interest rates, loan demand and deposit flows. To a lesser extent, the level of non-interest expenses such as compensation, employee benefits, data processing expenses, local deposit and federal income taxes also affect the Company's net income.

The operations of the Company and the entire thrift industry are significantly affected by prevailing economic conditions, competition and the monetary, fiscal and regulatory policies of governmental agencies. Lending activities are influenced by the demand for and supply of housing, competition among lenders, the level of interest rates and the availability of funds. Deposit flows and costs of funds are influenced by prevailing market rates of interest, primarily on competing investments, account maturities and the levels of personal income and savings in the Company's market area.

Aggregate Contractual Obligations

	Maturity by Period				Total
	Less than 1 year	Greater than 1 year to 3 years	Greater than 3 years to 5 years	Greater than 5 years	
December 31, 2007 (In thousands)					
Deposits	\$ 466,031	117,505	15,217	---	598,753
FHLB borrowings	32,000	19,000	10,000	40,882	101,882
Repurchase agreements	21,199	---	---	16,000	37,199
Subordinated debentures	---	---	---	10,310	10,310
Lease commitments	106	160	62	---	328
Purchase obligations	2,222	4,370	2,042	---	8,634
Total	\$ 521,558	141,035	27,321	67,192	757,106

Deposits represent non-interest bearing, money market, savings, NOW, certificates of deposit and all other deposits held by the Company. Amounts that have an indeterminate maturity period are included in the less than one-year category above.

FHLB borrowings represent the amounts that are due to FHLB of Cincinnati. All amounts have fixed maturity dates. The Company has two callable FHLB advances, totaling \$17 million. Both puttable advances may be called each quarter on or after June 30, 2008.

Subordinated debentures represent the amount borrowed in a private pool trust preferred issuance on September 25, 2003. The debentures are priced at the three-month London Interbank Offering Rate (LIBOR) plus 3.10%, currently 8.34%. The debentures re-price and pay interest quarterly and have a thirty-year final maturity. The debentures may be called at the issuer's discretion on a quarterly basis after five years.

Lease commitments represent the total minimum lease payments under non-cancelable operating leases.

The most significant operating contract is for the Company's data processing services, which re-prices monthly based on the number of accounts and other operational factors. Estimates have been made to include reasonable growth projections. In December 2007, the Company renewed the operating contract with the current data processing provider for a period not to exceed five years. The Company anticipates only a minor increase in fixed and variable cost rates with this contract.

Off Balance Sheet Arrangements

December 31, 2007 (In thousands)	Maturity by Period				Total
	Less than 1 year	Greater than 1 year to 3 years	Greater than 3 years to 5 years	Greater than 5 years	
Commercial lines of credit	\$ 6,375	3,296	985	259	10,915
Commitments to extend credit	17,114	17,574	489	16,165	51,342
Standby letters of credit	4,451	30	69	9	4,559
Home equity lines of credit	660	616	1,393	31,086	33,755
Total	\$28,600	21,516	2,936	47,519	100,571

Standby letters of credit represent commitments by the Company to repay a third party beneficiary when a customer fails to repay a loan or debt instrument. The terms and risk of loss involved in issuing standby letters of credit are similar to those involved in issuing loan commitments and extending credit. In addition to credit risk, the Company also has liquidity risk associated with stand by letters of credit because funding for these obligations could be required immediately. Unused lines of credit represent commercial and residential equity lines of credit with maturities ranging from one to fifteen years.

Accounting for Derivative Instruments and Hedging Activities

In October of 2004, Heritage Bank entered into a receive fixed pay variable swap transaction in the amount of \$10 million with Compass Bank of Birmingham in which Heritage Bank would pay Compass a fixed rate of 3.53% quarterly for four years while Compass would pay Heritage Bank a rate equal to the three month Libor. Heritage Bank has signed an inter-company transfer with the Company that allowed the Company to convert its variable rate subordinated debenture issuance to a fixed rate. The critical terms of the interest rate swap matched the term of the corresponding variable rate subordinated debt issuance. In January 2006, Heritage Bank terminated the swap transaction at a net gain of approximately \$270,000. Heritage Bank will recognize this gain over the original maturity of the swap, September 2008. As a result of the amortization of the gain on the swap, the Company recognized a decrease in the net interest expense on borrowed funds of \$98,240 for the twelve month periods ended December 31, 2006 and December 31, 2007, respectively. The Company will amortize the remaining gain of \$73,600 in 2008.

Quantitative and Qualitative Disclosure about Market Risk

Quantitative Aspects of Market Risk. The principal market risk affecting the Company is risk associated with interest rate volatility (interest rate risk). The Company maintains a trading account for investment securities that may be used to periodically hedge short-term interest rate risk. The Company did not have any activity in its trading account for the years ended December 31, 2007, 2006 and 2005, respectively. The Company is not subject to foreign currency exchange rate risk or commodity price risk. Substantially all of the Company's interest rate risk is derived from the Bank's lending and deposit taking activities. This risk could result in reduced net income, loss in fair values of assets and/or increases in fair values of liabilities due to upward changes in interest rates.

Qualitative Aspects of Market Risk The Company's principal financial objective is to achieve long-term profitability while reducing its exposure to fluctuating market interest rates. The Company has sought to reduce the exposure of its earnings to changes in market interest rates by attempting to manage the mismatch between assets and liabilities maturities and interest rates. The principal element in achieving this objective is to increase the interest-rate sensitivity of the Company's interest-earning assets by retaining for its portfolio loans with interest rates subject to periodic adjustment to market conditions. The Company relies on retail deposits as its primary source of funds. However, management is utilizing brokered deposits, wholesale repurchase agreements and FHLB borrowings as sources of liquidity. As part of its interest rate risk management strategy, the Bank promotes demand accounts, overnight repurchase agreements and certificates of deposit with primarily terms of up to five years.

Asset / Liability Management

Key components of a successful asset/liability strategy are the monitoring and managing of interest rate sensitivity of both the interest-earning asset and interest-bearing liability portfolios. The Company has employed various strategies intended to minimize the adverse affect of interest rate risk on future operations by providing a better match between the interest rate sensitivity between its assets and liabilities. In particular, the Company's strategies are intended to stabilize net interest income for the long-term by protecting its interest rate spread against increases in interest rates. Such strategies include the origination of adjustable-rate mortgage loans secured by one-to-four family residential real estate, and, to a lesser extent, multi-family real estate loans and the origination of other loans with interest rates that are more sensitive to adjustment based upon market conditions than long-term, fixed-rate residential mortgage loans. For the year ended December 31, 2007, approximately \$183.8 million of the \$222.9 million of one-to-four family residential loans originated by the Company (comprising 82.5% of such loans) had adjustable rates or will mature within one year.

The U.S. government agency securities generally are purchased for a term of fifteen years or less. Securities may or may not have call options. A security with call options improves the yield on the security but also has little or no positive price convexity. Non-callable securities or securities with one time calls offer a lower yield but more positive price convexity and an improved predictability of cash flow. Generally, securities with the greater call options (continuous and quarterly) are purchased only during times of extremely low interest rates. The reasons for purchasing these securities generally focus on the fact that a non callable or one time call is of little value if rates are exceptionally low.

At December 31, 2007, \$12.9 million in agency securities were due within one year, approximately \$33.5 million were due in one to five years, approximately \$23.7 million were due in five to ten years and approximately \$15.4 million were due after ten years. However, at December 31, 2007, \$47.3 million of these securities had a call provision, which authorizes the issuing agency to prepay the securities at face value at certain pre-established dates. If, prior to their maturity dates, market interest rates decline below the rates paid on the securities, the issuing agency may elect to exercise its right to prepay the securities. At December 31, 2007, \$45.4 million of these securities are callable but do not mature prior to December 31, 2008. The weighted average life of the agency bond portfolio is approximately 4.3 years and the modified duration of the agency bond portfolio is approximately 3.3 years.

The municipal bond portfolio largely consists of local school district bonds with the guarantee of the state of Kentucky or out of state bonds insured by private companies. At December 31, 2007 the Company has \$17.2 million in municipal bonds. These bonds were purchased to provide long-term income stability and higher tax equivalent yields to a small portion of the investment portfolio. At December 31, 2007, approximately \$10.2 million of the Company's municipal bond portfolio is callable with call dates ranging from January 2008 to June 2017. The call dates are staggered to eliminate the excessive cash flows within any one-year period. At December 31, 2007, \$400,000 were due in less than one year, \$5.8 million were due within one to five years, \$6.5 million were due in five to ten years and approximately \$4.4 million were due after ten years. At December 31, 2007, approximately \$2.2 million of municipal bonds had a call date of less than one year; approximately \$3.0 million had a call date from one to five years and approximately \$5.0 million in more than five years. At December 31, 2007, the average life of the municipal bond portfolio is approximately 6.4 years and the modified duration of the municipal bond portfolio is approximately 5.1 years.

At December 31, 2007, the Company held \$1.9 million (\$2 million par value) in corporate bonds. All corporate bonds purchased by the Company were investment grade when purchased. The Company's portfolio of corporate bonds includes two Ford Motor Acceptance Corporation (FMAC) bonds maturing in \$1 million increments in October 2008 and October 2009. During 2005, the national credit rating agencies downgraded Ford, the parent company of FMAC resulting in the loss of investment grade status. The downgrades are the result of the long-term business prospects and current and future health and pension liabilities of Ford. The Company conducts a financial analysis similar to that of a loan customer for each corporate purchase. This analysis includes reviewing quarterly and periodic SEC filings for both the parent company and Ford Motor Credit. The Company has determined that Ford maintains both an acceptable level and sources of liquidity to meet short-term obligations. The Company's analysis indicates that Ford has adequate levels and sources of liquidity to meet current and near-term obligations, including the funding of bond interest and principal payments.

Mortgage-backed securities entitle the Company to receive a pro rata portion of the cash flow from an identified pool of mortgages. Although mortgage-backed securities generally offer lesser yields than the loans for which they are exchanged, mortgage-backed securities present lower credit risk by virtue of the guarantees that back them, are more liquid than individual mortgage loans, and may be used to collateralize borrowings or other obligations of the Company. Further, mortgage-backed securities provide a monthly stream of both interest and principal, thereby providing the Company with a cash flow to reinvest at current market rates and limit the Company's interest rate risk.

At December 31, 2007, the Company held approximately \$36.1 million in fixed rate mortgage backed securities with an average life of approximately 5.7 years and a modified duration of approximately 4.4 years. The Company held approximately \$2.9 million in adjustable rate mortgage backed securities with an average life of approximately 6.4 years and a modified duration of approximately 4.7 years.

At December 31, 2007, the Company held approximately \$12.8 million in Collateral Mortgage Obligations (CMO). A CMO is a form of mortgage-backed security that has a structured payment stream based on various factors and does not necessarily remit monthly principal on a pro-rata basis. At December 31, 2007, the Company's CMO portfolio had an average life of approximately 2.2 years and a modified duration of approximately 2.0 years. For more information regarding investment securities, see Note 2 of Notes to Consolidated Financial Statements. The Company owns no mortgage backed securities or Collateral Mortgage Obligations consisting of subprime or second mortgage loans.

Interest Rate Sensitivity Analysis

The Company's profitability is affected by fluctuations in interest rates. A sudden and substantial increase or decrease in interest rates may adversely impact the Company's earnings to the extent that the interest rates on interest earning assets and interest bearing liabilities do not change at the same speed, to the same extent or on the same basis. As part of its effort to manage interest rate risk, the Bank monitors its net portfolio value (NPV), a methodology adopted by the OTS to assist the Bank in assessing interest rate risk.

Generally, NPV is the discounted present value of the difference between incoming cash flows on interest-earning assets and other assets and outgoing cash flows on interest-bearing liabilities and other liabilities. The application of the methodology attempts to quantify interest rate risk as the change in the NPV, which would result from a theoretical 200 basis point (1 basis point equals .01%) change in market rates. Both a 300 basis point increase in market interest rates and a 100 basis point decrease in market interest rates are considered.

The following table presents the Bank's NPV at December 31, 2007, as calculated by the OTS, based on information provided to the OTS by the Bank.

Change In Rates	Net Portfolio Value			NPV as % of PV of Assets		
	\$ Amount	\$ Change	% Change	NPV Ratio	Change	
		(Dollars in thousands)				
+300 bp	\$ 55,127	\$ (17,056)	(24) %	6.99%	(179) bp	
+200 bp	62,478	(9,704)	(13) %	7.80%	(98) bp	
+100 bp	67,983	(4,199)	(6) %	8.37%	(41) bp	
0 bp	72,183	---	---	8.78%	---	
-100 bp	74,877	2,694	4 %	9.01%	23 bp	
-200 bp	76,047	3,865	5 %	9.05%	48 bp	

Interest Rate Risk Measures: 200 Basis Point (bp) Rate Shock

Pre-Shock NPV Ratio: NPV as % of Present Value of Assets ...	8.78%
Exposure Measure: Post-Shock NPV Ratio.....	7.80%
Sensitivity Measure: Change in NPV Ratio.....	98 bp

The computation of prospective effects of hypothetical interest rate changes are based on numerous assumptions, including relative levels of market interest rates, loan prepayments and deposit decay rates, and should not be relied upon as indicative of actual results. The computations do not contemplate any actions the Bank could undertake in response to changes in interest rates. The matching of assets and liabilities may be analyzed by examining the extent to which such assets and liabilities are "interest rate sensitive" and by monitoring an institution's interest rate sensitivity "gap." An asset or liability is said to be interest rate sensitive within a specific period if it will mature or re-price within that period.

The interest rate sensitivity gap is defined as the difference between the amount of interest-earning assets maturing or re-pricing within a specific time period and the amount of interest-bearing liabilities maturing or re-pricing within that time period. A gap is considered positive when the amount of interest rate sensitive assets exceeds the amount of interest rate sensitive liabilities, and is considered negative when the amount of interest rate sensitive liabilities exceeds the amount of interest rate sensitive assets. At December 31, 2007, the Company had a negative one-year or less interest rate sensitivity gap of 22.13% of total interest-earning assets. Generally, during a period of rising interest rates, a negative gap position would be expected to adversely affect net interest income while a positive gap position would be expected to result in an increase in net interest income. Conversely during a period of falling interest rates, a negative gap would be expected to result in an increase in net interest income and a positive gap would be expected to adversely affect net interest income. The following table sets forth the amounts of interest-earning assets and interest-bearing liabilities outstanding at December 31, 2007, which are expected to mature or re-price in each of the time periods shown.

	One Year or Less	Over One Through Five Years	Over Five Through Ten Years	Over Ten Through Fifteen Years	Over Fifteen Years	Total
(Dollars in thousands)						
Interest-earning assets:						
Loans:						
One-to-four family	\$123,062	\$ 60,256	\$ 27,627	\$ 7,574	\$ 2,579	\$221,098
Multi-family residential.....	5,798	12,851	5,582	---	---	24,231
Construction	37,954	7,150	4,389	---	444	49,937
Non-residential	58,104	86,548	24,415	6,825	7,011	182,903
Secured by deposits	3,312	1,082	25	---	---	4,419
Other loans	40,734	36,548	6,418	1,073	8,891	93,664
Time deposits and interest-						
bearing deposits in FHLB	931	---	---	---	---	931
Federal funds sold.....	3,755	---	---	---	---	3,755
Securities	28,043	43,439	23,098	10,027	3,825	108,432
Mortgage-backed securities.....	11,604	28,356	6,871	4,430	548	51,809
Total.....	313,297	276,230	98,425	29,929	23,298	741,179
Interest-bearing liabilities:						
Deposits.....	413,805	132,722	--	---	--	546,527
Borrowed funds.....	63,509	29,000	56,882	---	--	149,391
Total.....	477,314	161,722	56,882	---	--	695,918
Interest sensitivity gap	<u>\$(164,017)</u>	<u>\$114,508</u>	<u>\$ 41,543</u>	<u>\$ 29,929</u>	<u>\$ 23,298</u>	<u>\$ 45,261</u>
Cumulative interest sensitivity						
Gap	<u>\$(164,017)</u>	<u>\$(49,509)</u>	<u>\$ (7,966)</u>	<u>\$ 21,963</u>	<u>\$ 45,261</u>	<u>\$ 45,261</u>
Ratio of interest-earning assets to						
Interest-bearing liabilities.....	<u>65.64%</u>	<u>170.81%</u>	<u>173.03%</u>	<u>---</u>	<u>---</u>	<u>106.50%</u>
Ratio of cumulative gap to						
total interest-earning assets	<u>=(22.13)%</u>	<u>(6.68)%</u>	<u>=(1.07)%</u>	<u>2.96%</u>	<u>6.11%</u>	<u>6.11%</u>

The preceding table was prepared based upon the assumption that loans will not be repaid before their respective contractual maturities, except for adjustable rate loans, which are classified, based upon their next re-pricing date. Further, it is assumed that fixed maturity deposits are not withdrawn prior to maturity and other deposits are withdrawn or re-priced within one year. Mortgage-backed securities are classified based on their lifetime prepayment speeds. Management of the Company does not believe that these assumptions will be materially different from the Company's actual experience. However, the actual interest rate sensitivity of the Company's assets and liabilities could vary significantly from the information set forth in the table due to market and other factors. The retention of adjustable-rate mortgage loans in the Company's portfolio helps reduce the Company's exposure to changes in interest rates. However, there are unquantifiable credit risks resulting from potential increased costs to borrowers as a result of re-pricing adjustable-rate mortgage loans. It is possible that during periods of rising interest rates, the risk of default on adjustable-rate mortgage loans may increase due to the upward adjustment of interest costs to the borrowers.

Average Balance, Interest and Average Yields and Rates

The following tables set forth certain information relating to the Company's average interest-earning assets and average interest-bearing liabilities and reflects the average yield on assets and average cost of liabilities for the periods and at the date indicated. Such yields and costs are derived by dividing income or expense by the average monthly balance of assets or liabilities, respectively, for the periods presented. Average balances are derived from month-end balances. Management does not believe that the use of month-end balances instead of daily balances has caused any material difference in the information presented.

The tables also present information for the periods and at the date indicated with respect to the difference between the average yield earned on interest-earning assets and average rate paid on interest-bearing liabilities, or "interest rate spread," which savings institutions have traditionally used as an indicator of profitability. Another indicator of an institution's net interest income is its "net yield on interest-earning assets," which is its net interest income divided by the average balance of interest-earning assets. Net interest income is affected by the interest rate spread and by the relative amounts of interest-earning assets and interest-bearing liabilities. When interest-earning assets approximate or exceed interest-bearing liabilities, any positive interest rate spread will generate net interest income.

At December 31, 2007		
	<u>Balance</u>	<u>Weighted Average Yield/Cost</u>
	(Dollars in thousands)	
Interest-earning assets:		
Loans receivable, net	\$ 576,252	7.60 %
Non taxable securities available for sale	17,156	5.45 % *
Taxable securities available for sale	125,154	4.70 %
Federal Home Loan Bank stock	3,836	7.00 %
Securities held to maturity	14,095	4.61 %
Time deposits and other interest- bearing cash deposits	<u>4,686</u>	<u>3.64%</u>
Total interest-earning assets	741,179	6.93%
Non-interest-earning assets	<u>67,173</u>	
Total assets	<u>\$ 808,352</u>	
Interest-bearing liabilities:		
Deposits	\$ 546,527	4.28%
FHLB borrowings	101,882	4.62 %
Repurchase agreements	37,199	4.18%
Subordinated debentures	<u>10,310</u>	<u>7.22%</u>
Total interest-bearing liabilities	695,918	4.36 %
Non-interest-bearing liabilities	<u>56,631</u>	
Total liabilities	752,549	
Common stock	41	
Additional paid-in capital	26,077	
Retained earnings	36,065	
Treasury stock	(6,112)	
Accumulated other comprehensive loss	<u>(268)</u>	
Total liabilities and equity	<u>\$ 808,352</u>	
Interest rate spread		<u>2.57%</u>
Ratio of interest-earning assets to interest-bearing liabilities		<u>106.5 %</u>

* Tax equivalent yield at the Company's 34% tax bracket and a 4.30% cost of funds rate.

Year Ended December 31,

	2007			2006			2005		
	Average Balance	Interest	Average Yield/Cost	Average Balance	Interest	Average Yield/Cost	Average Balance	Interest	Average Yield/Cost
(Dollars in Thousands)									
Interest-earning assets:									
Loans receivable, net.....	\$532,761	41,031	7.70%	\$451,239	31,861	7.06%	\$369,093	22,006	5.96%
Taxable securities AFS	138,392	6,512	4.71%	157,182	7,150	4.55%	142,942	5,891	4.12%
Non taxable securities AFS	15,159	727	4.80%	15,654	751	4.80%	19,414	975	5.02%
Securities held to maturity	17,549	771	4.39%	18,385	785	4.27%	21,449	977	4.55%
Time deposits and other interest-bearing cash deposits	10,152	519	5.11%	6,463	346	5.35%	3,456	119	3.44%
Total interest-earning assets	\$714,013	49,560	6.94%	\$648,923	40,893	6.30%	\$556,354	29,968	5.39%
Non-interest-earning assets	66,379			54,610			43,464		
Total assets	<u>780,392</u>			<u>703,533</u>			<u>599,818</u>		
Interest-bearing liabilities:									
Deposits.....	\$536,619	22,279	4.15%	\$471,766	16,905	3.58%	\$424,930	11,909	2.80%
Borrowings.....	136,103	6,612	4.86%	133,891	6,383	4.77%	90,056	3,565	3.96%
Total interest-bearing liabilities.....	672,722	28,891	4.29%	605,657	23,288	3.85%	514,986	15,474	3.00%
Non-interest-bearing liabilities	55,139			46,796			35,224		
Total liabilities	727,861			652,453			550,210		
Common stock	41			41			40		
Additional paid-in capital	25,996			25,969			25,941		
Retained earnings.....	33,917			33,087			30,335		
Unearned restricted shares	---			---			(181)		
Treasury stock.....	(5,788)			(4,959)			(4,857)		
Accumulated other comprehensive loss	(1,635)			(3,058)			(1,670)		
Total liabilities and Stockholders' equity.....	<u>780,392</u>			<u>703,533</u>			<u>599,818</u>		
Net interest income		<u>20,669</u>			<u>17,605</u>			<u>14,494</u>	
Interest rate spread			<u>2.65%*</u>			<u>2.45%*</u>			<u>2.39%*</u>
Net interest margin.....			<u>2.89%*</u>			<u>2.71%*</u>			<u>2.61%*</u>
Ratio of average interest- earning assets to average interest-bearing liabilities.....			<u>106.14%</u>			<u>107.14%</u>			<u>108.03%</u>

Using a 34% tax rate.

* The tax equivalent adjustment was \$527, \$225 and \$302 for 2007, 2006 and 2005 respectively

Rate Volume Analysis

The following table sets forth certain information regarding changes in interest income and interest expense of the Company for the periods indicated. For each category of interest-earning asset and interest-bearing liability, information is provided on changes attributable to: (i) changes in volume (changes in volume from year to year multiplied by the average rate for the prior year) and (ii) change in rate (changes in the average rate from year to year multiplied by the prior year's volume).

	Year Ended December 31,					
	2007 vs. 2006			2006 vs. 2005		
	Increase (Decrease) due to		Total Increase (Decrease)	Increase (Decrease) due to		Total Increase (Decrease)
Rate	Volume	Rate		Volume		
(Dollars in thousands)						
Interest-earning assets:						
Loans receivable	\$ 2,817	6,353	9,170	\$ 4,055	5,800	9,855
Securities available for sale, taxable	246	(884)	(638)	611	648	1,259
Securities available for sale, non taxable	(2)	(22)	(24)	(43)	(181)	(224)
Securities held to maturity	23	(37)	(14)	(61)	(131)	(192)
Other interest- earning assets	<u>(15)</u>	<u>188</u>	<u>173</u>	<u>66</u>	<u>161</u>	<u>227</u>
Total interest- earning assets	<u>3,069</u>	<u>5,598</u>	<u>8,667</u>	<u>4,628</u>	<u>6,297</u>	<u>10,925</u>
Interest-bearing liabilities:						
Deposits	2,681	2,693	5,374	3,318	1,678	4,996
Borrowings	<u>118</u>	<u>111</u>	<u>229</u>	<u>775</u>	<u>2,043</u>	<u>2,818</u>
Total interest- bearing liabilities	<u>2,799</u>	<u>2,804</u>	<u>5,603</u>	<u>4,093</u>	<u>3,721</u>	<u>7,814</u>
Increase in net interest income	\$ <u>270</u>	<u>2,794</u>	<u>3,064</u>	\$ <u>535</u>	<u>2,576</u>	<u>3,111</u>

Critical Accounting Policies and Estimates

The Company's financial statements are prepared in accordance with accounting principles generally accepted in the United States of America. The financial information contained within these statements is, to a significant extent, financial information that is based on appropriate measures of the financial effects of transactions and events that have already occurred. Based on its consideration of accounting policies that involved the most complex and subjective decisions and assessments, management has identified its most critical accounting policy to be that related to the allowance for loan losses. The Company's allowance for loan loss methodology incorporates a variety of risk considerations, both quantitative and qualitative; in establishing an allowance for loan loss that management believes is appropriate at each reporting date. Quantitative factors included the Company's historical loss experience, delinquency and charge-off trends, collateral values, changes in non-performing loans, and other factors. Quantitative factors also incorporate known information about individual loans, including borrower's sensitivity to economic conditions throughout the southeast and particular, the state of certain industries. Size and complexity of individual credits in relation to loan structure, existing loan policies and pace of portfolio growth are other qualitative factors that are considered in the methodology. As the Company adds new products and increases the complexity of the loan portfolio, its methodology accordingly may change. In addition, it may report materially different amounts for the provision for loan losses in the statement of operations if management's assessment of the above factors changes in future periods. This discussion and analysis should be read in conjunction with the Company's consolidated financial statements and the accompanying notes presented elsewhere herein. Although management believes the levels of the allowance for loan losses as of both December 31, 2007 and 2006 were adequate to absorb inherent losses in the loan portfolio, a decline in local economic conditions, or other factors, could result in increasing losses that cannot be reasonably predicted at this time. The Company also considers its policy on non-accrual loans as a critical accounting policy. Loans are placed on non-accrual when a loan is specifically determined to be impaired or when principal or interest is delinquent for 91 days or more. Any accrued interest on these loans is reserved for as part of management's evaluation of the allowance for loan loss account.

Comparison of Financial Condition at December 31, 2007 and December 31, 2006

The Company's total assets increased by \$37.5 million, from \$770.9 million at December 31, 2006 to \$808.4 million at December 31, 2007. Federal funds sold increased from \$3.3 million at December 31, 2006 to \$3.8 million at December 31, 2007. Securities held to maturity decreased \$3.9 million due to two agency bonds being called. The available for sale portfolio declined \$41.0 million.

The Company's net loan portfolio increased by \$81.3 million during the year ended December 31, 2007. Net loans totaled \$495.0 and \$576.3 at December 31, 2006 and December 31, 2007, respectively. The increase in the loan activity during the year ended December 31, 2007 was due to increased economic activity in many of the Company's markets as well as the Company's recent expansion into middle Tennessee. For the year ended December 31, 2007, the Company's tax equivalent average yield on loans was 7.70%, compared with 7.06% for the year ended December 31, 2006.

At December 31, 2007, the Company's investments classified as held to maturity were carried at an amortized cost and an estimated fair market value of \$14.1 million, and its securities classified as available for sale had an estimated fair market value of \$142.3 million and an amortized cost of \$142.8 million. At December 31, 2007, the Company's investment in Federal Home Loan Bank stock was carried at an amortized cost of \$3.8 million. See Note 2 of Notes to Consolidated Financial Statements.

The allowance for loan losses totaled \$4.8 million at December 31, 2007, an increase of approximately \$370,000 from the allowance for loan losses of \$4.5 million at December 31, 2006. The ratio of the allowance for loan losses to loans was 0.83% and 0.90% at December 31, 2007 and 2006, respectively. Also, at December 31, 2007, the Company's non-accrual loans were approximately \$547,000 or 0.09% of total loans, compared to \$762,000, or 0.15% of total loans, at December 31, 2006. The Company's ratio of allowance for loan losses to non-performing loans at December 31, 2007 and 2006 was 816.53% and 517.96%, respectively.

Comparison of Operating Results for the Years Ended December 31, 2007 and 2006

Net Income. The Company's net income for the years ended December 31, 2007 was \$4.1 million compared to \$3.9 million at December 31, 2006.

Net Interest Income. Net interest income for the year ended December 31, 2007 was \$20.1 million, compared to \$17.4 million for the year ended December 31, 2006. The increase in net interest income for the year ended December 31, 2007 was the result of the Company's ability to utilize excess cash flow from its investment portfolio to fund loan growth. For the year ended December 31, 2007, the Company's tax equivalent average yield on total interest-earning assets was 6.94% compared to 6.30% for the year ended December 31, 2006, and its average cost of interest-bearing liabilities was 4.29%, compared to 3.85% for the year ended December 31, 2006. As a result, the Company's tax equivalent interest rate spread for the year ended December 31, 2007 was 2.65%, compared to 2.45% for the year ended December 31, 2006 and its tax equivalent net interest margin was 2.89% for the year ended December 31, 2007, compared to 2.71% for the year ended December 31, 2006.

Interest Income. Interest income increased \$8.3 million to \$49.0 million from \$40.7 million, or by 20.4% during the year ended December 31, 2007 compared to 2006. The increase was attributable to an increase in the volume of loans outstanding. The average balance on securities held to maturity decreased approximately \$900,000, from \$18.4 million at December 31, 2006 to \$17.5 million at December 31, 2007. The average balance on taxable securities available for sale declined \$18.8 million, from \$157.2 million at December 31, 2006 to \$138.4 million at December 31, 2007. The average balance of non-taxable securities available for sale decreased approximately \$500,000, from \$15.7 million at December 31, 2006 to \$15.2 million at December 31, 2007. Average time deposits and other interest-bearing cash deposits increased \$3.7 million, from \$6.5 million at December 31, 2006 to \$10.2 million at December 31, 2007. Overall, average total interest-earning assets increased \$65.1 million from December 31, 2006 to December 31, 2007.

Interest Expense. Interest expense increased to \$28.9 million for the year ended December 31, 2007 compared to \$23.3 million for 2006. The increase in interest expense was attributable to an increase in the average balances of both interest bearing deposits and repurchase borrowings as well as an increase in short-term interest rates. The average cost of average interest-bearing deposits increased from 3.58% for the year ended December 31, 2006 to 4.15% for the year ended December 31, 2007.

Over the same period, the average balance of interest bearing deposits increased from \$471.8 million for the year ended December 31, 2006 to \$536.6 million at December 31, 2007. The average balance of FHLB borrowings declined from \$111.0 million for the year ended December 31, 2006 to \$95.7 million for the year ended December 31, 2007. The average cost of FHLB borrowings increased from 4.52% for the year ended December 31, 2006 to 4.63% for the year ended December 31, 2007. The average balance of repurchase agreements increased from by \$12.6 million for the year ended December 31, 2006 to \$30.1 million for the year ended December 31, 2007. This increase was largely the result of a \$10 million wholesale repurchased agreement executed during 2007. The average cost of repurchased agreements declined from 5.00% for the year ended December 31, 2006 to 4.68% for the year ended December 31, 2007.

Provision for Loan Losses. The Company determined that an additional \$976,000 and \$1.0 million in provision for loan losses was required for the years ended December 31, 2007 and December 31, 2006, respectively.

Non-Interest Income. Non-interest income increased by \$1.4 million for the year ended December 31, 2007 to \$7.2 million, compared to \$5.8 million for the year ended December 31, 2006. The increase in non-interest income is the result of higher income realized on deposit accounts. In 2007, the Company's fee income from its financial services division increased by \$400,000, to \$1.1 million. The increase was the result of both additional staffing and improved production.

Non-Interest Expense. Total non-interest expense for the year ended December 31, 2007 was \$20.6 million, compared to \$16.5 million in 2006. The increase was the result of the Company's expansion of retail offices in 2006 and 2007. In the last eighteen months, the Company's retail banking network has increased from nine to eighteen offices. In the last twenty-four months ending February 2008, the number of automated teller machines has increased from eleven to sixty-four.

Income Taxes. The effective tax rate for the year ended December 31, 2007 was 29.6% compared with an effective tax rate of 30.3% for the year ended December 31, 2006. The lower effective tax rate is the result of higher balances of tax exempt loans and securities.

Comparison of Operating Results for the Years Ended December 31, 2006 and 2005

Net Income. The Company's net income for the year ended December 31, 2006 was \$3.9 million compared to \$4.1 million for the year ended December 31, 2005.

Net Interest Income. Net interest income for the year ended December 31, 2006 was \$17.4 million, compared to \$14.2 million for the year ended December 31, 2005. The increase in net interest income for the year ended December 31, 2006 was the result of loan and investment portfolio growth and an increase in short-term interest rates. For the year ended December 31, 2006, the Company's tax equivalent average yield on total interest-earning assets was 6.30% compared to 5.39% for the year ended December 31, 2005, and its average cost of interest-bearing liabilities was 3.85%, compared to 3.00% for the year ended December 31, 2005. As a result, the Company's tax equivalent interest rate spread for the year ended December 31, 2006 was 2.45%, compared to 2.39% for the year ended December 31, 2005 and its tax equivalent net interest margin was 2.71% for the year ended December 31, 2006, compared to 2.61% for the year ended December 31, 2005.

Interest Income. Interest income increased \$11.0 million from \$29.7 million to \$40.7 million, or by 37.1% during the year ended December 31, 2006 compared to 2005. The increase was attributable to an increase in loan and investment volume as well as an increase in short-term interest rates on such interest earning assets. The average balance on securities held to maturity declined approximately \$3.0 million, from \$21.4 million at December 31, 2005 to \$18.4 million at December 31, 2006. The average balance on taxable securities available for sale increased \$14.3 million, from \$142.9 million at December 31, 2005 to \$157.2 million at December 31, 2006. The average balance of non-taxable securities available for sale decreased approximately \$3.7 million, from \$19.4 million at December 31, 2005 to \$15.7 million at December 31, 2006. Average time deposits and other interest-bearing cash deposits increased approximately \$3.0 million, from \$3.5 million at December 31, 2005 to \$6.5 million at December 31, 2006. Overall, average total interest-earning assets increased approximately \$92.6 million from December 31, 2005 to December 31, 2006.

Interest Expense. Interest expense increased to \$23.3 million for the year ended December 31, 2006 compared to \$15.5 million for 2005. The increase in interest expense was attributable to an increase in the average balances of both deposit and Federal Home Loan Bank (FHLB) borrowings as well as an increase in short-term interest rates. The average cost of average interest-bearing liabilities increased from 3.00% for the year ended December 31, 2005 to 3.85% for the year ended December 31, 2006. Over the same period, the average balance of interest bearing deposits increased from \$424.9 million for the year ended December 31, 2005 to \$471.8 million at December 31, 2006. The average balance of FHLB borrowings increased from \$79.7 million for the year ended December 31, 2005 to \$111.0 million for the year ended December 31, 2006. The average cost of FHLB borrowings increased from 3.62% for the year ended December 31, 2005 to 4.52% for the year ended December 31, 2006. The Company's cost of repurchase agreements was 5.00% for the year ended December 31, 2006. The Company did not offer repurchase agreements prior to 2006.

Provision for Loan Losses. The Company determined that an additional \$1.0 million in provision for loan losses was required for the year ended December 31, 2006. For the year ended December 31, 2005, the Company determined that a provision for loan losses of \$1.25 million was required.

Non-Interest Income. Non-interest income increased by \$1.3 million for the year ended December 31, 2006 to \$5.8 million, compared to \$4.5 million for the year ended December 31, 2005. The increase in non-interest income is the result of higher income realized on checking accounts and a larger volume of loan applications. Gains on the sale of loans and securities decreased from \$518,000 for the year ended December 31, 2005 to \$192,000 for the year ended December 31, 2006. The decrease in gains on the sale of securities is the result of the sale of the Bank's data processing provider, Intrive, Inc. in 2005.

Non-Interest Expense. Total non-interest expense for the year ended December 31, 2006 was \$16.5 million, compared to \$11.6 million in 2005. The increase was the result of several factors, including the June 2006 acquisition of four retail offices in Middle Tennessee, the addition of a new office in Hopkinsville, Kentucky, the addition of one retail office in Clarksville, Tennessee and the planned addition of two additional offices in Clarksville.

Income Taxes. The effective tax rate for the year ended December 31, 2006 was 30.3%, compared to 29.7% for 2005. The increase in the Company's effective tax rate is the result of a reduced balance in municipal bonds.

Liquidity and Capital Resources

The Company's primary business is that of the Bank. Management believes dividends that may be paid from the Bank to the Company will provide sufficient funds for the Company's current and anticipated needs; however, no assurance can be given that the Company will not have a need for additional funds in the future. The Bank is subject to certain regulatory limitations with respect to the payment of dividends to the Company.

Capital Resources. At December 31, 2007, the Bank exceeded all regulatory minimum capital requirements. For a detailed discussion of the OTS' regulatory capital requirements, and for a tabular presentation of the Bank's compliance with such requirements, see Note 15 of Notes to Consolidated Financial Statements.

Liquidity. Liquidity management is both a daily and long-term function of business management. If the Bank requires funds beyond its ability to generate them internally, the Bank believes that it could borrow funds from the FHLB. At December 31, 2007, the Bank had outstanding advances of \$101.9 million from the FHLB and \$34.9 million of letters of credit issued by the FHLB to secure municipal deposits. The Bank can immediately borrow an additional \$32.2 million from the FHLB. See Note 7 of Notes to Consolidated Financial Statements.

Subordinated Debentures Issuance. On September 25, 2003, the Company issued \$10,310,000 of subordinated debentures in a private placement offering. The securities have a thirty-year maturity and are callable at the issuer's discretion on a quarterly basis beginning five years after issuance. The securities are priced at a variable rate equal to the three-month Libor plus 3.10%. Interest is paid and the rate of interest may change on a quarterly basis. The Company's subsidiary, a federal chartered thrift supervised by the Office of Thrift Supervision (OTS) may recognize the proceeds of trust preferred securities as capital. OTS regulations provide that 25% of Tier 1 capital may consist of trust preferred proceeds. See Note 10 of Notes to Consolidated Financial Statements.

The Bank's primary sources of funds consist of deposits, repayment of loans and mortgage-backed securities, maturities of investments and interest-bearing deposits, and funds provided from operations. While scheduled repayments of loans and mortgage-backed securities and maturities of investment securities are predictable sources of funds, deposit flows and loan prepayments are greatly influenced by the general level of interest rates, economic conditions and competition. The Bank uses its liquidity resources principally to fund existing and future loan commitments, to fund maturing certificates of deposit and demand deposit withdrawals, to invest in other interest-earning assets, to maintain liquidity, and to meet operating expenses.

Management believes that loan repayments and other sources of funds will be adequate to meet the Bank's liquidity needs for the immediate future. A portion of the Bank's liquidity consists of cash and cash equivalents. At December 31, 2007, cash and cash equivalents totaled \$22.0 million. The level of these assets depends upon the Bank's operating, investing and financing activities during any given period.

Cash flows from operating activities for the years ended December 31, 2007, 2006 and 2005 were \$7.3 million, \$5.3 million, and \$5.1 million, respectively.

Cash flows from investing activities were a net use of funds of \$38.3 million, \$60.1 million and \$63.8 million in 2007, 2006 and 2005, respectively. A principal source of cash in this area has been purchases of securities available for sale of \$44.6 million offset by proceeds from sales, calls and maturities of securities of \$88.2 million during 2007. Maturities, calls and cash flow from securities classified as held to maturity exceeded purchases by \$3.9 million. At the same time, the investment of cash in loans was \$82.7 million in 2007, \$65.2 million in 2006 and \$42.6 million in 2005. Purchases of securities available for sale exceeded maturities and sales by \$9.7 million in 2006 and \$21.6 million in 2005. Cash flows from securities available for sale that were sold, matured or called exceeded purchase by \$43.4 million in 2007. There were no purchases of securities classified as held to maturity in 2007, 2006 and 2005.

At December 31, 2007, the Bank had \$51.3 million in outstanding commitments to originate loans and unused lines of credit of \$44.7 million. The Bank anticipates that it will have sufficient funds available to meet its current loan origination and lines of credit commitments. Certificates of deposit, which are scheduled to mature in one year or less totaled \$248.5 million at December 31, 2007. Based on historical experience, management believes that a significant portion of such deposits will remain with the Bank.

Impact of Inflation and Changing Prices

The consolidated financial statements and notes thereto presented herein have been prepared in accordance with accounting principles generally accepted in the United States of America, which require the measurement of financial position and operating results in terms of historical dollars without considering the change in the relative purchasing power of money over time and due to inflation. The impact of inflation is reflected in the increased cost of the Bank's operations.

Unlike most industrial companies, nearly all the assets and liabilities of the Company are monetary in nature. As a result, changes in interest rates have a greater impact on the Company's performance than do the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or to the same extent as the price of goods and services.

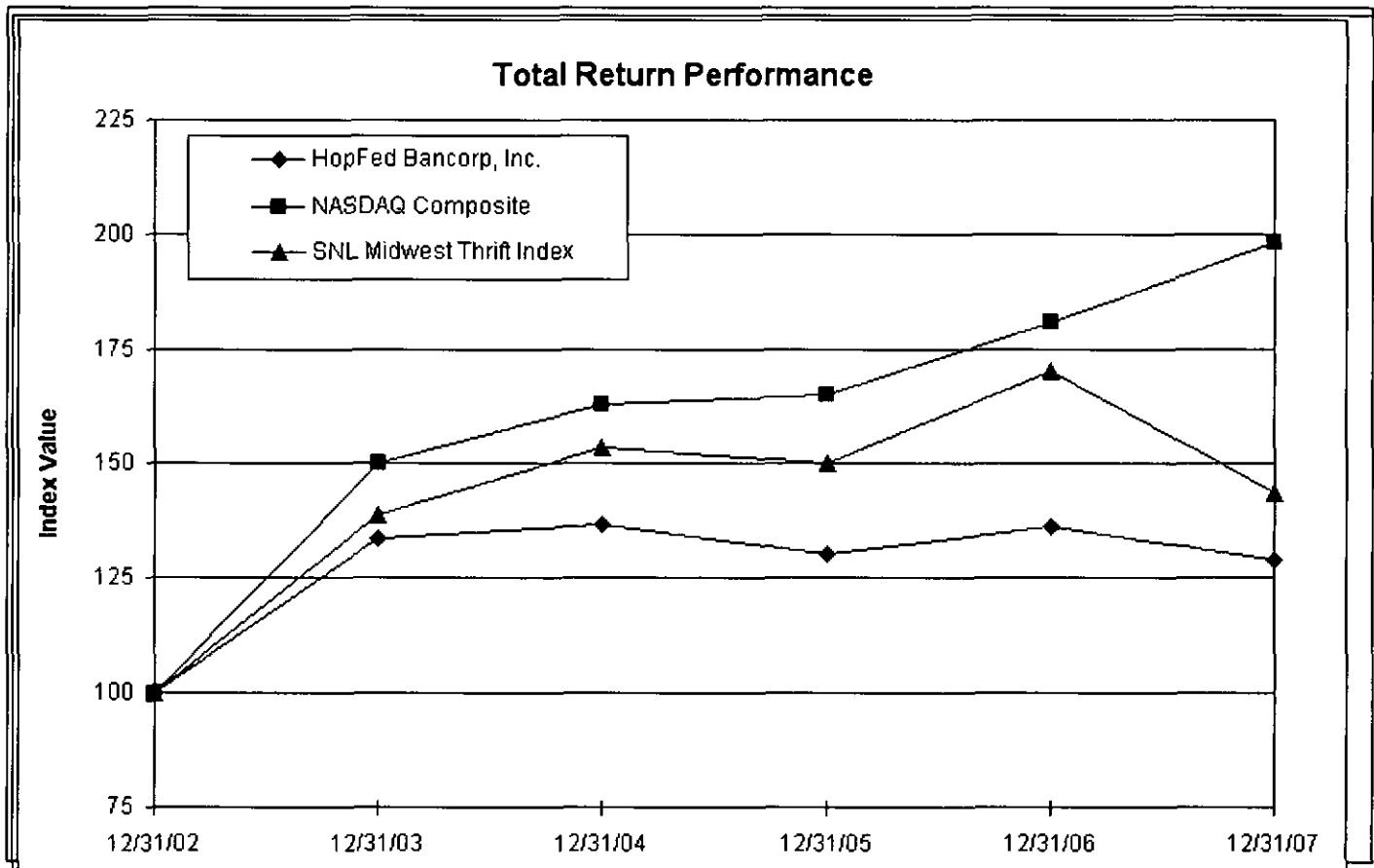
Forward-Looking Statements

Management's discussion and analysis includes certain forward-looking statements addressing, among other things, the Bank's prospects for earnings, asset growth and net interest margin. Forward-looking statements are accompanied by, and identified with, such terms as "anticipates," "believes," "expects," "intends," and similar phrases. Management's expectations for the Bank's future involve a number of assumptions and estimates. Factors that could cause actual results to differ from the expectations expressed herein include: substantial changes in interest rates, and changes in the general economy; changes in the Bank's strategies for credit-risk management, interest-rate risk management and investment activities. Accordingly, any forward-looking statements included herein do not purport to be predictions of future events or circumstances and may not be realized.

Stock Performance Comparison

The following graph, which was prepared by SNL Financial LC ("SNL"), shows the cumulative total return on the Common Stock of the Company since December 31, 2002, compared with the (1) the NASDAQ Composite Index, comprised of all U.S. Companies quoted on NASDAQ, (2) the SNL Midwest Thrift Index, comprised of publicly traded thrifts and thrift holding companies operating in the Midwestern United States. Cumulative total return on the Common Stock or the index equals the total increase in value since December 31, 2002 assuming reinvestment of all dividends paid into the Common Stock or the index, respectively. The graph was prepared assuming that \$100 was invested on December 31, 2002 in the Common Stock, and the securities included in the indices.

HopFed Bancorp, Inc.



Index	Period Ending					
	12/31/02	12/31/03	12/31/04	12/31/05	12/31/06	12/31/07
HopFed Bancorp, Inc.	100.00	133.78	136.56	130.35	136.38	128.83
NASDAQ Composite	100.00	150.01	162.89	165.13	180.85	198.60
SNL Midwest Thrift Index	100.00	138.93	153.42	149.92	170.16	143.72

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Consolidated Financial Statements

**HopFed Bancorp, Inc.
and Subsidiaries**

December 31, 2007, 2006 and 2005

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RAYBURN, BATES & FITZGERALD, P.C.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders
of HopFed Bancorp, Inc.
Hopkinsville, Kentucky

We have audited the accompanying consolidated balance sheets of HopFed Bancorp, Inc. and Subsidiaries (the "Company") as of December 31, 2007 and 2006, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2007. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. As of and for the years ended December 31, 2007, 2006, and 2005, the Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of HopFed Bancorp, Inc. and Subsidiaries as of December 31, 2007 and 2006, and the consolidated results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2007 in conformity with accounting principles generally accepted in the United States of America.

Rayburn, Bates & Fitzgerald, PC

Brentwood, Tennessee
March 28, 2008

HopFed Bancorp, Inc. and Subsidiaries

Consolidated Balance Sheets

December 31, 2007 and 2006
(Dollars in Thousands)

<u>Assets</u>	<u>2007</u>	<u>2006</u>
Cash and due from banks (notes 6 and 11)	\$17,343	14,423
Interest-earning deposits in Federal Home Loan Bank	931	4,190
Federal funds sold	<u>3,755</u>	<u>3,270</u>
Cash and cash equivalents	22,029	21,883
Federal Home Loan Bank stock, at cost (note 2)	3,836	3,639
Securities available for sale (notes 2 and 8)	142,310	183,339
Securities held to maturity, market value of \$14,109 for 2007 and \$17,690 for 2006, respectively (note 2)	14,095	18,018
Loans receivable, net of allowance for loan losses of \$4,842 for 2007 and \$4,470 for 2006, respectively (note 3)	576,252	494,968
Accrued interest receivable	5,235	4,809
Real estate and other assets owned	347	342
Bank owned life insurance	7,723	7,421
Premises and equipment, net (note 4)	27,260	25,200
Deferred tax assets (note 13)	823	1,712
Intangible asset (note 5)	2,665	3,626
Goodwill (note 5)	4,989	4,989
Other assets	<u>788</u>	<u>942</u>
Total assets	<u>\$808,352</u>	<u>770,888</u>
<u>Liabilities and Stockholders' Equity</u>		
Liabilities:		
Deposits: (note 6)		
Non-interest-bearing accounts	\$52,226	51,150
Interest-bearing accounts:		
NOW accounts	101,706	95,958
Savings and money market accounts	63,560	70,296
Other time deposits	<u>381,261</u>	<u>352,029</u>
Total deposits	\$598,753	569,433
Advances from Federal Home Loan Bank (note 7)	101,882	113,621
Repurchase agreements (note 8)	37,199	21,236
Subordinated debentures (note 10)	10,310	10,310
Advances from borrowers for taxes and insurance	316	287
Dividends payable	438	439
Accrued expenses and other liabilities (note 12)	<u>3,651</u>	<u>3,292</u>
Total liabilities	<u>752,549</u>	<u>718,618</u>

See accompanying notes to consolidated financial statements.

HopFed Bancorp, Inc. and Subsidiaries

Consolidated Balance Sheets, Continued

December 31, 2007 and 2006
(Dollars in Thousands)

	<u>2007</u>	<u>2006</u>
Stockholders' equity (notes 12, 15 and 16):		
Preferred stock, par value \$.01 per share; authorized - 500,000 shares; none issued or outstanding at December 31, 2007 and 2006	\$ ---	---
Common stock, par value \$.01 per share; authorized 7,500,000 shares; 4,079,092 issued and 3,592,033 outstanding at December 31, 2007 and 4,070,315 issued and 3,627,906 outstanding at December 31, 2006	41	41
Additional paid-in capital	26,077	25,918
Retained earnings-substantially restricted	36,065	33,678
Treasury stock (at cost, 487,059 shares at December 31, 2007 and 442,409 shares at December 31, 2006)	(6,112)	(5,406)
Accumulated other comprehensive loss, net of taxes	<u>(268)</u>	<u>(1,961)</u>
Total stockholders' equity	<u>55,803</u>	<u>52,270</u>
Total liabilities and stockholders' equity	<u>\$808,352</u>	<u>770,888</u>

Commitments and contingencies (notes 9, 11, and 14)

See accompanying notes to consolidated financial statements.

HopFed Bancorp, Inc. and Subsidiaries

Consolidated Statements of Income

For the Years ended December 31, 2007, 2006 and 2005
(Dollars in Thousands)

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Interest and dividend income:			
Loans receivable	\$40,720	31,861	22,006
Securities available for sale	6,512	7,150	5,891
Securities held to maturity	771	785	977
Nontaxable securities available for sale	511	526	673
Interest-earning deposits	<u>519</u>	<u>346</u>	<u>119</u>
Total interest and dividend income	<u>49,033</u>	<u>40,668</u>	<u>29,666</u>
Interest expense:			
Deposits (note 6)	22,279	16,905	11,909
Advances from Federal Home Loan Bank	4,428	5,021	2,885
Repurchase agreements	1,411	628	---
Subordinated debentures	<u>773</u>	<u>734</u>	<u>680</u>
Total interest expense	<u>28,891</u>	<u>23,288</u>	<u>15,474</u>
Net interest income	20,142	17,380	14,192
Provision for loan losses (note 3)	<u>976</u>	<u>1,023</u>	<u>1,250</u>
Net interest income after provision for loan losses	<u>19,166</u>	<u>16,357</u>	<u>12,942</u>
Non-interest income:			
Service charges	4,105	3,322	2,462
Merchant card income	494	319	120
Gain on sale of loans	98	141	138
Gain on sale of Intrieve, Inc. stock	---	18	345
Realized gain from sale of securities available for sale	6	33	35
Income from bank owned life insurance	302	263	260
Financial services commission	1,140	732	498
Other operating income	<u>1,086</u>	<u>937</u>	<u>674</u>
Total non-interest income	<u>7,231</u>	<u>5,765</u>	<u>4,532</u>

See accompanying notes to consolidated financial statements.

HopFed Bancorp, Inc. and Subsidiaries

Consolidated Statements of Income, Continued

For the Years ended December 31, 2007, 2006 and 2005
(Dollars in Thousands, Except Share and Per Share Amounts)

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Non-interest expenses:			
Salaries and benefits (note 12)	10,619	8,280	5,906
Occupancy expense (note 4)	2,672	1,726	1,038
Data processing expense	1,850	1,556	1,115
State deposit tax	504	465	437
Intangible amortization (note 5)	961	670	378
Professional services	1,412	1,496	855
Advertising expense	1,005	761	620
Postage and communications expense	550	432	333
Supplies expense	374	350	255
Other operating expenses	<u>606</u>	<u>778</u>	<u>663</u>
 Total non-interest expense	 <u>20,553</u>	 <u>16,514</u>	 <u>11,600</u>
 Income before income tax expense	 \$5,844	 5,608	 5,874
Income tax expense (note 13)	<u>\$1,728</u>	<u>1,700</u>	<u>1,744</u>
 Net income	 <u>\$4,116</u>	 <u>3,908</u>	 <u>4,130</u>
Earnings per share (note 17):			
Basic	<u>\$1.15</u>	<u>1.08</u>	<u>1.13</u>
Fully diluted	<u>\$1.14</u>	<u>1.07</u>	<u>1.13</u>
 Weighted average shares outstanding - basic	 <u>3,588,163</u>	 <u>3,634,138</u>	 <u>3,644,178</u>
Weighted average shares outstanding - diluted	<u>3,607,870</u>	<u>3,659,666</u>	<u>3,669,918</u>

See accompanying notes to consolidated financial statements.

HopFed Bancorp, Inc. and Subsidiaries
Consolidated Statements of Comprehensive Income
For the Years ended December 31, 2007, 2006 and 2005
(Dollars in Thousands)

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Net income			
Other comprehensive income, net of tax (note 21):	\$4,116	3,908	4,130
Unrealized gain (loss) on investment securities available for sale, net of tax	1,762	790	(2,087)
Gain (loss) on derivatives, net of tax	(65)	(74)	142
Reclassification adjustment for gains included in net income	<u>(4)</u>	<u>(22)</u>	<u>(23)</u>
Comprehensive income	<u>\$5,809</u>	<u>4,602</u>	<u>2,162</u>

See accompanying notes to consolidated financial statements.

HopFed Bancorp, Inc. and Subsidiaries
Consolidated Statements of Changes in Stockholders' Equity
For the Years ended December 31, 2007, 2006 and 2005
(Dollars in Thousands, Except Per Share and Share Amounts)

	Common Shares	Common Stock	Additional Paid-in Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Unearned Restricted Stock	Total Equity
Balance January 1, 2005	3,639,283	\$ 40	25,863	29,145	(4,857)	(687)	(131)	49,373
Net income	9,795	---	156	4,130	---	---	(156)	4,130
Restricted stock awards	---	---	---	---	---	---	---	---
Net change in unrealized gains (losses) on securities available for sale, net of taxes of \$1.103	---	---	---	---	---	(2,110)	---	(2,110)
Net change in unrealized gain (losses) on derivatives, net of taxes of \$89	---	---	---	(1,750)	---	142	---	142
Dividends (\$0.48 per share)	---	---	---	(1,750)	---	---	---	(1,750)
Compensation expense, restricted stock awards	---	---	---	---	---	---	57	57
Balance December 31, 2005	3,649,078	40	26,019	31,525	(4,857)	(2,655)	(230)	49,842
Change in accounting presentation	---	---	(230)	---	---	---	230	---
Net income	12,328	1	---	3,908	---	---	---	3,908
Restricted stock awards	---	---	---	---	---	---	---	---
Net change in unrealized gains (losses) on securities available for sale, net of taxes of \$396	---	---	---	---	---	---	---	---
Income recognized on derivative contract termination, net of income taxes of \$61	---	---	---	---	---	768	---	768
Dividends (\$0.48 per share)	---	---	---	(1,755)	---	(74)	---	(74)
Purchase of treasury stock	(33,500)	---	---	---	(549)	---	---	(1,755)
Compensation expense, options	---	---	29	---	---	---	---	(549)
Compensation expense, restricted stock awards	---	---	---	---	---	---	---	29
Balance December 31, 2006	3,627,906	41	25,918	33,678	(5,406)	(1,961)	---	52,270
Net income	9,082	---	---	4,116	---	---	---	4,116
Forfeit of restricted stock award	(305)	---	---	---	---	---	---	---
Net change in unrealized gains (losses) on securities available for sale, net of taxes of \$906	---	---	---	---	---	---	---	---
Purchase of treasury stock	(44,650)	---	---	---	(706)	---	---	(1,758)
Income recognized on derivative contract termination, net of income taxes of \$33	---	---	---	---	---	---	---	(706)
Dividends (\$0.48 per share)	---	---	---	(1,729)	---	(65)	---	(65)
Compensation expense, options	---	---	22	---	---	---	---	(1,729)
Compensation expense, restricted stock awards	---	---	---	---	---	---	---	22
Balance December 31, 2007	3,592,033	41	26,077	36,065	(6,112)	(2,688)	---	55,803

See accompanying notes to consolidated financial statements.

HopFed Bancorp, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

For the Years ended December 31, 2007, 2006 and 2005
(Dollars in Thousands)

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Cash flows from operating activities:			
Net income	\$4,116	3,908	4,130
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses	976	1,023	1,250
Depreciation	1,284	720	436
Amortization of intangible assets	961	670	378
Amortization of investment premiums and discounts, net	98	426	495
Provision (benefit) for deferred income taxes	(8)	(93)	(250)
Stock dividends on Federal Home Loan Bank stock	---	(198)	(155)
Compensation expense, restricted stock grants and options	159	129	57
Increase in cash surrender value of bank owned life insurance	(302)	(263)	(260)
Gain on sale of securities available for sale	(6)	(33)	(35)
Gain on sale of Intrieve, Inc. stock	---	(18)	(345)
Gain on sales of loans	(98)	(141)	(138)
Gain on settlement of derivative	(98)	(135)	---
Proceeds from sales of loans	5,547	9,431	12,007
Originations of loans sold	(5,449)	(9,290)	(11,869)
(Increase) decrease in:			
Accrued interest receivable	(426)	(973)	(644)
Other assets	154	(248)	(955)
Increase in accrued expenses and other liabilities	359	344	1,008
Net cash provided by operating activities	<u>7,267</u>	<u>5,259</u>	<u>5,110</u>
Cash flows from investing activities:			
Proceeds from calls and maturities of securities held to maturity	3,945	192	4,804
Proceeds from sale of Intrieve Inc. stock	---	18	360
Proceeds from sales, calls and maturities of securities available for sale	88,218	41,595	27,078
Proceeds from settlement of derivative	---	270	---
Purchase of securities available for sale	(44,639)	(51,300)	(48,694)
Net increase in loans	(82,740)	(65,232)	(42,631)
Purchase of Federal Home Loan Bank stock	(197)	(230)	(41)
Proceeds from sale of foreclosed asset	471	700	758
Proceeds from sales of premises and equipment	---	98	15
Purchase of premises and equipment	(3,317)	(8,669)	(5,477)
Net cash received in acquisition	---	<u>22,421</u>	---
Net cash used in investing activities	<u>(38,259)</u>	<u>(60,137)</u>	<u>(63,828)</u>

See accompanying notes to consolidated financial statements.

HopFed Bancorp, Inc. and Subsidiaries

Consolidated Statements of Cash Flows, Continued

**For the Years ended December 31, 2007, 2006 and 2005
(Dollars in Thousands)**

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Cash flows from financing activities:			
Net increase in demand deposits, savings, money market, NOW accounts and time deposits	\$29,320	21,220	46,533
(Decrease) increase in advance payments by borrowers for taxes and insurance	29	(8)	(6)
Advances from Federal Home Loan Bank	82,000	184,250	117,400
Repayment of advances from Federal Home Loan Bank	(93,739)	(163,801)	(105,547)
Increase in repurchase agreements	15,963	21,236	---
Purchase of treasury stock	(706)	(549)	---
Dividends paid	<u>(1,729)</u>	<u>(1,748)</u>	<u>(1,750)</u>
Net cash provided by financing activities	<u>31,138</u>	<u>60,600</u>	<u>56,630</u>
Increase (decrease) in cash and cash equivalents	146	5,722	(2,088)
Cash and cash equivalents, beginning of period	<u>21,883</u>	<u>16,161</u>	<u>18,249</u>
Cash and cash equivalents, end of period	<u>22,029</u>	<u>21,883</u>	<u>16,161</u>
Supplemental disclosures of Cash Flow Information:			
Interest paid	<u>13,225</u>	<u>11,393</u>	<u>15,283</u>
Income taxes paid	<u>1,542</u>	<u>2,175</u>	<u>2,015</u>
Supplemental disclosures of non-cash investing and financing activities:			
Foreclosures and in substance foreclosures of loans during year	<u>476</u>	<u>813</u>	<u>388</u>
Net unrealized gains on investment securities classified as available for sale	<u>2,664</u>	<u>1,164</u>	<u>(3,200)</u>
Increase (decrease) in deferred tax asset related to change in unrealized losses on investments	<u>(906)</u>	<u>(396)</u>	<u>1,103</u>
Dividends declared and payable	<u>431</u>	<u>439</u>	<u>438</u>
Issue of unearned restricted stock	<u>137</u>	<u>100</u>	<u>156</u>
Fair value of assets acquired	<u>---</u>	<u>61,409</u>	<u>---</u>
Fair value of liabilities assumed	<u>---</u>	<u>65,629</u>	<u>---</u>

See accompanying notes to consolidated financial statements.

HopFed Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2007, 2006 and 2005

(1) Summary of Significant Accounting Policies:

Nature of Operations and Customer Concentration

HopFed Bancorp, Inc. (the Corporation) is a bank holding company incorporated in the state of Delaware. The Company's principal business activities are conducted through its wholly-owned subsidiary, Heritage Bank (the Bank), which is a federally chartered savings bank engaged in the business of accepting deposits and providing mortgage, consumer, construction and commercial loans to the general public through its retail banking offices. The Bank's business activities are primarily limited to western Kentucky and middle and western Tennessee. The Bank is subject to competition from other financial institutions. Deposits at the Bank are insured up to the applicable limits by the Federal Deposit Insurance Corporation (FDIC). The Bank is subject to comprehensive regulation, examination and supervision by the Office of Thrift Supervision (OTS) and the FDIC.

A substantial portion of the Bank's loans are secured by real estate in the western Kentucky and middle and west Tennessee markets. In addition, foreclosed real estate is located in this same market. Accordingly, the ultimate ability to collect on a substantial portion of the Bank's loan portfolio and the recovery of a substantial portion of the carrying amount of foreclosed real estate is susceptible to changes in local market conditions.

Management believes that the allowance for loan losses is adequate. While management uses available information to recognize losses on loans and foreclosed real estate, future additions to the allowances may be necessary based on changes in local economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowances for losses on loans and foreclosed real estate. Such agencies may require the Bank to recognize additions to the allowances based on their judgments about information available to them at the time of their examination.

Principles of Consolidation

The consolidated financial statements include the accounts of the Corporation, the Bank and its wholly-owned subsidiary Fall & Fall Insurance (collectively the Company) for all periods. Significant inter-company balances and transactions have been eliminated in consolidation.

Accounting

The accounting and reporting policies of the Company are in accordance with accounting principles generally accepted in the United States of America and conform to general practices in the banking industry.

HopFed Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements, Continued

December 31, 2007, 2006 and 2005

(1) Summary of Significant Accounting Policies: (Continued)
Estimates

In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the consolidated balance sheet and revenues and expenses for the year. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses and the valuation of real estate acquired in connection with foreclosures or in satisfaction of loans. In connection with the determination of the allowances for loan losses and foreclosed real estate, management obtains independent appraisals for significant properties.

Cash and Cash Equivalents

Cash and cash equivalents are defined as cash on hand, amounts due on demand from banks, interest-earning deposits in the Federal Home Loan Bank and federal funds sold with maturities of three months or less.

Securities

The Company reports debt, readily-marketable equity, mortgage-backed and mortgage related securities in one of the following categories: (i) "held to maturity" (management has a positive intent and ability to hold to maturity) which are to be reported at cost, adjusted for premiums and discounts that are recognized in interest income; (ii) "trading" (held for current resale) which are to be reported at fair value, with unrealized gains and losses included in earnings; and (iii) "available for sale" (all other debt, equity, mortgage-backed and mortgage related securities) which are to be reported at fair value, with unrealized gains and losses reported net of tax as a separate component of stockholders' equity. At the time of new security purchases, a determination is made as to the appropriate classification. Realized and unrealized gains and losses on trading securities are included in net income. Unrealized gains and losses on securities available for sale are recognized as direct increases or decreases in stockholders' equity, net of any tax effect. Cost of securities sold is recognized using the specific identification method.

Interest income on securities is recognized as earned. The Company purchases many agency bonds at either a premium or discount to its par value. Premiums and discounts on agency bonds are amortized using the net interest method. For callable bonds purchased at a premium, the premium is amortized to the first call date. If the bond is not called on that date, the premium is fully amortized and the Company recognizes an increase in the net yield of the investment. For agency bonds purchased at a discount, the discount is accreted to the final maturity date. For callable bonds purchased at discount and called before maturity, the Company recognizes a gain on the sale of securities. The Company amortizes premiums and accretes discounts on mortgage back securities and collateralized mortgage obligations based on the average prepayment speeds in the three previous months.

Other Securities

Other securities, such as Federal Home Loan Bank stock are recognized at cost.

HopFed Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements, Continued

December 31, 2007, 2006 and 2005

(1) Summary of Significant Accounting Policies: (Continued)

Loans Receivable

Loans receivable are stated at unpaid principal balances, less the allowance for loan losses and deferred loan cost. The Statement of Financial Accounting Standards (SFAS 91), *Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*, requires the recognition of loan origination fee income over the life of the loan and the recognition of certain direct loan origination costs over the life of the loan. At December 31, 2007, the Company's deferred loan origination cost, net of unearned income, was approximately \$244,000.

Uncollectible interest on loans that are contractually past due is charged off, or an allowance is established based on management's periodic evaluation. The Company charges off loans after, in management's opinion, the collection of all or a large portion of the principal or interest is not collectible. The allowance is established by a charge to interest income equal to all interest previously accrued, and income is subsequently recognized only to the extent that cash payments are received while the loan is classified as non-accrual, when the loan is over ninety days past due. Loans may be returned to accrual status when all principal and interest amounts contractually due (including arrearages) are reasonably assured of repayment within an acceptable period of time, and there is a sustained period of repayment performance by the borrower in accordance with the contractual terms of interest and principal.

The Bank provides an allowance for loan losses and includes in operating expenses a provision for loan losses determined by management. Management's periodic evaluation of the adequacy of the allowance is based on the Bank's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, and current economic conditions. Management's estimate of the adequacy of the allowance for loan loss can be classified as either a reserve for currently classified loans or estimates of future losses in the current loan portfolio.

Loans are considered to be impaired when, in management's judgment, principal or interest is not collectible according to the contractual terms of the loan agreement. When conducting loan evaluations, management considers various factors such as historical loan performance, the financial condition of the borrower and adequacy of collateral to determine if a loan is impaired. Impaired loans may be classified as either substandard or doubtful and reserved for based on individual loans risk for loss. Loans not considered impaired may be classified as either special mention or watch and may be reserved for. Typically, unimpaired classified loans exhibit some form of weakness in either industry trends, collateral, or cash flow that result in a default risk greater than that of the Company's typical loan. All classified amounts include all unpaid interest and fees as well as the principal balance outstanding.

HopFed Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements, Continued

December 31, 2007, 2006 and 2005

(1) Summary of Significant Accounting Policies: (Continued)

Loans Receivable (Continued)

The measurement of impaired loans generally is based on the present value of future cash flows discounted at the historical effective interest rate, except that collateral-dependent loans generally are measured for impairment based on the fair value of the collateral. When the measured amount of an impaired loan is less than the recorded investment in the loan, the impairment is recorded as a charge to income and a valuation allowance, which is included as a component of the allowance for loan losses.

Management considers both the Bank's recent charge off history as well as industry trends when making an estimate as to the amount to reserve for losses in the current loan portfolio that are not individually classified. Industry trends are an especially important consideration as the Company's loan portfolio mix is changing. Portions of the loan portfolio, including commercial loans and non-residential real estate, have seen sizable increases in the last three years. Management believes that the limited time frame that these loans have been outstanding is not adequate for the development of a reasonable loss history. Management believes it has established the allowance in accordance with accounting principles generally accepted in the United States of America and has taken into account the views of its regulators and the current economic environment.

Fixed Rate Mortgage Originations

The Bank originates fixed rate first mortgage loans for customers in its local markets and sells these loans on the secondary market. The Company also operates a mortgage company that originates mortgage loans in the name of assorted investors. Originations may or may not result in the Bank retaining loan servicing rights. For the year ended December 31, 2007, the Bank maintained a servicing portfolio of one to four family real estate loans of approximately \$38.8 million. For the years ended December 31, 2007, 2006, and 2005, the Bank has reviewed the value of the servicing asset as well as the operational cost associated with servicing the portfolio. After this review, the Bank has determined that the values of its servicing rights are not material to the Company's consolidated financial statements.

Foreclosed Assets

Assets acquired through, or in lieu of, loan foreclosure are carried at the lower of cost or fair value less selling expenses. Costs of improving the assets are capitalized, whereas costs relating to holding the property are expensed. Management conducts periodic valuations and any adjustments to value are recognized in the current period's operations.

Brokered Deposits

The Company may chose to attract deposits from several sources, including using outside brokers to assist in obtaining time deposits using national distribution channels. Brokered deposits offer the Company an alternative to Federal Home Loan Bank advances.

HopFed Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements, Continued

December 31, 2007, 2006 and 2005

(1) Summary of Significant Accounting Policies: (Continued)

Repurchase Agreements

The Company sells investments from its portfolio to business and municipal customers with a written agreement to repurchase those investments on the next business day. The repurchase product gives business customers the opportunity to earn income on liquid cash reserves. These funds are overnight borrowings of the Company secured by Company assets and are not FDIC insured. The Company has also entered into two long-term repurchase agreements with third parties. The repurchase agreements have a ten year maturity and are callable quarterly.

Revenue Recognition

Mortgage loans held for sale are generally delivered to secondary market investors under firm sales commitments entered into prior to the closing of the individual loan. Loan sales and related gains or losses are recognized at settlement. Loan fees earned for the servicing of secondary market loans are recognized as earned.

Interest income on loans receivable is reported on the interest method. Interest income is not reported when full loan repayment is in doubt, typically when the loan is impaired or payments are past due more than 90 days. Interest continues to accrue on loans over 90 days past due if they are well secured and in the process of collection.

Income Taxes

Income taxes are accounted for through the use of the asset and liability method. Under the asset and liability method, deferred taxes are recognized for the tax consequences of temporary differences by applying enacted statutory rates applicable to future years to differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities. The effect on deferred taxes of a change in tax rates would be recognized in income in the period that includes the enactment date. The Company files its federal income tax return on a consolidated basis with its subsidiaries. All taxes are accrued on a separate entity basis.

Operating Segments

The Company's continuing operations include one primary segment, retail banking. The retail banking segment involves the origination of commercial, residential and consumer loans as well as the collections of deposits in fifteen branch offices.

Premises and Equipment

Land, land improvements, buildings, and furniture and equipment are carried at cost, less accumulated depreciation and amortization. Buildings and land improvements are depreciated generally by the straight-line method, and furniture and equipment are depreciated under various methods over the estimated useful lives of the assets. The Company capitalizes interest expense on construction in process at a rate equal to the Company's cost of funds. The estimated useful lives used to compute depreciation are as follows:

Land improvements	5-15 years
Buildings	40 years
Furniture and equipment	5-15 years

HopFed Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements, Continued

December 31, 2007, 2006 and 2005

(1) Summary of Significant Accounting Policies: (Continued)

Goodwill

In accordance with SFAS 142, *Goodwill and Other Intangible Assets*, goodwill is no longer amortized, but instead tested for impairment at least annually.

Intangible Assets

The intangible assets for insurance contracts and core deposits related to the Fulton acquisition of September 2002 are amortized using the straight-line method over the estimated period of benefit of seven years. The core deposit intangible asset related to the middle Tennessee acquisition of June 2006 is amortized using the sum of the year's digits method over an estimated period of nine years. The Company periodically evaluates the recoverability of the intangible assets and takes into account events or circumstances that warrant a revised estimate of the useful lives or indicates that impairment exists.

Bank Owned Life Insurance

Bank Owned Life Insurance policies (BOLI) are recorded at the cash surrender value or the amount to be realized upon current redemption.

Advertising

The Company expenses the production cost of advertising as incurred.

Financial Instruments

The Company has entered into off-balance-sheet financial instruments consisting of commitments to extend credit and commercial letters of credit. Such financial instruments are recorded in the consolidated financial statements when they are funded or related fees are incurred or received.

Derivative Instruments:

In 2004, the Company entered into a swap transaction in the amount of \$10 million with a financial institution. The critical terms of the interest rate swap match the term of the corresponding variable rate subordinated debt issuance. All components of the derivative instrument's gain or loss are included in the assessment of hedge effectiveness.

Under guidelines of *SFAS 133, Accounting for Derivative Instruments and Hedging Activities*, as amended, all derivative instruments are required to be carried at fair value on the consolidated balance sheet. SFAS 133 provides special hedge accounting provisions, which permit the change in fair value of the hedge item related to the risk being hedged to be recognized in earnings in the same period and in the same income statement line as the change in the fair value of the derivative.

A derivative instrument designated in a hedge relationship to mitigate exposure to changes in the fair value of an asset, liability or firm commitment attributable to a particular risk, such as interest rate risk, are considered fair value hedges under SFAS 133. Derivative instruments designated in a hedge relationship to mitigate exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges. Using these guidelines, The Company has documented the use of the above-mentioned swap as a cash flow hedge prior to its sale in January 2006.

HopFed Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements, Continued

December 31, 2007, 2006 and 2005

(1) Summary of Significant Accounting Policies: (Continued)

Derivative Instruments: (Continued)

Cash value hedges are accounted for by recording the fair value of the derivative instrument and the fair value related to the risk being hedged of the hedged asset or liability on the consolidated balance sheet with corresponding offsets recorded in the consolidated balance sheet. The adjustment to the hedged asset or liability is included in the basis of the hedged item, while the fair value of the derivative is recorded as a freestanding asset or liability. Actual cash receipts or payments and related amounts accrued during the period on derivatives included in a fair value hedge relationship are recorded as adjustments to the income or expense recorded on the hedged asset or liability.

Under both the fair value and cash flow hedge methods, derivative gains and losses not effective in hedging the change in fair value or expected cash flows of the hedged item are recognized immediately in the income statement. At the hedge's inception and at least quarterly thereafter, a formal assessment is performed to determine whether changes in the fair values or cash flows of the derivative instrument has been highly effective in offsetting changes in the fair values or cash flows of the hedged items and whether they are expected to be highly effective in the future. If it is determined a derivative instrument has not been, or will not continue to be highly effective as a hedge, hedged accounting is discontinued. SFAS 133 basis adjustments recorded on hedged assets and liabilities are amortized over the remaining life of the hedged item beginning no later than when hedge accounting ceases. There were no fair value hedging gains or losses, as a result of hedge ineffectiveness, recognized for the years ended December 31, 2007 and 2006. The Company recognized \$26,000 in interest expense for the years ended December 31, 2005 related to the interest rate swap.

In January 2006, the Bank settled the interest rate swap at a net gain of approximately \$270,000. The Company is recognizing this gain as a reduction of interest expense in equal installments on a quarterly basis beginning with the three month period ending March 31, 2006 through the three month period ending September 30, 2008. For the years ended December 31, 2006 and December 31, 2007, borrowing cost related to subordinated debentures was reduced by \$98,240 as a result of the settled interest rate swap.

The Bank, in the normal course of business, originates fixed rate mortgages that are sold to the Federal Home Loan Mortgage Corporation (Freddie Mac). Upon tentative underwriting approval by Freddie Mac, the Bank issues a thirty-day commitment to originate a fixed rate first mortgage under specific terms and conditions that the Bank intends to sell to Freddie Mac. As part of its activities to mitigate interest rate risk in the mortgage lending function, the Bank may commit to guarantee delivery of specific loan amounts, at specific yields, at specific dates to Freddie Mac with or without identifying specific closed loans. The Bank's failure to deliver loans under the terms and conditions of the commitment may result in a future liability to the Bank. SFAS 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities*, provides guidance on the types of loan commitments that are derivatives under SFAS 133 (and therefore required to be accounted for as derivatives) under the scope of SFAS 133. Generally, only commitments to originate mortgage loans that will be held for sale by the issuer of the loan are derivatives under the scope of SFAS 133. See Note 14 for additional information.

HopFed Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements, Continued

December 31, 2007, 2006 and 2005

(1) Summary of Significant Accounting Policies: (Continued)

Fair Values of Financial Instruments

SFAS 107, *Disclosures about Fair Value of Financial Instruments*, requires disclosure of fair value information about financial instruments, whether or not recognized in the consolidated balance sheets for which it is practicable to estimate that value. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in immediate settlement of the instruments. Fair value estimates are made at a point in time, based on relevant market information and information about the financial instrument. Accordingly, such estimates involve uncertainties and matters of judgment and therefore cannot be determined with precision. SFAS 107 excludes certain financial instruments and all non-financial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company.

The following are the more significant methods and assumptions used by the Company in estimating its fair value disclosures for financial instruments:

Cash and cash equivalents

The carrying amounts reported in the consolidated balance sheets for cash and cash equivalents approximate those assets' fair values, because they mature within 90 days or less and do not present credit risk concerns.

Available-for-sale and held-to-maturity securities

Fair values for investment securities available-for-sale and held-to-maturity are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments.

Loans receivable

The fair values for loans receivable are estimated using discounted cash flow analysis which considers future re-pricing dates and estimated repayment dates, and further using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Loan fair value estimates include judgments regarding future expected loss experience and risk characteristics.

Accrued interest receivable

Fair value is estimated to approximate the carrying amount because such amounts are expected to be received within 90 days or less and any credit concerns have been previously considered in the carrying value.

Repurchase agreements

Overnight repurchase agreements have a fair value at book, given that they mature overnight. Longer maturity repurchase agreements are assigned a fair value of book given the limited nature of a secondary market.

Bank owned life insurance

The fair value of bank owned life insurance is the cash value of the policy.

HopFed Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements, Continued

December 31, 2007, 2006 and 2005

- (1) Summary of Significant Accounting Policies: (Continued)
Fair Value of Financial Instruments (Continued)

Deposits

The fair values disclosed for deposits with no stated maturity such as demand deposits, interest-bearing checking accounts and savings accounts are, by definition, equal to the amount payable on demand at the reporting date (that is, their carrying amounts). The fair values for certificates of deposit and other fixed maturity time deposits are estimated using a discounted cash flow calculation that applies interest rates currently being offered on such type accounts to a schedule of aggregated contractual maturities on such time deposits.

Advances from the Federal Home Loan Bank

The fair value of these advances is estimated by discounting the future cash flows of these advances using the current rates at which similar advances could be obtained.

FHLB stock

The fair value of FHLB stock is recognized at cost.

Subordinated debentures

The fair value of subordinated debentures is cost. The subordinated debentures re-price quarterly at a rate equal to three month libor plus 3.10%.

Off-Balance-Sheet Instruments

Off-balance-sheet lending commitments approximate their fair values due to the short period of time before the commitment expires.

Earnings Per Share

Earnings per share (EPS) consists of two separate components, basic EPS and diluted EPS. Basic EPS is computed by dividing net income by the weighted average number of common shares outstanding for each period presented. Diluted EPS is calculated by dividing net income by the weighted average number of common shares outstanding plus dilutive common stock equivalents (CSE). CSE consists of dilutive stock options granted through the Company's stock option plan. Restricted stock awards represent future compensation expense and are dilutive. Common stock equivalents which are considered anti-dilutive are not included for the purposes of this calculation.

Stock Compensation

On January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123R, *Share Based Payment* (as amended). SFAS No. 123R established accounting requirements for share-based compensation to employees and carries forward prior guidance on share-based awards to non-employees. SFAS No. 123R eliminates the ability to account for share-based compensation transactions, as the Company did, using the intrinsic value method as prescribed by Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, and generally requires that such transactions be accounted for using a fair-value-based method and recognized as an expense in the accompanying consolidated statements of income.

HopFed Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements, Continued

December 31, 2007, 2006 and 2005

(1) Summary of Significant Accounting Policies: (Continued)

Stock Compensation: (Continued)

The Company adopted SFAS No. 123R using the modified prospective method which requires the application of the accounting standard as of January 1, 2006. The consolidated condensed financial statement dated March 31, 2006 was the first to reflect the impact of adopting SFAS No. 123R. In accordance with the modified prospective method, the consolidated financial statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS No. 123R.

For the twelve-month periods ended December 31, 2007 and December 31, 2006, the implementation of SFAS No. 123R had the following affect on the Company's consolidated financial statements:

	<u>2007</u>	<u>2006</u>
Income before income tax expense	\$(21,800)	\$(29,000)
Net income	\$(21,800)	\$(29,000)
Basic earnings per share	<u>\$(0.01)</u>	<u>\$(0.01)</u>
Fully diluted earnings per share	<u>\$(0.01)</u>	<u>\$(0.01)</u>

At December 31, 2007, the Company has 5,000 unvested stock options vesting in May 2008. All other options are fully vested. As a result of adopting SFAS No. 123R, the Company will incur additional after tax expense related to the vesting of stock options of approximately \$6,000 in 2008.

The Company utilized the Black-Scholes valuation model to determine the fair value of stock options on the date of grant. The model derives the fair value of stock options based on certain assumptions related to the expected stock prices volatility, expected option life, risk-free rate of return and the dividend yield of the stock. The expected live of options granted are estimated based on historical employee exercise behavior. The risk free rate of return coincides with the expected life of the options and is based on the ten year Treasury note rate at the time the options are issued. The historical volatility levels of the Company's common stock are used to estimate the expected stock price volatility. The set dividend yield is used to estimate the expected dividend yield of the stock.

The value of vested options outstanding at December 31, 2007 is \$1.6 million for options issued under the 1999 Plan and \$144,800 for options vested under the 2000 Plan. The fair value of options vested in 2007 is \$21,800. Shares issued for option exercises are expected to come from authorized but unissued shares.

HopFed Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements, Continued

December 31, 2007, 2006 and 2005

(1) Summary of Significant Accounting Policies: (Continued)

Stock Compensation: (Continued)

At December 31, 2007, the Company has stock options totaling 246,723 that are eligible to be awarded under the 1999 Stock Option Plan. Additional stock option information at December 31, 2007 includes:

	Outstanding Options	Weighted Average Exercise Price	Weighted Average Remaining Term	Aggregate Intrinsic Value
Outstanding, December 31, 2007	273,752	\$ 15.22	2.35 years	\$333,900
Exercisable, December 31, 2007	268,752	\$ 15.18	2.27 years	\$333,900

The following is a reconciliation of reported and pro forma net income and earnings per share had compensation cost for the plan been determined based on the fair value of SFAS 123, *Accounting for Stock-Based Compensation*, as amended for the year ended:

	<u>December 31, 2005</u> <u>(Dollars in thousands)</u>
Net income as reported	\$4,130
Total stock-based employee compensation expense determined under fair value based method for all awards granted, net of related tax effects	<u>(38)</u>
Pro forma net income	<u>\$4,092</u>
	<u>December 31, 2005</u>
Earnings per share:	
Basic - as reported	\$1.13
Basic - pro forma	\$1.12
<i>Diluted - as reported</i>	\$1.13
<i>Diluted - pro forma</i>	\$1.12

HopFed Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements, Continued

December 31, 2007, 2006 and 2005
(Table Amounts in Thousands)

(1) Summary of Significant Accounting Policies: (Continued)

Stock Compensation: (Continued)

The Company's Compensation Committee granted 9,082 shares of restricted stock in 2007, 12,328 shares of restricted stock in 2006 and 9,795 shares of restricted stock in 2005. The Company had 305 shares of restricted stock granted in 2006 that were forfeited in 2007. These shares vest over a four-year period but vesting may be accelerated as a result of factors outlined in the award agreement. The Company incurred compensation expense related to the HopFed Bancorp, Inc. 2004 Long Term Incentive Plan of \$137,000 in 2007, \$100,000 in 2006, and \$57,000 in 2005. The table below outlines the Company's future compensation expense related to the HopFed Bancorp, Inc. 2004 Long Term Incentive Plan for the years indicated:

<u>Year Ending</u>	<u>Approximate Future Compensation Expense</u>
December 31, 2008	\$140
December 31, 2009	\$102
December 31, 2010	\$ 59
December 31, 2011	\$ 18

The Compensation Committee may make additional awards of restricted stock, thereby increasing the future expense related to this plan. The early vesting of restricted stock awards due to factors outlined in the award agreement may accelerate future compensation expenses related to the plan. However, the total amount of future compensation expense would not change as a result of an accelerated vesting of shares. At December 31, 2007, the Company has 160,213 restricted shares available from the HopFed Bancorp, Inc. 2004 Long Term Incentive Plan that may be awarded.

HopFed Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements, Continued

December 31, 2007, 2006 and 2005

(1) Summary of Significant Accounting Policies: (Continued)

Effect of New Accounting Pronouncements

In February 2006, the FASB issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments (SFAS 155)*. SFAS 155 amends FASB Statement No. 133 and FASB Statement No. 140, and improves the financial reporting of certain hybrid financial instruments by requiring more consistent accounting that eliminates exemptions and provides embedded derivatives to be accounted for as a whole (eliminating the need to bifurcate the derivative from the host) if the holder elects to account for the whole instrument on a fair value basis. The Company was required to adopt the provisions of SFAS 155, as applicable, beginning in 2007. The adoption of SFAS 155 did not have a material impact on the Company's consolidated financial position and results of operations.

In March of 2006, the FASB issued SFAS No. 156, *Accounting for Servicing of Financial Assets, an amendment to FASB Statement No. 140 (FASB 156)*. SFAS 156 permits, but does not require, an entity to account for one or more classes of servicing rights at fair value, which the changes in fair value recorded on the Company's consolidated statement of income. The Company has a mortgage servicing portfolio of approximately \$41.2 million. The Company has chosen not to recognize servicing rights as an asset on its financial statements and thus has chosen not to implement SFAS 156.

In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109 (FIN 48)*. Fin 48 requires companies to recognize in their financial statements the impact of a tax position, taken or expected to be taken, if that position is more likely than not of being sustained on audited based on the technical merits of the position. The Company files consolidated federal and multi-state income tax returns. With few exceptions, we are not subject to federal income tax examinations for taxable periods prior to 2003, or state examinations prior to 2002. The provisions of FIN 48 were effective for the Company as of January 1, 2007 and did not have a material impact on the Company's financial statements.

HopFed Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements, Continued

December 31, 2007, 2006 and 2005

(1) Summary of Significant Accounting Policies: (Continued)

Effect of New Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements (SFAS 157)*. SFAS 157 defines fair value, establishes a framework for measuring fair value under GAAP and Enhances disclosures about fair value measurements. SFAS 157 defines fair value as the exchange price that would be received for or asset or paid to transfer a liability in the most economical market on the measurement date. SFAS is effective for the Company's financial statements issued for the year beginning January 1, 2008. Management has not yet evaluated the impact of the adoption of SFAS 157 on the Company's consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *Fair Value Option Statement for Financial Assets and Financial Liabilities – including an amendment of FASB Statement No. 115 (SFAS 159)*. SFAS No. 159 allows an entity the irrevocable option to elect fair value for the initial and subsequent measurement for certain financial assets and liabilities on an individual basis. Future changes in the fair value of these financial instruments would be recognized on the current period's statement of income while establishing additional disclosure requirements for these financial statements. The stated objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in the reported earnings caused by measuring related assets and liabilities differently without having to apply complex accounting provisions. FASB No. 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. Early adoption was permitted as of the beginning of the previous fiscal year provided that the entity made the choice in the first 120 days of that physical year and also elects to apply the provisions of FASB No. 157. The Company has chosen not to utilize the option of early adoption of FASB No. 159. The Company does not anticipate that the adoption of this statement will have a material effect on its consolidated financial statements.

In November 2007, the Securities and Exchange Commission issued *Staff Accounting Bulletin No. 109, (SAB 109)*. SAB 109 modifies how to apply generally accepted accounting principles to loan commitments that are accounted for at fair value through earnings. Prior to SAB 109, when companies measured the fair value of a derivative loan commitment, the expected net future cash flows related to the associated servicing of the loan was excluded. Under SAB 109, the expected net future cash flows related to the associated servicing of the loans sold will be included in the measurement of all written loan commitments that are accounted for at fair value of earnings. SAB 109 is effective for the Company January 1, 2008. The Company does not anticipate that the adoption of SAB 109 to have a material impact on its consolidated financial statements.

HopFed Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements, Continued

December 31, 2007, 2006 and 2005

(1) Summary of Significant Accounting Policies: (Continued)
Effect of New Accounting Pronouncements (Continued)

In March 2007, the FASB Emerging Issues Task Force reached a consensus on *Issue No. 06-10, Accounting for Deferred Compensation and Postretirement Benefit Aspects of Collateral Assignment Split-Dollar Life Insurance Arrangements*. This issue provides guidance to help companies determine whether a liability for the postretirement benefit associated with a collateral assignment split-dollar life insurance arrangement should be recorded in accordance with either *SFAS No. 106-Employees's Account for Postretirement Benefits Other Than Pensions* (if, in substance, a post retirement benefit plan exist) or *Accounting Principles Board Opinion 12* (if the arrangement is, in substance, an individual deferred compensation contract). EITF 06-10 also provides guidance on how a company should recognize and measure the asset in a collateral assignment split-dollar life insurance contract. EITF 06-10 was effective for the Company dated January 1, 2008. The Company does not anticipate that the adoption of this EITF to have a material impact on its consolidated financial statements.

In December 2007, the Financial Accounting Standards Board issued *SFAS No. 160, Noncontrolling Interest in Consolidated Financial Statements – An Amendment of ARB No. 51*. SFAS No. 160 requires noncontrolling interest to be treated as a separate component of equity, not as a liability or other item outside of equity. Disclosure requirements included net income and comprehensive income to be displayed for both the controlling and non-controlling interest and a separate schedule that shows the effects of any transactions with the non-controlling interest on the equity attributable to the controlling interest. The provisions of this statement are effective for fiscal years beginning after December 15, 2008. This statement should be applied prospectively except for the presentation and disclosure requirements which shall be applied retrospectively for all periods presented. The Company does not anticipate the adoption of SFAS No. 160 to have a material impact on its consolidated financial statements.

In December 2007, the Securities and Exchange Commission issued *SFAS 141R Business Combinations*. SFAS 141R clarified the definitions of both a business combination and a business. All business combinations will be accounted for under the purchase method. This standard defines the acquisition date as the only relevant date for recognition and measurement of the fair value of consideration paid. SFAS 141R requires the acquirer to expense all acquisition related cost. SFAS 141R defines the measurement period as the time after the acquisition date during which the acquirer may make adjustments to the provisional amounts recognized at the acquisition date. This period cannot exceed one year, and any subsequent adjustments to the provisional amounts are done so retrospectively and require a restatement of prior period data. The provisions of this statement are effective for business combinations during fiscal years beginning after December 31, 2008. The Company has not determined the impact of SFAS 141R on its consolidated financial statements.

HopFed Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements, Continued

December 31, 2007, 2006 and 2005
(Table Amounts in Thousands)

(2) Securities:

Securities, which consist of debt and equity investments, have been classified in the consolidated balance sheets according to management's intent. The carrying amount of securities available for sale and their estimated fair values follow:

	December 31, 2007			Estimated Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
Restricted:				
FHLB stock	<u>\$3,836</u>	==	==	<u>3,836</u>
Unrestricted:				
U.S. government and agency securities:				
Agency debt securities	\$71,442	656	(107)	71,991
Corporate bonds	2,037	--	(129)	1,908
Municipal bonds	17,379	25	(248)	17,156
Mortgage-backed securities:				
GNMA	1,341	--	(32)	1,309
FNMA	25,018	62	(414)	24,666
FHLMC	12,736	2	(222)	12,516
CMOs	<u>12,834</u>	<u>47</u>	<u>(117)</u>	<u>12,764</u>
	<u>142,787</u>	<u>792</u>	<u>(1,269)</u>	<u>142,310</u>

HopFed Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements, Continued

December 31, 2007, 2006 and 2005
(Table Amounts in Thousands)

(2) Securities: (Continued)

	December 31, 2006			Estimated Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
Restricted:				
FHLB stock	<u>\$3,639</u>	==	==	<u>3,639</u>
Unrestricted:				
U.S. government and agency securities:				
Agency debt securities	\$115,519	73	(1,367)	114,225
Corporate bonds	5,090	---	(105)	4,985
Municipal bonds	15,002	24	(397)	14,629
Mortgage-backed securities:				
GNMA	1,623	---	(53)	1,570
FNMA	25,181	51	(841)	24,391
FHLMC	9,998	---	(354)	9,644
CMOs	<u>14,068</u>	<u>36</u>	<u>(209)</u>	<u>13,895</u>
	<u>186,481</u>	<u>184</u>	<u>(3,326)</u>	<u>183,339</u>

The scheduled maturities of debt securities available for sale at December 31, 2007 and 2006 were as follows:

	Amortized Cost	Estimated Fair Value
<u>2007</u>		
Due within one year	\$11,424	\$11,384
Due in one to five years	37,084	37,100
Due in five to ten years	25,991	26,237
Due in more than ten years	<u>16,359</u>	<u>16,334</u>
	90,858	91,055
Mortgage-backed securities	<u>51,929</u>	<u>51,255</u>
Total unrestricted securities available for sale	<u>\$142,787</u>	<u>\$142,310</u>

HopFed Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements, Continued

December 31, 2007, 2006 and 2005
(Table Amounts in Thousands)

(2) Securities: (Continued)

<u>2006</u>	Amortized Cost	Estimated Fair Value
Due within one year	\$38,998	\$38,855
Due in one to five years	41,556	40,741
Due in five to ten years	41,248	40,586
Due after ten years	<u>13,809</u>	<u>13,657</u>
	135,611	133,839
Mortgage-backed securities	<u>50,870</u>	<u>49,500</u>
Total unrestricted securities available for sale	<u>\$186,481</u>	<u>\$183,339</u>

FHLB stock is an equity interest in the Federal Home Loan Bank. FHLB stock does not have a readily determinable fair value because ownership is restricted and a market is lacking. FHLB stock is classified as a restricted investment security, carried at cost and evaluated for impairment. The Bank had an equity interest in Intrieve, Incorporated, and the Bank's data processing service center. Intrieve, Inc. was purchased by Harland Financial Services in April 2005. As a result, the Company recognized a gain of approximately \$345,000 in 2005 and \$18,000 in 2006.

The estimated fair value and unrealized loss amounts of temporarily impaired investments as of December 31, 2007 are as follows:

	Less than 12 months		12 months or longer		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
<u>Held to maturity</u>						
U.S. government and agency securities:						
Agency debt securities	\$---	---	4,360	(10)	4,360	(10)
<u>Available for sale</u>						
U.S. government and agency securities:						
Agency debt securities	\$4,988	(2)	18,825	(105)	23,813	(107)
Corporate bonds	---	---	1,908	(129)	1,908	(129)
Municipal bonds	2,134	(17)	12,378	(231)	14,512	(248)
Mortgage-backed securities:						
GNMA	---	---	1,309	(32)	1,309	(32)
FNMA	4,351	(19)	17,418	(395)	21,769	(414)
FHLMC	2,341	(12)	8,104	(210)	10,445	(222)
CMOs	<u>1,659</u>	<u>(5)</u>	<u>7,321</u>	<u>(112)</u>	<u>8,980</u>	<u>(117)</u>
Total available for sale	<u>\$15,473</u>	<u>(55)</u>	<u>67,263</u>	<u>(1,214)</u>	<u>82,736</u>	<u>(1,269)</u>

HopFed Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements, Continued

December 31, 2007, 2006 and 2005

(2) Securities: (Continued)

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluations. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

At December 31, 2007, the Company has 121 securities with unrealized losses. With the exception of the Company's corporate bond portfolio, Management believes these unrealized losses relate to changes in interest rates and not credit quality. Management also believes the Company has the ability to hold these securities until maturity, or for the foreseeable future and therefore no declines are deemed to be other than temporary.

The Company's corporate bond portfolio consists of \$2 million of Ford Motor Acceptance Corporation bonds (FMAC) with \$1 million maturities in October 2008 and October 2009. The unrealized loss associated with these bonds is the result of a decline in the credit ratings of Ford, the parent company of FMAC, both of which are no longer investment grade. The Company reviews the statements of condition, operations, and cash flows of Ford and FMAC on a consolidated basis each quarter to ascertain that the company and its subsidiary have an adequate level of liquidity to meet both current and near-term obligations. At this time, management believes that both Ford and FMAC have adequate levels of liquidity to meet its obligations through the period that meets or exceeds the maturity of the Company's bonds held in its portfolio. Management will continue to monitor quarterly financial statements and Securities Exchange Commission (SEC) filings in an effort to monitor the ability of Ford and FMAC to meet their near-term liquidity needs.

As part of its normal course of business, the Bank holds significant balances of municipal and other deposits that require the Bank to pledge investment instruments as collateral. At December 31, 2007, the Bank pledged investments with a market value of approximately \$66.6 million to various municipal entities as required by law. In addition, the Bank has provided \$34.9 million of letters of credit issued by the Federal Home Loan Bank of Cincinnati to collateralize municipal deposits. The collateral for these letters of credit is the Bank's one to four family loan portfolio.

During 2007, the Company sold investment securities classified as available-for-sale for proceeds of \$1.5 million resulting in gross gains of \$6,000. During 2006, the Company sold investment securities classified as available-for-sale for proceeds of \$15.1 million resulting in gross gains of \$90,000 and gross losses of \$57,000. The Company sold investment securities classified as available-for-sale for proceeds of \$10.6 million resulting in gross gains of \$73,000 and gross losses of \$38,000 during 2005. During 2006 and 2005, the Company sold restricted investment securities for proceeds of \$18,000 and \$360,000 resulting in gross gains of \$18,000 and \$345,000 in 2006 and 2005, respectively.

HopFed Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements, Continued

December 31, 2007, 2006 and 2005
(Table Amounts in Thousands)

(2) Securities: (Continued)

The carrying amount of securities held to maturity and their estimated fair values follow:

	December 31, 2007			Estimated Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
<u>Held to maturity securities</u>				
U.S. government and agency securities:				
Agency debt securities	\$13,541	17	(10)	13,548
Mortgage-backed securities:				
GNMA	490	7	---	497
FNMA	<u>64</u>	---	---	<u>64</u>
	<u>554</u>	<u>7</u>	---	<u>561</u>
	<u>\$14,095</u>	<u>24</u>	<u>(10)</u>	<u>14,109</u>

	December 31, 2006			Estimated Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
<u>Held to maturity securities</u>				
U.S. government and agency securities:				
Agency debt securities	\$17,318	---	(337)	16,981
Mortgage-backed securities:				
GNMA	630	8	---	638
FNMA	<u>70</u>	1	---	71
	<u>700</u>	<u>9</u>	---	<u>709</u>
	<u>\$18,018</u>	<u>9</u>	<u>(337)</u>	<u>17,690</u>

HopFed Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements, Continued

December 31, 2007, 2006 and 2005
(Table Amounts in Thousands)

(2) Securities: (Continued)

The scheduled maturities of debt securities held to maturity at December 31, 2007 were as follows:

	<u>Amortized Cost</u>	<u>Estimated Fair Value</u>
<u>2007</u>		
Due within one year	\$ 2,875	\$ 2,867
Due in one to five years	3,172	3,184
Due in five to ten years	4,000	4,003
Due after ten years	<u>3,494</u>	<u>3,494</u>
	13,541	13,548
Mortgage-backed securities	<u>554</u>	<u>561</u>
 Total unrestricted securities held to maturity	 <u>\$14,095</u>	 <u>\$14,109</u>

(3) Loans Receivable, Net:

The Company originates most fixed rate loans for immediate sale to the Federal Home Loan Mortgage Corporation (FHLMC) or other investors. Generally, the sale of such loans is arranged shortly after the loan application is tentatively approved through commitments.

The components of loans receivable in the consolidated balance sheets as of December 31, 2007 and December 31, 2006 were as follows:

	<u>2007</u>	<u>2006</u>
Real estate loans:		
One-to-four family first mortgages	\$183,901	\$190,839
Second mortgages (closed end)	6,771	5,986
Home equity lines of credit	32,216	29,089
Multi-family	24,538	12,018
Construction	50,230	39,379
Commercial real estate	<u>183,168</u>	<u>147,050</u>
Total real estate loans	480,824	424,361
 Loans secured by deposits	 4,419	 3,855
Other consumer loans	21,331	21,630
Commercial loans	<u>74,276</u>	<u>49,592</u>
	580,850	499,438
Deferred loan cost, net of income	244	---
Less: allowance for loan losses	<u>4,842</u>	<u>4,470</u>
Total loans, net	<u>\$576,252</u>	<u>\$494,968</u>

HopFed Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements, Continued

December 31, 2007, 2006 and 2005
(Table Amounts in Thousands)

(3) Loans Receivable, Net (Continued)

Loans serviced for the benefit of others totaled approximately \$44.4 million, \$45.6 million and \$47.3 million at December 31, 2007, 2006 and 2005, respectively. Servicing loans for others generally consists of collecting mortgage payments, maintaining escrow amounts, disbursing payments to investors and foreclosure processing.

Qualified one-to-four family first mortgage loans and non-residential real estate loans are pledged to the Federal Home Loan Bank of Cincinnati as discussed in note 7.

Impaired loans and related valuation allowance amounts at December 31, 2007 and 2006 were as follows:

	<u>2007</u>	<u>2006</u>
Recorded investment	<u>\$2,073</u>	<u>1,650</u>
Valuation allowance	<u>\$488</u>	<u>361</u>

The average recorded investment in impaired loans for the years ended December 31, 2007, 2006 and 2005 was \$1,916,000, \$1,914,000, and \$2,273,000, respectively. Interest income recognized on impaired loans was not significant during the years ended December 31, 2007, 2006 and 2005.

An analysis of the change in the allowance for loan losses for the years ended December 31, 2007, 2006 and 2005 follows:

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Balance at beginning of year	\$4,470	\$4,004	\$3,273
Loans charged off	(921)	(1,003)	(649)
Recoveries	317	261	130
Credit devaluation of purchased loans	---	185	---
Provision for loan losses	<u>976</u>	<u>1,023</u>	<u>1,250</u>
Balance at end of year	<u>\$4,842</u>	<u>\$4,470</u>	<u>\$4,004</u>

Non-accrual loans totaled \$547,000 and \$762,000 at December 31, 2007 and 2006, respectively. Real estate and other assets owned totaled \$347,000 and \$342,000 at December 31, 2007 and 2006, respectively. Interest income foregone on such loans was not significant during 2007, 2006 and 2005. The Company is not committed to lend additional funds to borrowers whose loans have been placed on a non-accrual basis.

There were \$46,000 in loans three months or more past due and still accruing interest as of December 31, 2007. There were \$101,000 in loans three months or more past due and still accruing interest as of December 31, 2006.

HopFed Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements, Continued

December 31, 2007, 2006 and 2005
(Table Amounts in Thousands)

(3) Loans Receivable, Net: (Continued)

The Company originates loans to officers and directors and their affiliates at terms substantially identical to those available to other borrowers. Loans to officers and directors at December 31, 2007 and 2006 were approximately \$11,382,000 and \$8,655,000, respectively. At December 31, 2007, funds committed that were undisbursed to officers and directors approximated \$4.2 million.

The following summarizes activity of loans to officers and directors and their affiliates for the years ended December 31, 2007 and 2006:

	<u>2007</u>	<u>2006</u>
Balance at beginning of period	\$8,655	\$10,179
New loans	7,197	1,195
Principal repayments	<u>(4,470)</u>	<u>(2,719)</u>
Balance at end of period	<u>\$11,382</u>	<u>\$8,655</u>

(4) Premises and Equipment:

Components of premises and equipment included in the consolidated balance sheets as of December 31, 2007 and 2006 consisted of the following:

	<u>2007</u>	<u>2006</u>
Land	\$5,370	\$5,370
Land improvements	468	130
Buildings	19,844	15,192
Construction in process	---	3,213
Furniture and equipment	<u>5,398</u>	<u>3,989</u>
	31,080	27,894
Less accumulated depreciation	<u>3,820</u>	<u>2,694</u>
	<u>\$27,260</u>	<u>\$25,200</u>

Depreciation expense was approximately \$1,284,000, \$720,000, and \$436,000 for the years ended December 31, 2007, 2006 and 2005, respectively.

For the years ended December 31, 2007 and December 31, 2006, the Company capitalized interest expenses related to construction in process of approximately \$27,000 and \$115,000, respectively.

HopFed Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements, Continued

December 31, 2007, 2006 and 2005
(Table Amounts in Thousands)

(5) Goodwill and Intangible Assets:

Goodwill is tested for impairment on an annual basis and as events or circumstances change that would more likely than not reduce fair value below its carrying amount. In 2007 and 2006, the Company determined that its goodwill and intangibles were not impaired.

The amount of other intangible assets and the changes in the carrying amounts of other intangible assets for the years ended December 31, 2007, 2006 and 2005:

	<u>Core Deposits Intangible</u>	<u>Insurance Contracts Intangible</u>	<u>Total</u>
Balance, December 2004	\$1,669	86	1,755
Amortization	<u>(360)</u>	<u>(18)</u>	<u>(378)</u>
Balance, December 31, 2005	1,309	68	1,377
Acquisition of Tennessee offices	2,919	---	2,919
Amortization	<u>(652)</u>	<u>(18)</u>	<u>(670)</u>
Balance, December 31, 2006	3,576	50	3,626
Amortization	<u>(911)</u>	<u>(50)</u>	<u>(961)</u>
Balance, December 31, 2007	<u>\$2,665</u>	<u>---</u>	<u>2,665</u>

The estimated amortization expense for intangible assets for the subsequent years is as follows:

	<u>Core Deposits Intangible</u>
2008	\$847
2009	651
2010	357
2011	292
2012	227
Thereafter	<u>291</u>
	<u>\$2,665</u>

HopFed Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements, Continued

December 31, 2007, 2006 and 2005
(Table Amounts in Thousands)

(6) Deposits:

At December 31, 2007, the scheduled maturities of other time deposits were as follows:

2008	\$248,539
2009	97,563
2010	19,942
2011	8,640
2012	<u>6,577</u>
	<u>\$381,261</u>

The amount of other time deposits with a minimum denomination of \$100,000 was approximately \$143.6 million and \$143.7 million at December 31, 2007 and 2006, respectively. At December 31, 2007, directors, members of senior management and their affiliates had deposits in the Bank of approximately \$2,142,000.

Interest expense on deposits for the years ended December 31, 2007, December 31, 2006 and December 31, 2005 is summarized as follows:

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Demand and NOW accounts	\$3,216	2,692	1,865
Money market accounts	514	411	491
Savings	887	1,278	1,140
Other time deposits	<u>17,662</u>	<u>12,524</u>	<u>8,413</u>
	<u>\$22,279</u>	<u>16,905</u>	<u>11,909</u>

The Bank maintains clearing arrangements for its demand, NOW and money market accounts with Compass Bank. The Bank is required to maintain certain cash reserves in its account to cover average daily clearings. At December 31, 2007, average daily clearings were approximately \$5.0 million.

At December 31, 2007, the Company had approximately \$595,000 of deposit accounts in overdraft status and thus has been reclassified to loans on the accompanying consolidated balance sheet. The Company had approximately \$620,000 of deposit accounts in overdraft status at December 31, 2006. At December 31, 2007 and December 31, 2006, the Company had deposits classified as brokered deposits totaling \$19.8 million and \$24.9 million, respectively. The Company had no brokered deposits at December 31, 2005.

HopFed Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements, Continued

December 31, 2007, 2006 and 2005

(Table Amounts in Thousands, Except Percentages)

(7) Advances from Federal Home Loan Bank:

Federal Home Loan Bank (FHLB) advances are summarized as follows:

Types of Advances	December 31,			
	2007		2006	
	<u>Amount</u>	<u>Weighted Average Rate</u>	<u>Amount</u>	<u>Weighted Average Rate</u>
Fixed-rate	\$91,882	4.58%	\$89,821	4.62%
Variable-rate	\$10,000	3.88%	\$23,800	5.38%
Total	<u>\$101,882</u>	<u>4.51%</u>	<u>\$113,621</u>	<u>4.78%</u>

Scheduled maturities of FHLB advances as of December 31, 2007 are as follows:

Years Ended	Fixed	Fixed Rate	Variable	Variable
<u>December 31,</u>	<u>Rate</u>	<u>Avg Cost</u>	<u>Rate</u>	<u>Rate</u>
2008	32,000	5.17%	---	---
2009	10,000	3.83%	---	---
2010	9,000	4.26%	---	---
2011	10,000	5.26%	---	---
2012	---	n/a	---	---
Thereafter	<u>30,882</u>	<u>4.11%</u>	<u>10,000</u>	<u>3.88%</u>
Total	<u>91,882</u>	<u>4.58%</u>	<u>10,000</u>	<u>3.88%</u>

The Bank has an approved line of credit of \$30.0 million at December 31, 2007 which is secured by a blanket agreement to maintain residential first mortgage loans and non-residential real estate loans with a principal value of 125% of the outstanding advances and has a variable interest rate. The Company can immediately borrow the full amount of this line of credit at December 31, 2007. All borrowings with the FHLB are secured under a blanket agreement using the Bank's portfolio of 1-4 family home loans and non-residential real estate loans as collateral. At December 31, 2007, the Bank could borrow a total of \$32.2 million from the FHLB of Cincinnati.

HopFed Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements, Continued

December 31, 2007, 2006 and 2005
(Table Amounts in Thousands, Except Percentages)

(8) Repurchase Agreements

In 2006, the Bank enhanced its cash management product line to include an automated sweep of excess funds from checking accounts to repurchase accounts, allowing interest to be paid on excess funds remaining in checking accounts of business and municipal customers. Repurchase balances are overnight borrowings from customers and are not FDIC insured. In addition, the Company has entered into two long term repurchase agreements with third parties.

At December 31, 2007, the Company provided investment securities with a market value of \$36.1 million and a book value of \$35.9 million as collateral for repurchase agreements.

At December 31, 2007 and December 31, 2006, the respective cost and maturities of the Company's repurchase agreements are as follows:

December 31, 2007

<u>Third Party</u>	<u>Balance</u>	<u>Average Cost</u>	<u>Maturity</u>	<u>Comments</u>
Merrill Lynch	\$ 6,000	4.36%	9/18/2016	Quarterly callable
Deutsche Bank	10,000	4.28%	9/05/2014	Quarterly callable beginning 9/05/2008
Various customers	<u>21,199</u>	<u>4.79%</u>		Overnight
Total	<u>\$37,199</u>	<u>4.54%</u>		

December 31, 2006

<u>Third Party</u>	<u>Balance</u>	<u>Average Cost</u>	<u>Maturity</u>	<u>Comments</u>
Merrill Lynch	\$ 6,000	4.36%	9/18/2016	Quarterly callable
Various customers	<u>15,236</u>	<u>5.10%</u>		Overnight
Total	<u>\$21,236</u>	<u>5.00%</u>		

HopFed Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements, Continued

December 31, 2007, 2006 and 2005
(Table Amounts in Thousands)

(9) Financial Instruments:

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit, standby letters of credit, and financial guarantees. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets. The contract or notional amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit and financial guarantees written is represented by the contractual notional amount of those instruments. The Company uses the same credit policies in making these commitments and conditional obligations as it does for on-balance-sheet instruments.

	December 31,	
	2007	2006
Commitments to extend credit	\$51,342	\$41,993
Standby letters of credit	4,559	4,459
Unused commercial lines of credit	10,915	8,990
Unused home equity lines of credit	33,755	31,200

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the counter-party. Collateral held varies but may include property, plant, and equipment and income-producing commercial properties.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements, including commercial paper, bond financing, and similar transactions. Most guarantees extend from one to two years. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers.

The fair value of standby letters of credit is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements, the likelihood of the counter parties drawing on such financial instruments and the present creditworthiness of such counter parties. Such commitments have been made on terms which are competitive in the markets in which the Company operates, thus, the fair value of standby letters of credit equals the carrying value for the purposes of this disclosure. The maximum potential amount of future payments that the Company could be required to make under the guarantees totaled \$4,559,000 at December 31, 2007.

HopFed Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements, Continued

**December 31, 2007, 2006 and 2005
(Table Amounts in Thousands)**

(9) Financial Instruments: (Continued)

The estimated fair values of financial instruments were as follows at December 31, 2007:

	<u>Carrying Amount</u>	<u>Estimated Fair Value</u>
Financial assets:		
Cash and due from banks	\$17,343	17,343
Interest-earning deposits in Federal Home Loan Bank	931	931
Federal funds sold	3,755	3,755
Securities available for sale	142,310	142,310
Federal Home Loan Bank stock	3,836	3,836
Securities held to maturity	14,095	14,109
Loans receivable	576,252	600,772
Accrued interest receivable	5,235	5,235
Bank owned life insurance	7,723	7,723
Financial liabilities:		
Deposits	598,753	602,243
Advances from borrowers for taxes and insurance	316	316
Advances from Federal Home Loan Bank	101,882	105,007
Repurchase agreements	37,199	39,254
Subordinated debentures	10,310	10,310
Off-balance-sheet liabilities:		
Commitments to extend credit	--	--
Commercial letters of credit	--	--

HopFed Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements, Continued

December 31, 2007, 2006 and 2005
(Table Amounts in Thousands)

(9) Financial Instruments: (Continued)

The estimated fair values of financial instruments were as follows at December 31, 2006:

	<u>Carrying</u> <u>Amount</u>	<u>Estimated</u> <u>Fair</u> <u>Value</u>
Financial assets:		
Cash and due from banks	\$14,423	14,423
Interest-earning deposits in Federal Home Loan Bank	4,190	4,190
Federal funds sold	3,270	3,270
Securities available for sale	183,339	183,339
Federal Home Loan Bank stock	3,639	3,639
Securities held to maturity	18,018	17,690
Loans receivable	494,968	485,611
Accrued interest receivable	4,809	4,809
Bank owned life insurance	7,421	7,421
Financial liabilities:		
Deposits	569,433	570,247
Advances from borrowers for taxes and insurance	287	287
Advances from Federal Home Loan Bank	113,621	111,108
Repurchase agreements	21,236	21,236
Subordinated debentures	10,310	10,310
Off-balance-sheet liabilities:		
Commitments to extend credit	--	--
Commercial letters of credit	--	--

(10) Subordinated Debentures:

On September 25, 2003, the Company formed HopFed Capital Trust I (the Trust). The Trust is a statutory trust formed under the laws of the state of Delaware. In September 2003, the Trust issued variable rate capital securities with an aggregate liquidation amount of \$10,000,000 (\$1,000 per preferred security) to a third-party investor. The Company then issued floating rate junior subordinated debentures aggregating \$10,310,000 to the Trust. The junior subordinated debentures are the sole assets of the Trust. The junior subordinated debentures and the capital securities pay interest and dividends, respectively, on a quarterly basis. The variable interest rate is the three-month LIBOR plus 3.10% adjusted quarterly (8.34% for the quarter ending December 31, 2007). These junior subordinated debentures mature in 2033, at which time the capital securities must be redeemed. The junior subordinated debentures and capital securities can be redeemed contemporaneously, in whole or in part, beginning October 8, 2008 at a redemption price of \$1,000 per capital security.

HopFed Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements, Continued

December 31, 2007, 2006 and 2005

(10) Subordinated Debentures: (Continued)

The Company has provided a full-irrevocable and unconditional guarantee on a subordinated basis of the obligations of the Trust under the capital securities in the event of the occurrence of an event of default, as defined in such guarantee. Debt issuance cost and underwriting fees of \$190,000 were capitalized related to the offering and are being amortized to the first call date of the junior subordinated debentures.

(11) Concentrations of Credit Risk:

Most of the Bank's business activity is with customers located within the western part of the Commonwealth of Kentucky and middle and western Tennessee. One-to-four family residential and non residential real estate collateralize the majority of the loans. The Bank requires collateral for the majority of loans.

The distribution of commitments to extend credit approximates the distribution of loans outstanding. The contractual amounts of credit-related financial instruments such as commitments to extend credit and commercial letters of credit represent the amounts of potential accounting loss should the contract be fully drawn upon, the customer default, and the value of any existing collateral become worthless.

Cash and cash equivalents with financial institutions exceeded the insurance coverage as of December 31, 2007 and 2006. The excess balance of such items as of December 31, 2007 and 2006 was \$8.8 million and \$11.7 million, respectively.

(12) Employee Benefit Plans:

Stock Option Plan

On February 24, 1999, the Board of Directors of the Company adopted the HopFed Bancorp, Inc. 1999 Stock Option Plan (Option Plan), which was subsequently approved at the 1999 Annual Meeting of Stockholders. Under the Option Plan, the Option Committee has discretionary authority to grant stock options and stock appreciation rights to such employees, directors and advisory directors, as the committee shall designate. The Option Plan reserved 403,360 shares of common stock for issuance upon the exercise of options or stock appreciation rights.

The Company will receive the exercise price for shares of common stock issued to Option Plan participants upon the exercise of their option, and will receive no monetary consideration upon the exercise of stock appreciation rights. The Board of Directors granted options to purchase 403,360 shares of common stock under the Option Plan at an exercise price of \$20.75 per share, which was the fair market value on the date of the grant. As a result of the special dividend of \$4.00 per share paid in December, 1999, and in accordance with plan provisions, the number of options and the exercise price has been adjusted to 480,475 and \$17.42 respectively.

HopFed Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements, Continued

December 31, 2007, 2006 and 2005

(12) Employee Benefit Plans: (Continued)

Stock Option Plan (Continued)

On May 31, 2000, the Board of Directors of the Company adopted the HopFed Bancorp, Inc. 2000 Stock Option Plan (the "2000 Option Plan"). Under the 2000 Option Plan, the option committee has discretionary authority to grant stock options to such employees as the committee shall designate. The 2000 Option Plan reserves 40,000 shares of common stock for issuance upon the exercise of options. The Company will receive the exercise price for shares of common stock issued to 2000 Option Plan participants upon the exercise of their option. The Board of Directors has granted options to purchase 40,000 shares of common stock under the 2000 Option Plan at an exercise price of \$10.00 per share, which was the fair market value on the date of the grant.

The following summary represents the activity under the stock option plans:

	<u>Number of Shares</u>	<u>Weighted Average Exercise Price</u>
Options outstanding, December 2005	<u>273,752</u>	\$15.22
Granted	---	
Exercised	---	
Forfeited	---	
Options outstanding, December 2006	273,752	\$15.22
Granted	---	
Exercised	---	
Forfeited	---	
Options outstanding, December 2007	<u>273,752</u>	\$15.22

Stock options vest and become exercisable annually over a four-year period from the date of the grant.

The following is a summary of stock options outstanding at December 31, 2007:

<u>Exercise Price</u>	<u>Weighted Average Remaining Life (Years)</u>	<u>Outstanding Options</u>	<u>Options Exercisable</u>
\$ 17.42	1.2	153,752	153,752
12.33	3.6	60,000	60,000
17.34	6.4	20,000	15,000
<u>10.00</u>	<u>2.4</u>	<u>40,000</u>	<u>40,000</u>
\$ <u>15.22</u>	<u>2.3</u>	<u>273,752</u>	<u>268,752</u>

HopFed Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements, Continued

December 31, 2007, 2006 and 2005

(12) Employee Benefits Plan: (Continued)
HopFed Bancorp, Inc. 2004 Long Term Incentive Plan

On February 18, 2004, the Board of Directors of the Company adopted the HopFed Bancorp, Inc 2004 Long Term Incentive Plan (the Plan), which was subsequently approved at the 2004 Annual Meeting of Stockholders. Under the Plan, the Compensation Committee has discretionary authority to grant up to 200,000 shares in the form of restricted stock grants, options, and stock appreciation rights to such employees, directors and advisory directors as the committee shall designate. The grants vest in equal installments over a four-year period. Grants may vest immediately upon specific events, including a change of control of the Company, death or disability of award recipient, and termination of employment of the recipient by the Company without cause.

Awards are recognized as an expense to the Company in accordance with the vesting schedule. Awards in which the vesting is accelerated must be recognized as an expense immediately. Awards are valued at the closing stock price on the day the award is granted. In 2007, The Compensation Committee granted a total of 9,082 shares with a market value of \$140,000. In 2006, the Compensation Committee granted a total of 12,328 shares with a market value of \$192,000. A total of 305 restricted shares granted in 2006 were forfeited in 2007. In 2005, the Compensation Committee granted a total of 9,795 shares with a market value of \$156,000. The Company recognized \$137,000, \$100,000, and \$57,000 in compensation expense in 2007, 2006 and 2005, respectively.

401(K) Plan

During 2002, the Company initiated a 401(k) retirement program. The 401(k) plan is available to all employees who meet minimum eligibility requirements. Participants may generally contribute up to 15% of earnings, and in addition, management will match employee contributions up to 4%. In addition, the Company has chosen to provide all eligible employees an additional 4% of compensation without regards to the amount of the employee contribution. Expense related to Company contributions amounted to \$427,000, \$334,000, and \$270,000 in 2007, 2006 and 2005, respectively.

Deferred Compensation Plan

During the third quarter of 2002, the Company purchased assets and assumed the liabilities relating to a nonqualified deferred compensation plan for certain employees of the Fulton division. The Company owns single premium life insurance policies on the life of each participant and is the beneficiary of the policy value. When a participant retires, the benefits accrued for each participant will be distributed to the participant in equal installments for 15 years. The expense recognized by the Company for 2007, 2006, and 2005 amounted to \$19,000, \$21,000 and \$27,000, respectively. The Deferred Compensation Plan also provides the participant with life insurance coverage, which is a percentage of the net death proceeds for the policy, if any, applicable to the participant.

HopFed Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements, Continued

December 31, 2007, 2006 and 2005 (Table Amounts in Thousands, Except Percentages)

(13) Income Taxes:

The provision for income taxes for the years ended December 31, 2007, 2006 and 2005 consisted of the following:

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Current			
Federal	\$1,571	\$1,733	1,990
State	<u>165</u>	<u>60</u>	<u>4</u>
	1,736	1,793	1,994
Deferred			
Federal	(8)	(69)	(250)
State	<u>---</u>	<u>(24)</u>	<u>---</u>
	<u>(8)</u>	<u>(93)</u>	<u>(250)</u>
	<u>\$1,728</u>	<u>\$1,700</u>	<u>1,744</u>

Total income tax expense for the years ended December 31, 2007, 2006 and 2005 differed from the amounts computed by applying the federal income tax rate of 34 percent to income before income taxes as follows:

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Expected federal income tax expense at statutory tax rate	\$1,987	1,906	1,997
Effect of nontaxable interest income	(379)	(198)	(254)
Effect of nontaxable bank owned life insurance income	(103)	(89)	(88)
State taxes on income, net of federal benefit	109	23	---
Non deductible expenses	<u>114</u>	<u>58</u>	<u>89</u>
Total federal income tax expense	<u>\$1,728</u>	<u>1,700</u>	<u>1,744</u>
Effective rate	<u>29.57%</u>	<u>30.30%</u>	<u>29.70%</u>

The components of deferred taxes as of December 31, 2007 and 2006 are summarized as follows:

	<u>2007</u>	<u>2006</u>
Deferred tax assets:		
Allowance for loan loss	1,646	1,482
Accrued expenses	162	188
Unrealized depreciation on securities available for sale	<u>137</u>	<u>1,018</u>
	<u>1,945</u>	<u>2,688</u>
Deferred tax liabilities:		
FHLB stock dividends	(\$740)	(\$740)
Depreciation and amortization	(286)	(236)
Loans	<u>(96)</u>	<u>---</u>
	<u>(1,122)</u>	<u>(976)</u>
Net deferred tax asset	<u>\$823</u>	<u>\$1,712</u>

HopFed Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements, Continued

December 31, 2007, 2006 and 2005

(13) Income Taxes: (Continued)

The Small Business Protection Act of 1996, among other things, repealed the tax bad debt reserve method for thrifts effective for taxable years beginning after December 31, 1995. Thrifts such as the Bank may now only use the same tax bad debt reserve method that is allowed for commercial banks. A thrift with assets greater than \$500 million can no longer use the reserve method and may only deduct loan losses as they actually arise (i.e., the specific charge-off method).

The portion of a thrift's tax bad debt reserve that is not recaptured (generally pre-1988 bad debt reserves) under the 1996 law is only subject to recapture at a later date under certain circumstances. These include stock repurchase redemptions by the thrift or if the thrift converts to a type of institution (such as a credit union) that is not considered a bank for tax purposes. However, no further recapture would be required if the thrift converted to a commercial bank charter or was acquired by a bank. The Bank does not anticipate engaging in any transactions at this time that would require the recapture of its remaining tax bad debt reserves. Therefore, retained earnings at December 31, 2007 and 2006 includes approximately \$4,027,000 which represents such bad debt deductions for which no deferred income taxes have been provided.

(14) Commitments and Contingencies:

In the ordinary course of business, the Bank has various outstanding commitments and contingent liabilities that are not reflected in the accompanying consolidated financial statements.

The Bank had open loan commitments at December 31, 2007 and 2006 of approximately \$51,342,000 and \$41,993,000, respectively. At December 31, 2007, the Bank had no fixed rate loan commitments. Beginning October 2007, the Bank converted all fixed rate loan commitments to outside investors to Best Efforts. For accepting a lower commitment fee, the Bank has transferred the risk of the loan not closing to the investor. At December 31, 2006, the Bank has committed to sell fixed rate loans totaling \$215,000 at a rate of 6.25%. In the event that the Bank was unable to fulfill its commitment to sell these loans, the Bank's liability to its investor was not material to the consolidated financial statements of the Company. Unused lines of credit were approximately \$44.7 million and \$40.2 million at December 31, 2007 and 2006, respectively.

The Company and the Bank have agreed to enter into employment agreements with certain officers, which provide certain benefits in the event of their termination following a change in control of the Company or the Bank. The employment agreements provide for an initial term of three years. On each anniversary of the commencement date of the employment agreements, the term of each agreement may be extended for an additional year at the discretion of the Board. In the event of a change in control of the Company or the Bank, as defined in the agreement, the officers shall be paid an amount equal to two times the officer's base salary as defined in the employment agreement.

HopFed Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements, Continued

December 31, 2007, 2006 and 2005

(14) Commitments and Contingencies: (Continued)

The Company and the Bank have entered into commitments to rent facilities and lease operating equipment that are non-cancelable. At December 31, 2007, future minimal lease and rental commitments were as follows:

Years Ending <u>December 31, 2007</u>	
2008	\$106,000
2009	98,000
2010	62,000
2011	58,000
2012	<u>4,000</u>
	<u>\$328,000</u>

The Company incurred rental expenses of approximately \$28,000, \$77,000 and \$131,000 for the years ended December 31, 2005, 2006 and 2007, respectively. In 2007, the Company completed all outstanding construction projects.

In the normal course of business, the Bank and Company have entered into operating contracts necessary to conduct the Company's daily business. The most significant operating contract is for the Bank's data processing services. The monthly cost associated with this contract is variable based on the number of accounts and usage but averages approximately \$165,000 per month. In December 2005, the Company renewed this contract for five years. The contract expires in 2011. In addition, the Bank is a defendant in legal proceedings arising in connection with its business. It is the best judgment of management that neither the financial position nor results of operations of the Bank will be materially affected by the final outcome of these legal proceedings.

The Company is self-insured for medical benefits provide to employees. The Company has obtained stop-loss insurance to limit total medical claims in any one year to \$50,000 per covered individual, and \$1 million for all medical claims. The Company has established a liability for outstanding claims and incurred, but unreported claims. While management uses what it believes are pertinent factors in estimating the liability, it is subject to change due to claim experience, type of claims, and rising medical cost.

HopFed Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements, Continued

December 31, 2007, 2006 and 2005

(15) Regulatory Matters:

The Company is a unitary thrift holding company and, as such, is subject to regulation, examination and supervision by the Office of Thrift Supervision (OTS).

The Bank is also subject to various regulatory requirements administered by the OTS. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's and the Bank's financial statements.

Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of tangible and core capital (as defined in the regulations) to adjusted total assets (as defined), and of total capital (as defined) and Tier 1 to risk weighted assets (as defined). Management believes, as of December 31, 2007 and 2006, that the Bank meets all capital adequacy requirements to which it is subject.

The most recent notification from the OTS categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized the Bank must maintain minimum total, tangible and core capital ratios as set forth in the table below. There are no conditions or events since that notification that management believes have changed the institution's category.

HopFed Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements, Continued

December 31, 2007, 2006 and 2005
(Table Amounts in Thousands, Except Percentages)

(15) Regulatory Matters (Continued)

The Company's and the Bank's actual capital amounts and ratios as of December 31, 2007 and 2006 are presented below:

	<u>Company Actual</u>		<u>Bank Actual</u>		<u>Required for Capital Adequacy Purposes</u>		<u>Required to be Categorized as Well Capitalized Under Prompt Corrective Action Provisions</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
<u>As of December 31, 2007</u>								
Tangible capital to adjusted total assets	\$58,727	7.3%	\$55,698	7.0%	\$11,979	1.50%	N/A	N/A
Core capital to adjusted total assets	\$58,727	7.3%	\$55,698	7.0%	\$31,943	4.00%	\$39,931	5.00%
Total capital to risk weighted assets	\$63,569	11.0%	\$60,540	10.5%	\$46,249	8.00%	\$57,811	10.00%
Tier 1 capital to risk weighted assets	\$58,727	10.1%	\$55,698	9.6%	N/A	N/A	\$34,687	6.00%
<u>As of December 31, 2006</u>								
Tangible capital to adjusted total assets	\$55,924	7.3%	\$52,903	7.0%	\$11,423	1.50%	N/A	N/A
Core capital to adjusted total assets	\$55,924	7.3%	\$52,903	7.0%	\$30,460	4.00%	\$38,078	5.00%
Total capital to risk weighted assets	\$60,393	11.8%	\$57,373	11.3%	\$40,790	8.00%	\$50,988	10.00%
Tier 1 capital to risk weighted assets	\$55,924	11.0%	\$52,903	10.4%	N/A	N/A	\$30,593	6.00%

HopFed Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements, Continued

December 31, 2007, 2006 and 2005

(16) Stockholders' Equity:

The Company's sources of income and funds for dividends to its stockholders are earnings on its investments and dividends from the Bank. The Bank's primary regulator, the OTS, has regulations that impose certain restrictions on payment of dividends to the Company. Current regulations of the OTS allow the Bank (based upon its current capital level and supervisory status assigned by the OTS) to pay a dividend of up to 100% of net income to date during the calendar year plus the retained income for the preceding two years.

The Bank must provide the OTS with 30 days prior notice to the payment of the dividend. Any capital distribution in excess of this amount would require supervisory approval. Capital distributions are further restricted should the Bank's capital level fall below the fully phased-in capital requirements of the OTS. In no case will the Bank be allowed to make capital distributions reducing equity below the required balance of the liquidation account. For the years ended December 31, 2007, December 31, 2006 and December 31, 2005, the Bank paid a \$3,000,000 per year dividend to the Corporation. For the year ended December 31, 2007, the Bank could have paid the Corporation an additional dividend of approximately \$5.1 million without OTS supervisory approval.

OTS regulations also place restrictions after the conversion on the Company with respect to repurchases of its common stock. With prior notice to the OTS, the Company is allowed to repurchase its outstanding shares. In August 2006, the Company announced that it has replaced a previously announced stock buyback plan with a new plan to purchase up to 125,000 shares of common stock over the next two years. Under the current plan, the Company has purchased 78,150 shares of common stock at an average price of \$16.06 per share. As of December 31, 2007, a total of 487,059 shares had been repurchased from all active and inactive stock repurchase plans at an average price of \$12.55 per share.

HopFed Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements, Continued

December 31, 2007, 2006 and 2005

(17) Earnings Per Share:

Earnings per share of common stock are based on the weighted average number of basic shares and dilutive shares outstanding during the year.

The following is a reconciliation of weighted average common shares for the basic and dilutive earnings per share computations:

	<u>Years Ended December 31,</u>		
	<u>2007</u>	<u>2006</u>	<u>2005</u>
Basic earnings per share:			
Weighted average common shares	<u>3,588,163</u>	<u>3,634,138</u>	<u>3,644,178</u>
Diluted earnings per share:			
Weighted average common shares	3,588,163	3,634,138	3,644,178
Diluted effect of stock options	<u>19,707</u>	<u>25,528</u>	<u>25,740</u>
Weighted average common and incremental shares	<u>3,607,870</u>	<u>3,659,666</u>	<u>3,669,918</u>

HopFed Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements, Continued

December 31, 2007, 2006 and 2005
(Table Amounts in Thousands)

(18) Condensed Parent Company Only Financial Statements:

The following condensed balance sheets as of December 31, 2007 and 2006 and condensed statements of income and cash flows for the years ended December 31, 2007, 2006 and 2005 of the parent company only should be read in conjunction with the consolidated financial statements and the notes thereto.

Condensed Balance Sheets:

	<u>2007</u>	<u>2006</u>
Assets:		
Cash and due from banks	\$37	52
Receivable from subsidiary	6	6
Federal funds sold	1,900	2,340
Investment in subsidiary	42,148	38,558
Prepaid expenses and other assets	<u>1,795</u>	<u>1,384</u>
Total assets	<u>\$45,886</u>	<u>42,340</u>
Liabilities and stockholders' equity		
Liabilities		
Dividends payable	\$447	445
Interest payable	213	202
Subordinated debentures	<u>10,310</u>	<u>10,310</u>
Total liabilities	<u>10,970</u>	<u>10,957</u>
Stockholders' Equity:		
Common stock	41	41
Additional paid-in capital	21,806	21,647
Retained earnings	19,449	17,062
Treasury stock	(6,112)	(5,406)
Accumulated other comprehensive loss	<u>(268)</u>	<u>(1,961)</u>
Total Stockholders' equity	<u>34,916</u>	<u>31,383</u>
Total liabilities and stockholders' equity	<u>\$45,886</u>	<u>42,340</u>

HopFed Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements, Continued

December 31, 2007, 2006 and 2005
(Table Amounts in Thousands)

(18) Condensed Parent Company Only Financial Statements: (Continued)
Condensed Statements of Income:

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Interest and dividend income			
Dividend income	\$3,000	3,000	3,000
Time deposits	<u>86</u>	<u>77</u>	<u>39</u>
Total interest and dividend income	<u>3,086</u>	<u>3,077</u>	<u>3,039</u>
Interest expense	775	734	700
Non-interest expenses	<u>443</u>	<u>360</u>	<u>240</u>
Total expenses	<u>1,218</u>	<u>1,094</u>	<u>940</u>
Income before income taxes and equity in undistributed earnings of subsidiary	1,868	1,983	2,099
Income tax benefits	<u>(416)</u>	<u>(365)</u>	<u>(340)</u>
Income before equity in undistributed earnings of subsidiary	2,284	2,348	2,439
Equity in undistributed earnings of subsidiary	<u>1,832</u>	<u>1,560</u>	<u>1,691</u>
Net income	<u>\$4,116</u>	<u>3,908</u>	<u>4,130</u>

HopFed Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements, Continued

December 31, 2007, 2006 and 2005
(Table Amounts in Thousands)

(18) Condensed Parent Company Only Financial Statements: (Continued)

Condensed Statement of Cash Flows:

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Cash flows from operating activities			
Net income	\$4,116	3,908	4,130
Adjustments to reconcile net income to net cash (used in) provided by operating activities:			
Equity in undistributed earnings of subsidiary	(1,832)	(1,560)	(1,691)
Amortization of restricted stock	137	100	57
Stock option expense	22	29	---
Increase (decrease) in:			
Current income taxes payable	(369)	(364)	(350)
Accrued expenses	<u>(94)</u>	<u>(29)</u>	<u>44</u>
Net cash provided by operating activities	<u>1,980</u>	<u>2,084</u>	<u>2,190</u>
Cash flows for investing activities:			
Proceeds from settlement of derivative	---	270	---
(Advance for) payment on receivable from subsidiary	---	(1)	999
Net (increase) decrease in federal funds sold	<u>440</u>	<u>(90)</u>	<u>(1,400)</u>
Net cash provided by (used in) investing activities	<u>440</u>	<u>179</u>	<u>(401)</u>
Cash flows from financing activities:			
Purchase of treasury stock	(706)	(549)	---
Dividends paid	<u>(1,729)</u>	<u>(1,748)</u>	<u>(1,750)</u>
Net cash used in financing activities	<u>(2,435)</u>	<u>(2,297)</u>	<u>(1,750)</u>
Net increase (decrease) in cash	(15)	(34)	39
Cash and due from banks at beginning of year	<u>52</u>	<u>86</u>	<u>47</u>
Cash and due from banks at end of year	<u>\$37</u>	<u>52</u>	<u>86</u>

HopFed Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements, Continued

December 31, 2007, 2006 and 2005
(Table Amounts in Thousands)

(19) Investments in Affiliated Companies: (Unaudited)

Investments in affiliated companies accounted for under the equity method consist of 100% of the common stock of HopFed Capital Trust I (the Trust), a wholly owned statutory business trust. The Trust was formed on September 25, 2003. Summary financial information for the Trust follows:

Summary Balance Sheets

	<u>At Dec. 31,</u> <u>2007</u>	<u>At Dec. 31,</u> <u>2006</u>
Asset – investment in subordinated debentures issued by HopFed Bancorp, Inc.	\$ <u>10,310</u>	\$ <u>10,310</u>
Liabilities	\$ —	\$ —
Stockholders' equity		
Trust preferred securities	10,000	10,000
Common stock (100% owned by HopFed Bancorp, Inc.)	<u>310</u>	<u>310</u>
Total stockholder's equity	<u>10,310</u>	<u>10,310</u>
Total liabilities and stockholder's equity	\$ <u>10,310</u>	\$ <u>10,310</u>

Summary Statements of Income

	<u>Years Ended Dec. 31,</u> <u>2007</u>	<u>2006</u>
Income – interest income from subordinated debentures issued by HopFed Bancorp, Inc.	\$ <u>898</u>	\$ <u>858</u>
Net income	\$ <u>898</u>	\$ <u>858</u>

Summary Statements of Stockholders' Equity

	Trust Preferred Securities	Common Stock	Retained Earnings	Total Stockholder's Equity
Beginning balances, December 31, 2006	\$ 10,000	\$ 310	\$ —	\$ 10,310
Retained earnings:				
Net income	—	—	898	898
Dividends:				
Trust preferred securities	—	—	(871)	(871)
Common dividends paid to HopFed Bancorp, Inc.	—	—	(27)	(27)
Total retained earnings	—	—	—	—
Ending balances, December 31, 2007	<u>\$ 10,000</u>	<u>\$ 310</u>	<u>\$ —</u>	<u>\$ 10,310</u>

HopFed Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements, Continued

December 31, 2007, 2006 and 2005

(Table Amounts in Thousands, Except Per Share & Share Amounts)

- (20) Quarterly Results of Operations: (Unaudited)
Summarized unaudited quarterly operating results for the years ended December 31, 2007 and December 31, 2006 are as follows:

	<u>First Quarter</u>	<u>Second Quarter</u>	<u>Third Quarter</u>	<u>Fourth Quarter</u>
December 31, 2007:				
Interest and dividend income	\$11,780	12,283	12,391	12,579
Interest expense	<u>6,856</u>	<u>7,078</u>	<u>7,375</u>	<u>7,582</u>
Net interest income	4,924	5,205	5,016	4,997
Provision for loan losses	<u>240</u>	<u>238</u>	<u>224</u>	<u>274</u>
Net interest income after provision for loan losses	4,684	4,967	4,792	4,723
Noninterest income	1,741	1,766	1,877	1,847
Noninterest expense	<u>4,988</u>	<u>5,153</u>	<u>5,234</u>	<u>5,178</u>
Income before income taxes	1,437	1,580	1,435	1,392
Income taxes	<u>415</u>	<u>472</u>	<u>410</u>	<u>431</u>
Net income	<u>\$1,022</u>	<u>1,108</u>	<u>1,025</u>	<u>961</u>
Basic earnings per share	<u>\$0.28</u>	<u>0.31</u>	<u>0.29</u>	<u>0.27</u>
Diluted earnings per share	<u>\$0.28</u>	<u>0.31</u>	<u>0.28</u>	<u>0.27</u>
Weighted average shares outstanding:				
Basic	<u>3,629,520</u>	<u>3,587,986</u>	<u>3,584,053</u>	<u>3,571,547</u>
Diluted	<u>3,654,726</u>	<u>3,612,575</u>	<u>3,607,093</u>	<u>3,594,587</u>

HopFed Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements, Continued

December 31, 2007, 2006 and 2005

(Table Amounts in Thousands, Except Per Share & Share Amounts)

(20) Quarterly Results of Operations: (Unaudited) (Continued)

	<u>First Quarter</u>	<u>Second Quarter</u>	<u>Third Quarter</u>	<u>Fourth Quarter</u>
December 31, 2006:				
Interest and dividend income	\$8,779	9,382	10,975	11,532
Interest expense	<u>4,696</u>	<u>5,364</u>	<u>6,315</u>	<u>6,913</u>
Net interest income	4,083	4,018	4,660	4,619
Provision for loan losses	<u>213</u>	<u>204</u>	<u>312</u>	<u>294</u>
Net interest income after provision for loan losses	3,870	3,814	4,348	4,325
Noninterest income	1,047	1,261	1,703	1,754
Noninterest expense	<u>3,169</u>	<u>3,887</u>	<u>4,621</u>	<u>4,837</u>
Income before income taxes	1,748	1,188	1,430	1,242
Income taxes	<u>547</u>	<u>339</u>	<u>418</u>	<u>396</u>
Net income	<u>\$1,201</u>	<u>849</u>	<u>1,012</u>	<u>846</u>
Basic earnings per share	<u>\$0.33</u>	<u>0.23</u>	<u>0.28</u>	<u>0.23</u>
Diluted earnings per share	<u>\$0.33</u>	<u>0.23</u>	<u>0.28</u>	<u>0.23</u>
Weighted average shares outstanding:				
Basic	<u>3,649,078</u>	<u>3,650,279</u>	<u>3,637,288</u>	<u>3,621,572</u>
Diluted	<u>3,674,320</u>	<u>3,675,735</u>	<u>3,662,883</u>	<u>3,647,419</u>

(21) Comprehensive Income:

SFAS 130, *Reporting Comprehensive Income*, established standards for reporting comprehensive income. Comprehensive income includes net income and other comprehensive net income which is defined as non-owner related transactions in equity. The following table sets forth the amounts of other comprehensive income included in stockholders' equity along with the related tax effect for the years ended December 31, 2007, 2006 and 2005:

HopFed Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements, Continued

December 31, 2007, 2006 and 2005
(Table Amounts in Thousands)

(21) Comprehensive Income (Continued)

	<u>Pre-Tax Amount</u>	<u>Tax Benefit (Expense)</u>	<u>Net of Tax Amount</u>
December 31, 2007:			
Unrealized holding losses for the period	\$2,670	(908)	1,762
Reclassification adjustments for gains included in net income	(\$6)	2	(4)
Realized gain on settlement of derivative	<u>(\$98)</u>	<u>33</u>	<u>(65)</u>
	<u>\$2,566</u>	<u>(873)</u>	<u>1,693</u>

	<u>Pre-Tax Amount</u>	<u>Tax Benefit (Expense)</u>	<u>Net of Tax Amount</u>
December 31, 2006:			
Unrealized holding losses for the period	\$1,197	(407)	790
Reclassification adjustments for gains included in net income	(\$33)	11	(22)
Realized gain on settlement of derivative	<u>(\$135)</u>	<u>61</u>	<u>(74)</u>
	<u>\$1,029</u>	<u>(335)</u>	<u>694</u>

	<u>Pre-Tax Amount</u>	<u>Tax Benefit (Expense)</u>	<u>Net of Tax Amount</u>
December 31, 2005:			
Unrealized holding losses for the period	\$(2,947)	1,002	(1,945)
Reclassification adjustments for gains included in net income	<u>(\$35)</u>	<u>12</u>	<u>(23)</u>
	<u>\$(2,982)</u>	<u>1,014</u>	<u>(1,968)</u>

HopFed Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements, Continued

December 31, 2007, 2006 and 2005
(Table Amounts in Thousands)

(22) Business Combination:

The Company's wholly-owned subsidiary, Heritage Bank, completed the acquisition of four offices of AmSouth Bank located in Cheatham and Houston counties in Tennessee (Middle Tennessee Division) on June 29, 2006. This acquisition enhances the Company's position in the northern portion of the Nashville, Tennessee Metropolitan Statistical Area. The consolidated statement of income includes the results of operations for the Middle Tennessee Division beginning on June 29, 2006.

In accordance with SFAS No. 141, *Accounting for Business Combinations* (SFAS 141) and SFAS No. 142, *Goodwill and Intangible Assets* (SFAS 142), HopFed Bancorp Inc, recorded at fair value the following assets and liabilities of four AmSouth Bank offices assumed as of June 29, 2006:

<u>Assets</u>	<u>(Unaudited)</u>
Cash and cash equivalents	\$22,421
Loans:	
Home equity line of credit	16,984
Closed end home equity	12,081
Commercial loans	3,831
Personal loans	<u>1,618</u>
Total loans, gross	34,514
Allowance for loan loss	(185)
Loan market yield differential	(210)
Core deposit intangible	2,919
Goodwill	1,301
Premises and equipment	4,730
Accrued interest receivable	<u>139</u>
 Total assets	 <u>65,629</u>
 <u>Liabilities</u>	
Deposits:	
Non-interest bearing deposits	13,780
Now accounts	7,455
Savings and MMDA account	18,638
Time and other deposits	<u>25,612</u>
Total deposits	65,485
Accrued interest payable	123
Other liabilities	<u>21</u>
 Total liabilities	 <u>65,629</u>

HopFed Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements, Continued

December 31, 2007, 2006 and 2005

(Table Amounts in Thousands, Except Per Share Amounts)

(22) Business Combination: (Continued)

The Bank paid a deposit premium for the four offices of \$6,541,000, including intangibles of \$4,220,000, which are deductible for tax purposes. The amount allocated to the core deposit intangible was determined by a valuation conducted by an independent third party and is being amortized over the estimated useful life of nine years using the sum of the year's digit method.

An independent third party has completed a valuation analysis of the estimated fair market value of the acquired loan portfolio. This analysis was based on the portfolio balances, yields, and market rates on June 29, 2006. As a result, the Bank will accrete approximately \$210,000 in loan yield differential over the estimated average life of the individual portions of the purchased loan portfolios on an accelerated basis.

Management has completed an analysis of the credit quality of the purchased loan portfolio. As a result of this analysis, management has reduced the market value of the purchased loan portfolio by \$185,000 for estimated loan losses not specifically identified by current classification.

The following table presents pro forma information as if the acquisition had occurred at the beginning of 2006. The pro forma includes adjustment for interest income on loans, amortization of intangibles arising from the transaction, depreciation expense on property acquired, interest expense on deposits assumed, and related income tax affects. The pro forma financial information is not necessarily indicative of the results of operations as they would have been had the transaction been affected on the assumed dates

	<u>2006</u>
Net interest income after provision for loan loss expense	<u>\$19,601</u>
Net income	<u>4,188</u>
Basic earnings per share	<u>1.16</u>
Diluted earnings per share	<u>1.15</u>



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