

OFFICE OF THRIFT SUPERVISION
Washington, D.C. 20552

FORM 10-Q

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

For The Quarterly Period Ended: **January 31, 2007**

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

For the Transition Period from _____ to

Docket Number 8173

THE WASHINGTON SAVINGS BANK, F. S. B.
(Exact name of Registrant as specified in its Charter)

UNITED STATES
(State or other jurisdiction of
incorporation or organization)

52-1271169
(I.R.S. Employer
Identification No.)

4201 Mitchellville Road, Suite 200, Bowie, Maryland 20716
(Address of Principal Executive Offices)

(301) 352-3120
(Registrant's Telephone Number)

Indicate by check mark whether the Registrant has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months and has been subject to such filing requirements for the past 90 days.

YES NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer [] Accelerated filer [] Non-accelerated filer [X]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES NO

There were 7,577,860 shares of Common Stock (\$1.00 Par Value) outstanding as of March 2, 2007.

THE WASHINGTON SAVINGS BANK, F.S.B. AND SUBSIDIARIES
FORM 10-Q
INDEX

	<u>Page Number</u>
PART I. FINANCIAL INFORMATION	
Item 1. Financial Statements	
Consolidated Statements of Financial Condition at January 31, 2007 (Unaudited) and July 31, 2006 (Audited)	2
Consolidated Statements of Operations - Three Months and Six Months ended January 31, 2007 and 2006 (Unaudited)	3
Consolidated Statements of Changes in Stockholders' Equity For the Six Months ended January 31, 2007 and 2006 (Unaudited)	4
Consolidated Statements of Cash Flows - Six Months ended January 31, 2007 and 2006 (Unaudited)	5
Notes to Consolidated Financial Statements (Unaudited)	6
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	10
Item 3. Quantitative and Qualitative Disclosures about Market Risk	21
Item 4. Controls and Procedures	22
PART II.	
Item 1. Legal Proceedings	22
Item 1A. Risk Factors	23
Item 4. Submission of Matters to a Vote of Security Holders	23
Item 6. Exhibits	24
Signatures	25

Item 1. Financial Statements

**THE WASHINGTON SAVINGS BANK, F.S.B. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION**

	January 31, 2007 <u>(Unaudited)</u>	July 31, 2006 <u>(Audited)</u>
ASSETS		
Cash	\$ 2,399,340	\$ 3,706,470
Federal funds sold and interest bearing deposits at FHLB - Atlanta	1,923,000	1,064,000
Time deposits with other banks	-	9,000,000
Total cash and cash equivalents	<u>4,322,340</u>	<u>13,770,470</u>
Loans receivable - net:		
Held for sale	5,054,371	8,638,971
Held for investment (net of allowance for loan losses of \$4,511,168 and \$5,346,525 respectively)	<u>200,085,106</u>	<u>242,445,933</u>
Total loans receivable - net	<u>205,139,477</u>	<u>251,084,904</u>
Mortgage-backed securities - available for sale at fair value	50,812,357	46,489,371
Investment securities - available for sale at fair value	143,281,312	110,835,295
Bank owned life insurance	10,067,398	-
Investment in Federal Home Loan Bank stock, at cost	4,208,000	3,398,000
Accrued interest receivable on loans	1,428,290	1,730,544
Accrued interest receivable on investments	1,521,590	1,274,671
Real estate acquired in settlement of loans	1,413,621	1,583,540
Premises and equipment - net	6,062,251	6,090,425
Deferred income taxes	4,058,373	4,161,415
Income taxes receivable	639,802	1,867,803
Other assets	<u>670,597</u>	<u>1,836,948</u>
TOTAL ASSETS	\$ <u>433,625,408</u>	\$ <u>444,123,386</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits:		
Non-interest bearing	\$ 6,382,306	\$ 8,046,873
Interest bearing	<u>292,791,504</u>	<u>315,687,043</u>
Total deposits	<u>299,173,810</u>	<u>323,733,916</u>
Federal Home Loan Bank and other borrowings	71,000,000	58,000,000
Advances from borrowers for taxes and insurance	523,176	793,941
Accounts payable, accrued expenses and other liabilities	<u>1,340,536</u>	<u>1,648,749</u>
TOTAL LIABILITIES	<u>372,037,522</u>	<u>384,176,606</u>
STOCKHOLDERS' EQUITY:		
Preferred stock, no stated par value; 10,000,000 shares authorized; none issued and outstanding	-	-
Common stock, \$1 par value; 20,000,000 shares authorized; 8,090,850 and 8,036,025 issued and outstanding	8,090,850	8,036,025
Additional paid-in capital	2,277,089	2,143,567
Treasury Stock - 610,681 and 610,681 shares at cost	(645,124)	(645,124)
Retained earnings - substantially restricted	52,500,873	51,282,613
Accumulated other comprehensive loss	<u>(635,802)</u>	<u>(870,301)</u>
TOTAL STOCKHOLDERS' EQUITY	<u>61,587,886</u>	<u>59,946,780</u>
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ <u>433,625,408</u>	\$ <u>444,123,386</u>

See notes to consolidated financial statements.

THE WASHINGTON SAVINGS BANK, F.S.B. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Three Months ended January 31,		Six Months ended January 31,	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
INTEREST INCOME:				
Interest and fees on loans	\$ 4,244,235	\$ 6,903,677	9,136,219	\$ 15,397,156
Interest on mortgage-backed securities	700,461	196,299	1,333,458	196,299
Interest and dividends on investments	<u>2,086,098</u>	<u>1,574,703</u>	<u>3,850,026</u>	<u>2,497,727</u>
Total interest income	<u>7,030,794</u>	<u>8,674,679</u>	<u>14,319,703</u>	<u>18,091,182</u>
INTEREST EXPENSE:				
Interest on deposits	2,699,101	3,194,035	5,420,742	6,544,223
Interest on other borrowings	<u>1,027,801</u>	<u>766,136</u>	<u>1,839,590</u>	<u>1,526,680</u>
Total interest expense	<u>3,726,902</u>	<u>3,960,171</u>	<u>7,260,332</u>	<u>8,070,903</u>
NET INTEREST INCOME	3,303,892	4,714,508	7,059,371	10,020,279
(Recovery of) provision for loan losses	<u>-</u>	<u>-</u>	<u>(300,000)</u>	<u>200,000</u>
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	<u>3,303,892</u>	<u>4,714,508</u>	<u>7,359,371</u>	<u>9,820,279</u>
NON-INTEREST INCOME:				
Loan related fees	183,392	321,810	435,195	600,380
Gain on sale of loans	265,211	226,961	555,550	957,724
Loss on sale of investment securities	(46,840)	-	(46,840)	-
Gain on sale of real estate acquired in settlement of loans	7,961	103,884	305,092	192,297
(Loss)Gain on disposal of fixed assets	(1,703)	(6,484)	3,547	(8,654)
Service charges on deposits	18,175	25,321	39,339	52,115
Rental Income	147,503	147,865	277,742	297,133
Sale of building lots and homes	-	-	-	7,681
Other income	<u>133,167</u>	<u>129,119</u>	<u>204,779</u>	<u>200,985</u>
Total non-interest income	<u>706,866</u>	<u>948,476</u>	<u>1,774,404</u>	<u>2,299,661</u>
NON-INTEREST EXPENSE:				
Salaries and benefits	1,852,746	1,672,480	3,666,650	3,665,797
Occupancy expense	188,757	188,994	413,228	408,633
Depreciation	180,009	163,971	351,972	328,922
Advertising	23,540	28,388	48,934	58,477
Service bureau charges	139,294	127,089	269,936	280,324
Service charges from banks	21,786	26,037	45,769	56,855
Stationary, printing and supplies	45,525	58,235	102,368	129,317
Professional services	206,911	243,000	522,586	542,027
SAIF/FDIC Insurance	131,742	244,384	319,125	492,668
Other taxes	37,826	37,042	74,653	72,084
Provision for losses on real estate acquired in settlement of loans	-	83,374	-	146,374
Other	<u>579,077</u>	<u>638,812</u>	<u>1,054,287</u>	<u>1,238,548</u>
Total non-interest expense	<u>3,407,213</u>	<u>3,511,806</u>	<u>6,869,508</u>	<u>7,420,026</u>
EARNINGS BEFORE PROVISION FOR INCOME TAXES	603,545	2,151,178	2,264,267	4,699,914
PROVISION FOR INCOME TAXES	<u>161,800</u>	<u>786,100</u>	<u>747,600</u>	<u>1,754,300</u>
NET INCOME	<u>\$ 441,745</u>	<u>\$ 1,365,078</u>	<u>\$ 1,516,667</u>	<u>\$ 2,945,614</u>
BASIC INCOME PER COMMON SHARE	<u>\$ 0.06</u>	<u>\$ 0.18</u>	<u>\$ 0.20</u>	<u>\$ 0.40</u>
DILUTED INCOME PER COMMON SHARE	<u>\$ 0.05</u>	<u>\$ 0.17</u>	<u>\$ 0.19</u>	<u>\$ 0.36</u>
CASH DIVIDENDS PAID	<u>\$ 0.04</u>	<u>\$ -</u>	<u>\$ 0.04</u>	<u>\$ -</u>
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING	<u>7,467,150</u>	<u>7,405,996</u>	<u>7,447,415</u>	<u>7,403,724</u>
WEIGHTED AVERAGE DILUTED COMMON SHARES OUTSTANDING	<u>8,128,406</u>	<u>8,084,332</u>	<u>8,126,001</u>	<u>8,104,601</u>

See notes to consolidated financial statements.

THE WASHINGTON SAVINGS BANK, F.S.B. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
SIX MONTHS ENDED JANUARY 31, 2007 AND 2006 (Unaudited)

	Common Stock	Additional Paid-In Capital	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Income(Loss)	Total Stockholders' Equity
BALANCE, AUGUST 1, 2005	\$ 8,009,775	\$ 2,010,622	\$ (645,124)	\$ 46,220,169	\$ (8,146)	\$ 55,587,296
Exercise of Stock Options	11,500	35,758	-	-	-	47,258
Tax benefits from Stock-Based Compensation	-	4,369	-	-	-	4,369
Comprehensive Income:						
Net income	-	-	-	2,945,614	-	2,945,614
Net changes in unrealized gain (loss) on available for sale securities Net of taxes of \$21,985	-	-	-	-	(248,214)	(248,214)
Total comprehensive income						2,697,400
BALANCE, JANUARY 31, 2006	<u>\$ 8,021,275</u>	<u>\$ 2,050,749</u>	<u>\$ (645,124)</u>	<u>\$ 49,165,783</u>	<u>\$ (256,360)</u>	<u>\$ 58,336,323</u>
BALANCE, AUGUST 1, 2006	\$ 8,036,025	\$ 2,143,567	\$ (645,124)	\$ 51,282,613	\$ (870,301)	\$ 59,946,780
Exercise of Stock Options	54,825	103,236	-	-	-	158,061
Tax benefits from Stock-Based Compensation	-	30,286	-	-	-	30,286
Comprehensive Income:						
Net income	-	-	-	1,516,667	-	1,516,667
Net changes in unrealized gain (loss) on available for sale securities Net of taxes of \$139,896	-	-	-	-	234,499	234,499
Total comprehensive income						1,751,166
Cash dividend (\$0.04 per common share)	-	-	-	(298,407)	-	(298,407)
BALANCE, JANUARY 31, 2007	<u>\$ 8,090,850</u>	<u>\$ 2,277,089</u>	<u>\$ (645,124)</u>	<u>\$ 52,500,873</u>	<u>\$ (635,802)</u>	<u>\$ 61,587,886</u>

See notes to consolidated financial statements

THE WASHINGTON SAVINGS BANK, F.S.B. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

Six months ended
January 31,

	<u>2007</u>	<u>2006</u>
OPERATING ACTIVITIES:		
Net income	\$ 1,516,668	\$ 2,945,614
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Provision for loan losses	(300,000)	200,000
Stock-based compensation	-	11,314
Depreciation	348,425	337,578
Amortization	(68,571)	114,070
Loss on sale of investment securities	46,840	-
Gain on sale of other real estate owned	(305,092)	(192,297)
Excess tax benefits from stock based compensation	(30,286)	(4,369)
Gain on sale of loans	(555,550)	(957,724)
Gain on sale of building lots and homes	-	(7,681)
Origination of loans - held for sale	(60,491,148)	(136,260,434)
Proceeds from sale of loans held for sale	64,631,299	152,045,741
Increase in cash surrender value of bank owned life insurance	(67,398)	-
Decrease in other assets	1,166,351	395,399
Decrease(increase) in accrued interest receivable	55,335	(290,775)
(Decrease) in net deferred loan fees	(101,873)	(505,826)
Increase in income taxes payable	-	211,883
Decrease(increase) in income taxes receivable	1,228,002	(1,660,640)
(Decrease) in accrued interest payable	(31,978)	(48,939)
(Decrease) in accounts payable, accrued expenses and other liabilities	(308,214)	(687,960)
	<u>6,732,810</u>	<u>15,644,953</u>
Net cash provided by operating activities		
INVESTING ACTIVITIES:		
Net decrease in loans	41,925,298	121,217,894
Purchase of mortgage-backed securities - available for sale	(7,520,409)	(23,569,664)
Proceeds from principal payments and sales of mortgage-backed securities	3,438,495	373,704
Sale of investment securities	(46,840)	-
Purchase of Federal Home Loan Bank Stock	(810,000)	-
Bank owned life insurance	(10,000,000)	-
Purchase of investment securities - available for sale	(95,540,615)	(72,500,000)
Proceeds from maturities and sales of investment securities - available for sale	63,289,925	-
Purchase of premises and equipment	(320,251)	(265,031)
Land development costs incurred	-	(118,782)
Sale of Land Held-for-Development	-	7,681
Development of real estate acquired in settlement of loans	(55,228)	(41,980)
Proceeds from sale of real estate acquired in settlement of loans	1,367,638	1,298,886
	<u>(4,271,987)</u>	<u>26,402,708</u>
Net cash (used) provided by investing activities		
FINANCING ACTIVITIES:		
Net decrease in demand deposits, NOW accounts and savings accounts	(10,582,932)	(9,653,813)
Proceeds from issuance of certificates of deposit	2,083,766	2,492,556
Payments for maturing certificates of deposit	(16,028,962)	(26,258,209)
Net decrease in advance payments by borrowers for taxes and insurance	(270,765)	(740,015)
Cash dividend paid	(298,409)	-
Increase in advance from the Federal Home Loan Bank	18,000,000	-
Decrease in other borrowings	(5,000,000)	-
Proceeds from exercise of stock options	158,061	47,258
Excess tax benefits from stock based compensation	30,286	4,369
	<u>(11,908,955)</u>	<u>(34,107,854)</u>
Net cash used by financing activities		
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(9,448,132)	7,939,807
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	13,770,470	56,592,933
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 4,322,338	\$ 64,532,740
CASH PAID DURING THE PERIOD FOR:		
Income taxes	\$ 352,990	\$ 3,201,569
Interest	\$ 7,218,417	\$ 8,110,464
Non-cash transactions:		
Transfer from loans to foreclosed real estate	\$ 837,400	\$ 722,028

THE WASHINGTON SAVINGS BANK, F.S.B. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE SIX MONTHS ENDED JANUARY 31, 2007 AND 2006
(unaudited)

1. Financial Statements

The Consolidated Financial Statements for the three and six months ended January 31, 2007 and 2006 have been prepared by The Washington Savings Bank, F.S.B. ("WSB") without audit. In the opinion of management, all adjustments (which include only normal recurring adjustments) necessary to present fairly the financial position, results of operations, and cash flows at January 31, 2007, and for all periods presented have been made.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission and the Office of Thrift Supervision ("OTS"). Management believes that the disclosures are adequate to make the information presented not misleading. These financial statements should be read in conjunction with the financial statements and notes thereto included in WSB's Annual Report on Form 10-K for the year ended July 31, 2006 (the "2006 Annual Report"). There have been no significant changes to WSB's Accounting Policies as disclosed in the 2006 Annual Report. The results of operations for the period ended January 31, 2007, are not necessarily indicative of the operating results for the full year.

Certain prior year's amounts have been reclassified to conform with the current year's presentation.

2. Earnings Per Common Share

The following is the reconciliation of the numerators and denominators of the basic and diluted Earnings Per Common Share ("EPS") computation for all periods presented in the Consolidated Statements of Operations.

	<u>Three Months Ended January 31,</u>					
	<u>2007</u>			<u>2006</u>		
	<u>Net Income (Numerator)</u>	<u>Shares (Denominator)</u>	<u>Per Share Amount</u>	<u>Net Income (Numerator)</u>	<u>Shares (Denominator)</u>	<u>Per Share Amount</u>
Basic EPS						
Net income available to Common Stockholders	\$ <u>441,745</u>	7,467,150	\$ <u>0.06</u>	\$ <u>1,365,078</u>	7,405,996	\$ <u>0.18</u>
Effect of Dilutive Options						
Incremental Shares		<u>661,256</u>			<u>678,336</u>	
Diluted EPS						
Net income available to Common Stockholders	\$ <u>441,745</u>	<u>8,128,406</u>	\$ <u>0.05</u>	\$ <u>1,365,078</u>	<u>8,084,332</u>	\$ <u>0.17</u>

THE WASHINGTON SAVINGS BANK, F.S.B. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE SIX MONTHS ENDED JANUARY 31, 2007 AND 2006
(Continued)

	<u>Six Months Ended January 31,</u>					
	<u>2007</u>			<u>2006</u>		
	<u>Net Income</u> <u>(Numerator)</u>	<u>Shares</u> <u>(Denominator)</u>	<u>Per Share</u> <u>Amount</u>	<u>Net Income</u> <u>(Numerator)</u>	<u>Shares</u> <u>(Denominator)</u>	<u>Per Share</u> <u>Amount</u>
Basic EPS						
Net income available to Common Stockholders	\$ <u>1,516,667</u>	7,447,415	\$ <u>0.20</u>	\$ <u>2,945,614</u>	7,403,724	\$ <u>0.40</u>
Effect of Dilutive Options Incremental Shares		<u>678,586</u>			<u>700,877</u>	
Diluted EPS						
Net income available to Common Stockholders	\$ <u>1,516,667</u>	<u>8,126,001</u>	\$ <u>0.19</u>	\$ <u>2,945,614</u>	<u>8,104,601</u>	\$ <u>0.36</u>

Options to purchase 5,000 shares of common stock at \$9.11 per share were outstanding at January 31, 2007 and 2006, but were not included in the computation of diluted EPS because the options' exercise price was greater than the average market price of the common stock for the six months ended January 31, 2007 and 2006.

All other options were included in the computation of diluted EPS because the options' exercise prices were lower than the average market price of the common stock for the six months ended January 31, 2007.

3. Stock-Based Compensation

WSB has incentive compensation plans that permit the granting of incentive and non-qualified awards in the form of stock options. Generally, the terms of these plans stipulate that the exercise price of options may not be less than the fair market value of WSB's common stock on the date the options are granted. Options predominantly vest over a two year period from the date of grant, and expire not later than ten years from date of grant.

In December 2004, the Financial Accounting Standards Board ("FASB") issued Statement No. 123R, which requires stock-based compensation to be measured, based on the grant-date fair value of the awards and the cost to be recognized over the period during which an employee is required to provide service in exchange for the award. WSB adopted the provisions of SFAS No. 123R as of August 1, 2005.

Prior to August 1, 2005, WSB accounted for stock-based compensation in accordance with Accounting Principles Board Opinion (APB) No. 25 "Accounting for Stock Issued to Employees" and related Interpretations. Accordingly, no compensation expense had been recognized for stock options since all options granted had an exercise price equal to the market value of the underlying stock on the grant date. SFAS No. 123R was adopted using the modified prospective transition method. Under this method, the provisions of SFAS No. 123R apply to all awards granted or modified after the date of adoption. In addition, compensation

THE WASHINGTON SAVINGS BANK, F.S.B. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE SIX MONTHS ENDED JANUARY 31, 2007 AND 2006

expense must be recognized for any unvested stock option awards outstanding as of the date of adoption. Prior periods have not been restated. Total pre-tax stock-based compensation of \$11,300 and tax related benefits of \$4,400 was recognized in the Statement of Operations for the six months ending January 31, 2006. There were no awards granted and no compensation expense during the six months ending January 31, 2007.

Stock Option Plans - WSB has five stock option plans, which reserve shares of common stock for issuance to certain key employees and non-employee directors. The combination of these plans reserves 2,310,000 shares under option, of which 1,875,125 options have been granted and 434,875 options remain available for grant. Options granted generally expire ten years after grant date and are exercisable at 50% one year after the date of grant and the remaining 50% two years after the date of grant, with the exceptions of (1) the Non-Employee Directors' Plan, which options are exercisable at 25% on the first and second anniversary dates and the remaining 50% three years after the date of grant and (2) the 5,000 option grant to Phillip C. Bowman in September 2005, which were fully vested at time of grant and expire 5 years after the date of grant. The exercise price of the options granted pursuant to these plans is in each case the fair market value of the shares on the date of grant.

The following table summarizes stock option activity for the period ended January 31, 2007:

	Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value
Outstanding at July 31, 2006	1,032,425	\$2.91	
Exercised	54,825	2.88	
Granted	-	-	
Forfeited	2,250	4.04	
Outstanding at January 31, 2007	975,350	\$2.91	\$5,698,484
Exercisable at January 31, 2007	975,350	\$2.91	\$5,698,484

New Accounting Pronouncements

In July 2006, the Financial Accounting Standards Board (the "FASB") issued FASB Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement 109, which provides guidance on the measurement, recognition, and disclosure of tax positions taken or expected to be taken in a tax return. The interpretation also provides guidance on de-recognition, classification, interest and penalties, and disclosure. FIN 48 prescribes that a tax position should only be recognized if it is more-likely-than-not that the position will be sustained upon examination by the appropriate taxing authority. A tax position that meets this threshold is measured as the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement. The cumulative effect of applying FIN 48 is to be reported as an adjustment to the beginning balance of retained earnings in the period of adoption. FIN 48 is effective for fiscal years beginning after December 15, 2006. WSB is currently assessing the impact, if any, that the adoption may have on its financial statements.

THE WASHINGTON SAVINGS BANK, F.S.B. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE SIX MONTHS ENDED JANUARY 31, 2007 AND 2006

In September 2006, the FASB issued Statement No. 157, "Fair Value Measurements." This statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. The statement is effective for financial statements issued for fiscal years beginning after November 15, 2007. The adoption of this interpretation is not anticipated to have a material impact on our financial condition, results of operations or liquidity.

In September 2006, the FASB ratified the consensus reached by the EITF on Issue No. 06-4, Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements. EITF 06-4 requires the recognition of a liability and related compensation costs for endorsement split-dollar life insurance policies that provide a benefit to an employee that extends to postretirement periods as defined in SFAS No. 106, Employers' Accounting for Postretirement Benefits Other Than Pensions. The EITF reached a consensus that Bank Owned Life Insurance policies purchased for this purpose do not effectively settle the entity's obligation to the employee in this regard and, thus, the entity must record compensation costs and a related liability. Entities should recognize the effects of applying this issue through either, (a) a change in accounting principle through a cumulative-effective adjustment to retained earnings or to other components of equity or net assets in the balance sheet as of the beginning of the year of adoption, or (b) a change in accounting principle through retrospective application to all prior periods. This issue is effective for fiscal years beginning after December 15, 2007. Management is currently evaluating the impact of adopting this Issue on WSB's financial statements.

THE WASHINGTON SAVINGS BANK, F.S.B. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND
RESULTS OF OPERATIONS

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

General

The Washington Savings Bank, F.S.B. and subsidiaries' ("WSB") results of operations are primarily determined by the difference between the interest income and fees earned on loans, investments and other interest-earning assets and the interest expense paid on deposits and other interest-bearing liabilities. The difference between the average yield earned on interest-earning assets, and the average cost of interest-bearing liabilities is known as net interest-rate spread. The principal expense to WSB is the interest it pays on deposits and other borrowings. The difference between interest income on interest-earning assets and interest expense on interest-bearing liabilities is referred to as net interest income. Net interest income is significantly affected by general economic conditions and by policies of state and federal regulatory authorities and the monetary policies of the Federal Reserve Board. WSB's net income is also affected by the level of its non-interest income, including loan related fees, deposit-based fees, rental income, operations of its service corporation subsidiary, gain on sale of real estate acquired in settlement of loans ("REO"), and gain on sale of loans, as well as its operating and tax expenses.

Both basic and diluted EPS amounts are shown on the Consolidated Statements of Operations. However, "basic" earnings per share is utilized in this report's narrative when per share amounts are listed, unless otherwise stated.

This report contains forward-looking statements within the meaning of and pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. A forward-looking statement encompasses any estimate, prediction, opinion or statement of belief contained in this report and the underlying management assumptions, including those identified by terminology such as "may," "will," "believe," "expect," "estimate," "anticipate," "continue," or similar expressions. Forward-looking statements are based on current expectations and assessments of potential developments affecting market conditions, interest rates and other economic conditions and assumptions and results may ultimately vary from the statements made in this report. WSB's future results and prospects may be dependent upon a number of factors that could cause WSB's performance to compare unfavorably to prior periods. Among these factors are: (a) ongoing review of WSB's business and operations; (b) implementation of changes in lending practices and lending operations; (c) the Board of Directors ongoing review of WSB's capital management plan; (d) changes in accounting principles; (e) government legislation and regulation; (f) changes in interest rates; (g) changes in the economy; (h) credit or other risks of lending activity; (i) the impact of any legal or regulatory proceedings; and (j) other expectations, assessments and risks that are specifically mentioned in this report, in our Annual Report on Form 10-K for the year ended July 31, 2006 ("2006 Form 10-K") and in such other reports filed with the OTS. WSB wishes to caution readers not to place undue reliance on any forward-looking statements, which speak only as of the date made, and to advise readers that various factors, including those described above, could affect WSB's financial performance and could cause WSB's actual results or circumstances for future periods to differ materially from those anticipated or projected. Unless required by law, WSB does not undertake, and specifically disclaims any obligations to publicly release the result of any revisions that may be made to any forward-looking statements to reflect statements to the occurrence of anticipated or unanticipated events or circumstances after the date of such statements.

THE WASHINGTON SAVINGS BANK, F.S.B. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND
RESULTS OF OPERATIONS
(Continued)

Critical Accounting Policies

The preparation of consolidated financial statements requires management to make judgments in the application of certain of its accounting policies that involve significant estimates and assumptions about the effect of matters that are inherently uncertain. These estimates and assumptions are based on information available as of the date of the financial statements, and may materially impact the reported amounts of certain assets, liabilities, revenues and expenses as the information changes over time. Accordingly, different amounts could be reported as a result of the use of revised estimates and assumptions in the application of these accounting policies.

Accounting policies considered relatively more critical due to either the subjectivity involved in the estimate and/or the potential impact that changes in the estimates can have on the reported financial results include the accounting for the allowance for loan losses. Information concerning this policy is included in the "Critical Accounting Policies" section of Management's Discussion and Analysis in WSB's 2006 Form 10-K. There were no significant changes in this accounting policy during the first six months of fiscal 2007.

Recent Regulatory and Related Developments

In March 2004, WSB entered into the 2004 Supervisory Agreement with the OTS which addressed a number of supervisory issues. In June 2005, the Board of Directors of WSB adopted a Resolution at the request of OTS relating to WSB's compliance with the 2004 Supervisory Agreement and federal laws and regulations. Effective August 23, 2006, OTS terminated the 2004 Supervisory Agreement and permitted the Board of Directors of WSB to terminate the Resolution. The resolution of the Supervisory Agreement and non-objection to the termination of the Board Resolution, which is due in large part to the dedication and hard work by the Board, management and staff, was a significant step in our strategic plan for the Bank. We continue to work on transforming the Bank both in reducing concentrations and risk within the loan portfolio and in expanding loan and deposit products and services to be competitive within the industry which, we believe are in the best interest of our customers and shareholders. See "Regulatory section in WSB's 2006 Form 10-K.

WSB has evaluated its capital management plan including its dividend policy and believes that the current capital levels are appropriate to resume paying quarterly dividends effective with the first quarter of fiscal 2007. This development is a result of the progress made in our strategic plan for delivering long term shareholder value. On February 21, 2007, the Board of Directors declared a cash dividend of four cents per share to be paid on March 16, 2007, to stockholders of record as of March 2, 2007. The Board will continue to review WSB's dividend practice on a quarterly basis. WSB continues to remain "Well Capitalized" by regulatory standards.

THE WASHINGTON SAVINGS BANK, F.S.B. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND
RESULTS OF OPERATIONS
(Continued)

Consolidated Results of Operations

Net earnings for the three and six months ended January 31, 2007 were \$442,000, or \$0.06 per basic share and \$0.05 per diluted share, and \$1,517,000, or \$0.20 per basic share and \$0.19 per diluted share, respectively, compared to net earnings of \$1,365,000, or \$0.18 per basic share and \$0.17 per diluted share, and \$2,946,000, or \$0.40 per basic share and \$0.36 per diluted share for the corresponding fiscal 2006 periods. Net earnings for the three and six months period ended January 31, 2007, represent decreases of \$923,000, or 68%, and \$1,429,000, or 49% over the same periods last year.

The decrease in net income for the six month period reflects the continuing reduction in the Bank's concentration in higher-yielding construction loans and the general slowdown of the residential real estate market and the related decline in mortgage loan originations. WSB has seen a reduction in its construction loan portfolio by approximately 55% compared to January 31, 2006. Management continues to seek more diversity in its loan portfolio and has established a commercial business lending department and commercial real estate lending department. Management has hired experienced commercial business and commercial real estate lenders in an effort to significantly expand its nonresidential loan portfolio. Given the slowdown of the residential real estate market and the time and resources necessary to implement a more diverse lending strategy, management believes that the next several quarters may produce earnings significantly below that of similar periods a year ago. However, management believes that this strategy will better position the Bank to deliver greater profitability and increased shareholder value.

Due to the decreased demand for housing and current interest rate environment, mortgage loan originations both nationally and for the Bank, have declined. Reduction in WSB's loan production has resulted in a 30% decrease in net interest income and a 23% decrease in non-interest income, compared to same six month period last year. The decrease in non-interest income is primarily the result of a decrease in loan related fees: primarily gain on loan sales for loans sold in the secondary market. WSB has benefited the past several years from the historically low interest rate environment and strong demand for housing which had resulted in higher levels of mortgage originations and related earnings from loan fees and gains on loan sales.

A loss on sale of investment securities of \$47,000 pretax, \$29,000 net of tax, was taken in restructuring \$21 million of short term investments within the Bank's portfolio in an effort to minimize reinvestment risk while improving portfolio yield.

During the quarter, a settlement of the litigation involving a former employee against the Bank was reached. Management and the Board believe the settlement of the litigation was in the best interest of the Bank and its shareholders and will allow the Bank to better focus its financial and human resources and devote its attention to the Bank's business interests rather than protracted legal proceedings. Under the terms of the monetary settlement, a payment to the plaintiff was made, which after payment from insurance on the settlement and defense cost resulted in a one time increase in expenses of \$81,000.

THE WASHINGTON SAVINGS BANK, F.S.B. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND
RESULTS OF OPERATIONS
(Continued)

Interest Income/Expense

Total interest income decreased \$1.6 million, or 19.0%, for the second quarter of fiscal 2007, and decreased \$3.8 million, or 20.8% for the six month period ending January 31, 2007, compared to the corresponding periods last year, due primarily to a decrease in the average volume of interest-earning assets.

The average six-month balance of interest-earning assets decreased to \$418.0 million from \$502.1 million, due primarily to a decrease in the loans held-for-investment portfolio. The decrease in average yield on interest-earning assets to 6.85% from 7.21% is the result of the reinvestment of the loan portfolio runoff in short term investment securities. Investment in short term securities is being used to maintain liquidity for future loan growth as we restructure the existing loan portfolio under the business plan with a transition into a more diversified loan portfolio with lower credit risk.

Total interest expense decreased \$233,000, or 5.9% and \$811,000 or 10.0% for the three and six month periods ended January 31, 2007, compared to the same period in the prior year. The decrease for the six month period was attributable to a decrease in WSB's interest-bearing liabilities.

For the six month period ended January 31, 2007, WSB's average interest-bearing liabilities were \$384.9 million with an average rate of 3.78%, compared to \$454.7 million with an average rate of 3.52%, for the corresponding period last fiscal year.

Net interest income decreased \$1.4 million, or 29.9%, and \$3.0 million, or 29.5%, respectively, for the three and six month periods ended January 31, 2007, compared to the same periods in the prior fiscal year. Due to a lower average return on WSB's interest-earning assets, and a higher average cost of WSB's interest-bearing liabilities, WSB's net interest rate spread decreased to 3.07% for the six month period ended January 31, 2007 from 3.69% for the same period in the prior fiscal year. The ratio of WSB's interest-bearing assets to interest-bearing liabilities decreased to 108.60% from 110.43%.

Management continues to reinvest excess liquidity as a result of the loan portfolio runoff primarily in short term investment securities so as to provide liquidity for future loan growth. The reinvesting of high yielding loan funds into the investment portfolio will result in lower interest income until loan production again outpaces loan runoff and funds invested in our securities portfolio are redirected to loan production.

Provisions for Loan and REO Losses

WSB's loan portfolio is subject to varying degrees of credit risk. Credit risk is mitigated through portfolio diversification, and limiting exposure to any single customer or industry. WSB maintains an allowance for loan losses (the "allowance") to absorb losses inherent in the loan portfolio. The allowance is based on careful, continuous review and evaluation of the loan portfolio, along with ongoing, quarterly assessments of the probable losses inherent in that portfolio. The methodology for assessing the appropriateness of the allowance includes: (1) a formula allowance reflecting historical losses by credit category, (2) the specific allowance for risk rated credits on an individual or portfolio basis, and (3) a nonspecific allowance which considers risk factors not taken into factor by the other two components of the methodology. The amount of the allowance is reviewed monthly by WSB's Loan Committee, and reviewed and approved monthly by the Board of Directors.

THE WASHINGTON SAVINGS BANK, F.S.B. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND
RESULTS OF OPERATIONS
(Continued)

The allowance is increased by provisions for loan losses, which are charged to expense. Charge-offs of loan amounts determined by management to be uncollectible or impaired decrease the allowance, while recoveries of loans previously charged-off are added back to the allowance. WSB makes provisions for loan losses in amounts necessary to maintain the allowance at an appropriate level, as established by use of the allowance methodology. Under the methodology, WSB considers trends in credit risk against broad categories of homogenous loans, as well as a loan by loan review of loans criticized or classified by management. Classified loans exceeding \$300,000 are evaluated individually as part of the calculation of the adequacy of the allowance.

Management continues to see favorable developments in many of its previously internally criticized loans in which many such loans have been refinanced out of the bank or have seen credit enhancements secured from borrowers to better position the bank as to the collateral value securing outstanding loans. As a result of these developments within the portfolio, management believes no addition to the allowance was needed during the second quarter. A recovery of prior provisioning of \$300,000 was made from the allowance for loan losses during the first quarter of fiscal year 2007. No addition to the allowance for loan losses through provisioning was made during the second quarter of fiscal year 2007. The reserve for loans losses is very subjective in nature, relying significantly on historical loss experience, collateral valuations available to management on specific loans, and economic factors deemed to exist at quarter end affecting the inherent loss within the portfolio. Management believes the current reserve level is appropriate, and that the recapture of prior provisioning brings the subsequent reserve position to justified levels. While significant progress has been made addressing management's assessment as to the inherent risk within the portfolio, the slowing real estate market, especially as it pertains to custom high-end residential properties merits the existing allowance level, and management cautions the reader not to rely on the possibility of further recaptures of prior loan loss provisioning.

During the six months ended January 31, 2007, the allowance decreased in net by \$835,000, or 15.6%, to \$4.5 million from \$5.3 million at July 31, 2006, as a result of net charge-offs of \$535,000 and the reversal of prior provisioning of \$300,000. At January 31, 2007, the allowance was 2.20% of total loans held-for-investment, versus 2.16% of total loans held-for-investment, at July 31, 2006.

WSB has experienced a reduction in its loan portfolio as well as payoffs and/or credit enhancements of previously internally criticized loans, which has resulted in a lower level of inherent probable loss. Assets subject to WSB's Loan Committee criticism includes loans which meet the sub-standard criteria due to collateral deficiencies that may reflect possible losses. Based on the review of the individual loans involved, management estimates probable losses. Management has continued to assess the probable losses as new and relevant data is obtained.

THE WASHINGTON SAVINGS BANK, F.S.B. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND
RESULTS OF OPERATIONS
(Continued)

Management believes that the allowance reflects its best estimate of the losses existing in the \$204.6 million loans-held for investment portfolio as of January 31, 2007. The \$5.1 million loan held-for-sale portfolio has already been committed to be purchased by investors at January 31, 2007 and will be settled subsequent to that date. Analysis of WSB's history of sold loans indicates that minimal credit losses have been realized after the sale of loans.

WSB's determination of the adequacy of the allowance requires significant judgment, and estimates of probable losses inherent in the loans held-for-investment portfolio can vary significantly from the amounts actually observed. See Critical Accounting Policies in the 2006 Form 10-K. While management uses available information to recognize probable losses, future additions to the allowance may be necessary based on changes in the credits comprising the portfolios, changes in the financial condition of borrowers, such as may result from changes in economic conditions, or other considerations determined by management to be appropriate. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the loan portfolio and the allowance. Such review may result in additional provisions based upon their judgments of information available at the time of each examination.

Management has developed a comprehensive review process to monitor the adequacy of the allowance for loan losses. The review process and guidelines were developed utilizing guidance from federal banking regulatory agencies and relies on relevant observable data. The observable data considered in the determination of the allowance is modified as more relevant data becomes available. The results of this review process support management's view that the allowance reflects probable losses within the loan portfolio as of January 31, 2007. Please refer to WSB's 2006 Form 10-K under the caption "Significant Accounting Policies" for an overview of the underlying methodology management employs on a monthly basis to maintain the allowance.

Changes in the estimation methods may take place based on the status of the economy and the estimate of the value of the property securing loans and as a result, the allowance may increase or decrease. Future adjustments could substantially affect the amount of the allowance.

The following occurred during the first six months of fiscal 2007:

- WSB's continued reduction in the loans held for investment portfolio.
- WSB has experienced defaults primarily in construction residential loans and land lot loans. Such defaults on custom built properties and land lots carry additional risk of loss and are more susceptible to price increases during the construction process.
- As a result of an analysis of its current portfolio, WSB has recognized a decrease of the loss allocation percentages to internally classified loans. This decrease is due to a significant runoff that has been experienced in internally classified loans. A result of this runoff has been a corresponding reduction in the specific allocations for loss exposure.

THE WASHINGTON SAVINGS BANK, F.S.B. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND
RESULTS OF OPERATIONS
(Continued)

Management believes its evaluation as to the adequacy of the allowance as of January 31, 2007 is appropriate, and cautions the reader that the provision for this quarter is not necessarily indicative of future quarters provisioning. Subjective judgment is significant in the determination of the provision and allowance for loan losses, manifested in the valuation of collateral, a borrower's prospects of repayment, and in establishing allowance factors and components for the formula allowance for homogeneous loans. The establishment of allowance factors is a continuing exercise, based on management's assessment of the factors and their impact on the portfolio, and that allowance factors may change from period to period, resulting in an increase or decrease in the amount of the provision or allowance, based upon the same volume and classification of loans. A time lag between the recognition of loss exposure in the evaluation of the adequacy of the allowance and a loan's ultimate resolution and or charge-off is normal and to be expected. A discussion of some of the factors that have had a significant impact during the quarter in the evaluation of the adequacy of WSB's allowance for loan losses is discussed above.

WSB has experienced noticeable change in its loan portfolio during the quarter, which was observed in management's analysis of the adequacy of the allowance for loan loss during the quarter, and at quarter end. Management reviews monthly the adequacy of the allowance for loan losses, provisioning accordingly to meet the deemed losses within the portfolio. For a better understanding of the allowance and the evaluation process refer to WSB's 2006 Form 10-K for a more complete description.

WSB, as shown below in tabular format, has seen a decrease of charge-offs during the current quarter but experienced a significant increase during the first quarter of fiscal 2006. While there has been a decrease in loan charge-offs, we believe there is additional, yet unidentified, losses within the portfolio, which may be reflected as charge-offs against the allowance in future quarters, as these losses manifest themselves and loan collection efforts continue.

Fiscal year	2007		2006			
	2nd Qtr	1st Qtr	4th Qtr	3rd Qtr	2nd Qtr	1st Qtr
Provision for loan losses	\$ 0	\$ (300,000)	\$ 0	\$ 0	\$ 0	\$ 200,000
Loan charge-offs	\$ 157,866	\$ 400,659	\$ 575,177	\$ 280,564	\$ 51,024	\$ 1,548,218
Loan recoveries	8,354	14,813	186,238	79,359	9,830	400
Net Charge-offs	\$ 149,512	\$ 385,846	\$ 388,939	\$ 201,205	\$ 41,194	\$ 1,547,818
Allowance for loan losses at period end	\$ 4,511,168	\$ 4,660,680	\$ 5,346,526	\$ 5,735,465	\$ 5,936,670	\$ 5,977,864
Total loans held for investment at period end	204,596,274	215,099,302	247,792,458	266,349,126	305,525,989	367,610,162
Allowance to total loans held for investment at period end	2.20%	2.17%	2.16%	2.15%	1.94%	1.63%

At January 31, 2007, total non-performing loans were \$10.3 million of which included non-accrual loans of \$9.8 million and \$500,000 in accruing loans which were contractually past due more than four months but with current payments, or 5.04% of total loans held-for-investment at January 31, 2007, compared to \$10.8 million of which included non-accrual loans of \$9.7 million and \$1.1 million in accruing loans which were contractually past due more than four months but with current payments, or 4.35% of total loans held-for-investment, at July 31, 2006. The allowance is approximately 46.0% of non-accrual loans, versus 49.6% at July 31, 2006. Significant variation in this ratio may occur from period to period because the amount of non-performing

THE WASHINGTON SAVINGS BANK, F.S.B. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND
RESULTS OF OPERATIONS
(Continued)

loans depends largely on the condition of a small number of individual credits and borrowers relative to the total loan and lease portfolio. Most of the \$500,000 in loans that are contractually past due have current payments, request for extensions need to be formally filed on their current contract to extend the maturity date to bring the loan to current status.

While there has been a slight increase in non-accruals since July 31, 2006, there is not a direct relationship between the discontinuation of interest accrual and the level of inherent risk of loss associated with those loans or the portfolio.

Based upon management's analysis of WSB's Real Estate Owned ("REO"), WSB's had no provision for loss/write-down for the three and six month periods ending January 31, 2007. REO held at January 31, 2007 and July 31, 2006, was \$1.4 million and \$1.6 million, respectively, which was net of \$0 reserves for REO losses at January 31, 2007 and July 31, 2007.

Non-Interest Income

Total non-interest income decreased \$242,000, or 25.5%, and \$525,000, or 22.8% for the three and six month period ended January 31, 2007, respectively, compared to the same periods in the prior year. The decrease was attributable to a decrease in the gain on sale of loans, loan related fees and the loss on sale of investment securities which offset in part, the increase on the gain on sale of real estate acquired in settlement of loans and other income.

Gain on the sale of real estate acquired in settlement of loans increased by \$113,000 due to the sale of five properties in the first quarter and eight properties during the second quarter.

Loan-related fees decreased \$138,000, or 43.0% and \$165,000, or 27.5% for the three and six month periods ending January 31, 2007 due to a reduction in WSB's loan settlements. Real estate loans closed for the three and six month periods ended January 31, 2007, were approximately \$81.9 million and \$39.3 million, compared to approximately \$147.9 million and \$48.4 for the same periods last year. The decrease in real estate loans closed is primarily the result of a higher interest rate environment, which has slowed the housing market and a reduction in loan refinancing volume. Gain on the sale of loans increased slightly \$38,000 for the three month period ending January 31, 2007 but decreased \$402,000 for the six month period ending January 31, 2007. WSB's ability to realize gains in future periods depends largely on interest rates and the demand for mortgage loans.

The loss on sale of investment securities of \$47,000 pretax, \$29,000 net of tax, was taken in restructuring \$21 million of short term investments within the Bank's portfolio in an effort to minimize reinvestment risk while improving portfolio yield.

Non-Interest Expenses

Non-interest expenses decreased \$105,000, or 3.0% and \$551,000, or 7.4% for the three and six month periods ending January 31, 2007, as compared to the corresponding prior fiscal year periods.

THE WASHINGTON SAVINGS BANK, F.S.B. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND
RESULTS OF OPERATIONS
(Continued)

The decrease in non-interest expenses for the three month period ended January 31, 2007 compared to the same period last year was primarily due to decreases of \$113,000 in deposit insurance premiums and assessments, \$83,000 in provision for losses on real estate acquired in settlement of loans and \$60,000 in other expenses which consisted primarily of repairs and installation and foreclosure costs, which offset increases of \$180,000 in salaries and benefits. The increase in salaries and benefits was primarily the result of the full and final settlement of the litigation involving a former employee against the Bank. Under the terms of the monetary settlement, a payment to the plaintiff was made, which after payment from insurance on the settlement and defense cost resulted in a one time increase in expenses of \$81,000. The decrease in non-interest expense for the six month period ended January 31, 2007 compared to the same period last year was primarily due to decreases of \$174,000 in deposit insurance premiums and assessment, \$184,000 in other expense, which consisted primarily of repairs and installation and other operating expenses and \$146,000 in provision for losses on real estate acquired in settlement of loans.

A decrease in deposit insurance premiums and assessments is the result of the Federal Deposit Insurance Corporation ("FDIC") ruling, pursuant to the Federal Deposit Insurance Reform Act of 2005, to assess deposit insurance premiums against all depository institutions based on their current condition and nature of their activities and on the revenue needs, as determined by the FDIC for the Deposit Insurance Fund. Many insured depository institutions, including WSB, are entitled to a credit against these premiums based on the premiums they paid on or before December 31, 1996. Under the FDIC's current risk-based deposit insurance assessment system, the assessment rate for an insured depository institution depends on the assessment risk classification assigned to the institution by the FDIC which is determined by the institution's capital level and supervisory evaluations.

Income Taxes

The effective income tax rate for the six months ended January 31, 2007 was 33.0% compared to 37.3% for the same period last year. The decrease compared to last year is the result of higher percentage of income attributable to WSB's Investments portfolio of which a significant portion is not subject to Maryland state taxes.

Liquidity and Capital Resources

Total assets were \$433.6 million and \$444.1 million at January 31, 2007 and July 31, 2006, respectively. The 2.4% decrease in assets at January 31, 2007, compared to July 31, 2006, was primarily attributable to a decrease in the loan portfolio, partially offset by increases in the investment and mortgage-backed securities portfolios.

Deposits were \$299.2 million at January 31, 2007, compared to \$323.7 million at July 31, 2006. The decrease in deposits at January 31, 2007, compared to July 31, 2006, was primarily due to decreases in certificates of deposits. Management anticipates to continue to utilize excess funding liquidity to offset a runoff of higher costing certificate of deposits which were previously originated to fund loan production.

THE WASHINGTON SAVINGS BANK, F.S.B. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND
RESULTS OF OPERATIONS
(Continued)

Total borrowings, which consisted of Federal Home Loan Bank ("FHLB") advances, were \$71.0 million and \$58.0 million at January 31, 2007 and July 31, 2006. WSB maintains funding activities with correspondent banks and the Federal Home Loan Bank of Atlanta, which are cancelable by the lender and subject to lender discretion. To the extent WSB does not or can not use FHLB borrowings, it would rely on alternative funding sources including its depositor base and correspondent bank lines of credit.

WSB continually seeks to increase its core deposits and advertises its lower-cost NOW accounts, no fee checking incentives, an overdraft protection program, variable money fund savings account priced to current interest rates, and the advantages of customer access to ATM networks. WSB has expanded its products and services to its retail customers to include internet banking, bill paying, and online loan applications.

As a member of the FHLB system, and in order to maintain insurance with the FDIC, WSB must maintain average daily balances of long-term liquid assets of not less than 4% of the average daily balance of its liquidity base (net withdrawable savings accounts and borrowings during the preceding calendar month which are payable within one year). Liquid assets are defined as cash, Federal Reserve deposits, time and savings deposits in certain institutions, obligations of states and political subdivisions thereof, highly rated corporate debt, mortgage loans and mortgage-backed securities ("MBS"), and accrued interest receivable and principal on certain qualified unpledged assets, payable within five years. Internal sources of liquidity used by WSB are various short-term investments, mortgage-backed securities, and short-term borrowings. During January 2007, WSB's long-term average daily balances of liquid assets were \$216.5 million, which exceeded the \$12.2 million required.

Current regulations require subsidiaries of an institution to be separately capitalized and require investments in and extensions of credit to any subsidiary engaged in activities not permissible for a bank to be deducted in the computation of an institution's regulatory capital. These regulations have affected WSB through its service corporation subsidiary, which is engaged in real estate development and construction activities. At January 31, 2007, WSB's investment in its service corporation subsidiary was \$511,000, and the subsidiary's assets totaled \$699,000. Therefore, for regulatory capital calculations, WSB was required to deduct \$511,000 from its capital and \$699,000 from its assets. WSB's regulatory capital and regulatory assets below also reflect increases of \$636,000 and \$1.0 million, respectively, which represents unrealized losses (after-tax for capital deductions and pre-tax for asset deductions, respectively) on MBS and investment securities classified as available for sale. In addition, WSB's risk-based capital reflects an increase of \$3.1 million in the general loan loss reserve. The loan loss reserve factor represents 1.25% of WSB's risk weighted assets. Regulatory thrift capital ratios required, WSB's actual ratios, and the amount over which WSB's ratios exceed regulatory ratios required, as of January 31, 2007, are shown as follows.

THE WASHINGTON SAVINGS BANK, F.S.B. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND
RESULTS OF OPERATIONS
(Continued)

<u>Capital Category</u>	<u>Regulatory Ratios Required</u>	<u>WSB's Ratio</u>	<u>WSB's Excess of Requirements</u>	<u>Calculations</u>	<u>Based Upon</u>
Leverage	\$ 17,385,608 4.00%	\$ 61,712,746 14.20%	\$ 44,327,138 10.20%	\$ 61,712,746 \$ 434,640,212	Regulatory Capital Regulatory Assets
Tangible	\$ 6,519,603 1.50%	\$ 61,712,746 14.20%	\$ 55,193,143 12.70%	\$ 61,712,746 \$ 434,640,212	Regulatory Capital Regulatory Assets
Risk-Based	\$ 20,320,397 8.00%	\$ 64,841,914 25.53%	\$ 44,521,517 17.53%	\$ 64,841,914 \$ 254,004,965	Regulatory Capital Risk-Weighted Assets

WSB's management believes that, under current regulations, WSB will continue to meet its minimum capital requirements in the foreseeable future. However, events beyond the control of WSB, such as a shift in interest rates or a downturn in the economy in areas where WSB extends credit, could adversely affect future earnings and, consequently, the ability of WSB to meet its future minimum capital requirements.

Cash dividends are subject to determination and declaration by the Board of Directors, which takes into account WSB's financial condition, results of operations, tax considerations, industry standards, economic conditions, and other factors, including regulatory restrictions. However, the ability of WSB to pay quarterly cash dividends will be dependent on earnings, financial condition and business of WSB, as well as other factors, such as regulatory requirements. Cash dividends that are declared are paid in a subsequent quarter.

The Qualified Thrift Lender ("QTL") Test currently requires that "qualified thrift investments" be at least 65% of portfolio assets as defined by the OTS. At January 31, 2007, WSB's ratio was approximately 70% of defined portfolio assets.

Off Balance Sheet Transactions

WSB is a party to financial instruments with off-balance sheet risk including commitments to extend credit under existing lines of credit and commitments to sell loans. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated Statement of Financial Condition.

Off-balance sheet financial instruments whose contract amounts represent credit and interest rate risk are summarized as follows:

Commitments to originate new loans	\$ 7,100,750
Unfunded commitments to extend credit under existing construction, equity line and commercial lines of credit	27,826,025
Standby letters of credit	1,319,754
Commitments to sell loans held-for-sale	5,054,371

WSB does not have any unconsolidated special purpose entities or other similar forms of off-balance sheet financing arrangements.

THE WASHINGTON SAVINGS BANK, F.S.B. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND
RESULTS OF OPERATIONS
(Continued)

Commitments to originate new loans or to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Loan commitments generally expire within 90 days. Most equity line commitments for the unfunded portion of equity lines are for a term of 12 months, and commercial lines of credit are generally renewable on an annual basis. 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. WSB evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by WSB upon extension of credit, is based on management's credit evaluation of the borrower.

Commitments to sell loans held-for-sale are agreements to sell loans to third parties at an agreed upon price.

Contractual Obligations

The following chart list WSB's contractual obligations as of January 31, 2007:

	Payments due by period (dollars in thousands)				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Long-term debt	\$ 71,000	\$ 23,000	\$ 10,000	\$ 38,000	\$ -
Operating leases	735	173	474	88	-
Time Deposits	<u>248,340</u>	<u>83,002</u>	<u>151,945</u>	<u>13,393</u>	<u>-</u>
Total	<u>\$ 320,075</u>	<u>\$ 106,175</u>	<u>\$ 162,419</u>	<u>\$ 51,481</u>	<u>\$ -</u>

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Management of WSB considers interest rate risk ("IRR") and credit risk as the two most significant factors impacting WSB's financial performance. WSB currently utilizes no derivatives to mitigate its credit risk, relying instead on loan review and an adequate loan loss allowance. WSB's exposure to IRR is reviewed on at least a quarterly basis by the Board of Directors and management, and is measured in accordance with OTS Thrift Bulletin No. 13a using interest rate risk sensitivity analysis, including Net Portfolio Value ("NPV") and net interest income under various rate scenarios.

The OTS provides all institutions that file the Consolidated Maturity Rate Schedule ("CMR") as part of their quarterly thrift financial report with an interest rate sensitivity report of NPV on a calendar quarter basis. The NPV is defined as the netting of the present value of expected cash flows related to existing assets and liabilities and off-balance sheet contracts. In addition to the discounted cash flow analysis, the OTS simulator model also employs an option-based pricing approach to measuring the interest rate sensitivity of the NPV. Per the OTS interest rate risk exposure report, WSB's sensitivity measure, or decline in the NPV ratio, at December 31, 2006 was a minimal 171 basis points, compared to 230 basis points at December 31, 2005. WSB relies on the OTS model and does not prepare its own model.

THE WASHINGTON SAVINGS BANK, F.S.B. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND
RESULTS OF OPERATIONS
(Continued)

The following table compares the calculated estimates of change in NPV and net interest income as of December 31, 2006 (the most recent data available) to current limits established by management and approved by the Board of Directors.

	Percentage Change In			
	Net Interest Income		Net Portfolio Value as a % of PV of Assets	
Basis Point Change In Market Rates	Board Limits	Projected Change	Minimum Board Limits	OTS Projections
+200	-30%	+18%	6%	14%
- 100	-30%	- 9%	10%	16%

Item 4. Controls and Procedures

WSB's management, under the supervision and with the participation of WSB's Principal Executive Officer and Principal Financial Officer, evaluated the effectiveness of the design and operation of WSB's disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d – 15(e) of the Securities Exchange Act of 1934, as of the end of the period covered by this report. Based on that evaluation, WSB's Principal Executive Officer and Principal Financial Officer concluded that WSB's disclosure controls and procedures are effective in timely alerting them to material information which is required to be included in the periodic reporting that WSB must file with the OTS.

During the quarterly period covered by the report, there were no changes (including corrective actions with regard to significant or material weaknesses) in the WSB's internal controls over financial reporting that has materially affected, or are reasonably likely to materially affect WSB's internal controls over financial reporting.

PART II.

Item 1. Legal Proceedings

On July 29, 2005, WSB was notified of suit in John Sullivan v. The Washington Savings Bank, F.S.B., Stephen J. Troese, Randall Robey and the Office of Thrift Supervision (U.S. District Court for the District of Maryland, Case No. L05-CV2083). The complaint arises out of the termination of Mr. Sullivan's employment by WSB, alleges a range of federal and state statutory and common law claims, and purports to claim compensatory damages in the amount of \$1 million and, in connection with certain tort claims, \$5 million in punitive damages, plus all costs, interests, and attorney's fees. WSB had undertaken to indemnify, and advance expenses for, its co-defendants, Stephen Troese, a director of the Company, and Randall Robey, an officer of the Company. On May 12, 2006, the court released OTS from the suit. On September 19, 2005, WSB filed a motion with the court to dismiss the complaint on the ground that all claims are subject to arbitration, and in the alternative has sought to dismiss most claims against it and co-defendants Troese and Robey for failure to state a claim. On June 28, 2006, the Court granted that motion and dismissed the case, concluding that all claims were subject to arbitration. The plaintiff moved for reconsideration of that decision and proceeded with arbitration.

THE WASHINGTON SAVINGS BANK, F.S.B. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND
RESULTS OF OPERATIONS
(Continued)

On January 24, 2007, The Washington Savings Bank, F.S.B (the "Company"), along with Randy Robey, an officer of the Company, and Stephen J. Troese, a director of the Company, entered into a Settlement Agreement with John Sullivan, in full and final settlement of pending litigation and arbitration between the parties. The parties also agreed to mutually release each other against all claims. Under the terms of the monetary settlement, a payment to the plaintiff was made, which after payment from insurance on the settlement and defense cost resulted in a one time increase in expenses of \$81,000. On February 4, 2007, the parties filed a stipulation of dismissal with prejudice with the U.S. District Court for the District of Maryland and a notice of settlement and dismissal with prejudice with the Judicial Arbitration and Mediation Services (JAMS). On February 6, 2007, the U.S. District Court for the District of Maryland entered an order dismissing the federal litigation with prejudice.

On April 6, 2006, the Internal Revenue Service issued a notice attributable to the disallowance of a conservation easement charitable donation. On May 8, 2006, WSB filed a timely Protest appealing an Internal Revenue Service proposed adjustment on the valuation of the conservation easement donated to the Maryland Environmental Trust. The bank maintains that it complied with the statutory requirements of 26 U.S.C. §170(h). Based the relevant statutory provisions, regulations and case law on point, WSB believes the Bank will be successful in establishing that it complied with and satisfied the applicable rules and regulations and therefore, is entitled to a charitable conservation easement donation. The courts have traditionally resolved valuation disputes by reaching a middle ground between the competing values as proposed by the Internal Revenue Service and the taxpayer. Therefore, at this time, we are unable to determine whether or to what extent WSB's valuation of the conservation easement will be sustained.

Item 1A. Risk Factors

During the quarter, no material changes in risk factors have occurred since the July 31, 2006 year end. See page 16 of WSB's 2006 Form 10K for a complete discussion and analysis of risk factors.

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

WSB's Annual Meeting of Stockholders was held on November 16, 2006. WSB's Annual Report on Form 10-K, Notice of Meeting, Proxy Statement, and form of Proxy were mailed on October 20, 2006, to stockholders of record as of October 6, 2006. On said record date, there were 7,426,844 shares of common stock outstanding. The matters proposed by WSB's Board of Directors for a vote by security holders were the re-election of Directors George Q. Conover, Eric S. Lodge and Michael J. Sullivan, each for a three-year term.

Messrs. Bowman, Harnett, Huffman and Troese whose terms did not expire at this annual meeting, are continuing as Directors of WSB.

THE WASHINGTON SAVINGS BANK, F.S.B. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND
RESULTS OF OPERATIONS
(Continued)

There were no additional Director nominations or other business brought before the Meeting. Messrs. Conver, Lodge and Sullivan were reelected as Directors for a three-year term each, as follows:

	Votes <u>For</u>	Withhold <u>Authority</u>	<u>Abstain</u>	<u>Against</u>
George Q. Conover	6,090,700	351,037	0	0
Eric S. Lodge	6,092,982	348,755	0	0
Michael J. Sullivan	6,093,153	348,584	0	0

Item 6. Exhibits

- 3.1 Amended and Restated Federal Stock Charter of WSB. (Incorporated by reference from WSB's Quarterly Report on Form 10-Q for the quarter ended January 31, 1997.)
- 3.2 Amended and Restated By-Laws of WSB. (Incorporated by reference from WSB's Form 8-K, as filed on February 22, 2005.)
- 3.3 Certificate of Amendment to Federal Stock Charter of WSB. (Incorporated by reference from WSB's Definitive Proxy Statement filing for the year ended July 31, 2001, as filed on October 22, 2001.)
- 31.1 Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Filed herewith).
- 31.2 Certification of Principal Financial Officer pursuant Section 302 of the Sarbanes-Oxley Act of 2002. (Filed herewith).
- 32.1 Certification of Principal Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. (Furnished herewith).
- 32.2 Certification of Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. (Furnished herewith).

SIGNATURES

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

THE WASHINGTON SAVINGS BANK, F.S.B.

By: /s/ Phillip C. Bowman
Phillip C. Bowman
Chief Executive Officer

By: /s/ Randall M. Robey
Randall M. Robey
Senior Vice President and Chief Financial Officer

Date: March 15, 2007

EXHIBIT 31.1

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER PURSUANT TO SECTION 302 OF THE
SARBANES-OXLEY ACT OF 2002**

I, Phillip C. Bowman, Chief Executive Officer of The Washington Savings Bank, F.S.B. (“WSB”), certify that:

1. I have reviewed this quarterly report on Form 10-Q of WSB;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of WSB as of, and for, the periods presented in this quarterly report;
4. WSB’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and we have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision to ensure that material information relating to WSB, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) evaluated the effectiveness of WSB’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - c) disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and
5. WSB’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting to WSB’s auditors and the audit committee of WSB’s board of directors (or persons performing the equivalent function):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect WSB’s ability to record, process, summarize and report financial data; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in WSB’s internal control over financial reporting.

Date: March 15, 2007

By: /s/ Phillip C. Bowman
Phillip C. Bowman
Chief Executive Officer

**CERTIFICATION OF CHIEF FINANCIAL OFFICER PURSUANT TO SECTION 302 OF THE
SARBANES-OXLEY ACT OF 2002**

I, Randall M. Robey, Sr. Vice-President and Chief Financial Officer of The Washington Savings Bank, F.S.B. (“WSB”), certify that:

1. I have reviewed this quarterly report on Form 10-Q of WSB;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of WSB as of, and for, the periods presented in this quarterly report;
4. WSB’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and we have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision to ensure that material information relating to WSB, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) evaluated the effectiveness of WSB’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - c) disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and
4. WSB’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting to WSB’s auditors and the audit committee of WSB’s board of directors (or persons performing the equivalent function):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect WSB’s ability to record, process, summarize and report financial data; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in WSB’s internal control over financial reporting.

Date: March 15, 2007

By: /s/ Randall M. Robey
Randall M. Robey
Sr. Vice President
and Chief Financial Officer

EXHIBIT 32.1

Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350

I hereby certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, to my knowledge and on the date hereof, that the accompanying Quarterly Report on Form 10-Q of The Washington Savings Bank, F.S.B. (“WSB”) for the quarterly period ended January 31, 2007, fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and that the information contained in this Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of WSB.

By: /s/ Phillip C. Bowman
Phillip C. Bowman
Chief Executive Officer

March 15, 2007

EXHIBIT 32.2

Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350

I hereby certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, to my knowledge on the date hereof, that the accompanying Quarterly Report on Form 10-Q of The Washington Savings Bank, F.S.B. ("WSB") for the quarterly period ended January 31, 2007, fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and that the information contained in this Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of WSB.

By: /s/ Randall M. Robey
Randall M. Robey
Sr. Vice President
and Chief Financial Officer

March 15, 2007