

MAI SYSTEMS CORP  
Form PRER14C  
September 28, 2005

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**SCHEDULE 14C**

**Information Statement  
Pursuant to Section 14(c) of the Securities Exchange Act of 1934**

Check the appropriate box:

- a.  Preliminary Information Statement
- b.  Confidential, for Use of the Commission Only (as permitted by Rule 14c-5(d) (2))
- c.  Definitive Information Statement

## MAI SYSTEMS CORPORATION

(Name of Registrant as Specified in its Charter)

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- (1) Title of each class of securities to which transaction applies:
- (2) Aggregate number of securities to which transaction applies:
- (3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):\$
- (4) Proposed maximum aggregate value of transaction: \$
- (5) Total fee paid: \$

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  - (4) Date Filed:
-

**MAI SYSTEMS CORPORATION**

26110 Enterprise Way

Lake Forest, California 92630

(949) 598-6000

**INFORMATION STATEMENT**

**WE ARE NOT ASKING YOU FOR A PROXY AND**

**YOU ARE REQUESTED NOT TO SEND US A PROXY.**

Our Board of Directors and the Investor Group described below are furnishing this information statement to all holders of record of the issued and outstanding shares of our common stock, \$0.01 par value, as of the close of business on December 30, 2004 (the Approval Record Date), in connection with a proposed Amendment to our Amended and Restated Certificate of Incorporation ( Amendment ) to effectuate a 1-for-150 reverse stock split. If consummated, the reverse stock split would enable us to terminate our periodic reporting obligations under Sections 13 and 15(d) of the Securities Exchange Act of 1934, as amended ( Exchange Act ), the registration of our common stock under Section 12(g) of the Exchange Act and the quotation of our common stock on the OTC Bulletin Board. .

Section 242 of the Delaware General Corporation Law requires us to obtain stockholder approval of the Amendment. We have one class of capital stock outstanding, our common stock. Only stockholders of record at the close of business on the Approval Record Date are entitled to approve and adopt the Amendment. As of the Approval Record Date, 57,847,862 shares of our common stock were issued and outstanding, held of record by approximately 577 stockholders. Each share of common stock issued and outstanding on the Approval Record Date is entitled to one vote with regard to the approval and adoption of the Amendment. There are no dissenters' rights of appraisal with respect to the Amendment.

Under the Delaware General Corporation Law and our bylaws, our stockholders may approve the Amendment without a meeting, without prior notice and without a vote if a written consent to the Amendment is signed by the holders of outstanding shares having not less than the minimum number of votes that would be necessary to authorize or take such action at a meeting at which all shares entitled to vote on the action were present and voted (here, a majority of the outstanding shares of common stock). The holders of a majority of the outstanding shares of our common stock are members of HIS Holding, LLC, an investor group consisting of two members of our senior management, W. Brian Kretzmer and James W. Dolan, the Chairman of the Board, Richard S. Ressler, and certain of our principal senior lenders, The Canyon Value Realization Fund (Cayman), Ltd., Canyon Value Realization Fund, L.P., and CPI Securities L.P ( Investor Group ). The Investor Group has approved the Amendment by written consent dated effective as of December 30, 2004. Accordingly, your consent is not required and is not being solicited in connection with the Amendment. See The Reverse Stock Split- Approval of the Reverse Stock Split By Our Directors and Stockholders at page 7 for further details.

We will pay the expenses of furnishing this information statement, including the cost of preparing, assembling and mailing this information statement. We anticipate that this information statement will be sent or given on or about October , 2005 to the record holders of common stock as of close of business on the Approval Record Date, and that the Amendment will be filed with the Delaware Secretary of State and become effective no earlier than the twentieth day after this information statement is sent or given to those holders of common stock.

**Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of the reverse stock split, passed upon the merits or fairness of the reverse stock split, or passed upon the adequacy or accuracy of the disclosure in this information statement. Any representation to the contrary is a criminal offense.**

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**SUMMARY TERM SHEET**

**Summary of the Proposed Reverse Stock Split**





*Purpose of the Reverse Stock Split*

The purpose of the reverse stock split is to position ourselves to terminate our public reporting so that we may continue future operations as a private company, relieving us of the costs, administrative burdens and competitive disadvantages associated with operating as a public company. We intend to accomplish this purpose by reducing the number of holders of record of our common stock to fewer than 300 by cashing out the fractional shares that would otherwise result from the reverse stock split. See *Reasons for the Reverse Stock Split* at page 15.

*Establishment and Findings of Special Committee*

Our Board of Directors adopted resolutions on November 15, 2004 establishing a Special Committee of the Board of Directors to investigate whether the Amendment to our Amended and Restated Certificate of Incorporation to implement the reverse stock split was advisable, in the best interests of, and substantively and procedurally fair to, our unaffiliated stockholders, whether they are cashed out and/or remain as our stockholders. The form of the Amendment is attached to this information statement as **Appendix A**. See *Special Committee of the Board of Directors* at page 9.

The Special Committee retained its own legal counsel to advise it on all matters related to the reverse stock split. The Special Committee did not obtain a third party fairness report, opinion, appraisal, or other independent assessment of the fairness of the terms of the reverse stock split or the value of our common stock, but did rely on an internal company study. See *Procedural Factors Disfavoring the reverse stock split; Interests of our Chairman and Executive Officers in the reverse stock split - The Special Committee and Our Board of Directors Did Not Obtain a Fairness Report* at page 17.

In determining the price to be paid in lieu of issuing fractional shares of \$0.17 per share, the Special Committee considered, among other things, the historical market price for our common stock for the 30-, 60- and 90-day periods prior to December 1, 2004. The Special Committee also reviewed an internal study prepared by management that considered historical market prices and recent transactions, earnings value, discounted cash flow value, net asset value (liquidation value) and net book value in evaluating the fairness of the price being offered to all stockholders. See *Financial Analysis and Summary of Factors Reviewed to Determine \$0.17 Per Share Fractional Share Purchase Price* at page 11 and *Financial Analysis Performed by Management* at page 11.

After a complete review of the reverse stock split proposal and consultation with legal counsel, the Special Committee on December 2, 2004 presented its findings to the Board of Directors. The Special Committee reported on each of the three principal means of reducing our number of shareholders: merger, tender offer and reverse stock split. The Special Committee found that the reverse stock split was the most viable and cost-effective alternative available to us to reduce the number of our stockholders below 300, thereby positioning us to terminate our public reporting obligations. The Special Committee further concluded that by continuing future operations as a private company, we would be relieved of the costs, administrative burdens and competitive disadvantages associated with operating as a public company. See *Special Committee of the Board of Directors* at page 9; *Background of the Reverse Stock Split; Alternatives Considered by the Special Committee and the Board of Directors* at page 14; and *Special Factors Considered in Approving the Reverse Stock Split* at page 14.

The Special Committee further found that the advantages of the reverse stock split to the unaffiliated stockholders (both those being cashed out and those remaining as stockholders after the reverse stock split) outweighed the disadvantages, and that it was substantively and procedurally fair, and, therefore, that the transaction was in all of our stockholders' best interests. See "Special Committee of the Board of Directors" at page 9 and "Special Factors Considered in Approving the Reverse Stock Split" at page 14.

The Special Committee met on September 23, 2005 to receive an updated report from management on the reverse stock split. At this meeting, the Special Committee reaffirmed the reverse stock split and all of their prior findings and confirmed that the transaction was still substantively and procedurally fair and in the best interests of all of the shareholders.

*Approval of Board of Directors*

On December 2, 2004, our Board of Directors (with Richard S. Ressler, our Chairman, recusing himself because he is the controlling shareholder of Orchard Capital Corporation, the managing member of the Investor Group) adopted resolutions authorizing and approving the Amendment and the implementation of the reverse stock split. The Board of Directors directed management to submit the Amendment to our stockholders for approval and reserved the right to

abandon the Amendment and the reverse stock split at any time prior to its effective time. See *The Reverse Stock Split - Approval of the Reverse Stock Split By Our Board of Directors and Stockholders* at page 7 and *Substantive and Procedural Factors Considered by the Special Committee and Our Board of Directors as to the Fairness of the Reverse Stock Split* at page 16.

*Approval of Stockholders*

We had approximately 577 stockholders of record holding an aggregate of 57,847,862 shares of common stock outstanding as of the Approval Record Date. Of those shares, approximately 83.5%, or 48,312,968 shares, were controlled by the Investor Group. Each stockholder is entitled to one vote per share. The proposed action to implement the reverse stock split requires the affirmative vote or written consent of the holders of a majority of the outstanding shares of our common stock as of the Approval Record Date. Members of the Investors Group that hold a majority of our voting power approved the Amendment by written consent effective as of December 30, 2004. See *The Reverse Stock Split - Approval of the Reverse Stock Split By Our Board of Directors and Stockholders* at page 7.

The Board of Directors met on September 23, 2005 to receive an updated report from management on the reverse stock split. At this meeting, the Board of Directors also received the recommendation of the Special Committee reaffirming the reverse stock split and all of their prior findings and confirmed that the transaction was still substantively and procedurally fair and in the best interests of all of the shareholders. At this time, the Board of Directors (with Richard S. Ressler again recusing himself) voted to reaffirm the implementation of the reverse stock split.

*Recent Transactions and Potential Conflicts of Interest with Investor Group*

Members of the Investor Group that control the majority of our common stock include the Chairman of our Board of Directors, Richard S. Ressler, two of our executive officers, W. Brian Kretzmer and James W. Dolan, and certain of our senior lenders, The Canyon Value Realization Fund (Cayman), Ltd., Canyon Value Realization Fund, L.P., and CPI Securities L.P. See *Other Information - Background Information Concerning Our Directors, Executive Officers and Controlling Stockholders*, page 25.

In April 2004, the Investor Group acquired 2,433,333 of our shares of common stock and approximately \$3.1 million of our indebtedness from CSA Private Limited, a subsidiary of Computer Sciences Corporation. See *Prior Transactions Between the Investor Group and Our Company - Investor Group Purchase of Company Shares Owned by Computer Sciences Corporation*, page 27.

In September 2004, the Investor Group acquired a controlling interest in the Company by converting approximately \$3.3 million in company indebtedness and investing \$1 million in our company for approximately 42 million shares of our common stock. See *Prior Transactions Between the Investor Group and Our Company -*

September 22, 2004 Stockholder Approval of the Management Equity/Conversion Transaction that Resulted in a Change in Control of Our Company, page 27.

There are potential conflicts of interest between the Investor Group and our unaffiliated shareholders. For example, the reverse stock split will increase the percentage ownership interest of the Investor Group in our common stock. In addition, the reverse stock split will reduce the liquidity of our common stock, which may have a greater impact on our unaffiliated stockholders than on the Investor Group. See Procedural Factors Disfavoring the Reverse Stock Split; Interests of our Chairman and Executive Officers in the Reverse Stock Split, page 17.

*Estimated Effective Time*

We anticipate that the Amendment will be filed with the Delaware Secretary of State and the reverse stock split will become effective on or about October , 2005. However, in no event will the reverse stock split be consummated earlier than that twentieth day after this information statement is sent or given to those persons or entities that held common stock as of the Approval Record Date. See The Reverse Stock Split - Effective Time of the Reverse Stock Split at page 7.

*Implementation and Effects of Reverse Stock Split*

Following the reverse stock split, we anticipate that we will have approximately 250 stockholders of record holding an aggregate of approximately 385,000 outstanding shares of our common stock. See Effects of the Reverse Stock Split on our Company at page 20.

Every holder of record of common stock at the effective time will be entitled to receive one share of our common stock in exchange for every 150 shares of common stock held by that holder immediately prior to the effective time. No fractional shares will be issued. Instead, in lieu of issuing fractional shares to holders who would otherwise be entitled to receive a fractional share of our common stock as a result of the reverse stock split, we will pay cash consideration at the rate of \$0.17 for each share of common stock that was outstanding before the effective time but

was not converted into a full share of post-split common stock. See *The Reverse Stock Split - Basic Terms* at page 6; *Effects of the Reverse Stock Split on Stockholders Who Hold Fewer than 150 Shares of common stock in a Single Account* at page 19; and *Effects of the Reverse Stock Split on Stockholders Who Hold More Than 150 Shares of our common Stock in a Single Account* at page 19.

We plan to pay the expenses and cash consideration for the reverse stock split using our available cash. We estimate that we will use approximately \$75,000 in cash to complete the reverse stock split, which includes professional fees and other expenses related to the transaction and cash payments to be made in lieu of issuing fractional shares. We estimate that the fractional shares that would otherwise be issued in the reverse stock split would aggregate to approximately 139,000 pre-split whole shares of common stock, resulting in cash payments to cashed-out stockholders of approximately \$24,000 (139,000 whole shares at \$0.17). See *Source of Funds and Financial Effect of the Reverse Stock Split* at page 8.

Our common stock is traded over-the-counter on the OTC Bulletin Board under the symbol MAIY.OB. On December 8, 2004, the last trading price for our common stock prior to the announcement of the proposed reverse stock split was \$0.16. The closing trading price for our common stock on September 23, 2005 was \$0.055. The cash consideration to be paid for fractional shares represents a premium of approximately 11%, 10% and 7% over the weighted average closing trading price of the common stock over the 30-, 60- and 90- day periods, respectively, prior to the announcement of the reverse stock split and a premium of 209% over the closing trading price of \$0.055 on September 23, 2005. See *Market Prices of Our Common Stock and Dividend Policy* at page 29.

**Following the reverse stock split, we plan to terminate our public reporting, which means that our common stock will not qualify to be traded on any automated quotation system operated by a national securities association and will no longer be traded on the OTC Bulletin Board. Our common stock may be eligible to trade in the Pink Sheets, however we have no present plans to apply for our common stock to be traded in the Pink Sheets. For this reason, stockholders will experience a loss of liquidity after the reverse stock split and may be required to hold their shares of common stock for an indefinite period of time. See *Substantive Factors Disfavoring the Reverse Stock Split - Cessation of Public Sale Opportunities* at page 18.**



Following the reverse stock split and the termination of our public reporting, we will no longer be a public-reporting company, but rather will operate as a private company. We expect our business and operations to continue as they are currently being conducted and, except as disclosed in this information statement, the reverse stock split is not anticipated to materially affect the conduct of our business. We expect to be subject to substantially the same risks and uncertainties after the reverse stock split. See *Conduct of our Business after the Reverse Stock Split Future Company Plans* at page 21.

We believe the reverse stock split will be treated as a tax-free recapitalization for federal income tax purposes, which will result in no material federal income tax consequences to us. Depending on each stockholder's individual situation, the reverse stock split may give rise to certain income tax consequences for stockholders. See *Certain Material Federal Income Tax Consequences* at page 22.

### **SPECIAL FACTORS**

#### **The Reverse Stock Split**





*Basic Terms*

Under the terms of the reverse stock split, every holder of record at the effective time will be entitled to receive one share of our common stock in exchange for every 150 shares held by such person immediately prior to the effective time. No fractional shares will be issued. Instead, in lieu of issuing fractional shares to stockholders who would otherwise be entitled to receive a fractional share of our common stock as a result of the reverse stock split, we will pay cash consideration at the rate of \$0.17 for each share of common stock that was outstanding immediately prior to the effective time but was not converted into a full share of post-split common stock.

To avoid being completely cashed out as a result of the reverse stock split, a stockholder may:

purchase a sufficient number of shares of common stock on the open market and have them registered in the stockholder's name and consolidated with its current record account if it is a record holder, or have them entered in its account with a nominee, such as its broker or bank, in which the stockholder currently holds shares of common stock,

so that the stockholder holds at least 150 shares of common stock in its account immediately prior to the effective time; or

if applicable, consolidate the stockholder's accounts, or accounts with nominees, so that the stockholder holds at least 150 shares of common stock in a single record account immediately prior to the effective time.

For payment purposes, we intend for the reverse stock split to treat stockholders holding common stock in a street name through a nominee, such as a bank or broker, in the same manner as stockholders whose shares are registered in their own names. Nominees will be instructed to effect the reverse stock split for their beneficial holders. Accordingly, we also refer to those street name holders who receive a cash payment instead of fractional shares as cashed-out stockholders. However, nominees may have different procedures, and stockholders holding shares in street name should contact their nominees.

The reverse stock split is structured to be a Rule 13e-3 transaction under the Exchange Act because it is intended to, and if completed will likely, reduce the number of record holders of our common stock to fewer than 300, which will position us to terminate our public reporting. In connection with the reverse stock split, we and the members of the Investor Group have filed a Rule 13e-3 Transaction Statement on Schedule 13E-3 with the Commission. We intend to apply for the termination of our public reporting obligations as soon as practicable after the effective time.

*Effective Time of the Reverse Stock Split*



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The time for determining the shares of our common stock that will be subject to the reverse stock split will be the time that the Amendment is filed with the Delaware Secretary of State and becomes effective by its terms, which we estimate will be no later than 5:00 p.m. Eastern Standard Time on October 1, 2005. In no event, however, will the effective time of the reverse stock split be earlier than the twentieth day after this information statement is sent or given to those persons or entities that held our common stock as of the Approval Record Date.

### *Approval of the Reverse Stock Split By Our Board of Directors and Stockholders*

As detailed below in Special Committee of the Board of Directors, our Board of Directors has approved the Amendment and the implementation of the reverse stock split and reserved the right to abandon the Amendment and the reverse stock split at any time prior to the effective time. Under the Delaware General Corporation Law and our bylaws, our stockholders may approve the Amendment and reverse stock split without a meeting, without prior notice and without a vote if a written consent to the Amendment is signed by the holders of outstanding shares having not less than the minimum number of votes that would be necessary to authorize or take such action at a meeting at which all shares entitled to vote on the action were present and voted (here, a majority of the outstanding shares of common stock). The Investor Group, which holds a majority of the outstanding shares of our common stock, has approved the Amendment by written consent dated effective as of December 30, 2004. Accordingly, no other stockholder approval is required and is not being solicited in connection with the Amendment.

Information about the Investor Group that consented to the Amendment and the number of shares of common stock owned as of the Approval Record Date and included in the written consent approving the reverse stock split is as follows:

<b>Name of Stockholder</b>	<b>Number of Shares</b>
HIS Holding, LLC 6922 Hollywood Boulevard, Suite 900 Los Angeles, California 90028	43,172,110

The managing member of HIS Holding, LLC is Orchard Capital Corporation, a California corporation, of which Richard S. Ressler is president and the controlling shareholder. The number of shares shown as owned and included in the written consent approving the reverse stock split excludes shares held separately by the four members of HIS Holding, LLC because shares held separately were not made part of the written consent. The members of HIS Holding, LLC include Richard S. Ressler, our Chairman, W. Brian Kretzmer, our Chief Executive Officer and President, James W. Dolan, our Chief Financial and Operating Officer, and certain of our principal lenders, The Canyon Value Realization Fund (Cayman), Ltd., Canyon Value Realization Fund, L.P., and CPI Securities L.P. Additional beneficial ownership information is contained below in Interests of Certain Persons in or Opposition to the Reverse Stock Split- Security Ownership of Certain Beneficial Owners and Management.

*Stock Certificates*



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Our transfer agent, Mellon Investor Services, has been appointed as our exchange agent to carry out the exchange of existing common stock certificates for new common stock certificates and to send cash payments in lieu of issuing fractional shares. Promptly following the effective time, the transfer agent will send a letter of transmittal to each stockholder. The letter will describe the procedures for surrendering stock certificates in exchange for new common stock certificates and/or the cash consideration. Upon receipt of the stock certificates and properly completed letters of transmittal, the transfer agent will issue the appropriate new stock certificates and/or make the appropriate cash payment within approximately 20 business days.

No service charges will be payable by our stockholders in connection with the exchange of certificates or the payment of cash in lieu of issuing fractional shares because we will bear those expenses. We will not pay interest on cash sums due to any stockholder in connection with the reverse stock split.

All stock certificates outstanding immediately prior to the effective time evidencing ownership of our common stock will be deemed cancelled without further action by their holders as of the effective date. Please do not send any stock certificates to our transfer agent or us in connection with the reverse stock split until you receive and complete a letter of transmittal.

### *Provision for Unaffiliated Stockholders*

Neither we, nor any executive officer or director of our company nor any person controlling us has made any provision in connection with the reverse stock split to grant unaffiliated stockholders access to our corporate files or to obtain counsel or appraisal services for such stockholders. In lieu of such provisions, we appointed a Special Committee to protect the interests of our unaffiliated stockholders. Even though the Special Committee consists of directors of our company and therefore is not completely unaffiliated from us, committees of independent directors are a commonly used mechanism to ensure fairness in transactions of this type. The Special Committee determined that an appraisal of the value of our common stock or fairness opinion regarding the reverse stock split were not required. See discussion below under Special Committee of the Board of Directors And Procedural Factors Disfavoring the Reverse Stock Split; Interests of our Chairman and Executive Officers in the Reverse Stock Split.

### *Source of Funds and Financial Effect of the Reverse Stock Split*





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Given that the actual number of shares of common stock that we will purchase is unknown at this time, the total cash we will pay to stockholders is currently unknown, but is estimated to be approximately \$24,000. The \$24,000 estimate is based upon actual shares held in individual accounts per our transfer agent records plus the actual number of accounts held in street name per records received from ADP considering that the maximum number of shares acquired from each account will be 149 fractional shares. This amount was calculated by multiplying all estimated fractional shares to be repurchased by the \$0.17 per share repurchase price. We expect to pay the cash consideration to be paid in connection with the reverse stock split and other expenses for the reverse stock split through our available cash. The reverse stock split and the use of approximately \$75,000 in cash to complete the reverse stock split, which includes professional fees and other expenses related to the transaction and cash payments to be made in lieu of issuing fractional shares, are not expected to adversely affect our capitalization, liquidity, results of operations or cash flow. We will bear all expenses, excluding brokerage commissions and taxes, if any, related to implementation of the reverse stock split.

### *Fees and Expenses*



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The following is a reasonably itemized statement of the fees and expenses that have been incurred or that are estimated to be incurred in connection with the reverse stock split and the transactions related thereto: \$24,000 in cash consideration for fractional shares; \$5,000 to our auditors; \$25,000 to our legal counsel; \$11,000 for printing and other costs in connection with the mailing of this information statement; and \$10,000 for exchange agent services.

### *Accounting Consequences*

The reverse stock split will not affect the par value of our common stock, which remains \$0.01 per share. The reverse stock split will result in an increase in per share net income or loss and net book value of our common stock because fewer shares of our common stock will be outstanding. Our financial statements, supplementary financial information and quantitative and qualitative disclosures about market risk, included in **Appendix C** of this information statement, do not reflect the reverse stock split. See **Appendix B** of this information statement for pro forma financial information reflecting the reverse stock split.

*Certain Legal Matters*



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We are not aware of any license or regulatory permit that appears to be material to our business that might be adversely affected by the reverse stock split, nor any approval or other action by any governmental, administrative or regulatory agency or authority, domestic or foreign, that would be required to consummate the reverse stock split, other than approvals, filings or notices required under federal and state securities laws and the corporate laws of the States of Delaware and California.

### **Special Committee of the Board of Directors**

Subsequent to our 2004 annual stockholders meeting that was held on September 22, 2004, our Board of Directors requested that our senior management and legal counsel present to our Board of Directors an analysis of the positive and negative factors relating to the privatization of our company. At the first Board of Directors meeting following the annual stockholders meeting, the Board first considered and discussed a going private transaction as a means of substantially reducing our general and administrative expenses and allowing senior management to redirect its focus on maximizing revenues. Thereafter, pursuant to a unanimous written consent dated September 22, 2004, all Board members requested that a review of possible privatization of our company be commenced.

On November 15, 2004, our Board of Directors held a special meeting during which our senior management and David M. Griffith, our in-house general counsel, described the benefits and detriments of and various alternatives for taking our company private, including merger, tender offer and reverse stock split. As prior counsel to our special committee formed to review the Management Equity/Conversion Transaction, Rutan & Tucker, LLP, Costa Mesa, California, participated telephonically in a portion of this meeting because of their expertise in going private transactions. Our Board of Directors and management determined that the reverse stock split would be the best means of accomplishing this goal.

In view of the possible conflicts of interest involved in the reverse stock split, our Board of Directors unanimously decided on November 15, 2004, that it would be advisable to form the Special Committee of independent members of our Board of Directors. Some of the potential conflicts of interest that were discussed at this special meeting included those that could arise between the Investor Group and our unaffiliated stockholders because the reverse stock split will increase the percentage ownership interest of the Investor Group in our common stock. In addition, the reverse stock split will reduce the liquidity of our common stock, which may have a greater impact on our unaffiliated stockholders than on the Investor Group.

The Board of Directors decided to appoint to the Special Committee the same independent disinterested directors that had reviewed the Management Equity/Conversion Transaction discussed below under Prior Transactions Between the Investor Group and Our Company. The Special Committee was formed consisting of Messrs. Mayer and Ross, with Mr. Ross as the Chairman, to evaluate the reverse stock split proposal and assess whether the proposal is in the best interests of our stockholders. Neither of these directors is employed by or affiliated with our company or the Investor Group or any of their affiliates (except in the capacity as a director of our company). However, Mr. Ross's son is an employee (but not an executive officer) of CIM Group, an affiliate of MAI. CIM Group is a real estate development company that is affiliated with MAI because it is an entity under the control of Richard S. Ressler, our Chairman and majority beneficial stockholder.

Our Board of Directors further determined that it would be prudent for the Special Committee to retain independent legal counsel to assist in reviewing the reverse stock split proposal. On November 15, 2004, the Special Committee interviewed Rutan & Tucker, LLP, Costa Mesa, California, and decided to retain this firm. The principal role that Rutan & Tucker, LLP played in the reverse stock split was as legal counsel to the Special Committee, although this firm has also advised us on issues related to preparation of this information statement. Other than its representation of the Special Committee, Rutan & Tucker, LLP has no relationship (legal or otherwise) with any of the independent directors that constitute the Special Committee. The Special Committee also instructed senior management to prepare an internal study of the reverse stock split and a pricing analysis for the price to be paid to stockholders in lieu of issuing fractional shares in the reverse stock split.

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On November 30, 2004, senior management presented to the Special Committee and its legal counsel, Rutan & Tucker, LLP, an internal company study of the reverse stock split and a pricing analysis for the repurchase of fractional shares. During the course of the presentation, the Special Committee raised numerous questions and requested additional information and analysis, each of which was responded to by our senior management and our in-house legal counsel, David M. Griffith, and attorneys of Rutan & Tucker, LLP.

The Special Committee determined that it would not be cost-effective to obtain a third party fairness report, opinion, appraisal, or other independent assessment of the fairness of the terms of the reverse stock split or the value of our common stock, and was satisfied that they could rely on the internal company study for their pricing analysis. The Special Committee came to this



conclusion because we had very recently incurred the expense of having a fairness opinion issued for the Management Equity/Conversion Transaction. The estimated cost to update this fairness opinion equaled or exceeded the initial opinion cost of \$35,000. The updating of the opinion was done by the same members of senior management, W. Brian Kretzmer, our Chief Executive Officer and President, and James W. Dolan, our Chief Financial and Operating Officer, who had worked closely with the firm that had produced the initial fairness opinion, by supplying them with the financial information and other data required for them to fully complete their analysis from their opinion on the fairness of the share price used in the Management Equity/Conversion Transaction. Based on their substantial experience with the process of preparing the assumptions and analysis that went into the fairness opinion, the Special Committee concluded that they could rely on the study prepared by Messrs. Kretzmer and Dolan. See the discussion below under Financial Analysis Performed by Management.

On December 1, 2004, the Special Committee approved a price to be paid in lieu of issuing fractional shares in connection with the reverse stock split. Each of the Special Committee members reviewed the information set forth below under Financial Analysis and Summary of Factors Reviewed to Determine \$0.17 Per Share Fractional Share Purchase Price . The Special Committee, by written consent dated as of December 2, 2004, approved a 1-for-150 reverse split of our common stock, with \$0.17 per share to be paid in cash in lieu of issuing fractional shares. The selected split ratio was a result of calculations intended to determine how many stockholders needed to be cashed out to achieve our goal of going private.

On December 2, 2004 the Special Committee presented its findings to our Board of Directors at a special meeting of the Board. The Special Committee found that the purpose of the reverse stock split was to reduce the number of our stockholders below 300, thereby positioning us to terminate our public reporting and continue future operations as a private company and relieving us of the substantial costs, administrative burdens and competitive disadvantages associated with operating as a public company. The Special Committee further reported that the advantages of the reverse stock split to the unaffiliated stockholders (both those being cashed out and those remaining as stockholders after the reverse stock split) outweighed the disadvantages, and that it was substantively and procedurally fair, and therefore, in the best interests of our company and our unaffiliated stockholders. The Special Committee found that for those smaller unaffiliated stockholders holding less than 150 shares who would be cashed out, that the price paid to them exceeded what they would receive in an open market sale after deducting commissions. For those unaffiliated stockholders holding more than 150 shares who would remain as stockholders after the reverse stock split, the Special Committee found that although they would experience a reduction in liquidity of their shares, the value of their shares may increase as a result of our anticipated reduced annual general and administrative expenses associated with being a non-reporting entity.

At the December 2, 2004 special meeting, our Board of Directors reviewed the Special Committee's presentation and the internal company study of the reverse stock split and pricing analysis. Our Board of Directors asked questions and received answers regarding the reverse stock split from the Special Committee and representatives of senior management. The Special Committee advised our Board of Directors that it had approved the reverse stock split, and recommended that our Board of Directors approve the reverse stock split. After extensive consideration and discussion, at this special meeting our Board of Directors (with Richard S. Ressler, our Chairman, recusing himself because he is the controlling shareholder of Orchard Capital Corporation, the managing member of the Investor Group), then adopted the Special Committee's recommendation regarding the reverse stock split based on the Special Committee's determination that the reverse stock split was fair and in the best interests of our company and our unaffiliated stockholders (both those being cashed out and those remaining as stockholders after the reverse stock split).

On September 23, 2005, both our Special Committee and our Board of Directors met to receive an updated report from management on the reverse stock split. At this meeting the Board of Directors also received the recommendation of the Special Committee reaffirming the reverse stock split and all of their prior findings and confirmed that the transaction was still substantively and procedurally fair and in the best interests of all of the shareholders. At this time the Board of Director (with Richard S. Ressler again recusing himself) voted to reaffirm the implementation of the reverse stock split.

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### *Fairness Determination by Certain Members of the Investor Group and Filing Persons*

Certain of the members of the Investor Group and those individuals or entities deemed filing persons for purposes of Schedule 13E-3 have adopted the findings of our Special Committee and Board of Directors regarding the material factors upon which it was determined that the reverse stock split was fair to our unaffiliated stockholders. Specifically, Richard S. Ressler, Orchard Capital Corporation, James W. Dolan, W. Brian Kretzmer, HIS Holding, LLC have stated their belief as to the fairness of the proposed transaction to unaffiliated stockholders, both those who will be cashed out by the reverse stock split and those who will remain as stockholders after the reverse split, based upon their ratification of the analysis and conclusions of our Special Committee and Board as to the reverse stock split. There are potential conflicts of interest between the Investor Group and our unaffiliated shareholders. For example, the reverse stock split will increase the percentage ownership interest of the Investor Group in our common stock. In addition, the reverse stock split will reduce the liquidity of our common stock, which may have a greater impact on our unaffiliated stockholders than on the Investor Group. See Procedural Factors Disfavoring the Reverse Stock Split; Interests of our Chairman and Executive Officers in the Reverse Stock Split, page 17.

*Disclosure of Financial Interests of Special Committee Members*



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As of September 23, 2005, the Special Committee members each held options to purchase 12,500 shares of common stock and each was the beneficial owner of 37,500 shares of common stock. Mr. Ross is employed by (but not an executive officer of) CIM Group, an affiliate of our company.

### *Financial Analysis and Summary of Factors Reviewed to Determine \$0.17 Per Share Fractional Share Purchase Price*

In determining the price to be paid in lieu of issuing fractional shares, the Special Committee considered, among other things, the historical market price for our common stock for the 30-, 60-, and 90-day periods prior to December 1, 2004 and the closing trading price on September 23, 2005. As discussed below, the Special Committee also considered our going concern value (which includes earnings value and discounted cash flow value) net asset value (liquidation value) and net book value in reviewing the fairness of the price being offered to unaffiliated stockholders. In determining the \$0.17 per share price to be paid for fractional shares, substantial weight (80%) was given to the historical market price analysis. Of the remaining 20%, 15% weight was given to the net asset value (liquidation value) analysis and net book value analysis, in the aggregate, the remaining 5% weight was given to the earnings value (earnings times an appropriate multiplier) analysis and the discounted cash flow (net present value of projected cash flows) analysis, in the aggregate, with most of the 5% weight given to the earnings value analysis. Management also put substantial weight on the fact that on September 22, 2004, our shareholders approved the conversion of over \$3 million of indebtedness and the private placement of \$1 million by the Investor Group at \$0.10 per share. Although management determined that the payment of a purchase price of \$0.10 per share in lieu of issuing fractional shares in connection with the reverse stock split was fair, we intend to pay a purchase price of \$0.17 per share, representing a premium of \$0.07 per share (70%) over the fair value as determined by management below. In determining this premium, we considered, among other things, that the weighted average closing prices of our common stock for the 30-, 60- and 90-day periods preceding December 1, 2004 and the closing trading price on September 23, 2005 were approximately \$0.153, \$0.154, \$0.159 and \$0.055 per share, respectively. We also considered that the fractional shares that would otherwise be issued in the reverse stock split would aggregate to approximately 139,000 pre-split whole shares of common stock, resulting in cash payments to cashed-out stockholders of approximately \$24,000 based on the \$0.17 per share price. This cash total represents only an additional aggregate \$10,000 above the cash payments that would be calculated based on management's estimated fair value of our common stock of \$0.10 per share, which amount is not material to us.

### *Financial Analysis Performed by Management*

The following paragraphs summarize the financial analyses performed by management as of November 29, 2004 to assist the Special Committee and our Board of Directors in determining the price to be paid in lieu of issuing fractional shares in the reverse stock split. Management recommended to the Special Committee a fractional share price of \$0.10 per share.

Management reviewed the information, data and methodology used by the firm that had issued the fairness opinion that was included in our 2004 proxy statement relating to the valuation of our common stock in connection Management Equity/Conversion Transaction at \$0.10 per share. Management updated the analysis based on current information and data. Management's update indicated that there were no material changes in the analysis that would alter the basis for a valuation of \$0.10 per share. Accordingly, management concluded that the \$0.10 per share valuation is fair to our unaffiliated stockholders.

In arriving at its recommendation, management relied on both financial and other information and assured the Special Committee that it was not aware of any facts or circumstances that would make any such information inaccurate or misleading. With respect to the preliminary financial projections utilized, management assumed that those projections were reasonable based on the best currently available estimates and judgments, and that those projections provide a reasonable basis upon which it could form a recommendation. Management also assumed that the reverse stock split would be consummated substantially in accordance with the terms as generally set forth in this information statement.

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Management's recommendation is based upon market, economic and other conditions as they existed on, and could be evaluated as of, the date of their analyses. The estimates contained in management's analyses and the ranges of valuations resulting from any particular analysis are not necessarily indicative of actual values or future results, which may be significantly more or less favorable than those suggested by such analyses. In addition, analyses relating to the value of businesses or securities do not necessarily purport to be appraisals or to reflect the prices at which businesses or securities actually may be sold. Accordingly, management's analyses and estimates are inherently subject to uncertainty.

Management presented six material factors in its financial analyses supporting its recommendation:

historical market price of our common stock;

our going concern value, which included:

earnings value (earnings times an appropriate multiplier); and

discounted cash flow (net present value of projected cash flows);

net asset value (liquidation value); and

net book value.

Each of these factors was analyzed in comparison with similar companies to ours and similar transactions to the reverse stock split transaction and is summarized below.

**Historical Market Price Analysis.** Management utilized a historical stock price analysis to review and compare our stock performance to the price recommended in the reverse stock split. In addition, management reviewed the liquidity of our shares in the public trading markets and the daily closing market price and trading volume of our shares for various periods ended November 30, 2004 and as of September 23, 2005. While the 30-, 60- and 90-day average price of \$0.153, \$0.156 and \$0.163 per share, respectively, were higher than the consideration price recommended by management of \$0.10 per share, management concluded that trading of our stock on the OTC Bulletin Board may not reflect the fair price of the stock because of the thin trading market, wide bid-ask spread, the stock dilution from the recent Management Equity/Conversion Transaction that was approved by our stockholders on September 22, 2004 and resulted in the issuance on November 1, 2004 of approximately 43,172,000 shares of our common stock, and high historical volatility of our stock price. Additionally, the average daily trading volume of our common stock for the three- and twelve-month periods prior to November 30, 2004 were approximately 14,000 and 15,000 shares, respectively, and approximately 2,000 shares for the month of August 2005. As there has not been a market for large share transactions in our common stock, any large transaction may result in significantly lower trading prices than the historical prices noted above.

**Going Concern Value.** Management reviewed projections that assume that we are a going concern based upon the current status of our business. Management analyzed the reasonableness of the projections based upon historical performance, current financial conditions and industry comparisons. Management was then able to arrive at a going concern value based on the earnings value (total invested capital) and discounted cash flow value discussed below.

**Earnings Value.** Management reviewed our historical revenues and earnings before interest, taxes, depreciation and amortization ( EBITDA ) and compared these figures to the total invested capital value (market capitalization plus debt) of \$13.0 million that is implied by using a share price of \$0.153, which represents the weighted average daily closing market price of our common stock for the 30-day period ended November 30, 2004. The implied multiples for the ratio of total invested capital to revenues for 2003 and for the average of the five years ending December 31, 2003, were 0.7 and 0.5, respectively. The implied multiples for the ratio of total invested capital to EBITDA for 2003 and for the average of the five years ending December 31, 2003 were 5.1 and 9.4, respectively. Management then compared these implied multiples for us to those publicly traded companies operating in the software and IT consulting industries. Factors considered in this analysis included our size in terms of revenues and assets, declining revenues and profitability, financial distress in terms of negative working capital and non-compliance with debt covenants, the absence of highly comparable public companies, and the fact that we are in a highly competitive software and IT consulting industry. Based on these factors, we used the same screening criteria and publicly traded companies as used by the firm that opined on the fairness of the price of our common stock for purposes of the Management Equity/Conversion Transaction for comparable software and IT companies having a debt-to-equity ratio greater than 80%. Several of the comparable companies also had negative EBITDA. The publicly traded comparable software and IT technology companies identified included eight companies: Anacomp Inc., Brightstar Information Technology Group Inc., Datatec Systems Inc., Datec Group Ltd., ePlus Inc., Internet Initiative Japan Inc., Sapiens International Corp, USDATA Corp. We then calculated the multiples for the ratio of total invested capital to revenues and EBITDA for these eight comparable companies. The multiples for the ratio of total invested capital to revenues for these comparable companies averaged 0.93 to 1. The multiples for the ratio of total invested capital to EBITDA for these comparable companies averaged 14.4 to 1. At \$0.10 per share, our ratios were 0.69 to 1 and 13.7 to 1, respectively, which are comparable to the aforementioned comparable company ratios. Although little weight was put on this analysis, the reverse stock split consideration price of \$0.10 per share was determined to be fair under this analysis.



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Following is a table that reconciles our historical earnings to EBITDA for each of the last five fiscal years used for purposes of the aforementioned analysis:

	1999	2000	2001	2002	2003
Income (loss) from continuing operations before income taxes	\$ (11,993)	\$ 1,606	\$ 3,833	\$ 447	\$ 42
Depreciation and amortization	\$ 2,208	\$ 1,489	\$ 1,452	\$ 819	\$ 512
EBITDA	\$ (9,785)	\$ 3,095	\$ 5,285	\$ 1,266	\$ 554

**Discounted Cash Flow Value.** Based upon forecasts and after review of historical performance, current financial conditions, industry outlook, competitive market landscape, and other analyses, management developed projected cash flows that it deemed reasonable and valid at the time of valuation. The projected cash flows incorporated various assumptions, including, but not limited to, net sales growth, profit margins, income taxes, depreciation, capital expenditures, and working capital levels, all of which are critical to the development of projected cash flows. These projected cash flows were then discounted at a weighted cost of capital of 20% as calculated using the capital asset pricing model. Management believed that the discount rate of 20% was appropriate for us and our industry.

The following assumptions were utilized to determine our discounted cash flow value (see our historical financial information included in **Appendix C** which should be read in conjunction with these assumptions which are based upon such historical results):

### **Overall:**

Management did not foresee any material change in the business environment or substantial change in our operations. The present business model was expected to continue and for that reason management believed our projections represent performance consistent with the last three years. There will be some cautious growth as new products are introduced. A full hospitality industry recovery was not expected yet and, therefore, the overall market conditions will not materially change. Management therefore did not anticipate any material gain in market share

### **Revenue:**

Revenue in a continuingly uncertain industry is expected to grow only slightly at a rate of 6.4% per year over the period. Although our revenues have decreased at an average rate of approximately 14% per year from 1999 to 2003, management believed this forecasted growth to be reasonable and achievable. Management believed this forecasted growth was reflective of our market position, industry challenges and the overall expected acceptance of our new products. Management believed that during the initial 24 months of selling the new products, we will be successful, but will be limited by our capacity to install. We will therefore be selective in the acquisition of new business to ensure our success and profitability. This assumption reflects our belief that the life cycle for our new products is 5 to 10 years and that the new products will carry us through 2010.

### **Operating Expenses:**

Management expects that operating expenses will increase at a rate of approximately 3.5% over the period reflecting our recently demonstrated ability to manage costs from 2000-2004. In 2005, development expenses shall increase as our previous new products become available for general release in 2005. Selling general and administrative efforts will slightly increase as we bring the new products to market and we gain

momentum in 2006 and beyond as we expect revenues to increase at a rate of 6.45% per year.

**Gross Margins:**

Management anticipates the overall gross margins percentage of revenue to be sustainable around 70%, excluding amortization of any intangible assets to cost of sales (see financial statements at **Appendix C**). Our direct costs are well understood and tightly controlled and we are not subject to major changes in our business model.

Our discounted cash flow value was calculated to be approximately \$8.7 million. Subtracting our debt of approximately \$7.7 million results in approximately \$1 million of value to the stockholders, or about \$0.02 per share (\$1 million divided by 57.8 million shares outstanding). Based upon this analysis, the reverse stock split consideration price of \$0.10 per share was determined to be fair to our unaffiliated stockholders.

**Net Asset Value (Liquidation Value).** Management concluded that our total debt may approximate or exceed any asset value upon liquidation, leaving little if any value to equity holders in liquidation. Based upon this determination, the fractional share price of \$0.10 per share may be greater than our net asset value.

**Net Book Value.** Management determined that in valuing us on a net book value, we have a negative book value, and therefore, the value represented by the recommended fractional share price of \$0.10 per share was significantly greater than the net book value of our company.

**Conclusion.** Based upon its review of these and other factors, management concluded that as of the date of its analyses, the recommended price of \$0.10 per share to be paid in lieu of issuing fractional shares in connection with the reverse stock split was fair from a financial point of view to the unaffiliated stockholders. While the foregoing summary describes the material analyses and factors reviewed by management, it does not purport to be a complete description of the presentations by management to the Special Committee or the analyses performed by management in arriving at its conclusion. The preparation of this analysis is a complex process and is not necessarily susceptible to partial analysis or summary description. Management believes that its analyses must be considered as a whole and that selecting portions of its analyses and of the factors considered by it, without considering all analyses and factors, could create a misleading view of the processes underlying the recommendation. As noted above, management's recommendation was most heavily weighted (80%) on the historical market price analysis as the trading price of our stock is the most objective analysis to rely upon. Of the remaining 20%, 15% weight was given to the net asset value (liquidation value) analysis and net book value analysis, in the aggregate. The remaining 5% weight was given to the our earnings value (earnings times an appropriate multiplier) analysis and discounted cash flow (net present value of projected cash flows) analysis, in the aggregate, with most of the 5% weight given to our earnings value analysis, as certain of the various assumptions used in the discounted cash flow analysis are subjective in nature and, accordingly, less reliable than calculations using historical or market trading data. As certain assumptions are more or less probable than other assumptions, the range of valuations resulting from certain of these lesser weighted analysis described above should not be taken to be management's view of our actual value. In performing these other analyses, management made numerous assumptions with respect to industry performance, general business and economic conditions and other matters, many of which are beyond our control. Management also put substantial weight on the fact that on September 22, 2004, our stockholders approved the conversion of over \$3 million of indebtedness and the private placement of \$1 million by the Investor Group at \$0.10 per share. The analyses performed by management are not necessarily indicative of actual values or actual future results, which may be significantly more or less favorable than suggested by such analyses. The analyses performed were prepared solely as part of management's analysis of the fairness, from a financial point of view, of management's recommended price per share to be paid in lieu of issuing fractional shares in connection with the reverse stock split, and were provided to the Special Committee solely in connection with the delivery of the management recommendation.

### **Special Factors Considered in Approving the Reverse Stock Split**



*Purpose of the Reverse Stock Split*

The purpose of the reverse stock split is to position us to terminate our public reporting and enable us to continue future operations as a private company, thereby relieving us of the costs, administrative burdens and competitive disadvantages associated with operating as a public company. We intend to accomplish this purpose by reducing the number of holders of record of our common stock to fewer than 300 by cashing out the fractional shares that would otherwise result from the reverse stock split.

*Background of the Reverse Stock Split; Alternatives Considered by the Special Committee and the Board of Directors*

Faced by a continuing lack of interest from public market investors and the need to increase our working capital and reduce our administrative expenses, we determined that maintaining our public company status came at a significant cost to us with no significant benefit. We determined that terminating our public reporting would result in substantial cost savings and better competitive positioning, which would help us maximize stockholder value. In order to terminate our public reporting, we must reduce the number of record holders of our common stock to fewer than 300.

The Special Committee and our Board of Directors reviewed several alternatives for reducing our number of record holders. The first alternative involved a tender offer. In a tender offer, publicly held shares are purchased directly from a company's stockholders. The proponent of the transaction approaches the target company to consider the proposal. When the two sides reach an agreement, the acquiror sends the stockholders a written offering document, the offer to purchase, which contains disclosures required by Commission rules, and a letter of transmittal, which stockholders may use to tender their shares. The target company issues a press release announcing, among other things, that the company recommends that stockholders accept the offer and tender their shares. Tender offers are commonly conditioned on the acquiror holding at least 90% of each class of stock of the company following the closing of the offer, which provides the acquiror with the ability to complete a short-form merger without holding a meeting of stockholders or soliciting proxies. In a short-form merger, the shares that were not tendered are typically converted into the right to receive the same consideration that was paid to the

tendering stockholders or the right to assert appraisal rights. At the conclusion of the short-form merger, the target company typically has one stockholder, a subsidiary of the acquiror.

The second alternative considered was a merger with a third party. A common form is a reverse triangular merger in which an entity formed by the acquiror merges with and into the target company, which survives the merger. As a result of the merger, the outstanding shares of the target company's stock, other than shares owned by the acquiror, are converted into the right to receive the merger consideration. The merger consideration is the cash paid to the stockholders of the target corporation. A merger typically leaves the surviving company with one stockholder, a subsidiary of the acquiror.

The final alternative considered was the reverse stock split. We have made repeated attempts over a significant period of time to merge our company with a variety of other companies and have been unsuccessful in our attempts to do so on acceptable terms. Additionally, we believe that a tender offer would fail to achieve the desired results because we have a significant number of stockholders who own a small number of shares. As of the Approval Record Date, we had approximately 577 stockholders of record, including approximately 69 owning fewer than five shares, approximately 291 owning fewer than 100 shares, and approximately 328 owning fewer than 150 shares.

Because the results of a reverse stock split are more predictable and automatic, our Board of Directors believes that the reverse stock split is the most expeditious and economical way of reducing the number of holders of record to fewer than 300 and positioning us to effect the termination of our public reporting. As a result, on December 2, 2004, and reaffirmed on September 23, 2005, our Board of Directors (with Richard S. Ressler recusing himself because he is the controlling shareholder of Orchard Capital Corporation, Managing Member of the Investor Group), approved a 1-for-150 reverse stock split of our common stock, subject to stockholder approval. The selected split ratio was a result of calculations intended to determine how many record holders needed to be cashed out to achieve our goal of going private.

#### **Reasons for the Reverse Stock Split**



*Cost Savings*

We incur direct and indirect costs associated with our status as a public company. Among the most significant are the costs associated with compliance with the public reporting obligations imposed by the Commission, which have been greatly increased as a result of the Sarbanes-Oxley Act of 2002. Many of the requirements of this legislation are only now being felt by our company as a result of the phase-in schedule for smaller public companies. The timing of the reverse stock split relates to the expenses of operating for another year as a public reporting company, as a large portion of these expenses are incurred at the beginning of the fiscal year. Direct costs associated with compliance with the Commission's public reporting requirements include, but are not limited to auditing fees, legal fees, financial printer fees and miscellaneous clerical and other administrative expenses, such as word processing, conversion to EDGAR, telephone and fax charges associated with the preparation and filing of periodic reports, proxy materials and other reports and statements with the Commission.

Based on our experience in prior years, our direct costs of complying with the Commission's public reporting requirements are estimated to approximate \$600,000 annually, based on estimated annual audit and accounting fees of \$80,000, estimated annual legal fees of \$40,000, estimated financial printer fees of \$45,000, estimated transfer agent fees of \$35,000, estimated costs associated with filing reports with the Commission (including internal administrative staff) of \$50,000, estimated costs for directors' and officers' insurance of \$150,000, estimated ongoing costs associated with Sarbanes-Oxley compliance of \$140,000 (estimated at \$250,000 in 2005) and estimated miscellaneous costs of \$60,000. Indirect costs associated with compliance with our public reporting obligations include, among other things, the time our executive officers expend to prepare and review our periodic reports. Because we have only a few executive personnel, these indirect costs are substantial. Due to additional regulations and compliance procedures required of public companies under the Sarbanes-Oxley Act of 2002, we expect that the direct and indirect costs identified above will increase in the future.

The cost of administering each registered stockholder's account is the same regardless of the number of shares held in that account. As of the Approval Record Date, our common stock was held of record by approximately 577 stockholders, and approximately 328 stockholders of record held fewer than 150 shares, representing approximately 57% of the total number of holders of record of our Common stock. These accounts holding fewer than 150 shares represented approximately 2% of the total number of outstanding shares of our common stock. Assuming that the reverse stock split does not occur, the estimated cost relating to our public reporting for each stockholder account, will be approximately \$1,040 in 2005.

Our Board of Directors considered the cost to us of continuing to file periodic reports with the Commission and complying with the proxy and annual report requirements under the Exchange Act compared to the benefits to us and our stockholders of continuing to operate as a public company. Under the circumstances, our Board of Directors determined that the benefits that we and our stockholders would typically expect to derive from our status as a public company are not being



realized and are not likely to be realized in the foreseeable future. As a result, our Board of Directors concluded that the elimination of the costs of complying with our public reporting obligations outweighed the benefits of continuing to incur such costs. We are, therefore, undertaking the reverse stock split at this time to save us the substantial costs, which we expect to increase over time, and resources required to comply with the public reporting and other obligations associated with operating as a public company. However, the actual savings to be realized from terminating our public reporting may be higher or lower than our estimates.

#### *Lack of Capital from Public Markets*

We have been unable to take advantage of the capital available through the public markets due to our historically low stock price. Further, our Board of Directors does not presently intend to raise capital through sales of our securities in a public offering or to acquire other business entities using our common stock as the consideration for the acquisition. Accordingly, we have not, and are not likely to make use of, or benefit from, the advantages generally associated with operating as a public company.

#### *Competitive Disadvantage*

As a public company, we are required to make certain disclosures in connection with our public reporting. Those public disclosures can place us at a competitive disadvantage by providing our non-public competitors with strategic information about our business, operations and results while not having access to similar information about those competitors.

In light of our limited size and resources, competitive disadvantages related to our public reporting obligations and our lack of intent to raise capital through a public offering or effect acquisitions using our stock, our Board of Directors does not believe the costs associated with maintaining our public reporting and maintaining our stockholder accounts with less than 150 shares are justified. Our Board of Directors believes that it is in the best interests of us and our stockholders as a whole to eliminate the administrative burden and costs associated with maintaining our public reporting and maintaining stockholder accounts of fewer than 150 shares.

### **Substantive and Procedural Factors Considered by the Special Committee and Our Board of Directors as to the Fairness of the Reverse Stock Split**

Our Special Committee and Board of Directors have analyzed the reverse stock split and its anticipated effects on our stockholders and have deemed the reverse stock split and related termination of our public reporting to be substantively and procedurally fair to, and in the best interests of, our affiliated and unaffiliated stockholders, whether they are cashed out or remain as stockholders following the reverse stock split. In reaching this conclusion, our Special Committee and Board of Directors also considered, in no particular order and without preference, the factors described below.

#### **Procedural Factors Favoring the Reverse Stock Split**



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### *The Reverse Stock Split Provides Certain Smaller Stockholders with Liquidity*

Many of our stockholders hold small positions of less than 150 shares which cannot be cost effectively sold because the brokerage commission in an open market transaction would eliminate most or all of the proceeds to the stockholder. The reverse stock split will provide stockholders who hold fewer than 150 shares at the effective time the opportunity to liquidate their investment in us by not being required to pay a brokerage commission.

### *The Reverse Stock Split Includes the Opportunity to Remain a Stockholder of our Company*

Prior to the effective time, a current holder of fewer than 150 shares of our common stock may elect to remain a stockholder of our company by acquiring sufficient shares so that they hold at least 150 shares in their account immediately prior to the effective time. Our Board of Directors considers the structure of the reverse stock split to be fair to all unaffiliated stockholders because it allows them to control the decision of whether to remain a stockholder of our company following the reverse stock split or to receive the cash consideration offered in connection with the reverse stock split.

### *No Unusual Conditions to the Reverse Stock Split*

Our Board of Directors also considered the likelihood that the reverse stock split would be implemented. In this regard, it considered that there are no unusual requirements or conditions to the reverse stock split, and that we have the financial resources to implement the reverse stock split expeditiously.

*The Reverse Stock Split Ratio was Calculated Without Bias Toward Any Particular Group of Stockholders and Will Apply Equally to All Shares of our Common Stock*

The purpose of the reverse stock split is to reduce the number of record holders to fewer than 300 so that we can file to terminate our public reporting and continue future operations as a private company. The split ratio is a result of calculations that were intended to determine how many stockholders needed to be cashed out in order to reduce the number of record holders to fewer than 300. Our Board of Directors feels the current ratio of 1-for-150 is fair because it was calculated without bias toward any one group of stockholders. The ratio will be applied equally to all shares of our common stock.

### **Procedural Factors Disfavoring the Reverse Stock Split; Interests of our Chairman and Executive Officers in the Reverse Stock Split**

*The Reverse Stock Split Was Approved by our Affiliated Stockholders Without a Vote by Unaffiliated Stockholders*

The Investor Group, comprised principally of certain of our officers and directors, recently acquired a 85.09% controlling interest in our Company in September 2004. Based upon this controlling interest, this affiliated stockholder now holds sufficient shares of our common stock to approve the reverse stock split without securing the approval of our other affiliated or unaffiliated stockholders. Nevertheless, our Board of Directors believe that this potential conflict is outweighed by the substantive features and procedural safeguards of the reverse stock split, including the equal application of the reverse stock split to all shares of our common stock, the fact that all unaffiliated stockholders will have the option to remain stockholders of our company (by purchasing additional shares prior to the effective time), and the fairness of the price offered to all stockholders.

*The Special Committee and Our Board of Directors Did Not Obtain a Fairness Report*

The Special Committee and our Board of Directors did not obtain a fairness report, opinion, appraisal or other independent assessment on behalf of the unaffiliated stockholders because the reverse stock split is structured in such a way that it will apply equally to both affiliated and unaffiliated stockholders. Additionally, our Special Committee did not retain an unaffiliated representative to act solely on behalf of unaffiliated stockholders for purposes of negotiating the terms of the reverse stock split. Instead, the transaction was approved unanimously by our disinterested directors who are not employees of our company, and the Special Committee did an extensive financial review to confirm the fairness of the reverse stock split as discussed above under **Financial Analysis and Summary of Factors Reviewed to Determine \$0.17 Per Share Fractional Share Purchase Price** and **Financial Analysis Performed by Management**.

Our decision to not secure a third-party fairness report could result in unfairness to unaffiliated stockholders. Unaffiliated stockholders will have their shares bought out at a price that has been determined to be fair by our Special Committee and Board of Directors based upon a study prepared by our senior management whose ownership stake in the company will be increased by a minimal amount as a result of the reverse stock split.

. While all of our affiliated stockholders will remain stockholders of our company following the reverse stock split by virtue of the size of their holdings, unaffiliated stockholders will have the same opportunity if they so choose (by purchasing additional shares prior to the effective time

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of the reverse split). In light of this equal treatment, the Special Committee and our Board of Directors concluded that the expense associated with obtaining a fairness opinion was not justified.

*As a Result of the Reverse Stock Split, Stockholders Who Own More than 150 Shares, Such as Members of the Investor Group, Will Increase Their Percentage Ownership Interest in Our Company*

Based on information and estimates of record ownership of shares of common stock as of the Approval Record Date, the beneficial ownership percentage of our executive officers and directors, including vested options, will increase from 80.75% to 80.94% as a result of the reverse stock split. The beneficial ownership percentage of the Investor Group will increase from 85.09% to 85.30%, as a result of the reduction by an estimated 139,000 pre-split whole shares in the number of shares of our common stock outstanding due to the payment of cash in lieu of issuance of fractional shares. The ownership of individual investors within the Investor Group will increase by no more than 0.2% each as a result of the Reverse Stock Split.

## **Substantive Factors Favoring the Reverse Stock Split**

### *Direct and Indirect Cost Savings*

As discussed above under *Reasons for the Reverse Stock Split - Cost Savings*, we incur direct and indirect costs associated with our status as a public company. Among the most significant are the costs associated with compliance with the public reporting imposed by the Commission. We estimate that we will save approximately \$600,000 annually in direct general and administrative costs by being a private company. We also believe that because of the Sarbanes-Oxley Act, such direct costs would increase in the future. Additionally, the indirect cost to our company in terms of senior management time spent on complying with the public reporting will also be saved.

### *The Reverse Stock Split Offers Stockholders the Opportunity to Receive Cash at a Premium In Lieu of Fractional Shares*

Our Board of Directors considered several methods for valuing our common stock to determine the \$0.17 price per share to be paid to stockholders in lieu of issuing fractional shares of our common stock as a result of the reverse stock split. The cash consideration to be paid to holders of fractional shares represents a premium of approximately 11%, 10% and 7% over the weighted average closing trading price of the common stock over the 30-, 60- and 90-day periods, respectively, prior to the announcement of the reverse stock split and a premium of 209% over the closing trading price of \$0.055 on September 23, 2005.

## **Substantive Factors Disfavoring the Reverse Stock Split**



*Cessation of Public Sale Opportunities*

We intend to apply to terminate our public reporting following the reverse stock split. As a result, stockholders may no longer have the alternative of selling their shares of our common stock in the public market, and there may be no effective trading market for our common stock. Any stockholder desiring to sell his or her shares may have a difficult time finding a buyer. This illiquidity may reduce the price a buyer is willing to pay for shares of our common stock. We anticipate that the public market for shares of our common stock will be substantially reduced or eliminated altogether. Following the reverse stock split, our common stock will not qualify to be traded on any automated quotation system operated by a national securities association and will no longer be traded on the OTC Bulletin Board. Our common stock may be eligible to trade in the Pink Sheets, however we have no present plans to apply for our common stock to be traded in the Pink Sheets. For this reason, stockholders will experience a loss of liquidity after the reverse stock split and may be required to hold their shares of common stock for an indefinite period of time. We do not have any present plans to sell our assets or enter into any other transaction that would provide liquidity for the shares. However, we may explore from time to time various methods to provide liquidity to stockholders, including a sale or merger of our company or its assets.

Because only approximately 14,000 shares per day, on average, of our common stock have been traded over the three months ended December 8, 2004, the current public market is somewhat illiquid based upon the light trading volume. Larger shareholders may be required to liquidate their positions in our common stock over a period of several trading days. Our Board of Directors believes, however that the further loss of liquidity caused by the reverse stock split will be outweighed by the benefits of terminating our public reporting.

*Cessation of Publicly Available Information*

Upon terminating our public reporting, we will no longer file, among other things, annual or quarterly reports with the Commission. Updated information regarding our business, results of operations and financial condition like the information that is currently available to the general public and our investors will not be available once we terminate our public reporting. We intend to explore methods to distribute financial information to our stockholders on a cost-effective basis. Our Board of Directors does not believe this factor makes the transaction unfair to unaffiliated stockholders because any detriment to unaffiliated stockholders that may result from the termination of our public reporting will be offset by the anticipated cost-saving benefits and competitive advantages to us of no longer publicly filing reports with the Commission.

*Inability to Participate in Any Future Increase in the Value of Our Common Stock*

Cashed-out stockholders will have no further equity interest in us with respect to their cashed out shares. Accordingly, they will no longer have the opportunity to participate in the potential upside of any increase in the value of our common stock. Our Board of Directors determined that this factor does not make the transaction unfair to unaffiliated stockholders because unaffiliated stockholders who desire to hold shares of our common stock after the reverse stock split can do so by acquiring sufficient shares so that they hold at least 150 shares in their account immediately prior to the effective time.



### **Effects of the Reverse Stock Split on Stockholders Who Hold Fewer than 150 Shares of Common stock in a Single Account**

When the reverse stock split is effected, stockholders holding fewer than 150 shares of our common stock in a single account immediately prior to the effective time will not receive a fractional share of our common stock as a result of the reverse stock split, but rather will receive cash consideration. Given the historical illiquidity of our common stock, we believe the structure of the reverse stock split benefits the cashed-out stockholders. Among the potential detriments of the reverse stock split is the fact that after the reverse stock split, cashed-out stockholders will have no further ownership interest in the company, and will no longer be entitled to vote as a stockholder or share in our future assets, earnings, or profits. The cashed-out stockholder's only right will be to receive cash in lieu of the issuance to them of fractional shares of common stock.

All cash consideration amounts owed to the cashed-out stockholders as a result of the reverse stock split will be subject to applicable federal and state income taxes and state-abandoned property, or escheat, laws. Additional details regarding the federal tax consequences are described later in this information statement under the heading **Certain Material Federal Income Tax Consequences**. Additional details regarding state-abandoned property, or escheat, laws are described later in this information statement under the heading **Escheat Laws**.

As soon as practical after the consummation of the reverse stock split, we or our exchange agent will mail a letter of transmittal to each stockholder. The letter of transmittal will contain instructions for the surrender of stock certificates to our exchange agent in exchange for the payment of the cash consideration. No cash payment will be made to any cashed-out stockholder until the stockholder has surrendered his or her outstanding certificates, together with the completed letter of transmittal, to our exchange agent. For more detailed information, see **Stock Certificates**. After the reverse stock split, stockholders will have no rights as stockholders with respect to the pre-split shares of common stock or the fractional shares that would have resulted from the reverse stock split, whether or not those stockholders have been paid cash consideration.

### **Effects of the Reverse Stock Split on Stockholders Who Hold More Than 150 Shares of our Common Stock in a Single Account**

When the reverse stock split is effected, stockholders with 150 or more shares of our common stock in a single account immediately prior to the effective time will:

as of the effective time, have their shares of common stock converted into post-split common stock and receive one new share of common stock for every 150 shares of pre-split common stock in their account; and

receive cash consideration in lieu of fractional shares that would otherwise be issued to them as a result of the reverse stock split.

The remaining stockholders will benefit from having the opportunity to share in our future successes, if any. However, the remaining stockholders will not have the option to liquidate all of their shares like the cashed-out stockholders. Further, once we are private, it will be even more difficult to value, and therefore, sell their shares of common stock if they so desire.

**Procedure for Stockholders Who Hold Shares in Street Name**



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Stockholders who hold our shares in street name will be contacted by their broker or other institutional manager and receive from them a copy of our exchange agent's transmittal letter and instructions for surrendering their stock certificates in exchange for either cash consideration (if they hold fewer than 150 shares), or cash consideration and new stock certificates (if they hold more than 150 shares). They will transmit their instructions to their representative, who in turn will electronically transmit their shares to our exchange agent.

### **General Examples of Potential Effects of the Reverse Stock Split**

In general, the results of the reverse stock split can be illustrated by the following examples:

**Hypothetical Scenario No. 1.** Stockholder A is a registered stockholder who holds 100 shares of our common stock in her record account at the effective time. Instead of receiving a fractional share of our common stock immediately after the reverse stock split, Stockholder A's 100 shares will be converted into the right to receive \$17.00 (100 x \$0.17). Alternatively, if Stockholder A wants to continue her investment in our company, she can buy at least 50 more shares of our common stock and hold the shares in her record account, so long as the purchase is complete before the effective time.

**Hypothetical Scenario No. 2.** Stockholder B has two separate record accounts. As of the effective time, he holds 100 shares of our common stock in one account and 50 shares of our common stock in the other. All of his shares are registered in his name only. Stockholder B will be entitled to receive cash payments equal to the number of shares of our common stock that he holds in each record account, instead of receiving fractional shares following the reverse stock split. Stockholder B would receive two checks totaling \$25.50 ( $100 \times \$0.17 = \$17.00$ ;  $50 \times \$0.17 = \$8.50$ ;  $\$17.00 + \$8.50 = \$25.50$ ). Alternatively, if Stockholder B wants to continue his investment in our company, he can consolidate his two accounts prior to the effective time by. In that case, his holdings will not be cashed out in connection with the reverse stock split because he will hold 150 shares of our common stock in one record account, which would convert into one post-split share of our common stock. He would have to act far enough in advance so that the consolidation is complete before the effective time.

**Hypothetical Scenario No. 3.** Stockholder C holds 330 shares of common stock prior to the effective time. After the reverse stock split, Stockholder C will hold in his record account two shares of our common stock ( $330/150 = 2.2$ ) and, instead of receiving a fractional share of our common stock in his record account immediately after the reverse stock split, Stockholder C's unconverted 30 shares will be converted into the right to receive \$5.10 ( $30 \times \$0.17$ ) of cash consideration.

#### **Effect of the Reverse Stock Split on Option Holders**

Upon effectiveness of the reverse stock split, any outstanding options under our 1993 Employee Stock Option Plan and our 1995 Non-Employee Directors Stock Option Plan will have their number of shares and exercise prices adjusted to give effect to the 1-for-150 reverse stock split, with any fractional shares resulting from such adjustment converting to a right to receive \$0.17 in cash per pre-reverse stock split share less the exercise price of such pre-reverse stock split shares subject to exercise of the option. The vesting schedule for the options will remain unchanged. Any authorized but un-issued options under our 1993 Employee Stock Option Plan and our 1995 Non-Employee Directors Stock Option Plan will have the number of shares adjusted to give effect to the 1-for-150 reverse stock split.

#### **Effects of the Reverse Stock Split on Our Company**

44,960 -- -- -- 35,990 222,644

Chief Executive Officer

James R.

Barlow 2012 167,475 91,500 285,944 223,212 -- 41,935 810,066

Executive Vice President

and 2011 160,000 75,500 30,691 21,240 -- 42,681 330,112

Chief Operating Officer

K. Matthew

Sawrie 2012 113,869 -- 110,382 71,430 79,152 23,168 398,001

Senior Vice President 2011 109,574 -- -- 11,658 61,231 20,278 202,741

Commercial Lending

(1) Reflects the aggregate grant date fair value computed in accordance with FASB ASC Topic 718 for awards of restricted stock and grants of stock options during the fiscal year. The assumptions used in valuing the restricted stock awards and stock option awards are set forth in Note 12 to the Consolidated Financial Statements included in our Form 10-K for the year ended June 30, 2012.

(2) Includes for fiscal 2012, contributions under the Home Federal Bank 401(k) Plan, allocations of shares under the employee stock ownership plan, life insurance premiums and \$8,250 and \$9,000 in directors' fees paid to Messrs. Herndon and Barlow, respectively, and directors' bonuses of \$2,000 paid to each of Messrs. Herndon and Barlow.

#### Narrative to Summary Compensation Table

Base salaries for our named executive officers are approved by the Compensation Committee. Base salaries as of the end of fiscal 2012 established by the Compensation Committee were \$148,102, \$169,950 and \$115,552 for Messrs. Herndon, Barlow and Sawrie, respectively, which represented increases of 3.0% over their prior base salaries. Messrs. Herndon and Barlow received a discretionary bonus equal to 10% of their then current base salaries in December 2011. Based on Home Federal Bancorp's results of operations through the second quarter ended December 31, 2011, the Compensation Committee awarded additional discretionary bonuses, paid in February 2012, to Messrs. Herndon and Barlow of \$42,000 and \$75,000, respectively. Mr. Sawrie, who did not receive a bonus, received incentive compensation as a participant in our Loan Officer Incentive Plan, the terms of which are described below. The named executive officers received awards of restricted stock and stock options in January 2012 under our 2011 Recognition and Retention Plan and 2011 Stock Option Plan. The awards reflected contributions of Messrs. Herndon, Barlow and Sawrie to our second step conversion offering completed in December 2010.

#### Employment Agreements

Home Federal Bank entered into employment agreements with Messrs. Herndon and Barlow effective February 21, 2009. The Board of Directors approved an amended and restated agreement with Mr. Barlow, effective January 13, 2010, which amended and restated the prior agreement. Pursuant to the employment agreements, Messrs. Herndon and Barlow serve as Chairman of the Board and Chief Executive Officer and as President and Chief Operating Officer, respectively, of Home Federal Bank for a term of three years commencing on the effective date and renewable on each February 21 thereafter. The term of each agreement is extended for an additional year on February 21, unless Home Federal Bank or the executive gives notice to the other party not to extend the agreements. At least annually, the Board of Directors of Home Federal Bank will consider whether to continue to renew the employment agreements. The agreements provided for initial base salaries of \$135,500 and \$155,000 per year for each of Messrs. Herndon and Barlow, respectively. Such base salaries may be increased at the discretion of the Board of Directors of

Home Federal Bank but may not be decreased during the term of the agreements without the prior written consent of the executives. Home Federal Bank also agreed to provide each of Messrs. Herndon and Barlow with an automobile during the term of the agreements.

The agreements are terminable with or without cause by Home Federal Bank. The agreements provide that in the event of (A) a wrongful termination of employment (including a voluntary termination by Messrs. Herndon or Barlow for "good reason" which includes (i) a material diminution in the executive's base compensation, authorities, duties or responsibilities without his consent (ii) a requirement that the executive report to a corporate officer or employee instead of reporting directly to the Board of Directors, or (iii) a material change in the executive's geographic location of employment), (B) a change in control of Home Federal Bank or Home Federal Bancorp, or (C) the executive's termination of employment by Home Federal Bank for other than cause, disability, retirement or the executive's death, each of the executives would be entitled to (1) an amount of cash severance which is equal to three times the sum of his base salary as of the date of termination plus his prior calendar year's bonus and (2) continued participation in certain employee benefit plans of Home Federal Bank until the earlier of 36 months or the date the executive receives substantially similar benefits from full-time employment with another employer. The agreements with Home Federal Bank provide that in the event any of the payments to be made thereunder or otherwise upon termination of employment are deemed to constitute "parachute payments" within the meaning of Section 280G of the Internal Revenue Code, then such payments and benefits received thereunder shall be reduced by the minimum amount necessary to result in no portion of the payments and benefits being non-deductible by Home Federal Bank for federal income tax purposes.

Home Federal Bancorp entered into an employment agreement with Mr. Herndon, effective February 21, 2009, to serve as Chairman of the Board, President and Chief Executive Officer of Home Federal Bancorp which is on terms substantially similar to Mr. Herndon's agreement with Home Federal Bank, except as follows. The agreement provides that severance payments payable to Mr. Herndon by Home Federal Bancorp shall include the amount by which the severance benefits payable by Home Federal Bank are reduced as a result of Section 280G of the Internal Revenue Code, if the parachute payments exceed 105% of three times the executive's "base amount" as defined in Section 280G of the Internal Revenue Code. If the parachute payments are not more than 105% of the amount equal to three times the executive's base amount, the severance benefits payable by Home Federal Bancorp will be reduced so they do not constitute "parachute payments" under Section 280G of the Internal Revenue Code. In addition, the agreement provides that Home Federal Bancorp shall reimburse Mr. Herndon for any resulting excise taxes payable by him, plus such additional amount as may be necessary to compensate him for the payment of state and federal income, excise and other employment-related taxes on the additional payments. Under the agreement, Mr. Herndon's compensation, benefits and expenses will be paid by Home Federal Bancorp and Home Federal Bank in the same proportion as the time and services actually expended by the executive on behalf of each company.

#### Loan Officer Incentive Plan

Home Federal Bank adopted a Loan Officer Incentive Plan as an annual incentive compensation plan to reward participating loan officers with variable cash awards that are contingent upon the net interest income produced from the loan officer's identified loan portfolio. Mr. Sawrie is our only named executive officer who participates in the plan. Participants in the Loan Officer Incentive Plan are selected by the chief executive officer and president at the beginning of each fiscal year and recommended for approval by the compensation committee of the Board of Directors which administers the plan.

The terms of the Loan Officer Incentive Plan are reviewed annually. For fiscal 2012, participants in the Loan Officer Incentive Plan received a cash reward equal to 4% of the income base from loans originated by the particular loan officer prior to the beginning of the fiscal year. Participants also received a cash reward equal to 6% of the income base from new loans originated by the particular loan officer during the 12-month performance period which coincides with the fiscal year.

Each fiscal year, the cumulative interest income from loans existing at the beginning of the performance period will be calculated. Interest expense, equal to loan volume times our most recent average cost of funds, will be deducted from interest income to arrive at the loan officer's contribution amount for existing loans. The loan officer's contribution is



then multiplied by a loan portfolio rating (up to 100%) to calculate an income base. The income base for existing loans is then multiplied by 4% to determine the cash incentive award from existing loans.

The cumulative interest income from new loans originated during the performance period is then calculated. Interest expense, equal to loan volume multiplied by our most recent average cost of funds, will be deducted from interest income to arrive at net interest income. Loan initiation fees associated with such newly originated loans shall be added to net interest income to arrive at the loan officer's contribution amount for newly originated loans. The loan officer's contribution is then multiplied by a loan portfolio rating (up to 100%) to calculate an income base. The income base for new loans is then multiplied by 6% to determine the cash incentive award from loans originated during the performance period. The incentive awards from existing loans and new loans are added to determine the total award payment. Upon the approval of the compensation committee, cash incentive awards are calculated and paid on a semi-annual basis to participants who are employed and in good standing on the date of such payments.

#### Retirement Benefits

Retirement benefits are an important element of a competitive compensation program for attracting senior executives, especially in the financial services industry. We froze our defined benefit pension plan in February 2003. Mr. Herndon is our only named executive officer with accrued benefits under the pension plan. Our executive compensation program currently includes (i) a 401(k) profit sharing plan which enables our employees to supplement their retirement savings with elective deferral contributions and with matching and discretionary contributions by us, and (ii) an employee stock ownership plan that allows participants to accumulate retirement benefits in the form of employer stock at no current cost to the participant.

**401(k) and Profit Sharing Plan.** We adopted the Home Federal Bank Employees' Savings and Profit Sharing Plan and Trust ("401(k) Plan") effective November 15, 2004. To participate in the 401(k) Plan, eligible employees must have completed three months of full time service and attained age 21. Participating employees may make elective salary reduction contributions of up to \$17,000, of their eligible compensation for 2012. Home Federal Bank will contribute a basic "safe harbor" contribution of 100% of the first 6% of plan salary elective deferrals. We are also permitted to make discretionary contributions to be allocated to participant accounts.

**Employee Stock Ownership Plan.** We established an employee stock ownership plan for our employees in connection with our mutual to stock conversion in 2005. We acquired additional shares in connection with our second-step conversion in 2010. The shares were purchased by the employee stock ownership plan with funds borrowed from Home Federal Bancorp and are held in a suspense account and released for allocation as debt service payments are made. Additional discretionary contributions may be made to the plan in either cash or shares of common stock, although we have no plans to do so at this time. Shares released from the suspense account are allocated to each eligible participant's plan account pro rata based on compensation. Forfeitures may be used for the payment of expenses or be reallocated among the remaining participants. Employees who have been credited with at least 1,000 hours of service during a 12-month period and who have attained age 21 are eligible to participate in the employee stock ownership plan. Participants become 100% vested after three years of service. Participants also become fully vested in their account balances upon a change in control (as defined), death, disability or retirement. Benefits may be payable upon retirement or separation from service.

#### Stock Option Plans and Recognition and Retention Plans

In August 2005, shareholders approved our 2005 Stock Option Plan and our 2005 Recognition and Retention Plan. Pursuant to the terms of the 2005 Stock Option Plan, options to acquire up to 158,868 shares of common stock were available to be granted to employees and directors. Pursuant to the terms of the 2005 Recognition and Retention Plan, awards of up to 63,547 shares of restricted common stock were available to be granted to employees and directors. In December 2011, shareholders approved our 2011 Stock Option Plan and our 2011 Recognition and Retention Plan. Pursuant to the terms of the 2011 Stock Option Plan, options to acquire up to 169,235 shares of common stock were granted to employees and directors and 25,287 are available for future grants. Pursuant to the terms of the 2011 Recognition and Retention Plan, awards of 69,251 shares of restricted common stock were made to

employees and directors and 8,557 shares are available for future award. Under all of the stock benefit plans, awards may vest no faster than 20% per year, beginning one year from the date of grant. However, under the plans, vesting of any award is accelerated upon the death or disability of a recipient or upon a change-in-control of Home Federal Bancorp. Outstanding stock awards and stock options for our named executive officers are reflected in the below table "Outstanding Equity Awards at Fiscal Year-End."

## Survivor Benefit Plan

In June 2011, Home Federal Bank purchased bank owned life insurance on the lives of its employees. In consideration for entering into consent to insurance agreements, on July 13, 2011, Home Federal Bank entered into Survivor Benefit Plan Participation Agreements with employees including Messrs. Herndon, Barlow and Sawrie. The agreements provide that the officer's beneficiary will receive three times the officer's base salary if serving as an officer of Home Federal Bank at the date of death. The agreements may be amended or terminated at any time by Home Federal Bank as long as it does not reduce or delay any benefit payable to a participant whose death has already occurred.

## Outstanding Equity Awards at Fiscal Year-End

The table below sets forth outstanding equity awards to our named executive officers under our Stock Option Plans and Recognition and Retention Plans at June 30, 2012. We have not made any equity incentive plan awards.

Name	Option Awards		Stock Awards					
	Number of Securities Underlying		Option Exercise Price	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested	Market Value of Shares or Units of Stock That Have Not Vested(3)		
	Exercisable	Unexercisable						
Daniel R. Herndon	39,628	--	\$ 10.82	8/18/2015	11,671	(1)	\$ 172,147	
	--	29,178	14.70	1/31/2022				
James R. Barlow	1,922	7,689	10.93	8/19/2020	2,247	(2)	33,143	
	--	48,630	14.70	1/31/2022	19,452	(1)	286,917	
K. Matthew Sawrie	--	3,844	10.93	8/19/2020	7,509	(1)	110,758	
	--	15,562	14.70	1/31/2022				

(1) The unexercisable stock options and unvested restricted stock awards are vesting at a rate of 20% per year commencing on January 31, 2013.

(2) The unexercisable stock options and unvested restricted stock awards are vesting at a rate of 20% per year commencing on August 19, 2011.

(3) Calculated by multiplying the closing market price of our common stock on June 29, 2012, which was \$14.75, by the applicable number of shares of common stock underlying the unvested stock awards.

## Related Party Transactions

Home Federal Bank offers extensions of credit to its directors, officers and employees as well as members of their immediate families for the financing of their primary residences and other purposes. These loans are made in the ordinary course of business, on substantially the same terms, including interest rates and collateral, as those prevailing

at the time for comparable loans with persons not related to Home Federal Bank and none of such loans involve more than the normal risk of collectability or present other unfavorable features.

Under Home Federal Bancorp's Audit Committee Charter, the Audit Committee is required to review and approve all related party transactions, as described in Item 404 of Regulation S-K promulgated by the Securities and Exchange Commission.

## STOCK OWNERSHIP

The following table sets forth as of September 19, 2012, the voting record date for the annual meeting, certain information as to the common stock beneficially owned by each person or entity, including any "group" as that term is used in Section 13(d)(3) of the Securities Exchange Act of 1934, who or which was known to us to be the beneficial owner of more than 5% of the issued and outstanding common stock.

Name of Beneficial Owner or Number of Persons in Group	Amount and Nature of Beneficial Ownership as of September 19, 2012(1)	Percent of Common Stock
Home Federal Bancorp, Inc. of Louisiana Employee Stock Ownership Plan c/o Home Federal Bank 624 Market Street Shreveport, Louisiana 71101	219,863	(3) 7.7 %
Castine Capital Management, LLC One International Place, Suite 2401 Boston, Massachusetts 02110	153,772	(4) 5.4
FJ Capital Long/Short Equity Fund LLC 1313 Dolley Madison Boulevard, Suite 306 McLean, Virginia 22101	157,446	(5) 5.5
Sandler O'Neill Asset Management, LLC 150 East 52nd Street, 30th Floor New York, New York 10022	245,900	(6) 8.7
Stilwell Value Partners I, L.P. 111 Broadway, 12th Floor New York, New York 10006	270,200	(7) 9.5
Third Avenue Management LLC 622 Third Avenue, 32nd Floor New York, New York 10017	254,698	(8) 9.0

The following table sets forth the number of shares of common stock beneficially owned by (1) directors of Home Federal Bancorp, (2) the other named executive officer and (3) all directors and executive officers of Home Federal Bancorp as a group.

Name of Beneficial Owner or Number of Persons in Group	Amount and Nature of Beneficial Ownership as of September 19, 2012(1)	Percent of Common Stock(2)
Directors:		
44,960 -- -- 35,990 222,644	Chief Executive Officer	James R. Barlow 2012(2) 167,47

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James R. Barlow	46,328	(9)(10)	1.6	
Walter T. Colquitt III	11,002	(9)(11)	*	
Mark M. Harrison	9,032	(9)(12)	*	
Daniel R. Herndon	130,725	(9)(13)	4.6	
David A. Herndon III	39,374	(9)(14)	1.4	
Woodus K. Humphrey	10,711	(9)	*	
Scott D. Lawrence	21,857	(9)(15)	*	
Clyde D. Patterson	35,436	(9)(16)	1.2	
Thomas Steen Trawick, Jr.	1,786	(9)	*	
Timothy W. Wilhite, Esq.	9,112	(9)	*	
<b>Other Named Executive Officer:</b>				
K. Matthew Sawrie	16,621	(9)(17)	*	
All Directors and Executive Officers as a Group (12 persons)	338,060	(9)	11.6	%

\*Represents less than 1% of our outstanding common stock.

(1)Based upon filings made pursuant to the Securities Exchange Act of 1934 and information furnished by the respective individuals. Under regulations promulgated pursuant to the Securities Exchange Act of 1934, shares of common stock are deemed to be beneficially owned by a person if he or she directly or indirectly has or shares (i) voting power, which includes the power to vote or to direct the voting of the shares, or (ii) investment power, which includes the power to dispose or to direct the disposition of the shares. Unless otherwise indicated, the named beneficial owner has sole voting and dispositive power with respect to the shares. None of the shares reflected as being beneficially owned by executive officers and directors are pledged as security.

(Footnotes continued on following page)

- (2) Each beneficial owner's percentage ownership is determined by assuming that options held by such person (but not those held by any other person) and that are exercisable within 60 days of the voting record date have been exercised.
- (3) As of September 19, 2012, 41,086 shares held in the Home Federal Bank Employee Stock Ownership Plan trust had been allocated to the accounts of participating employees. Amounts held by the plan trustees, Messrs. Daniel Herndon and Clyde Patterson, reflect shares allocated to their individual accounts and exclude all other shares held in the trust. Under the terms of the plan, the trustees vote all allocated shares in accordance with the instructions of the participating employees. Any unallocated shares are generally required to be voted by the plan trustees in the same ratio on any matter as to those shares for which instructions are given by the participants.
- (4) Based on a Schedule 13G filed with Securities and Exchange Commission (the "SEC") on April 26, 2012 by Castine Capital Management, LLC and Paul Magidson, managing member.
- (5) This information is based on a Schedule 13D filed with the SEC on April 30, 2012 by (i) FJ Capital Long/Short Equity Fund LLC, a Delaware limited liability company ("FJ Capital") and Mr. Friedman, managing member, (ii) Mr. Friedman, individually and (iii) Compo Investments Partners LP ("Compo") and Mr. Friedman, investment manager. FJ Capital beneficially owned 112,294 shares; Compo beneficially owned 10,000 shares and Mr. Friedman owned an aggregate of 157,446 shares.
- (6) Based on a Schedule 13G filed with the SEC on February 14, 2012 by Sandler O'Neill Asset Management, LLC, a New York limited liability company and Terry Maltese, managing member.
- (7) According to an Amendment No. 1 to Schedule 13D filed with the SEC on May 17, 2012, the shares are beneficially owned by Joseph Stilwell, including shares held in the name of following members of a group: Stilwell Value Partners I, L.P.; Stilwell Partners, L.P.; and Stilwell Value LLC.
- (8) This information is based on a Schedule 13G filed with the Securities and Exchange Commission by Third Avenue Management LLC on February 14, 2012.
- (9) Includes options to acquire shares of Home Federal Bancorp common stock that are exercisable within 60 days of September 19, 2012, under our Stock Option Plans and unvested shares held in the Recognition and Retention Plan Trusts over which the directors and executive officers do not have current voting or investment powers as follows:

Name	Stock Awards	Stock Options
James R. Barlow	21,138	3,844
Walter T. Colquitt, III	2,218	6,067
Mark M. Harrison	3,112	--
Daniel R. Herndon	11,671	29,628
David A. Herndon III	2,218	4,807
Woodus K. Humphrey	2,218	6,807
Scott D. Lawrence	2,218	3,807
Clyde D. Patterson	2,218	13,802
Thomas Steen Trawick, Jr.	1,439	--
Timothy W. Wilhite, Esq	3,112	--
K. Matthew Sawrie	7,509	--
All directors and executive officers as a group (12 persons)	60,627	70,684

(10)



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Includes 550 shares held by Mr. Barlow's spouse, 10,000 shares held in Mr. Barlow's individual retirement account, 5,855 share units held in Home Federal Bank's 401(k) Plan for the benefit of Mr. Barlow, however, for purposes of voting authority, Mr. Barlow had voting power over 5,294 shares and 1,495 shares allocated to Mr. Barlow's account in the Home Federal Bank employee stock ownership plan.

- (11) Includes 940 shares held jointly with Dr. Colquitt's spouse.
- (12) Includes 911 shares held by Mr. Harrison's spouse, 1,138 shares held jointly with his daughters and 2,733 shares held in his individual retirement account.
- (13) Includes 28,702 share units held in Home Federal Bank's 401(k) Plan for the benefit of Mr. Herndon; however, for purposes of voting authority, Mr. Herndon had voting power over 25,954 shares, 5,725 shares allocated to Mr. Herndon's account in the Home Federal Bank employee stock ownership plan and 20,761 shares held by Herndon Investment Company LLC over which Mr. Herndon disclaims beneficial ownership except with respect to his 50% ownership interest therein.
- (14) Includes 20,761 shares held by Herndon Investment Company LLC, of which Mr. Herndon is a 50% owner, and over which he disclaims beneficial ownership except with respect to his pecuniary interest therein.
- (15) Includes 4,555 shares held in Mr. Lawrence's individual retirement account and 4,555 shares held jointly with Mr. Lawrence's spouse.
- (16) Includes 5,057 share units held in Home Federal Bank's 401(k) Plan for the benefit of Mr. Patterson, however, for purposes of voting authority, Mr. Patterson had voting power over 4,573 shares and 4,329 shares allocated to Mr. Patterson's account in the Home Federal Bank employee stock ownership plan.
- (17) Includes 1,094 shares allocated to Mr. Sawrie in the Home Federal Bank employee stock ownership plan and 735 share units held in Home Federal Bank's 401(k) Plan, however, for purposes of voting authority, Mr. Sawrie had voting power over 664 shares.

## Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934, as amended, requires the officers and directors, and persons who own more than 10% of Home Federal Bancorp's common stock to file reports of ownership and changes in ownership with the Securities and Exchange Commission. Officers, directors and greater than 10% shareholders are required by regulation to furnish Home Federal Bancorp with copies of all Section 16(a) forms they file. We know of no person who owns 10% or more of our common stock.

Based solely on our review of the copies of such forms furnished to us, or written representations from our officers and directors, we believe that during, and with respect to, the fiscal year ended June 30, 2012, our officers and directors complied in all respects with the reporting requirements promulgated under Section 16(a) of the Securities Exchange Act of 1934 with the exception of a Form 3 for Mr. Trawick which was filed late due to an administrative error.

#### RATIFICATION OF APPOINTMENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM (PROPOSAL TWO)

The Audit Committee of the Board of Directors of Home Federal Bancorp has appointed LaPorte, A Professional Accounting Corporation to perform the audit of our financial statements for the year ending June 30, 2013, and further directed that the selection of auditors be submitted for ratification by the shareholders at the annual meeting.

We have been advised by LaPorte that neither that firm nor any of its associates has any relationship with Home Federal Bancorp or its subsidiaries other than the usual relationship that exists between an independent registered public accounting firm and its clients. LaPorte will have one or more representatives at the annual meeting who will have an opportunity to make a statement, if they so desire, and will be available to respond to appropriate questions.

In determining whether to appoint LaPorte as our independent registered public accounting firm, the Audit Committee considered whether the provision of services, other than auditing services, by LaPorte is compatible with maintaining their independence. In fiscal 2012 and 2011, LaPorte performed auditing services as well as reviewed our public filings. The Audit Committee believes that LaPorte's performance of these services is compatible with maintaining the independent registered public accounting firm's independence.

#### Audit Fees

The following table sets forth the aggregate fees paid by us to LaPorte for professional services rendered by LaPorte in connection with the audit of Home Federal Bancorp's consolidated financial statements for fiscal 2012 and 2011, as well as the fees paid by us to LaPorte for audit-related services, tax services and all other services rendered by LaPorte to us during fiscal 2012 and 2011.

	Year Ended June 30,	
	2012	2011
Audit fees(1)	\$ 80,816	\$ 70,378
Audit-related fees(2)	2,600	52,769
Tax fees	--	--
All other fees	--	--
Total	\$ 83,416	\$ 123,147

- (1) Audit fees consist of fees incurred in connection with the audit of our annual financial statements and the review of the interim financial statements included in our quarterly reports filed with the Securities and Exchange Commission, as well as work generally only the independent auditor can reasonably be expected to provide, such as statutory audits, consents and assistance with and review of documents filed with the Securities and Exchange Commission.
- (2) Audit-related fees for 2012 consist of accounting research and for 2011 consist of fees incurred in connection with the review of registration statements in connection with our second step conversion and reorganization.

The Audit Committee selects our independent registered public accounting firm and pre-approves all audit services to be provided by it to Home Federal Bancorp. The Audit Committee also reviews and pre-approves all audit-related and non-audit related services rendered by our independent registered public accounting firm in accordance with the Audit Committee's charter. In its review of these services and related fees and terms, the Audit Committee considers, among other things, the possible effect of the performance of such services on the independence of our independent registered public accounting firm. The Audit Committee pre-approves certain audit-related services and certain non-audit related tax services which are specifically described by the Audit Committee on an annual basis and separately approves other individual engagements as necessary.

Each new engagement of LaPorte, A Professional Accounting Corporation was approved in advance by the Audit Committee or its Chair, and none of those engagements made use of the de minimis exception to pre-approval contained in the Securities and Exchange Commission's rules.

The Board of Directors recommends that you vote FOR the ratification of the appointment of LaPorte, A Professional Accounting Corporation for the fiscal year ending June 30, 2013.

#### SHAREHOLDER PROPOSALS, NOMINATIONS AND COMMUNICATIONS WITH THE BOARD OF DIRECTORS

Shareholder Proposals. Any proposal which a shareholder wishes to have included in the proxy materials of Home Federal Bancorp relating to the next annual meeting of shareholders of Home Federal Bancorp, which is anticipated to be held in November 2013, must be made in writing and filed with the Corporate Secretary, DeNell W. Mitchell, Home Federal Bancorp, 624 Market Street, Shreveport, Louisiana, 71101, no later than June 14, 2013. If such proposal is in compliance with all of the requirements of Rule 14a-8 under the Securities Exchange Act of 1934, as amended, it will be included in the proxy statement and set forth on the form of proxy issued for such annual meeting of shareholders. It is urged that any such proposals be sent certified mail, return receipt requested.

Shareholder proposals which are not submitted for inclusion in Home Federal Bancorp's proxy materials pursuant to Rule 14a-8 may be brought before an annual meeting pursuant to Article 8.D. of our Articles of Incorporation. Notice of the proposal must be given in writing and delivered to, or mailed and received at, our principal executive offices no later than June 14, 2013. The notice must include the information required by Article 8.D. of our Articles of Incorporation.

Shareholder Nominations. Our Bylaws provide that all nominations for election to the Board of Directors, other than those made by the Board or a committee thereof, shall be made by a shareholder who has complied with the notice and information requirements contained in Article 5.F. of our Bylaws. Written notice of a shareholder nomination generally must be communicated to the attention of the Secretary and either delivered to, or mailed and received at, our principal executive offices no later than June 14, 2013, with respect to the next annual meeting of shareholders.

Other Shareholder Communications. Shareholders who wish to communicate with the Board may do so by sending written communications addressed to the Board of Directors of Home Federal Bancorp, Inc., c/o DeNell W. Mitchell, Corporate Secretary, at 624 Market Street, Shreveport, Louisiana 71101. Ms. Mitchell will forward such communications to the director or directors to whom they are addressed.



## ANNUAL REPORTS

A copy of Home Federal Bancorp's Annual Report including the Form 10-K for the year ended June 30, 2012 accompanies this proxy statement. Such annual report is not part of the proxy solicitation materials.

Upon receipt of a written request, we will furnish to any shareholder without charge a copy of the exhibits to the Annual Report on Form 10-K for the year ended June 30, 2012. Such written requests should be directed to Ms. DeNell W. Mitchell, Corporate Secretary, Home Federal Bancorp, Inc., 624 Market Street, Shreveport, Louisiana 71101.

## OTHER MATTERS

Management is not aware of any business to come before the annual meeting other than the matters described above in this proxy statement. However, if any other matters should properly come before the meeting, it is intended that the proxies solicited hereby will be voted with respect to those other matters in accordance with the judgment of the persons voting the proxies.

The cost of the solicitation of proxies will be borne by Home Federal Bancorp. Home Federal Bancorp will reimburse brokerage firms and other custodians, nominees and fiduciaries for reasonable expenses incurred by them in sending the proxy materials to the beneficial owners of Home Federal Bancorp's common stock. In addition to solicitations by mail, directors, officers and employees of Home Federal Bancorp may solicit proxies personally or by telephone without additional compensation.

You may elect to receive future proxy materials, as well as other investor communications, in a single package per address. This practice, known as "householding," is designed to reduce our paper use, and printing and postage costs. To make the election, please indicate on your proxy card under "Householding Election" your consent to receive such communications in a single package per address. Your consent to householding will be perpetual until you revoke it. You may revoke your consent or request separate copies of our proxy materials by notifying our Corporate Secretary at 624 Market Street, Shreveport, Louisiana 71101. If you revoke your consent, we will start sending you individual copies of proxy materials and other investor communications within 30 days of your revocation.



October 12, 2012

To: Participants in the Home Federal Bank Employees' Savings and Profit Sharing Plan (the "401(k) Plan")

Re: Instructions for voting shares of Home Federal Bancorp, Inc. of Louisiana

As described in the enclosed materials, proxies are being solicited in connection with the proposals to be considered at the upcoming Annual Meeting of Shareholders of Home Federal Bancorp. We hope you will take advantage of the opportunity to direct the manner in which shares of common stock of Home Federal Bancorp allocated to your account in the Home Federal Bank 401(k) Plan will be voted.

Enclosed with this letter is the Proxy Statement, which describes the matters to be voted upon, Annual Report for the year ended June 30, 2012 and Voting Instruction Ballot. After you have reviewed the Proxy Statement, we urge you to vote your allocated shares held in the 401(k) Plan by marking, dating, signing and returning the enclosed Voting Instruction Ballot in the envelope provided or voting by phone or the Internet. In order to be effective, your voting instructions must be received no later than 11:59 P.M. Eastern Time on November 7, 2012.

We urge each of you to vote, as a means of participating in the governance of the affairs of Home Federal Bancorp. If your voting instructions are not received, the shares allocated to your 401(k) Plan account will generally not be voted. While I hope that you will vote in the manner recommended by the Board of Directors, the most important thing is that you vote in whatever manner you deem appropriate. Please take a moment to do so.

Please note that the enclosed material relates only to those shares which have been allocated to you in your account under the 401(k) Plan. If you also own shares of Home Federal Bancorp common stock outside of the 401(k) Plan, you should receive other voting material for those shares owned by you individually. Please return all your voting material so that all your shares may be voted.

Sincerely,

Daniel R. Herndon  
President



October 12, 2012

To: Participants in the Home Federal Bank Employees' Stock Ownership Plan (the "ESOP")

Re: Instructions for voting shares of Home Federal Bancorp, Inc. of Louisiana

As described in the enclosed materials, proxies are being solicited in connection with the proposals to be considered at the upcoming Annual Meeting of Shareholders of Home Federal Bancorp. We hope you will take advantage of the opportunity to direct the manner in which shares of common stock of Home Federal Bancorp allocated to your account in the Home Federal Bank ESOP will be voted.

Enclosed with this letter is the Proxy Statement, which describes the matters to be voted upon, Annual Report for the year ended June 30, 2012 and Voting Instruction Ballot. After you have reviewed the Proxy Statement, we urge you to vote your allocated shares held in the ESOP by marking, dating, signing and returning the enclosed Voting Instruction Ballot in the envelope provided or voting by phone or the Internet. In order to be effective, your voting instructions must be received no later than 11:59 P.M. Eastern Time on November 7, 2012.

We urge each of you to vote, as a means of participating in the governance of the affairs of Home Federal Bancorp. If your voting instructions are not received, the shares allocated to your ESOP account will generally not be voted. While I hope that you will vote in the manner recommended by the Board of Directors, the most important thing is that you vote in whatever manner you deem appropriate. Please take a moment to do so.

Please note that the enclosed material relates only to those shares which have been allocated to you in your account under the ESOP. If you also own shares of Home Federal Bancorp common stock outside of the ESOP, you should receive other voting material for those shares owned by you individually. Please return all your voting material so that all your shares may be voted.

Sincerely,

Daniel R. Herndon  
President











