SOUTHERN MISSOURI BANCORP INC
Form 10-Q
November 09, 2016
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2016

OR

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

For the transition period from _______ to

Commission file number 0-23406
Southern Missouri Bancorp, Inc.
(Exact name of registrant as specified in its charter)

Missouri	43-1665523
(State or jurisdiction of incorporation)	(IRS employer id. no.)

531 Vine Street Poplar Bluff, MO 63901
(Address of principal executive offices) (Zip code)

(573) 778-1800
Registrant's telephone number, including area code

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

Yes X No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data file required to be submitted and posted pursuant to Rule 405 of regulation S-T (§232.405 of this chapter) during the proceeding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes X No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer," and "smaller reporting

company" in Rule 12b-2 of the Exchange Act (check one):

Large accelerated filer Accelerated filer X Non-accelerated filer Smaller reporting company

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

Yes No X

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date:

Class	Outstanding at November 8, 2016
Common Stock, Par Value $.01	7,436,266 Shares

SOUTHERN MISSOURI BANCORP, INC.
FORM 10-Q

INDEX

PART I.	Financial Information	PAGE NO.
Item 1.	Condensed Consolidated Financial Statements	
	- Condensed Consolidated Balance Sheets	3
	- Condensed Consolidated Statements of Income	4
	- Condensed Consolidated Statements of Comprehensive Income	5
	- Condensed Consolidated Statements of Cash Flows	6
	- Notes to Condensed Consolidated Financial Statements	7
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	31
Item 3.	Quantitative and Qualitative Disclosures about Market Risk	43
Item 4.	Controls and Procedures	45
PART II.	OTHER INFORMATION	46
Item 1.	Legal Proceedings	46
Item 1a.	Risk Factors	46
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	46
Item 3.	Defaults upon Senior Securities	46
Item 4.	Mine Safety Disclosures	46
Item 5.	Other Information	46
Item 6.	Exhibits	47
	- Signature Page	48
	- Certifications	49

PART I: Item 1: Condensed Consolidated Financial Statements

SOUTHERN MISSOURI BANCORP, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
SEPTEMBER 30, 2016 AND JUNE 30, 2016

(dollars in thousands)	September 30, 2016 (unaudited)	June 30, 2016
Cash and cash equivalents	$21,480	$22,554
Interest-bearing time deposits	498	723
Available for sale securities	124,249	129,224
Stock in FHLB of Des Moines	6,771	6,009
Stock in Federal Reserve Bank of St. Louis	2,350	2,343
Loans receivable, net of allowance for loan losses of $14,456 and $13,791 at September 30, 2016 and June 30, 2016, respectively	1,203,772	1,135,453
Accrued interest receivable	6,608	5,512
Premises and equipment, net	46,615	46,943
Bank owned life insurance – cash surrender value	30,282	30,071
Goodwill	4,556	4,556
Other intangible assets, net	3,101	3,295
Prepaid expenses and other assets	19,530	17,227
Total assets	$1,469,812	$1,403,910
Liabilities and Stockholders' Equity		
Deposits	$1,167,350	$1,120,693
Securities sold under agreements to repurchase	25,450	27,085
Advances from FHLB of Des Moines	129,184	110,216
Accounts payable and other liabilities	3,516	4,477
Accrued interest payable	749	720
Subordinated debt	14,776	14,753
Total liabilities	1,341,025	1,277,944
Common stock, $.01 par value; 10,000,000 shares authorized; 7,436,866 and 7,437,616 shares, respectively, issued at September 30, 2016 and June 30, 2016	74	74
Additional paid-in capital	34,452	34,432
Retained earnings	92,763	89,798
Accumulated other comprehensive income	1,498	1,662
Total stockholders' equity	128,787	125,966
Total liabilities and stockholders' equity	$1,469,812	$1,403,910

See Notes to Condensed Consolidated Financial Statements

3

SOUTHERN MISSOURI BANCORP, INC
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
FOR THE THREE-MONTH PERIODS ENDED SEPTEMBER 30, 2016 AND 2015 (Unaudited)

	Three months ended September 30,	
	2016	2015
(dollars in thousands except per share data)		
INTEREST INCOME:		
Loans	$14,250	$13,098
Investment securities	506	495
Mortgage-backed securities	345	370
Other interest-earning assets	4	7
Total interest income	15,105	13,970
INTEREST EXPENSE:		
Deposits	1,932	1,785
Securities sold under agreements to repurchase	27	29
Advances from FHLB of Des Moines	418	317
Subordinated debt	152	135
Total interest expense	2,529	2,266
NET INTEREST INCOME	12,576	11,704
PROVISION FOR LOAN LOSSES	925	618
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	11,651	11,086
NONINTEREST INCOME:		
Deposit account charges and related fees	942	924
Bank card interchange income	685	636
Loan late charges	85	77
Loan servicing fees	56	35
Other loan fees	238	170
Net realized gains on sale of loans	272	133
Earnings on bank owned life insurance	211	145
Other income	86	82
Total noninterest income	2,575	2,202
NONINTEREST EXPENSE:		
Compensation and benefits	4,787	4,323
Occupancy and equipment, net	2,031	1,665
Deposit insurance premiums	175	161
Legal and professional fees	203	126
Advertising	239	254
Postage and office supplies	132	159
Intangible amortization	228	310
Bank card network expense	279	253
Other operating expense	1,085	737
Total noninterest expense	9,159	7,988
INCOME BEFORE INCOME TAXES	5,067	5,300
INCOME TAXES	1,358	1,665

NET INCOME	$3,709	$3,635
Less: dividend on preferred shares	-	50
Net income available to common shareholders	$3,709	$3,585
Basic earnings per common share	$0.50	$0.48
Diluted earnings per common share	$0.50	$0.48
Dividends per common share	$0.10	$0.09

See Notes to Condensed Consolidated Financial Statements

4

SOUTHERN MISSOURI BANCORP, INC
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
FOR THE THREE-MONTH PERIODS ENDED SEPTEMBER 30, 2016 AND 2015 (Unaudited)

	Three months ended September 30,	
	2016	2015
(dollars in thousands)		
Net income	$3,709	$3,635
Other comprehensive income:		
Unrealized (losses) gains on securities available-for-sale	(230)	391
Unrealized losses on available-for-sale securities for which a portion of an other-than-temporary impairment has been recognized in income	(30)	(4)
Tax benefit (expense)	96	(143)
Total other comprehensive (loss) income	(164)	244
Comprehensive income	$3,545	$3,879

See Notes to Condensed Consolidated Financial Statements

SOUTHERN MISSOURI BANCORP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE THREE-MONTH PERIODS ENDED SEPTEMBER 30, 2016 AND 2015 (Unaudited)

	Three months ended September 30,	
(dollars in thousands)	2016	2015
Cash Flows From Operating Activities:		
Net income	$3,709	$3,635
Items not requiring (providing) cash:		
Depreciation	754	536
Loss on disposal of fixed assets	3	-
Stock option and stock grant expense	20	36
Amortization of intangible assets	228	310
Amortization of purchase accounting adjustments	(306)	(487)
Increase in cash surrender value of bank owned life insurance	(211)	(145)
Gain on sale of foreclosed assets	(20)	(5)
Provision for loan losses	925	618
Net amortization of premiums and discounts on securities	256	200
Originations of loans held for sale	(9,171)	(5,713)
Proceeds from sales of loans held for sale	7,919	5,413
Gain on sales of loans held for sale	(272)	(133)
Changes in:		
Accrued interest receivable	(1,096)	(495)
Prepaid expenses and other assets	489	225
Accounts payable and other liabilities	(2,396)	(280)
Deferred income taxes	228	(538)
Accrued interest payable	29	(81)
Net cash provided by operating activities	1,088	3,096
Cash flows from investing activities:		
Net increase in loans	(67,813)	(16,019)
Net change in interest-bearing deposits	225	225
Proceeds from maturities of available for sale securities	8,507	4,541
Net purchases of Federal Home Loan Bank stock	(762)	(696)
Net purchases of Federal Reserve Bank of Saint Louis stock	(7)	-
Purchases of available-for-sale securities	(4,048)	(2,247)
Purchases of premises and equipment	(430)	(3,598)
Investments in state & federal tax credits	(1,661)	(162)
Proceeds from sale of foreclosed assets	459	266
Net cash used in investing activities	(65,530)	(17,690)
Cash flows from financing activities:		
Net increase in demand deposits and savings accounts	8,819	8,697
Net increase (decrease) in certificates of deposits	37,878	(6,162)
Net decrease in securities sold under agreements to repurchase	(1,635)	(2,903)
Proceeds from Federal Home Loan Bank advances	144,150	88,500
Repayments of Federal Home Loan Bank advances	(125,100)	(71,100)
Exercise of stock options	-	36

Dividends paid on preferred stock	-	(50)
Dividends paid on common stock	(744)	(668)
Net cash provided by financing activities	63,368	16,350
(Decrease) increase in cash and cash equivalents	(1,074)	1,756
Cash and cash equivalents at beginning of period	22,554	16,775
Cash and cash equivalents at end of period	$21,480	$18,531
Supplemental disclosures of cash flow information:		
Noncash investing and financing activities:		
Conversion of loans to foreclosed real estate	$295	$135
Conversion of foreclosed real estate to loans	54	-
Conversion of loans to repossessed assets	5	123
Cash paid during the period for:		
Interest (net of interest credited)	$838	$730
Income taxes	1,882	1,615

See Notes to Condensed Consolidated Financial Statements

SOUTHERN MISSOURI BANCORP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 1: Basis of Presentation

The accompanying unaudited interim consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Securities and Exchange Commission (SEC) Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all material adjustments (consisting only of normal recurring accruals) considered necessary for a fair presentation have been included. The consolidated balance sheet of the Company as of June 30, 2016, has been derived from the audited consolidated balance sheet of the Company as of that date. Operating results for the three-month period ended September 30, 2016, are not necessarily indicative of the results that may be expected for the entire fiscal year. For additional information, refer to the audited consolidated financial statements included in the Company's June 30, 2016, Form 10-K, which was filed with the SEC.

The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, Southern Bank. All significant intercompany accounts and transactions have been eliminated in consolidation.

Note 2: Organization and Summary of Significant Accounting Policies

Organization. Southern Missouri Bancorp, Inc., a Missouri corporation (the Company) was organized in 1994 and is the parent company of Southern Bank (the Bank). Substantially all of the Company's consolidated revenues are derived from the operations of the Bank, and the Bank represents substantially all of the Company's consolidated assets and liabilities. SB Real Estate Investments, LLC is a wholly-owned subsidiary of the Bank formed to hold Southern Bank Real Estate Investments, LLC. Southern Bank Real Estate Investments, LLC is a REIT which is controlled by the investment subsidiary, but which has other preferred shareholders in order to meet the requirements to be a REIT. At September 30, 2016, assets of the REIT were approximately $406 million, and consisted primarily of loan participations acquired from the Bank.

The Bank is primarily engaged in providing a full range of banking and financial services to individuals and corporate customers in its market areas. The Bank and Company are subject to competition from other financial institutions. The Bank and Company are subject to the regulation of certain federal and state agencies and undergo periodic examinations by those regulatory authorities.

Basis of Financial Statement Presentation. The financial statements of the Company have been prepared in conformity with accounting principles generally accepted in the United States of America and general practices within the banking industry. In the normal course of business, the Company encounters two significant types of risk: economic and regulatory. Economic risk is comprised of interest rate risk, credit risk, and market risk. The Company is subject to interest rate risk to the degree that its interest-bearing liabilities reprice on a different basis than its interest-earning assets. Credit risk is the risk of default on the Company's investment or loan portfolios resulting from the borrowers' inability or unwillingness to make contractually required payments. Market risk reflects changes in the value of the investment portfolio, collateral underlying loans receivable, and the value of the Company's investments in real estate.

Principles of Consolidation. The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, the Bank. All significant intercompany accounts and transactions have been eliminated.

Use of Estimates. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses, estimated fair values of purchased loans, other-than-temporary impairments (OTTI), and fair value of financial instruments.

Cash and Cash Equivalents. For purposes of reporting cash flows, cash and cash equivalents includes cash, due from depository institutions and interest-bearing deposits in other depository institutions with original maturities of three months or less. Interest-bearing deposits in other depository institutions were $3.0 million and $10.5 million at September 30 and June 30, 2016, respectively. The deposits are held in various commercial banks in amounts not exceeding the FDIC's deposit insurance limits, as well as at the Federal Reserve and the Federal Home Loan Bank of Des Moines.

Interest-bearing Time Deposits. Interest bearing deposits in banks mature within seven years and are carried at cost.

Available for Sale Securities. Available for sale securities, which include any security for which the Company has no immediate plan to sell but which may be sold in the future, are carried at fair value. Unrealized gains and losses, net of tax, are reported in accumulated other comprehensive income, a component of stockholders' equity. All securities have been classified as available for sale.

Premiums and discounts on debt securities are amortized or accreted as adjustments to income over the estimated life of the security using the level yield method. Realized gains or losses on the sale of securities is based on the specific identification method. The fair value of securities is based on quoted market prices or dealer quotes. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities.

The Company does not invest in collateralized mortgage obligations that are considered high risk.

When the Company does not intend to sell a debt security, and it is more likely than not the Company will not have to sell the security before recovery of its cost basis, it recognizes the credit component of an other-than-temporary impairment of a debt security in earnings and the remaining portion in other comprehensive income. As a result of this guidance, the Company's consolidated balance sheet as of the dates presented reflects the full impairment (that is, the difference between the security's amortized cost basis and fair value) on debt securities that the Company intends to sell or would more likely than not be required to sell before the expected recovery of the amortized cost basis. For available-for-sale debt securities that management has no intent to sell and believes that it more likely than not will not be required to sell prior to recovery, only the credit loss component of the impairment is recognized in earnings, while the noncredit loss is recognized in accumulated other comprehensive loss. The credit loss component recognized in earnings is identified as the amount of principal cash flows not expected to be received over the remaining term of the security as projected based on cash flow projections.

Federal Home Loan Bank and Federal Reserve Bank Stock. The Bank is a member of the Federal Home Loan Bank (FHLB) system, and the Federal Reserve Bank of St. Louis. Capital stock of the FHLB and the Federal Reserve is a required investment based upon a predetermined formula and is carried at cost.

Loans. Loans are generally stated at unpaid principal balances, less the allowance for loan losses and net deferred loan origination fees.

Interest on loans is accrued based upon the principal amount outstanding. The accrual of interest on loans is discontinued when, in management's judgment, the collectability of interest or principal in the normal course of business is doubtful. The Company complies with regulatory guidance which indicates that loans should be placed in nonaccrual status when 90 days past due, unless the loan is both well-secured and in the process of collection. A loan that is "in the process of collection" may be subject to legal action or, in appropriate circumstances, through other collection efforts reasonably expected to result in repayment or restoration to current status in the near future. A loan is considered delinquent when a payment has not been made by the contractual due date. Interest income previously accrued but not collected at the date a loan is placed on nonaccrual status is reversed against interest income. Cash

receipts on a nonaccrual loan are applied to principal and interest in accordance with its contractual terms unless full payment of principal is not expected, in which case cash receipts, whether designated as principal or interest, are applied as a reduction of the carrying value of the loan. A nonaccrual loan is generally returned to accrual status when principal and interest payments are current, full collectability of principal and interest is reasonably assured, and a consistent record of performance has been demonstrated.

The allowance for losses on loans represents management's best estimate of losses probable in the existing loan portfolio. The allowance for losses on loans is increased by the provision for losses on loans charged to expense and reduced by loans charged off, net of recoveries. Loans are charged off in the period deemed uncollectible, based on management's analysis of expected cash flows (for non-collateral dependent loans) or collateral value (for collateral-dependent loans). Subsequent recoveries of loans previously charged off, if any, are credited to the allowance when received. The provision for losses on loans is determined based on management's assessment of several factors: reviews and evaluations of specific loans, changes in the nature and volume of the loan portfolio, current economic conditions and the related impact on specific borrowers and industry groups, historical loan loss experience, the level of classified and nonperforming loans and the results of regulatory examinations.

Loans are considered impaired if, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Depending on a particular loan's circumstances, we measure impairment of a loan based upon either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's observable market price, or the fair value of the collateral less estimated costs to sell if the loan is collateral dependent. Valuation allowances are established for collateral-dependent impaired loans for the difference between the loan amount and fair value of collateral less estimated selling costs. For impaired loans that are not collateral dependent, a valuation allowance is established for the difference between the loan amount and the present value of expected future cash flows discounted at the historical effective interest rate or the observable market price of the loan. Impairment losses are recognized through an increase in the required allowance for loan losses. Cash receipts on loans deemed impaired are recorded based on the loan's separate status as a nonaccrual loan or an accrual status loan.

Some loans are accounted for in accordance with ASC 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality. For these loans ("purchased credit impaired loans"), the Company recorded a fair value discount and began carrying them at book value less their face amount (see Note 4). For these loans, we determined the contractual amount and timing of undiscounted principal and interest payments (the "undiscounted contractual cash flows"), and estimated the amount and timing of undiscounted expected principal and interest payments, including expected prepayments (the "undiscounted expected cash flows"). Under acquired impaired loan accounting, the difference between the undiscounted contractual cash flows and the undiscounted expected cash flows is the nonaccretable difference. The nonaccretable difference is an estimate of the loss exposure of principal and interest related to the purchased credit impaired loans, and the amount is subject to change over time based on the performance of the loans. The carrying value of purchased credit impaired loans is initially determined as the discounted expected cash flows. The excess of expected cash flows at acquisition over the initial fair value of the purchased credit impaired loans is referred to as the "accretable yield" and is recorded as interest income over the estimated life of the acquired loans using the level-yield method, if the timing and amount of the future cash flows is reasonably estimable. The carrying value of purchased credit impaired loans is reduced by payments received, both principal and interest, and increased by the portion of the accretable yield recognized as interest income. Subsequent to acquisition, the Company evaluates the purchased credit impaired loans on a quarterly basis. Increases in expected cash flows compared to those previously estimated increase the accretable yield and are recognized as interest income prospectively. Decreases in expected cash flows compared to those previously estimated decrease the accretable yield and may result in the establishment of an allowance for loan losses and a provision for loan losses. Purchased credit impaired loans are generally considered accruing and performing loans, as the loans accrete interest income over the estimated life of the loan when expected cash flows are reasonably estimable. Accordingly, purchased credit impaired loans that are contractually past due are still considered to be accruing and performing as long as there is an expectation that the estimated cash flows will be received. If the timing and amount of cash flows is not reasonably estimable, the loans may be classified as nonaccrual loans.

Loan fees and certain direct loan origination costs are deferred, and the net fee or cost is recognized as an adjustment to interest income using the interest method over the contractual life of the loans.

Foreclosed Real Estate. Real estate acquired by foreclosure or by deed in lieu of foreclosure is initially recorded at fair value less estimated selling costs. Costs for development and improvement of the property are capitalized.

Valuations are periodically performed by management, and an allowance for losses is established by a charge to operations if the carrying value of a property exceeds its estimated fair value, less estimated selling costs.

Loans to facilitate the sale of real estate acquired in foreclosure are discounted if made at less than market rates. Discounts are amortized over the fixed interest period of each loan using the interest method.

Premises and Equipment. Premises and equipment are stated at cost less accumulated depreciation and include expenditures for major betterments and renewals. Maintenance, repairs, and minor renewals are expensed as incurred. When property is retired or sold, the retired asset and related accumulated depreciation are removed from the accounts and the resulting gain or loss taken into income. The Company reviews property and equipment for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If such assets are considered to be impaired, the impairment loss recognized is measured by the amount by which the carrying amount exceeds the fair value of the assets.

Depreciation is computed by use of straight-line and accelerated methods over the estimated useful lives of the assets. Estimated lives are generally seven to forty years for premises, three to seven years for equipment, and three years for software.

Bank Owned Life Insurance. Bank owned life insurance policies are reflected in the consolidated balance sheets at the estimated cash surrender value. Changes in the cash surrender value of these policies, as well as a portion of the insurance proceeds received, are recorded in noninterest income in the consolidated statements of income.

Goodwill. The Company's goodwill is evaluated annually for impairment or more frequently if impairment indicators are present. A qualitative assessment is performed to determine whether the existence of events or circumstances leads to a determination that it is more likely than not the fair value is less than the carrying amount, including goodwill. If, based on the evaluation, it is determined to be more likely than not that the fair value is less than the carrying value, then goodwill is tested further for impairment. If the implied fair value of goodwill is lower than its carrying amount, a goodwill impairment is indicated and goodwill is written down to its implied fair value. Subsequent increases in goodwill value are not recognized in the financial statements.

Intangible Assets. The Company's intangible assets at September 30, 2016 included gross core deposit intangibles of $5.9 million with $3.1 million accumulated amortization, gross other identifiable intangibles of $3.8 million with accumulated amortization of $3.8 million, and FHLB mortgage servicing rights of $310,000. At June 30, 2016, the Company's intangible assets included gross core deposit intangibles of $5.9 million with $3.0 million accumulated amortization, and gross other identifiable intangibles of $3.8 million with accumulated amortization of $3.8 million, and FHLB mortgage servicing rights of $275,000. The Company's core deposit intangible assets are being amortized using the straight line method, over periods ranging from five to six years, with amortization expense expected to be approximately $684,000 in the remainder of fiscal 2017, $911,000 in fiscal 2018, $655,000 in fiscal 2019, $500,000 in fiscal 2020, and $42,000 in fiscal 2021.
Income Taxes. The Company accounts for income taxes in accordance with income tax accounting guidance (ASC 740, Income Taxes). The income tax accounting guidance results in two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to the taxable income or excess of deductions over revenues. The Company determines deferred income taxes using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax bases of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur.

Deferred income tax expense results from changes in deferred tax assets and liabilities between periods. Deferred tax assets are recognized if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term more likely than not means a likelihood of more than 50 percent; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50 percent likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more-likely-than-not recognition threshold considers the facts, circumstances, and information available at the reporting date and is subject to management's judgment. Deferred tax assets are reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized.

The Company recognizes interest and penalties on income taxes as a component of income tax expense.

The Company files consolidated income tax returns with its subsidiaries.

Incentive Plan. The Company accounts for its Management and Recognition Plan (MRP) and Equity Incentive Plan (EIP) in accordance with ASC 718, "Share-Based Payment." Compensation expense is based on the market price of the Company's stock on the date the shares are granted and is recorded over the vesting period. The difference between the aggregate purchase price and the fair value on the date the shares are considered earned represents a tax benefit to the Company that is recorded as an adjustment to additional paid in capital

Outside Directors' Retirement. The Bank adopted a directors' retirement plan in April 1994 for outside directors. The directors' retirement plan provides that each non-employee director (participant) shall receive, upon termination of service on the Board on or after age 60, other than termination for cause, a benefit in equal annual installments over a five year period. The benefit will be based upon the product of the participant's vesting percentage and the total Board fees paid to the participant during the calendar year preceding termination of service on the Board. The vesting percentage shall be determined based upon the participant's years of service on the Board.

In the event that the participant dies before collecting any or all of the benefits, the Bank shall pay the participant's beneficiary. No benefits shall be payable to anyone other than the beneficiary, and benefits shall terminate on the death of the beneficiary.

Stock Options. Compensation cost is measured based on the grant-date fair value of the equity instruments issued, and recognized over the vesting period during which an employee provides service in exchange for the award.

Earnings Per Share. Basic earnings per share available to common stockholders is computed using the weighted-average number of common shares outstanding. Diluted earnings per share available to common stockholders includes the effect of all weighted-average dilutive potential common shares (stock options and warrants) outstanding during each period. All per share data has been restated to reflect the two-for-one common stock split in the form of a 100% common stock dividend paid on January 30, 2015.

Comprehensive Income. Comprehensive income consists of net income and other comprehensive income, net of applicable income taxes. Other comprehensive income includes unrealized appreciation (depreciation) on available-for-sale securities, unrealized appreciation (depreciation) on available-for-sale securities for which a portion of an other-than-temporary impairment has been recognized in income, and changes in the funded status of defined benefit pension plans.

Transfers Between Fair Value Hierarchy Levels. Transfers in and out of Level 1 (quoted market prices), Level 2 (other significant observable inputs) and Level 3 (significant unobservable inputs) are recognized on the period ending date.

The following paragraphs summarize the impact of new accounting pronouncements:

In June 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-13, Financial Instruments – Credit Losses (Topic 326). The Update amends guidance on reporting credit losses for assets held at amortized cost basis and available for sale debt securities. For assets held at amortized cost basis, Topic 326 eliminates the probable initial recognition threshold in current GAAP and, instead, requires an entity to reflect its current estimate of all expected credit losses. The update affects loans, debt securities, trade receivables, net investments in leases, off balance sheet credit exposures, and any other financial assets not excluded from the scope that have the contractual right to receive cash. For public companies, the ASU is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Management is evaluating the impact that this new guidance will have on the Company's consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, "Leases," to revise the accounting related to lease accounting. Under the new guidance, a lessee is required to record a right-of-use (ROU) asset and a lease liability on the balance

sheet for all leases with terms longer than 12 months. The ASU is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Adoption of the standard requires the use of a modified retrospective transition approach for all periods presented at the time of adoption. Management is evaluating the impact of the new guidance, but does not expect the adoption of this guidance to have a material impact on the Company's consolidated financial statements.

In January 2016, the FASB issued ASU 2016-01, "Recognition and Measurement of Financial Assets and Financial Liabilities," to generally require equity investments be measured at fair value with changes in fair value recognized in net income, simplify the impairment assessment of equity investments without readily-determinable fair value, and change disclosure and presentation requirements regarding financial instruments and other comprehensive income, and clarify that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets. For public entities, the guidance is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Management is evaluating the new guidance, but does not expect the adoption of this guidance to have a material impact on the Company's consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606). The update provides a five-step revenue recognition model for all revenue arising from contracts with customers and affects all entities that enter into contracts to provide goods or services to their customers (unless the contracts are included in the scope of other standards). The guidance requires an entity to recognize the revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services. For public entities, the guidance is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period, and must be

applied either retrospectively or using the modified retrospective approach. In April 2015, the FASB voted to propose a one-year deferral of the effective date of ASU 2014-09 and issued an exposure draft. Management is evaluating the new guidance, but does not expect the adoption of this guidance to have a material impact on the Company's consolidated financial statements. Early adoption would be permitted, but not before the original public entity effective date.

Note 3: Securities

The amortized cost, gross unrealized gains, gross unrealized losses, and approximate fair value of securities available for sale consisted of the following:

	September 30, 2016			
(dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Investment and mortgage backed securities:				
U.S. government-sponsored enterprises (GSEs)	$6,465	$ 51	$ -	$6,516
State and political subdivisions	42,966	1,607	(20)	44,553
Other securities	6,845	199	(748)	6,296
Mortgage-backed: GSE residential	65,592	1,299	(7)	66,884
Total investments and mortgage-backed securities	$121,868	$ 3,156	$ (775)	$124,249

	June 30, 2016			
(dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Investment and mortgage backed securities:				
U.S. government-sponsored enterprises (GSEs)	$6,460	$ 57	$ -	$6,517
State and political subdivisions	44,368	1,820	(3)	46,185
Other securities	5,861	206	(776)	5,291
Mortgage-backed GSE residential	69,893	1,342	(4)	71,231
Total investments and mortgage-backed securities	$126,582	$ 3,425	$ (783)	$129,224

The amortized cost and estimated fair value of investment and mortgage-backed securities, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without penalties.

	September 30, 2016	
(dollars in thousands)	Amortized Cost	Estimated Fair Value
Within one year	$861	$866
After one year but less than five years	11,124	11,316
After five years but less than ten years	20,362	20,880
After ten years	23,929	24,303
Total investment securities	56,276	57,365

Mortgage-backed securities	65,592	66,884
Total investments and mortgage-backed securities	$121,868	$124,249

The carrying value of investment and mortgage-backed securities pledged as collateral to secure public deposits and securities sold under agreements to repurchase amounted to $97.6 million at September 30, 2016 and $106.7 million at June 30, 2016. The securities pledged consist of marketable securities, including $5.5 million and $5.5 million of U.S. Government and Federal Agency Obligations, $47.9 million and $52.2 million of Mortgage-Backed Securities, $10.1 million and $13.6 million of Collateralized Mortgage Obligations, $33.5 million and $34.8 million of State and Political Subdivisions Obligations, and $600,000 and $600,000 of Other Securities at September 30, 2016 and June 30, 2016, respectively.

The following tables show our investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at September 30 and June 30, 2016:

	September 30, 2016					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
(dollars in thousands)						
Obligations of state and political subdivisions	$4,692	$ 20	$-	$ -	$4,692	$ 20
Other securities	-	-	1,104	748	1,104	748
Mortgage-backed securities	6,828	7	-	-	6,828	7
Total investments and mortgage-backed securities	$11,520	$ 27	$1,104	$ 748	$12,624	$ 775

	June 30, 2016					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
(dollars in thousands)						
Obligations of state and political subdivisions	$720	$ 3	$-	$ -	$720	$ 3
Other securities	-	-	1,080	776	1,080	776
Mortgage-backed securities	2,912	4	-	-	2,912	4
Total investments and mortgage-backed securities	$3,632	$ 7	$1,080	$ 776	$4,712	$ 783

Other securities. At September 30, 2016, there were three pooled trust preferred securities with an estimated fair value of $702,000 and unrealized losses of $740,000 in a continuous unrealized loss position for twelve months or more. These unrealized losses were primarily due to the long-term nature of the pooled trust preferred securities and a reduced demand for these securities, and concerns regarding the financial institutions that issued the underlying trust preferred securities. Rules adopted by the federal banking agencies in December 2013 to implement Section 619 of the Dodd-Frank Act (the "Volcker Rule") generally prohibit banking entities from engaging in proprietary trading and from investing in, sponsoring, or having certain relationships with a hedge fund or private equity fund. All pooled trust preferred securities owned by the Company were included in a January 2014 listing of securities which the agencies considered to be grandfathered with regard to these prohibitions; as such, banking entities are permitted to retain their interest in these securities, provided the interest was acquired on or before December 10, 2013, unless acquired pursuant to a merger or acquisition.

The September 30, 2016, cash flow analysis for these three securities indicated it is probable the Company will receive all contracted principal and related interest projected. The cash flow analysis used in making this determination was based on anticipated default, recovery, and prepayment rates, and the resulting cash flows were discounted based on the yield anticipated at the time the securities were purchased. Other inputs include the actual collateral attributes, which include credit ratings and other performance indicators of the underlying financial institutions, including profitability, capital ratios, and asset quality. Assumptions for these three securities included annualized prepayments of 1.5 to 1.7 percent; recoveries of 35 percent on currently deferred issuers within the next two years; new deferrals of 47 to 64 basis points annually; and eventual recoveries of six to nine percent of new deferrals.

One of these three securities has continued to receive cash interest payments in full since our purchase; the second of the three securities received principal-in-kind (PIK), in lieu of cash interest, for a period of time following the

recession and financial crisis which began in 2008, but resumed interest payments during fiscal 2014. Our cash flow analysis indicates that interest payments are expected to continue for these two securities. Because the Company does not intend to sell these securities and it is not more-likely-than-not that the Company will be required to sell these securities prior to recovery of their amortized cost basis, which may be maturity, the Company does not consider these investments to be other-than-temporarily impaired at September 30, 2016.

For the last of these three securities, with an estimated fair value of $234,000 and unrealized losses of $239,000, the Company has been receiving PIK in lieu of cash interest since June 2009. Pooled trust preferred securities generally allow, under the terms of the issue, for issuers included in the pool to defer interest for up to five consecutive years. After five years, if not cured, the issuer is considered to be in default and the trustee may demand payment in full of principal and accrued interest. Issuers are also considered to be in default in the event of the failure of the issuer or a subsidiary bank. Both deferred and defaulted issuers are considered non-performing, and the trustee calculates, on a quarterly or semi-annual basis, certain coverage tests prior to the payment of cash interest to owners of the various tranches of the securities. The tests must show that performing collateral is sufficient to meet requirements for senior tranches, both in terms of cash flow and collateral value, before cash interest can be paid to subordinate tranches. If the tests are not met, available cash flow is diverted to pay down the principal balance of senior tranches until the coverage tests are met, before cash interest payments to subordinate tranches may resume. The Company is receiving PIK for this security due to failure of the required coverage tests described above at senior tranche levels

of the security. The risk to holders of a tranche of a security in PIK status is that the pool's total cash flow will not be sufficient to repay all principal and accrued interest related to the investment. The impact of payment of PIK to subordinate tranches is to strengthen the position of senior tranches, by reducing the senior tranches' principal balances relative to available collateral and cash flow, while increasing principal balances, decreasing cash flow, and increasing credit risk to the tranches receiving PIK. For this security in receipt of PIK, the principal balance is increasing, cash flow has stopped, and, as a result, credit risk is increasing. The Company expects this security to remain in PIK status for a period of less than one year. Despite these facts, because the Company does not intend to sell this security and it is not more-likely-than-not that the Company will be required to sell this security prior to recovery of its amortized cost basis, which may be maturity, the Company does not consider this investment to be other-than-temporarily impaired at September 30, 2016.

At December 31, 2008, analysis of a fourth pooled trust preferred security indicated other-than-temporary impairment (OTTI). The loss recognized at that time reduced the amortized cost basis for the security, and as of September 30, 2016, the estimated fair value of the security exceeds the new, lower amortized cost basis.

The Company does not believe any other individual unrealized loss as of September 30, 2016, represents OTTI. However, the Company could be required to recognize OTTI losses in future periods with respect to its available for sale investment securities portfolio. The amount and timing of any additional OTTI will depend on the decline in the underlying cash flows of the securities. Should the impairment of any of these securities become other-than-temporary, the cost basis of the investment will be reduced and the resulting loss recognized in the period the other-than-temporary impairment is identified.

Credit losses recognized on investments. As described above, one of the Company's investments in trust preferred securities experienced fair value deterioration due to credit losses, but is not otherwise other-than-temporarily impaired. During fiscal 2009, the Company adopted ASC 820, formerly FASB Staff Position 157-4, "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly." The following table provides information about the trust preferred security for which only a credit loss was recognized in income and other losses are recorded in other comprehensive income (loss) for the three-month periods ended September 30, 2016 and 2015.

(dollars in thousands)	Accumulated Credit Losses Three-Month Period Ended September 30,	
	2016	2015
Credit losses on debt securities held		
Beginning of period	$352	$365
Additions related to OTTI losses not previously recognized	-	-
Reductions due to sales	-	-
Reductions due to change in intent or likelihood of sale	-	-
Additions related to increases in previously-recognized OTTI losses	-	-