SOUTHERN MISSOURI BANCORP INC
Form 10-Q
February 09, 2017
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 December 31, 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.)

2991 Oak Grove Road 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 February 8, 2017
Common Stock, Par Value $.01	7,450,041 Shares

SOUTHERN MISSOURI BANCORP, INC.
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PART I: Item 1: Condensed Consolidated Financial Statements

SOUTHERN MISSOURI BANCORP, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2016 AND JUNE 30, 2016

(dollars in thousands)	December 31, 2016 (unaudited)	June 30, 2016
Cash and cash equivalents	$30,367	$22,554
Interest-bearing time deposits	498	723
Available for sale securities	132,116	129,224
Stock in FHLB of Des Moines	5,906	6,009
Stock in Federal Reserve Bank of St. Louis	2,350	2,343
Loans receivable, net of allowance for loan losses of $14,992 and $13,791 at December 31, 2016 and June 30, 2016, respectively	1,209,836	1,135,453
Accrued interest receivable	6,791	5,512
Premises and equipment, net	46,371	46,943
Bank owned life insurance – cash surrender value	30,491	30,071
Goodwill	4,556	4,556
Other intangible assets, net	2,922	3,295
Prepaid expenses and other assets	20,145	17,227
Total assets	$1,492,349	$1,403,910
Liabilities and Stockholders' Equity		
Deposits	$1,211,816	$1,120,693
Securities sold under agreements to repurchase	22,542	27,085
Advances from FHLB of Des Moines	107,502	110,216
Accounts payable and other liabilities	4,573	4,477
Accrued interest payable	763	720
Subordinated debt	14,800	14,753
Total liabilities	1,361,996	1,277,944
Common stock, $.01 par value; 12,000,000 and 10,000,000 shares authorized, respectively, 7,450,041 and 7,437,616 shares issued, respectively, at December 31, 2016 and June 30, 2016	75	74
Additional paid-in capital	34,724	34,432
Retained earnings	96,192	89,798
Accumulated other comprehensive income (loss)	(638)	1,662
Total stockholders' equity	130,353	125,966
Total liabilities and stockholders' equity	$1,492,349	$1,403,910

See Notes to Condensed Consolidated Financial Statements

SOUTHERN MISSOURI BANCORP, INC
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
FOR THE THREE- AND SIX- MONTH PERIODS ENDED DECEMBER 31, 2016 AND 2015 (Unaudited)

	Three months ended December 31,		Six months ended December 31,	
	2016	2015	2016	2015
(dollars in thousands except per share data)				
INTEREST INCOME:				
Loans	$14,229	$13,362	$28,479	$26,460
Investment securities	500	496	1,006	992
Mortgage-backed securities	350	368	695	738
Other interest-earning assets	4	9	8	17
Total interest income	15,083	14,235	30,188	28,207
INTEREST EXPENSE:				
Deposits	2,043	1,847	3,975	3,633
Securities sold under agreements to repurchase	25	29	52	58
Advances from FHLB of Des Moines	282	320	700	637
Subordinated debt	160	139	312	274
Total interest expense	2,510	2,335	5,039	4,602
NET INTEREST INCOME	12,573	11,900	25,149	23,605
PROVISION FOR LOAN LOSSES	656	496	1,581	1,114
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	11,917	11,404	23,568	22,491
NONINTEREST INCOME:				
Deposit account charges and related fees	952	901	1,894	1,825
Bank card interchange income	719	632	1,404	1,268
Loan late charges	100	81	185	158
Loan servicing fees	74	40	130	75
Other loan fees	319	178	557	347
Net realized gains on sale of loans	241	153	513	287
Earnings on bank owned life insurance	210	466	421	611
Other income	85	340	171	421
Total noninterest income	2,700	2,791	5,275	4,992
NONINTEREST EXPENSE:				
Compensation and benefits	4,513	4,399	9,300	8,757
Occupancy and equipment, net	1,991	1,676	4,021	3,341
Deposit insurance premiums	146	163	320	323
Legal and professional fees	325	144	528	270
Advertising	242	219	482	473
Postage and office supplies	145	154	277	313
Intangible amortization	228	259	456	569
Bank card network expense	274	230	553	483
Other operating expense	842	922	1,928	1,625
Total noninterest expense	8,706	8,166	17,865	16,154
INCOME BEFORE INCOME TAXES	5,911	6,029	10,978	11,329

INCOME TAXES	1,735	1,820	3,093	3,485
NET INCOME	$4,176	$4,209	$7,885	$7,844
Less: dividend on preferred shares	-	35	-	85
Net income available to common shareholders	$4,176	$4,174	$7,885	$7,759
Basic earnings per common share	$0.56	$0.56	$1.06	$1.05
Diluted earnings per common share	$0.56	$0.56	$1.06	$1.04
Dividends per common share	$0.10	$0.09	$0.20	$0.18

See Notes to Condensed Consolidated Financial Statements

SOUTHERN MISSOURI BANCORP, INC
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
FOR THE THREE- AND SIX- MONTH PERIODS ENDED DECEMBER 31, 2016 AND 2015 (Unaudited)

	Three months ended December 31,		Six months ended December 31,	
	2016	2015	2016	2015
(dollars in thousands)				
Net income	$4,176	$4,209	$7,885	$7,844
Other comprehensive income (loss):				
Unrealized gains (losses) on securities available-for-sale	(3,401)	(343)	(3,631)	47
Unrealized gains (losses) on available-for-sale securities for which a portion of an other-than-temporary impairment has been recognized in income	10	(4)	(20)	(8)
Tax benefit (expense)	1,255	129	1,351	(14)
Total other comprehensive income (loss)	(2,136)	(218)	(2,300)	25
Comprehensive income	$2,040	$3,991	$5,585	$7,869

See Notes to Condensed Consolidated Financial Statements

SOUTHERN MISSOURI BANCORP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE SIX-MONTH PERIODS ENDED DECEMBER 31, 2016 AND 2015 (Unaudited)

	Six months ended December 31,	
(dollars in thousands)	2016	2015
Cash Flows From Operating Activities:		
Net income	$7,885	$7,844
Items not requiring (providing) cash:		
Depreciation	1,507	1,139
(Gain) loss on disposal of fixed assets	(9)	33
Stock option and stock grant expense	232	133
Amortization of intangible assets	456	569
Amortization of purchase accounting adjustments	(577)	(1,450)
Increase in cash surrender value of bank owned life insurance	(420)	(611)
(Gain) loss on sale of foreclosed assets	(5)	70
Provision for loan losses	1,581	1,114
Net amortization of premiums and discounts on securities	526	400
Originations of loans held for sale	(17,999)	(10,781)
Proceeds from sales of loans held for sale	18,193	10,630
Gain on sales of loans held for sale	(513)	(287)
Changes in:		
Accrued interest receivable	(1,279)	(478)
Prepaid expenses and other assets	958	551
Accounts payable and other liabilities	(1,100)	(546)
Deferred income taxes	235	(640)
Accrued interest payable	43	(77)
Net cash provided by operating activities	9,714	7,613
Cash flows from investing activities:		
Net increase in loans	(75,726)	(26,154)
Net change in interest-bearing deposits	225	723
Proceeds from maturities of available for sale securities	13,371	8,271
Net redemptions of Federal Home Loan Bank stock	103	229
Net purchases of Federal Reserve Bank of Saint Louis stock	(7)	-
Purchases of available-for-sale securities	(20,440)	(8,124)
Purchases of premises and equipment	(939)	(6,951)
Investments in state & federal tax credits	(1,661)	(162)
Proceeds from sale of fixed assets	11	-
Proceeds from sale of foreclosed assets	484	1,121
Proceeds from BOLI claim	-	549
Net cash used in investing activities	(84,579)	(30,498)
Cash flows from financing activities:		
Net increase in demand deposits and savings accounts	55,029	60,536
Net increase in certificates of deposits	36,172	1,548
Net decrease in securities sold under agreements to repurchase	(4,543)	(4,266)
Proceeds from Federal Home Loan Bank advances	336,055	247,950
Repayments of Federal Home Loan Bank advances	(338,605)	(253,650)

Exercise of stock options	61	36
Dividends paid on preferred stock	-	(135)
Dividends paid on common stock	(1,491)	(1,336)
Redemption of preferred stock	-	(20,000)
Net cash provided by financing activities	82,678	30,683
Increase in cash and cash equivalents	7,813	7,798
Cash and cash equivalents at beginning of period	22,554	16,775
Cash and cash equivalents at end of period	$30,367	$24,573
Supplemental disclosures of cash flow information:		
Noncash investing and financing activities:		
Conversion of loans to foreclosed real estate	$472	$281
Conversion of foreclosed real estate to loans	54	185
Conversion of loans to repossessed assets	44	141
Cash paid during the period for:		
Interest (net of interest credited)	$1,930	$1,652
Income taxes	2,582	2,500

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- and six- month periods ended December 31, 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 real estate investment trust (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 December 31, 2016, assets of the REIT were approximately $408 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 $1.1 million and $10.5 million at December 31 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 (loss), 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, the Company initially recorded the loans at fair value, which includes estimated future losses expected to be incurred over the life of the loan. 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 December 31, 2016 included gross core deposit intangibles of $5.9 million with $3.3 million accumulated amortization, gross other identifiable intangibles of $3.8 million with accumulated amortization of $3.8 million, and FHLB mortgage servicing rights of $359,000. 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 $456,000 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 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, whether before or after the reorganization date.

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 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) 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 January 2017, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2017-04, Intangibles - Goodwill and Other (Topic 350), Simplifying the Test for Goodwill Impairment. The objective of the Update is to expand the simplification of the subsequent measurement of goodwill to include public business entities and not-for-profit entities. The simplification eliminates Step 2 from the goodwill impairment test, which measures a goodwill impairment loss by comparing the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill. For public companies that are U.S. Securities and Exchange Commission (SEC) filers, the ASU is effective for fiscal years beginning after December 15, 2019, including interim periods, and should be applied on a prospective basis. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. 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 October 2016, the FASB issued ASU 2016-16, Income Taxes (Topic 740). The Update provides guidance to improve the accounting for the income tax consequences of intra-entity transfers of assets other than inventory. Under the new guidance, companies should recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. Intellectual property and property, plant, and equipment, are two common examples of assets included in the scope of this Update. For public companies, the ASU is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. 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 August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230), Classification of Certain Cash Receipts and Cash payments. The Update provides guidance on how certain cash receipts and payments are presented and classified in the statement of cash flows, with the objective of reducing the diversity in practice. The Update addresses eight specific cash flow issues. For public companies, the ASU is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years, and should be applied retrospectively. 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 June 2016, the FASB issued 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:

	December 31, 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)	$6,470	$ 22	$ (36)	$6,456
State and political subdivisions	45,963	819	(580)	46,202
Other securities	6,572	161	(689)	6,044
Mortgage-backed: GSE residential	74,120	110	(816)	73,414
Total investments and mortgage-backed securities	$133,125	$ 1,112	$ (2,121)	$132,116

	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.

	December 31, 2016	
(dollars in thousands)	Amortized Cost	Estimated Fair Value
Within one year	$607	$610
After one year but less than five years	11,530	11,577
After five years but less than ten years	20,986	21,072
After ten years	25,882	25,443
Total investment securities	59,005	58,702
Mortgage-backed securities	74,120	73,414
Total investments and mortgage-backed securities	$133,125	$132,116

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 $112.4 million at December 31, 2016 and $106.7 million at June 30, 2016. The securities pledged consist of marketable securities, including $6.4 million and $5.5 million of

U.S. Government and Federal Agency Obligations, $52.5 million and $52.2 million of Mortgage-Backed Securities,

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$14.1 million and $13.6 million of Collateralized Mortgage Obligations, $38.8 million and $34.8 million of State and Political Subdivisions Obligations, and $600,000 and $600,000 of Other Securities at December 31, 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 December 31 and June 30, 2016:

	December 31, 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)						
U.S. government-sponsored enterprises (GSEs)	$3,460	$ 36	$-	$ -	$3,460	$ 36
Obligations of state and political subdivisions	18,946	580	-	-	18,946	580
Other securities	-	-	1,147	689	1,147	689
Mortgage-backed securities	54,732	806	343	10	55,075	816
Total investments and mortgage-backed securities	$77,138	$ 1,422	$1,490	$ 699	$78,628	$ 2,121

	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 December 31, 2016, there were three pooled trust preferred securities with an estimated fair value of $753,000 and unrealized losses of $681,000 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 December 31, 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 1.3 to 1.7 percent; recoveries of 31 percent on currently deferred issuers within the next two years; new deferrals of 47 to 50 basis points annually; and eventual recoveries of eight 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. The third security received PIK for a period of time following the recession and financial crisis which began in 2008, but resumed interest payments during the second quarter of fiscal 2017. Our cash flow analysis indicates that interest payments are expected to continue for these three securities, and that all contracted principal and interest will be received. 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 December 31, 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 December 31, 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 December 31, 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 (loss) income for the six-month periods ended December 31, 2016 and 2015.

(dollars in thousands)	Accumulated Credit Losses Six-Month Period Ended December 31, 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	-	-
Reductions due to increases in expected cash flows	(4)	(5)
End of period	$348	$360

Note 4: <u>Loans and Allowance for Loan Losses</u>

Classes of loans are summarized as follows:

(dollars in thousands)	December 31, 2016	June 30, 2016
Real Estate Loans:		
Residential	$404,397	$392,974
Construction	61,680	77,369
Commercial	519,429	452,052

Consumer loans	49,562	46,541
Commercial loans	201,645	202,045
	1,236,713	1,170,981
Loans in process	(11,898)	(21,779)
Deferred loan fees, net	13	42
Allowance for loan losses	(14,992)	(13,791)
Total loans	$1,209,836	$1,135,453

The Company's lending activities consist of origination of loans secured by mortgages on one- to four-family residences and commercial and agricultural real estate, construction loans on residential and commercial properties, commercial and agricultural business loans and consumer loans. The Company has also occasionally purchased loan participation interests originated by other lenders and secured by properties generally located in the states of Missouri and Arkansas.

Residential Mortgage Lending. The Company actively originates loans for the acquisition or refinance of one- to four-family residences. This category includes both fixed-rate and adjustable-rate mortgage ("ARM") loans amortizing over periods of up to 30 years, and the properties securing such loans may be owner-occupied or non-owner-

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occupied. Single-family residential loans do not generally exceed 90% of the lower of the appraised value or purchase price of the secured property. Substantially all of the one- to four-family residential mortgage originations in the Company's portfolio are located within the Company's primary lending area.

The Company also originates loans secured by multi-family residential properties that are often located outside the Company's primary lending area but made to borrowers who operate within the primary market area. The majority of the multi-family residential loans that are originated by the Bank are amortized over periods generally up to 25 years, with balloon maturities typically up to ten years. Both fixed and adjustable interest rates are offered and it is typical for the Company to include an interest rate "floor" and "ceiling" in the loan agreement. Generally, multi-family residential loans do not exceed 85% of the lower of the appraised value or purchase price of the secured property.

Commercial Real Estate Lending. The Company actively originates loans secured by commercial real estate including land (improved, unimproved, and farmland), strip shopping centers, retail establishments and other businesses. These properties are typically owned and operated by borrowers headquartered within the Company's primary lending area, however, the property may be located outside our primary lending area.

Most commercial real estate loans originated by the Company generally are based on amortization schedules of up to 25 years with monthly principal and interest payments. Generally, the interest rate received on these loans is fixed for a maturity of up to seven years, with a balloon payment due at maturity. Alternatively, for some loans, the interest rate adjusts at least annually after an initial period up to seven years. The Company typically includes an interest rate "floor" in the loan agreement. Generally, improved commercial real estate loan amounts do not exceed 80% of the lower of the appraised value or the purchase price of the secured property. Agricultural real estate terms offered differ slightly, with amortization schedules of up to 25 years with an 80% loan-to-value ratio, or 30 years with a 75% loan-to-value ratio.

Construction Lending. The Company originates real estate loans secured by property or land that is under construction or development. Construction loans originated by the Company are generally secured by mortgage loans for the construction of owner occupied residential real estate or to finance speculative construction secured by residential real estate, land development, or owner-operated or non-owner occupied commercial real estate. During construction, these loans typically require monthly interest-only payments and have maturities ranging from six to twelve months. Once construction is completed, loans may be converted to permanent status with monthly payments using amortization schedules of up to 30 years on residential and generally up to 20 years on commercial real estate.

While the Company typically utilizes maturity periods ranging from 6 to 12 months to closely monitor the inherent risks associated with construction loans for these loans, weather conditions, change orders, availability of materials and/or labor, and other factors may contribute to the lengthening of a project, thus necessitating the need to renew the construction loan at the balloon maturity. Such extensions are typically executed in incremental three month periods to facilitate project completion. The Company's average term of construction loans is approximately eight months. During construction, loans typically require monthly interest only payments which may allow the Company an opportunity to monitor for early signs of financial difficulty should the borrower fail to make a required monthly payment. Additionally, during the construction phase, the Company typically obtains interim inspections completed by an independent third party. This monitoring further allows the Company opportunity to assess risk. At December 31, 2016, construction loans outstanding included 52 loans, totaling $10.2 million, for which a modification had been agreed to. At June 30, 2016, construction loans outstanding included 42 loans, totaling $10.3 million, for which a modification had been agreed to. All modifications were solely for the purpose of extending the maturity date due to conditions described above. None of these modifications were executed due to financial difficulty on the part of the borrower and, therefore, were not accounted for as TDRs.

Consumer Lending. The Company offers a variety of secured consumer loans, including home equity, direct and indirect automobile loans, second mortgages, mobile home loans and loans secured by deposits. The Company originates substantially all of its consumer loans in its primary lending area. Usually, consumer loans are originated with fixed rates for terms of up to five years, with the exception of home equity lines of credit, which are variable, tied to the prime rate of interest and are for a period of ten years.

Home equity lines of credit (HELOCs) are secured with a deed of trust and are issued up to 100% of the appraised or assessed value of the property securing the line of credit, less the outstanding balance on the first mortgage and are typically issued for a term of ten years. Interest rates on the HELOCs are generally adjustable. Interest rates are based upon the loan-to-value ratio of the property with better rates given to borrowers with more equity.

Automobile loans originated by the Company include both direct loans and a smaller amount of loans originated by auto dealers. The Company generally pays a negotiated fee back to the dealer for indirect loans. Typically, automobile loans are made for terms of up to 60 months for new and used vehicles. Loans secured by automobiles have fixed rates and are generally made in amounts up to 100% of the purchase price of the vehicle.

Commercial Business Lending. The Company's commercial business lending activities encompass loans with a variety of purposes and security, including loans to finance accounts receivable, inventory, equipment and operating lines of credit, including agricultural production and equipment loans. The Company offers both fixed and adjustable rate commercial business loans. Generally, commercial loans secured by fixed assets are amortized over periods up to five years, while commercial operating lines of credit or agricultural production lines are generally for a one year period.

The following tables present the balance in the allowance for loan losses and the recorded investment in loans (excluding loans in process and deferred loan fees) based on portfolio segment and impairment methods as of December 31 and June 30, 2016, and activity in the allowance for loan losses for the three- and six-month periods ended December 31, 2016 and 2015:

	At period end and for the six months ended December 31, 2016					
(dollars in thousands)	Residential Real Estate	Construction Real Estate	Commercial Real Estate	Consumer	Commercial	Total
Allowance for loan losses:						
Balance, beginning of period	$3,247	$ 1,091	$ 5,711	$ 738	$ 3,004	$13,791
Provision charged to expense	316	(170)	1,124	52	259	1,581
Losses charged off	(97)	(31)	-	(39)	(270)	(437)
Recoveries	6	1	16	5	29	57
Balance, end of period	$3,472	$ 891	$ 6,851	$ 756	$ 3,022	$14,992
Ending Balance: individually evaluated for impairment	$-	$ -	$ -	$ -	$ -	$-
Ending Balance: collectively evaluated for impairment	$3,472	$ 891	$ 6,851	$ 756	$ 3,022	$14,992
Ending Balance: loans acquired with deteriorated credit quality	$-	$ -	$ -	$ -	$ -	$-
Loans:						
Ending Balance: individually evaluated for impairment	$-	$ -	$ -	$ -	$ -	$-
Ending Balance: collectively evaluated for impairment	$401,588	$ 48,412	$ 509,705	$ 49,562	$ 200,748	$1,210,015
Ending Balance: loans acquired with deteriorated credit quality	$2,809	$ 1,370	$ 9,724	$ -	$ 897	$14,800

	For the three months ended December 31, 2016					
(dollars in thousands)	Residential	Construction Real Estate	Commercial Real Estate	Consumer	Commercial	Total

	Real Estate					
Allowance for loan losses:						
Balance, beginning of period	$3,153	$ 1,121	$ 6,370	$ 738	$ 3,074	$14,456
Provision charged to expense	316	(200)	465	53	22	656
Losses charged off	-	(31)	-	(35)	(101)	(167)
Recoveries	3	1	16	-	27	47
Balance, end of period	$3,472	$ 891	$ 6,851	$ 756	$ 3,022	$14,992

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(dollars in thousands)	At period end and for the six months ended December 31, 2015 Residential Real Estate	Construction Real Estate	Commercial Real Estate	Consumer	Commercial	Total
Allowance for loan losses:						
Balance, beginning of period	$2,819	$ 899	$ 4,956	$ 758	$ 2,866	$12,298
Provision charged to expense	475	147	324	60	108	1,114
Losses charged off	(90)	-	(77)	(35)	(100)	(302)
Recoveries	3	-	46	3	10	62
Balance, end of period	$3,207	$ 1,046	$ 5,249	$ 786	$ 2,884	$13,172
Ending Balance: individually evaluated for impairment	$-	$ -	$ -	$ -	$ 144	$144
Ending Balance: collectively evaluated for impairment	$3,207	$ 1,046	$ 5,249	$ 786	$ 2,740	$13,028
Ending Balance: loans acquired with deteriorated credit quality	$-	$ -	$ -	$ -	$ -	$-

(dollars in thousands)	For the three months ended December 31, 2015 Residential Real Estate	Construction Real Estate	Commercial Real Estate	Consumer	Commercial	Total
Allowance for loan losses:						
Balance, beginning of period	$3,295	$ 865	$ 5,049	$ 750	$ 2,853	$12,812
Provision charged to expense	(64)	181	210	59	110	496
Losses charged off	(26)	-	(56)	(25)	(88)	(195)
Recoveries	2	-	46	2	9	59
Balance, end of period	$3,207	$ 1,046	$ 5,249	$ 786	$ 2,884	$13,172

(dollars in thousands)	At June 30, 2016 Residential Real Estate	Construction Real Estate	Commercial Real Estate	Consumer	Commercial	Total
Allowance for loan losses:						
Balance, end of period	$3,247	$ 1,091	$ 5,711	$ 738	$ 3,004	$13,791
Ending Balance: individually evaluated for impairment	$-	$ -	$ -	$ -	$ -	$-
Ending Balance: collectively evaluated for impairment	$3,247	$ 1,091	$ 5,711	$ 738	$ 3,004	$13,791
Ending Balance: loans acquired with deteriorated credit quality	$-	$ -	$ -	$ -	$ -	$-
Loans:						
Ending Balance: individually evaluated for impairment	$-	$ -	$ -	$ -	$ -	$-
Ending Balance: collectively evaluated for impairment	$389,978	$ 54,187	$ 442,173	$ 46,541	$ 201,013	$1,133,892
Ending Balance: loans acquired with deteriorated credit quality	$2,996	$ 1,403	$ 9,879	$ -	$ 1,032	$15,310

Management's opinion as to the ultimate collectability of loans is subject to estimates regarding future cash flows from operations and the value of property, real and personal, pledged as collateral. These estimates are affected by changing economic conditions and the economic prospects of borrowers.

The allowance for loan losses is maintained at a level that, in management's judgment, is adequate to cover probable credit losses inherent in the loan portfolio at the balance sheet date. The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when an amount is determined to be uncollectible, based on management's analysis of expected cash flow (for non-collateral-dependent loans) or collateral value (for collateral-dependent loans). Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of allocated and general components. The allocated component relates to loans that are classified as impaired. For those loans that are classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan.

Under the Company's methodology, loans are first segmented into 1) those comprising large groups of smaller-balance homogeneous loans, including single-family mortgages and installment loans, which are collectively evaluated for impairment, and 2) all other loans which are individually evaluated. Those loans in the second category are further segmented utilizing a defined grading system which involves categorizing loans by severity of risk based on conditions that may affect the ability of the borrowers to repay their debt, such as current financial information, collateral valuations, historical payment experience, credit documentation, public information, and current trends. The loans subject to credit classification represent the portion of the portfolio subject to the greatest credit risk and where adjustments to the allowance for losses on loans as a result of provision and charge offs are most likely to have a significant impact on operations.

A periodic review of selected credits (based on loan size and type) is conducted to identify loans with heightened risk or probable losses and to assign risk grades. The primary responsibility for this review rests with loan administration personnel. This review is supplemented with periodic examinations of both selected credits and the credit review process by the Company's internal audit function and applicable regulatory agencies. The information from these reviews assists management in the timely identification of problems and potential problems and provides a basis for deciding whether the credit represents a probable loss or risk that should be recognized.

A loan is considered impaired when, based on current information and events, it is probable that the scheduled payments of principal or interest will not be able to be collected when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis for commercial and agricultural loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price or the fair value of the collateral if the loan is collateral dependent.

Groups of loans with similar risk characteristics are collectively evaluated for impairment based on the group's historical loss experience adjusted for changes in trends, conditions and other relevant factors that affect repayment of the loans. Accordingly, individual consumer and residential loans are not separately identified for impairment measurements, unless such loans are the subject of a restructuring agreement due to financial difficulties of the borrower.

The general component covers non-impaired loans and is based on quantitative and qualitative factors. The loan portfolio is stratified into homogeneous groups of loans that possess similar loss characteristics and an appropriate loss ratio adjusted for qualitative factors is applied to the homogeneous pools of loans to estimate the incurred losses in the loan portfolio.

Included in the Company's loan portfolio are certain loans accounted for in accordance with ASC 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality. These loans were written down at acquisition to an amount estimated to be collectible. As a result, certain ratios regarding the Company's loan portfolio and credit quality cannot be used to compare the Company to peer companies or to compare the Company's current credit quality to prior periods. The ratios particularly affected by accounting under ASC 310-30 include the allowance for loan losses as a percentage of loans, nonaccrual loans, and nonperforming assets, and nonaccrual loans and nonperforming loans as a percentage of total loans.

The following tables present the credit risk profile of the Company's loan portfolio (excluding loans in process and deferred loan fees) based on rating category and payment activity as of December 31, 2016 and June 30, 2016. These tables include purchased credit impaired loans, which are reported according to risk categorization after acquisition based on the Company's standards for such classification:

	December 31, 2016				
(dollars in thousands)	Residential Real Estate	Construction Real Estate	Commercial Real Estate	Consumer	Commercial
Pass	$400,627	$ 49,590	$ 510,861	$ 49,423	$ 200,460
Watch	252	-	3,050	-	-
Special Mention	-	-	-	-	-
Substandard	3,518	192	5,518	139	1,185
Doubtful	-	-	-	-	-
Total	$404,397	$ 49,782	$ 519,429	$ 49,562	$ 201,645

	June 30, 2016				
(dollars in thousands)	Residential Real Estate	Construction Real Estate	Commercial Real Estate	Consumer	Commercial
Pass	$388,733	$ 55,202	$ 443,933	$ 46,341	$ 200,252
Watch	583	-	3,095	24	16
Special Mention	-	-	-	-	-
Substandard	3,658	388	5,024	176	1,777
Doubtful	-	-	-	-	-
Total	$392,974	$ 55,590	$ 452,052	$ 46,541	$ 202,045

The above amounts include purchased credit impaired loans. At December 31, 2016, purchased credited impaired loans comprised $8.9 million of credits rated "Pass"; $3.0 million of credits rated "Watch"; none rated "Special Mention"; $2.9 million of credits rated "Substandard"; and none rated "Doubtful". At June 30, 2016, purchased credit impaired loans accounted for $9.2 million of credits rated "Pass"; $3.0 million of credits rated "Watch"; none rated "Special Mention"; $3.1 million of credits rated "Substandard"; and none rated "Doubtful".

Credit Quality Indicators. The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends among other factors. The Company analyzes loans individually by classifying the loans as to credit risk. This analysis is performed on all loans at origination, and is updated on a quarterly basis for loans risk rated Special Mention, Substandard, or Doubtful. In addition, lending relationships of $1 million or more, exclusive of any consumer or owner-occupied residential loan, are subject to an annual credit analysis which is prepared by the loan administration department and presented to a loan committee with appropriate lending authority. A sample of lending relationships in excess of $2.5 million are subject to an independent loan review annually, in order to verify risk ratings. The Company uses the following definitions for risk ratings:

Watch – Loans classified as watch exhibit weaknesses that require more than usual monitoring. Issues may include deteriorating financial condition, payments made after due date but within 30 days, adverse industry conditions or management problems.

Special Mention – Loans classified as special mention exhibit signs of further deterioration but still generally make payments within 30 days. This is a transitional rating and loans should typically not be rated Special Mention for more than 12 months

Substandard – Loans classified as substandard possess weaknesses that jeopardize the ultimate collection of the principal and interest outstanding. These loans exhibit continued financial losses, ongoing delinquency, overall poor financial condition, and insufficient collateral. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Doubtful – Loans classified as doubtful have all the weaknesses of substandard loans, and have deteriorated to the level that there is a high probability of substantial loss.

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be Pass rated loans.

The following tables present the Company's loan portfolio aging analysis (excluding loans in process and deferred loan fees) as of December 31 and June 30, 2016. These tables include purchased credit impaired loans, which are reported according to aging analysis after acquisition based on the Company's standards for such classification:

	December 31, 2016						
(dollars in thousands)	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total Loans Receivable	Greater Than 90 Days Past Due and Accruing
Real Estate Loans:							
Residential	$2,675	$456	$ 710	$3,841	$400,556	$ 404,397	$ -
Construction	-	-	-	-	49,782	49,782	-
Commercial	1,087	725	100	1,912	517,517	519,429	-
Consumer loans	335	121	4	460	49,102	49,562	3
Commercial loans	120	222	92	434	201,211	201,645	