

GUARANTY FEDERAL BANCSHARES INC  
Form 10-Q  
August 07, 2015  
UNITED STATES

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, DC 20549**

**FORM 10-Q**

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

For the quarterly period ended June 30, 2015

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 0-23325

**Guaranty Federal Bancshares, Inc.**

(Exact name of registrant as specified in its charter)

**Delaware**

**43-1792717**

(State or other jurisdiction of  
incorporation or organization)

(IRS Employer Identification No.)

**1341 West Battlefield**

**Springfield, Missouri**

**65807**

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (417) 520-4333

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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  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 preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  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 definitions of “large accelerated filer”, “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act. Yes  No

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date.

<u>Class</u>	<u>Outstanding as of August 1, 2015</u>
Common Stock, Par Value \$0.10 per share	4,379,935 Shares

**GUARANTY FEDERAL BANCSHARES, INC.**

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**PART I FINANCIAL INFORMATION****Item 1. Financial Statements****GUARANTY FEDERAL BANCSHARES, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS****JUNE 30, 2015 (UNAUDITED) AND DECEMBER 31, 2014**

<b>ASSETS</b>	<b>6/30/15</b>	<b>12/31/14</b>
Cash	\$3,437,429	\$3,604,316
Interest-bearing deposits in other financial institutions	17,979,902	8,889,574
Cash and cash equivalents	21,417,331	12,493,890
Available-for-sale securities	83,408,795	86,467,985
Held-to-maturity securities	51,341	60,993
Stock in Federal Home Loan Bank, at cost	2,837,500	3,156,900
Mortgage loans held for sale	1,618,290	1,214,632
Loans receivable, net of allowance for loan losses of June 30, 2015 - \$6,651,308 - December 31, 2014 - \$6,588,597	504,632,124	486,586,636
Accrued interest receivable:		
Loans	1,751,924	1,704,374
Investments and interest-bearing deposits	333,398	325,684
Prepaid expenses and other assets	4,166,398	4,530,191
Foreclosed assets held for sale	3,215,284	3,165,447
Premises and equipment, net	10,691,085	10,602,763
Bank owned life insurance	14,597,640	14,417,220
Income taxes receivable	290,124	320,416
Deferred income taxes	3,627,076	3,412,513
	<b>\$652,638,310</b>	<b>\$628,459,644</b>

**LIABILITIES AND STOCKHOLDERS' EQUITY****LIABILITIES**

Deposits	\$519,547,082	\$479,818,282
Federal Home Loan Bank and Federal Reserve Bank advances	52,100,000	60,350,000
Securities sold under agreements to repurchase	-	10,000,000
Subordinated debentures	15,465,000	15,465,000
Advances from borrowers for taxes and insurance	385,182	143,984
Accrued expenses and other liabilities	982,485	963,386
Accrued interest payable	195,937	242,145
	<b>588,675,686</b>	<b>566,982,797</b>

**COMMITMENTS AND CONTINGENCIES**

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**STOCKHOLDERS' EQUITY**

Capital Stock:

Series A preferred stock, \$0.01 par value; authorized 2,000,000 shares	-	-
Common stock, \$0.10 par value; authorized 10,000,000 shares; issued June 30, 2015 and December 31, 2014 - 6,844,503 and 6,823,203 shares, respectively	684,450	682,320
Additional paid-in capital	50,272,806	50,366,546
Retained earnings, substantially restricted	50,978,228	48,549,691
Accumulated other comprehensive loss		
Unrealized loss on available-for-sale securities, net of income taxes	(699,744 )	(448,421 )
	101,235,740	99,150,136
Treasury stock, at cost; June 30, 2015 and December 31, 2014 - 2,466,068 and 2,492,552 shares, respectively	(37,273,116 )	(37,673,289 )
	63,962,624	61,476,847
	\$652,638,310	\$628,459,644

See Notes to Condensed Consolidated Financial Statements

**GUARANTY FEDERAL BANCSHARES, INC.****CONDENSED CONSOLIDATED STATEMENTS OF INCOME****THREE MONTHS AND SIX MONTHS ENDED JUNE 30, 2015 AND 2014 (UNAUDITED)**

	Three months ended		Six months ended	
	6/30/2015	6/30/2014	6/30/2015	6/30/2014
		Retrospectively		Retrospectively
		Adjusted -		Adjusted -
		Note 7		Note 7
<b>Interest Income</b>				
Loans	\$5,988,875	\$ 5,576,155	\$11,893,441	\$ 11,443,713
Investment securities	351,481	415,318	704,531	872,884
Other	46,154	46,110	76,175	81,050
	6,386,510	6,037,583	12,674,147	12,397,647
<b>Interest Expense</b>				
Deposits	625,261	562,700	1,220,190	1,169,493
Federal Home Loan Bank and Federal Reserve Bank advances	297,379	298,636	596,185	594,327
Subordinated debentures	133,997	133,035	266,858	266,198
Other	55,739	65,975	120,833	131,225
	1,112,376	1,060,346	2,204,066	2,161,243
<b>Net Interest Income</b>	5,274,134	4,977,237	10,470,081	10,236,404
<b>Provision for Loan Losses</b>	-	325,000	150,000	525,000
<b>Net Interest Income After Provision for Loan Losses</b>	5,274,134	4,652,237	10,320,081	9,711,404
<b>Noninterest Income</b>				
Service charges	315,275	318,434	596,634	631,419
Gain on sale of investment securities	148,516	7,603	155,313	10,691
Gain on sale of mortgage loans held for sale	364,709	250,667	743,775	436,245
Gain on sale of Small Business Administration loans	344,439	-	344,439	-
Net loss on foreclosed assets	(6,663 )	(61,182 )	(17,762 )	(76,965 )
Other income	345,477	346,973	691,063	678,798
	1,511,753	862,495	2,513,462	1,680,188
<b>Noninterest Expense</b>				
Salaries and employee benefits	2,488,220	2,231,963	4,941,312	4,536,731
Occupancy	463,360	419,614	936,587	846,675
FDIC deposit insurance premiums	113,578	120,029	220,338	256,963
Prepayment penalty on securities sold under agreements to repurchase	463,992	-	463,992	-
Data processing	201,342	165,486	393,823	326,272
Advertising	131,250	106,251	262,500	212,502
Other expense	690,038	618,270	1,462,903	1,605,704
	4,551,780	3,661,613	8,681,455	7,784,847
<b>Income Before Income Taxes</b>	2,234,107	1,853,119	4,152,088	3,606,745
<b>Provision for Income Taxes</b>	696,158	514,436	1,284,595	966,636

<b>Net Income</b>	1,537,949	1,338,683	2,867,493	2,640,109
<b>Preferred Stock Dividends and Discount Accretion</b>	-	111,000	-	357,210
<b>Net Income Available to Common Shareholders</b>	\$1,537,949	\$ 1,227,683	\$2,867,493	\$ 2,282,899
<b>Basic Income Per Common Share</b>	\$0.35	\$ 0.29	\$0.66	\$ 0.61
<b>Diluted Income Per Common Share</b>	\$0.35	\$ 0.28	\$0.65	\$ 0.60

See Notes to Condensed Consolidated Financial Statements



**GUARANTY FEDERAL BANCSHARES, INC.****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)****THREE MONTHS AND SIX MONTHS ENDED JUNE 30, 2015 AND 2014 (UNAUDITED)**

	Three months ended		Six months ended	
	6/30/2015	6/30/2014	6/30/2015	6/30/2014
<b>NET INCOME</b>	\$1,537,949	\$1,338,683	\$2,867,493	\$2,640,109
<b>OTHER ITEMS OF COMPREHENSIVE INCOME (LOSS):</b>				
Change in unrealized gain (loss) on investment securities available-for-sale, before income taxes	(1,030,923)	1,248,693	(243,613 )	2,533,631
Less: Reclassification adjustment for realized gains on investment securities included in net income, before income taxes	(148,516 )	(7,603 )	(155,313 )	(10,691 )
Total other items in comprehensive income (loss)	(1,179,439)	1,241,090	(398,926 )	2,522,940
Income tax expense (benefit) related to other items of comprehensive income	(436,393 )	459,203	(147,603 )	933,488
Other comprehensive income (loss)	(743,046 )	781,887	(251,323 )	1,589,452
<b>TOTAL COMPREHENSIVE INCOME</b>	<b>\$794,903</b>	<b>\$2,120,570</b>	<b>\$2,616,170</b>	<b>\$4,229,561</b>

See Notes to Condensed Consolidated Financial Statements

**GUARANTY FEDERAL BANCSHARES, INC.****CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY****SIX MONTHS ENDED JUNE 30, 2015 (UNAUDITED)**

	Common Stock	Additional Paid- In Capital	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Income (loss)	Total
<b>Balance, January 1, 2015</b>	\$682,320	\$50,366,546	\$(37,673,289)	\$48,549,691	\$ (448,421 )	\$61,476,847
Net income	-	-	-	2,867,493	-	2,867,493
Change in unrealized gain (loss) on available-for-sale securities, net of income taxes	-	-	-	-	(251,323 )	(251,323 )
Dividends on common stock (\$0.10 per share)	-	-	-	(438,956 )	-	(438,956 )
Stock award plans	-	(202,914 )	400,173	-	-	197,259
Stock options exercised	2,130	109,174	-	-	-	111,304
<b>Balance, June 30, 2015</b>	\$684,450	\$50,272,806	\$(37,273,116)	\$50,978,228	\$ (699,744 )	\$63,962,624

See Notes to Condensed Consolidated Financial Statements

**GUARANTY FEDERAL BANCSHARES, INC****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****SIX MONTHS ENDED JUNE 30, 2015 AND 2014 (UNAUDITED)**

	<b>6/30/2015</b>	<b>6/30/2014</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$2,867,493	\$2,640,109
Items not requiring (providing) cash:		
Deferred income taxes	(66,960 )	254,961
Depreciation	450,843	382,086
Provision for loan losses	150,000	525,000
Gain on sale of Small Business Administration loans	(344,439 )	-
Gain on sale of mortgage loans held for sale and investment securities	(899,088 )	(446,936 )
Gain (loss) on foreclosed assets held for sale	(8,905 )	25,593
Amortization of deferred income, premiums and discounts	397,669	313,135
Stock award plan expense	197,259	190,490
Origination of loans held for sale	(27,448,305)	(14,709,615)
Proceeds from sale of loans held for sale	27,788,422	14,547,659
Increase in cash surrender value of bank owned life insurance	(180,420 )	(184,969 )
Changes in:		
Accrued interest receivable	(55,264 )	13,403
Prepaid expenses and other assets	363,793	503,666
Accounts payable and accrued expenses	(29,498 )	(103,039 )
Income taxes receivable	30,292	(128,952 )
Net cash provided by operating activities	3,212,892	3,822,591
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Net change in loans	(18,025,610)	9,451,794
Principal payments on held-to-maturity securities	9,652	9,300
Principal payments on available-for-sale securities	4,960,336	4,235,914
Proceeds from calls/maturities of available-for-sale securities	-	3,151,000
Purchase of premises and equipment	(539,165 )	(229,092 )
Purchase of available-for-sale securities	(19,740,808)	(25,995,159)
Proceeds from sale of available-for-sale securities	17,244,115	18,106,890
Redemption of Federal Home Loan Bank stock	319,400	6,200
Proceeds from sale of foreclosed assets held for sale	87,894	403,046
Net cash provided by (used in) investing activities	(15,684,186)	9,139,893
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Cash dividends paid on common stock	(436,567 )	-
Net increase (decrease) in demand deposits, NOW and savings accounts	39,790,239	(4,450,772 )
Net decrease in certificates of deposit	(61,439 )	(1,715,598 )
Net decrease of securities sold under agreements to repurchase	(10,000,000)	-
Proceeds from FHLB advances	-	1,050,000
Repayments of FHLB advances	(8,250,000 )	(3,000,000 )
Stock options exercised	111,304	84,806

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Redemption of preferred stock	-	(12,000,000)
Proceeds from issuance of common stock	-	15,814,312
Advances from borrowers for taxes and insurance	241,198	195,594
Cash dividends paid on preferred stock	-	(413,000 )
Net cash provided by (used in) financing activities	21,394,735	(4,434,658 )
<b>INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>8,923,441</b>	<b>8,527,826</b>
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD</b>	<b>12,493,890</b>	<b>12,303,200</b>
<b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>	<b>\$21,417,331</b>	<b>\$20,831,026</b>

See Notes to Condensed Consolidated Financial Statements

## **NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

### **Note 1: Basis of Presentation**

The accompanying unaudited interim condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 8-03 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting only of normal recurring accruals) considered necessary for a fair presentation have been included.

These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in Guaranty Federal Bancshares, Inc.'s (the "Company") Annual Report on Form 10-K for the year ended December 31, 2014 filed with the Securities and Exchange Commission (the "SEC"). The results of operations for the periods are not necessarily indicative of the results to be expected for the full year. The condensed consolidated balance sheet of the Company as of December 31, 2014, has been derived from the audited consolidated balance sheet of the Company as of that date. Certain information and note disclosures normally included in the Company's annual financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted.

### **Note 2: Principles of Consolidation**

The accompanying condensed consolidated financial statements include the accounts of the Company and its wholly owned subsidiary, Guaranty Bank (the "Bank"). All significant intercompany transactions and balances have been eliminated in consolidation.

### **Note 3: Securities**

The amortized cost and approximate fair values of securities classified as available-for-sale were as follows:

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	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Approximate Fair Value
<b>As of June 30, 2015</b>				
Equity Securities	\$ 102,212	\$ 20,365	\$(12,012 )	\$ 110,565
Debt Securities:				
U. S. government agencies	8,532,812	-	(153,513 )	8,379,299
Municipals	15,919,342	83,883	(184,754 )	15,818,471
Corporates	3,950,889	13,996	(66,135 )	3,898,750
Government sponsored mortgage-backed securities and SBA loan pools	56,014,245	98,797	(911,332 )	55,201,710
	\$84,519,500	\$ 217,041	\$(1,327,746)	\$83,408,795

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Approximate Fair Value
<b>As of December 31, 2014</b>				
Equity Securities	\$102,212	\$ 16,121	\$(13,310 )	\$ 105,023
Debt Securities:				
U. S. government agencies	10,528,055	-	(271,282 )	10,256,773
Municipals	15,474,316	185,747	(70,173 )	15,589,890
Government sponsored mortgage-backed securities and SBA loan pools	61,075,181	235,977	(794,859 )	60,516,299
	\$87,179,764	\$ 437,845	\$(1,149,624)	\$86,467,985

Maturities of available-for-sale debt securities as of June 30, 2015:

	Amortized Cost	Approximate Fair Value
< 1 year	\$285,000	\$285,382
1-5 years	4,727,836	4,702,048
6-10 years	11,415,094	11,267,064
After 10 years	11,975,113	11,842,026
Government sponsored mortgage-backed securities and SBA loans not due on a single maturity date	56,014,245	55,201,710
	\$84,417,288	\$83,298,230

The amortized cost and approximate fair values of securities classified as held to maturity are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Approximate Fair Value
<b>As of June 30, 2015</b>				
Debt Securities:				
Government sponsored mortgage-backed securities	\$ 51,341	\$ 1,379	\$ -	\$ 52,720

Amortized Cost	Gross Unrealized Gains	Gross Unrealized	Approximate Fair Value
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(Losses)

**As of December 31, 2014**

Debt Securities:

Government sponsored mortgage-backed securities	\$ 60,993	\$ 1,626	\$ -	\$ 62,619
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Maturities of held-to-maturity securities as of June 30, 2015:

	Amortized Cost	Approximate Fair Value
Government sponsored mortgage-backed securities not due on a single maturity date	\$ 51,341	\$ 52,720

The book value of securities pledged as collateral, to secure public deposits and for other purposes, amounted to \$60,804,064 and \$53,355,716 as of June 30, 2015 and December 31, 2014, respectively. The approximate fair value of pledged securities amounted to \$59,966,322 and \$52,907,065 as of June 30, 2015 and December 31, 2014, respectively.

Realized gains and losses are recorded as net securities gains. Gains on sales of securities are determined on the specific identification method. Gross gains of \$155,313 and \$10,691 as of June 30, 2015 and June 30, 2014, respectively, were realized from the sale of available-for-sale securities. The tax effect of these net gains was \$57,466 and \$3,956 as of June 30, 2015 and June 30, 2014, respectively.

The Company evaluates all securities quarterly to determine if any unrealized losses are deemed to be other than temporary. Certain investment securities are valued at less than their historical cost. These declines are primarily the result of the rate for these investments yielding less than current market rates, or declines in stock prices of equity securities. Based on evaluation of available evidence, management believes the declines in fair value for these securities are temporary. It is management's intent to hold the debt securities to maturity or until recovery of the unrealized loss. Should the impairment of any of these debt securities become other than temporary, the cost basis of the investment will be reduced and the resulting loss recognized in net income in the period the other-than-temporary impairment is identified, to the extent the loss is related to credit issues, and to other comprehensive income to the extent the decline on debt securities is related to other factors and the Company does not intend to sell the security prior to recovery of the unrealized loss.

Certain other investments in debt and equity securities are reported in the financial statements at an amount less than their historical cost. Total fair value of these investments at June 30, 2015 and December 31, 2014, was \$64,533,448 and \$60,733,191, respectively, which is approximately 77% and 70% of the Company's investment portfolio. These declines primarily resulted from changes in market interest rates and failure of certain investments to meet projected earnings targets.

The following table shows 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 June 30, 2015 and December 31, 2014.

June 30, 2015						
Description of Securities	Less than 12 Months		12 Months or More		Total	Unrealized Losses
	Fair Value	Unrealized	Fair Value	Unrealized	Fair Value	
		Losses		Losses		
Equity Securities	\$-	\$-	\$35,915	\$(12,012 )	\$35,915	\$(12,012 )
U. S. government agencies	2,911,150	(71,662 )	5,468,149	(81,851 )	8,379,299	(153,513 )
Municipals	10,042,716	(152,045 )	702,305	(32,709 )	10,745,021	(184,754 )
Corporates	3,008,750	(66,135 )	-	-	3,008,750	(66,135 )
Government sponsored mortgage-backed securities and SBA loan pools	24,796,548	(341,405 )	17,567,915	(569,927 )	42,364,463	(911,332 )
	\$40,759,164	\$(631,247 )	\$23,774,284	\$(696,499 )	\$64,533,448	\$(1,327,746)

December 31, 2014						
Description of Securities	Less than 12 Months		12 Months or More		Total	Unrealized Losses
	Fair Value	Unrealized	Fair Value	Unrealized	Fair Value	
		Losses		Losses		
Equity Securities	\$-	\$-	\$34,618	\$(13,310 )	\$34,618	\$(13,310 )
U. S. government agencies	-	-	10,256,773	(271,282 )	10,256,773	(271,282 )
Municipals	2,677,626	(7,692 )	5,859,560	(62,481 )	8,537,186	(70,173 )
Government sponsored mortgage-backed securities and SBA loan pools	12,703,301	(70,049 )	29,201,313	(724,810 )	41,904,614	(794,859 )
	\$15,380,927	\$(77,741 )	\$45,352,264	\$(1,071,883 )	\$60,733,191	\$(1,149,624)

**Note 4: Loans and Allowance for Loan Losses**

Categories of loans at June 30, 2015 and December 31, 2014 include:

	June 30, 2015	December 31, 2014
Real estate - residential mortgage:		
One to four family units	\$95,902,509	\$97,900,814
Multi-family	39,993,133	33,785,959
Real estate - construction	35,368,786	36,784,584
Real estate - commercial	228,795,902	215,605,054
Commercial loans	89,707,877	92,114,216
Consumer and other loans	21,822,792	17,246,437
Total loans	511,590,998	493,437,064
Less:		
Allowance for loan losses	(6,651,308 )	(6,588,597 )
Deferred loan fees/costs, net	(307,566 )	(261,831 )
Net loans	\$504,632,124	\$486,586,636

Classes of loans by aging at June 30, 2015 and December 31, 2014 were as follows:

**As of June 30, 2015**

	30-59 Days Past Due	60-89 Days Past Due	90 Days and more Past Due	Total Past Due	Current	Total Loans Receivable	Total Loans > 90 Days and Accruing
<i>(In Thousands)</i>							
Real estate - residential mortgage:							
One to four family units	\$432	\$111	\$397	\$940	\$94,963	\$95,903	\$ -
Multi-family	-	-	-	-	39,993	39,993	-
Real estate - construction	-	-	-	-	35,368	35,368	-
Real estate - commercial	-	-	-	-	228,796	228,796	-
Commercial loans	125	612	220	957	88,751	89,708	-
Consumer and other loans	1	5	29	35	21,788	21,823	-
Total	\$558	\$728	\$646	\$1,932	\$509,659	\$511,591	\$ -

As of December 31, 2014

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans Receivable	Total Loans > 90 Days and Accruing
<i>(In Thousands)</i>							
Real estate - residential mortgage:							
One to four family units	\$ 113	\$ 428	\$ 279	\$ 820	\$ 97,081	\$ 97,901	\$ -
Multi-family	-	-	-	-	33,786	33,786	-
Real estate - construction	-	-	-	-	36,785	36,785	-
Real estate - commercial	-	-	-	-	215,605	215,605	-
Commercial loans	-	-	227	227	91,887	92,114	-
Consumer and other loans	23	35	-	58	17,188	17,246	-
Total	\$ 136	\$ 463	\$ 506	\$ 1,105	\$ 492,332	\$ 493,437	\$ -

Nonaccruing loans are summarized as follows:

	June 30, 2014	December 31, 2014
Real estate - residential mortgage:		
One to four family units	\$745,789	\$911,240
Multi-family	-	-
Real estate - construction	2,683,792	2,892,772
Real estate - commercial	-	459,823
Commercial loans	938,908	1,026,772
Consumer and other loans	29,242	-
Total	\$4,397,731	\$5,290,607

The following tables present the activity in the allowance for loan losses based on portfolio segment for the three and six months ended June 30, 2015 and 2014:

<b>Three months ended</b>	Commercial		One to	Multi-family	Commercial	Consumer	Unallocated	Total
<b>June 30, 2015</b>	Construction	Real Estate	four family			and Other		
<b>Allowance for loan losses:</b>	<i>(In Thousands)</i>							
Balance, beginning of period	\$1,361	\$ 1,986	\$ 884	\$ 133	\$ 1,804	\$ 221	\$ 367	\$6,756
Provision charged to expense	(16 )	(41 )	18	18	87	22	(88 )	\$-
Losses charged off	-	-	(99 )	-	-	(15 )	-	\$(114 )
Recoveries	1	-	2	-	2	4	-	\$9
Balance, end of period	\$1,346	\$ 1,945	\$ 805	\$ 151	\$ 1,893	\$ 232	\$ 279	\$6,651

<b>Six months ended</b>	Commercial		One to	Multi-family	Commercial	Consumer	Unallocated	Total
<b>June 30, 2015</b>	Construction	Real Estate	four family			and Other		
<b>Allowance for loan losses:</b>	<i>(In Thousands)</i>							
Balance, beginning of period	\$1,330	\$ 1,992	\$ 900	\$ 127	\$ 1,954	\$ 185	\$ 101	\$6,589
Provision charged to expense	8	(47 )	(6 )	24	(64 )	57	178	\$150
Losses charged off	-	-	(99 )	-	-	(33 )	-	\$(132 )

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Recoveries	8	-	10	-	3	23	-	\$44
Balance, end of period	\$1,346	\$ 1,945	\$ 805	\$ 151	\$ 1,893	\$ 232	\$ 279	\$6,651

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Three months ended June 30, 2014	Commercial				Consumer		Unallocated	Total
	Construction Real Estate	Real Estate	One to four family	Multi-family	Commercial	and Other		
<b>Allowance for loan losses:</b>								
<i>(In Thousands)</i>								
Balance, beginning of period	\$ 2,008	\$ 2,344	\$ 962	\$ 147	\$ 1,799	\$ 228	\$ 273	\$ 7,761
Provision charged to expense	76	(51 )	65	(1 )	477	32	(273 )	\$ 325
Losses charged off	(207 )	(9 )	(14 )	-	(1,058 )	(49 )	-	\$(1,337)
Recoveries	2	-	1	-	26	10	-	\$ 39
Balance, end of period	\$ 1,879	\$ 2,284	\$ 1,014	\$ 146	\$ 1,244	\$ 221	\$ -	\$ 6,788

Six months ended June 30, 2014	Commercial				Consumer		Unallocated	Total
	Construction Real Estate	Real Estate	One to four family	Multi-family	Commercial	and Other		
<b>Allowance for loan losses:</b>								
<i>(In Thousands)</i>								
Balance, beginning of period	\$ 2,387	\$ 2,059	\$ 997	\$ 209	\$ 1,519	\$ 272	\$ 359	\$ 7,802
Provision charged to expense	(304 )	234	114	(63 )	914	(11 )	(359 )	\$ 525
Losses charged off	(207 )	(9 )	(100 )	-	(1,222 )	(68 )	-	\$(1,606)
Recoveries	3	-	3	-	33	28	-	\$ 67
Balance, end of period	\$ 1,879	\$ 2,284	\$ 1,014	\$ 146	\$ 1,244	\$ 221	\$ -	\$ 6,788

The following tables present the recorded investment in loans based on portfolio segment and impairment method as of June 30, 2015 and December 31, 2014:

As of June 30, 2015	Commercial				Consumer		Unallocated	Total
	Construction Real Estate	Real Estate	One to four family	Multi-family	Commercial	and Other		
<b>Allowance for loan losses:</b>								
<i>(In Thousands)</i>								
Ending balance: individually evaluated for impairment	\$ 375	\$ -	\$ -	\$ -	\$ 313	\$ 21	\$ -	\$ 709
Ending balance: collectively evaluated for impairment	\$ 971	\$ 1,945	\$ 805	\$ 151	\$ 1,580	\$ 211	\$ 279	\$ 5,942
<b>Loans:</b>								

Ending balance: individually evaluated for impairment	\$2,684	\$ -	\$745	\$ -	\$ 939	\$2,279	\$ -	\$6,647
Ending balance: collectively evaluated for impairment	\$32,684	\$228,796	\$95,158	\$39,993	\$88,769	\$19,544	\$ -	\$504,944

<b>December 31, 2014</b>	Commercial Construction Real Estate	Commercial One to four family	Multi-family	Commercial	Consumer and Other	Unallocated	Total	
<b>Allowance for loan losses:</b>	<i>(In Thousands)</i>							
Ending balance: individually evaluated for impairment	\$376	\$158	\$36	\$ -	\$203	\$12	\$ -	\$785
Ending balance: collectively evaluated for impairment	\$954	\$1,834	\$864	\$127	\$1,751	\$173	\$101	\$5,804
<b>Loans:</b>								
Ending balance: individually evaluated for impairment	\$2,893	\$460	\$847	\$ -	\$1,027	\$801	\$ -	\$6,028
Ending balance: collectively evaluated for impairment	\$33,892	\$215,145	\$97,054	\$33,786	\$91,087	\$16,445	\$ -	\$487,409



The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to income. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. 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 collectibility 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. The general component covers nonclassified loans and is based on historical charge-off experience and expected loss given default derived from the Bank's internal risk rating process. Other adjustments may be made to the allowance for pools of loans after an assessment of internal or external influences on credit quality that are not fully reflected in the historical loss or risk rating data.

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest 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 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.

The following table summarizes the recorded investment in impaired loans at June 30, 2015 and December 31, 2014:

	June 30, 2015			December 31, 2014		
	Recorded Unpaid Principal Balance	Specific Allowance	Balance	Recorded Unpaid Principal Balance	Specific Allowance	Balance
<b>Loans without a specific valuation allowance</b>						
Real estate - residential mortgage:						
One to four family units	\$746	\$ 746	\$ -	\$632	\$ 632	\$ -
Multi-family	-	-	-	-	-	-
Real estate - construction	74	74	-	74	74	-
Real estate - commercial	-	-	-	-	-	-
Commercial loans	326	326	-	341	341	-
Consumer and other loans	2,265	2,265	-	-	-	-
<b>Loans with a specific valuation allowance</b>						
Real estate - residential mortgage:						
One to four family units	\$-	\$ -	\$ -	\$279	\$ 279	\$ 36
Multi-family	-	-	-	-	-	-
Real estate - construction	2,610	3,865	375	2,819	4,074	376
Real estate - commercial	-	-	-	460	460	158
Commercial loans	613	916	313	685	988	203
Consumer and other loans	183	183	21	91	91	12
<b>Total</b>						
Real estate - residential mortgage:						
One to four family units	\$746	\$ 746	\$ -	\$911	\$ 911	\$ 36
Multi-family	-	-	-	-	-	-
Real estate - construction	2,684	3,939	375	2,893	4,148	376
Real estate - commercial	-	-	-	460	460	158
Commercial loans	939	1,242	313	1,026	1,329	203
Consumer and other loans	2,448	2,448	21	91	91	12
<b>Total</b>	<b>\$6,817</b>	<b>\$ 8,375</b>	<b>\$ 709</b>	<b>\$5,381</b>	<b>\$ 6,939</b>	<b>\$ 785</b>

The following table summarizes average impaired loans and related interest recognized on impaired loans for the three and six months ended June 30, 2015 and 2014:

	For the Three Months Ended June 30, 2015 Average		For the Three Months Ended June 30, 2014 Average	
	Investment in Impaired Loans ( <i>In Thousands</i> )	Interest Income Recognized	Investment in Impaired Loans	Interest Income Recognized
<b>Loans without a specific valuation allowance</b>				
Real estate - residential mortgage:				
One to four family units	\$749	\$ 1	\$823	\$ -
Multi-family	-	-	-	-
Real estate - construction	74	-	94	-
Real estate - commercial	-	-	264	-
Commercial loans	327	-	3,486	98
Consumer and other loans	16	-	-	-
<b>Loans with a specific valuation allowance</b>				
Real estate - residential mortgage:				
One to four family units	\$361	\$ -	\$325	\$ -
Multi-family	-	-	-	-
Real estate - construction	2,610	-	3,532	-
Real estate - commercial	-	-	574	-
Commercial loans	620	-	699	-
Consumer and other loans	127	-	272	-
<b>Total</b>				
Real estate - residential mortgage:				
One to four family units	\$1,110	\$ 1	\$1,148	\$ -
Multi-family	-	-	-	-
Real estate - construction	2,684	-	3,626	-
Real estate - commercial	-	-	838	-
Commercial loans	947	-	4,185	98
Consumer and other loans	143	-	272	-
<b>Total</b>	<b>\$4,884</b>	<b>\$ 1</b>	<b>\$10,069</b>	<b>\$ 98</b>

	For the Six Months Ended June 30, 2015 Average		For the Six Months Ended June 30, 2014 Average	
	Investment in Impaired Loans (In Thousands)	Interest Income Recognized	Investment in Impaired Loans	Interest Income Recognized
<b>Loans without a specific valuation allowance</b>				
Real estate - residential mortgage:				
One to four family units	\$729	\$ 2	\$752	\$ 1
Multi-family	-	-	-	-
Real estate - construction	74	-	95	-
Real estate - commercial	-	-	408	-
Commercial loans	332	-	3,088	98
Consumer and other loans	13	-	-	-
<b>Loans with a specific valuation allowance</b>				
Real estate - residential mortgage:				
One to four family units	\$456	\$ -	\$329	\$ -
Multi-family	-	-	-	-
Real estate - construction	2,680	-	3,883	-
Real estate - commercial	-	-	412	-
Commercial loans	621	-	1,897	-
Consumer and other loans	139	-	375	-
<b>Total</b>				
Real estate - residential mortgage:				
One to four family units	\$1,185	\$ 2	\$1,081	\$ 1
Multi-family	-	-	-	-
Real estate - construction	2,754	-	3,978	-
Real estate - commercial	-	-	820	-
Commercial loans	953	-	4,985	98
Consumer and other loans	152	-	375	-
<b>Total</b>	<b>\$5,044</b>	<b>\$ 2</b>	<b>\$11,239</b>	<b>\$ 99</b>

At June 30, 2015, the Bank's impaired loans shown in the table above included loans that were classified as troubled debt restructurings ("TDR"). The restructuring of a loan is considered a TDR if both (i) the borrower is experiencing financial difficulties and (ii) the creditor has granted a concession.

In assessing whether or not a borrower is experiencing financial difficulties, the Bank considers information currently available regarding the financial condition of the borrower. This information includes, but is not limited to, whether (i) the debtor is currently in payment default on any of its debt; (ii) a payment default is probable in the foreseeable future

without the modification; (iii) the debtor has declared or is in the process of declaring bankruptcy and (iv) the debtor's projected cash flow is sufficient to satisfy the contractual payments due under the original terms of the loan without a modification.

The Bank considers all aspects of the modification to loan terms to determine whether or not a concession has been granted to the borrower. Key factors considered by the Bank include the debtor's ability to access funds at a market rate for debt with similar risk characteristics, the significance of the modification relative to unpaid principal balance or collateral value of the debt, and the significance of a delay in the timing of payments relative to the original contractual terms of the loan. The most common concessions granted by the Bank generally include one or more modifications to the terms of the debt, such as (i) a reduction in the interest rate for the remaining life of the debt, (ii) an extension of the maturity date at an interest rate lower than the current market rate for new debt with similar risk, (iii) a reduction on the face amount or maturity amount of the debt as stated in the original loan, (iv) a temporary period of interest-only payments, (v) a reduction in accrued interest, and (vi) an extension of amortization.

The following table presents the carrying balance of TDRs as of June 30, 2015 and December 31, 2014:

	June 30, 2015	December 31, 2014
Real estate - residential mortgage:		
One to four family units	\$220,087	\$505,047
Multi-family	-	-
Real estate - construction	2,683,792	2,892,772
Real estate - commercial	-	459,823
Commercial loans	719,108	799,572
Consumer and other loans	-	-
Total	\$3,622,987	\$4,657,214

The bank did not have any new TDRs for the six months ending June 30, 2015. The Bank has allocated \$687,284 and \$773,652 of specific reserves to customers whose loan terms have been modified in TDR as of June 30, 2015 and December 31, 2014, respectively.

There were no TDRs for which there was a payment default within twelve months following the modification during the six months ending June 30, 2015 and 2014. A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms.

As part of the on-going monitoring of the credit quality of the Bank's loan portfolio, management tracks loans by an internal rating system. All loans are assigned an internal credit quality rating based on an analysis of the borrower's financial condition. The criteria used to assign quality ratings to extensions of credit that exhibit potential problems or well-defined weaknesses are primarily based upon the degree of risk and the likelihood of orderly repayment, and their effect on the Bank's safety and soundness. The following are the internally assigned ratings:

**Pass:** This rating represents loans that have strong asset quality and liquidity along with a multi-year track record of profitability.

**Special mention:** This rating represents loans that are currently protected but are potentially weak. The credit risk may be relatively minor, yet constitute an increased risk in light of the circumstances surrounding a specific loan.

Substandard: This rating represents loans that show signs of continuing negative financial trends and unprofitability and therefore, is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any.

Doubtful: This rating represents loans that have all the weaknesses of substandard classified loans with the additional characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable.

Risk characteristics applicable to each segment of the loan portfolio are described as follows.

Real estate-Residential 1-4 family: The residential 1-4 family real estate loans are generally secured by owner-occupied 1-4 family residences. Repayment of these loans is primarily dependent on the personal income and credit rating of the borrowers. Credit risk in these loans can be impacted by economic conditions within the Bank's market areas that might impact either property values or a borrower's personal income. Risk is mitigated by the fact that the loans are of smaller individual amounts and spread over a large number of borrowers.

Real estate-Construction: Construction and land development real estate loans are usually based upon estimates of costs and estimated value of the completed project and include independent appraisal reviews and a financial analysis of the developers and property owners. Sources of repayment of these loans may include permanent loans, sales of developed property or an interim loan commitment from the Bank until permanent financing is obtained. These loans are considered to be higher risk than other real estate loans due to their ultimate repayment being sensitive to interest rate changes, general economic conditions and the availability of long-term financing. Credit risk in these loans may be impacted by the creditworthiness of a borrower, property values and the local economies in the Bank's market areas.

Real estate-Commercial: Commercial real estate loans typically involve larger principal amounts, and repayment of these loans is generally dependent on the successful operations of the property securing the loan or the business conducted on the property securing the loan. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Credit risk in these loans may be impacted by the creditworthiness of a borrower, property values and the local economies in the Bank's market areas.

Commercial: The commercial portfolio includes loans to commercial customers for use in financing working capital needs, equipment purchases and expansions. The loans in this category are repaid primarily from the cash flow of a borrower's principal business operation. Credit risk in these loans is driven by creditworthiness of a borrower and the economic conditions that impact the cash flow stability from business operations.

Consumer: The consumer loan portfolio consists of various term and line of credit loans such as automobile loans and loans for other personal purposes. Repayment for these types of loans will come from a borrower's income sources that are typically independent of the loan purpose. Credit risk is driven by consumer economic factors (such as unemployment and general economic conditions in the Bank's market area) and the creditworthiness of a borrower.

The following tables provide information about the credit quality of the loan portfolio using the Bank's internal rating system as of June 30, 2015 and December 31, 2014:

<b>June 30, 2015</b>	Commercial Construction Real Estate	One to four family	Multi-family	Commercial	Consumer and Other	Total
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*(In Thousands)*

## Rating:

Pass	\$25,735	\$ 218,931	\$88,399	\$ 39,414	\$ 79,300	\$ 21,491	\$473,270
Special Mention	6,949	3,900	5,225	579	3,595	-	20,248
Substandard	2,684	5,965	2,279	-	6,209	332	17,469
Doubtful	-	-	-	-	604	-	604
Total	\$35,368	\$ 228,796	\$95,903	\$ 39,993	\$ 89,708	\$ 21,823	\$511,591

<b>December 31, 2014</b>	Commercial Construction Real Estate <i>(In Thousands)</i>	One to four family	Multi-family	Commercial	Consumer and Other	Total	
Rating:							
Pass	\$27,370	\$ 207,311	\$94,129	\$ 33,786	\$ 78,197	\$ 17,015	\$457,808
Special Mention	6,522	5,076	2,501	-	10,273	-	24,372
Substandard	2,893	2,758	1,271	-	3,644	231	10,797
Doubtful	-	460	-	-	-	-	460
Total	\$36,785	\$ 215,605	\$97,901	\$ 33,786	\$ 92,114	\$ 17,246	\$493,437

For loans amortized at cost, interest income is accrued based on the unpaid principal balance. Loan origination fees net of certain direct origination costs, are deferred and amortized as a level yield adjustment over the respective term of the loan.

The accrual of interest on loans is discontinued at the time the loan is 90 days past due unless the loan is well-secured and in process of collection. Past due status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not collected for loans that are placed on nonaccrual or charged off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

#### **Note 5: Benefit Plans**

The Company has stock-based employee compensation plans, which are described in the Company's December 31, 2014 Annual Report on Form 10-K.

The following tables below summarize transactions under the Company's equity plans for six months ended June 30, 2015:

#### **Stock Options**

	Number of shares		Weighted Average
	Incentive Stock Option	Non-Incentive Stock Option	
			Exercise Price
Balance outstanding as of January 1, 2015	140,300	82,500	\$ 18.23
Granted	-	-	-
Exercised	(1,300 )	(20,000 )	5.23
Forfeited	(18,000 )	-	23.33
Balance outstanding as of June 30, 2015	121,000	62,500	19.24
Options exercisable as of June 30, 2015	121,000	62,500	19.24

**Restricted Stock**

	Number of Shares	Weighted Average Grant-Date Fair Value
Balance of shares non-vested as of January 1, 2015	30,503	\$ 10.26
Granted	28,451	14.78
Vested	(15,083)	11.64
Forfeited	-	-
Balance of shares non-vested as of June 30, 2015	43,871	12.72

The total intrinsic value of stock options exercised for the six months ended June 30, 2015 and 2014 was \$201,406 and \$116,226, respectively. The total intrinsic value of outstanding stock options was \$670,810 and \$833,326 at June 30, 2015 and 2014. The total intrinsic value of outstanding exercisable stock options was \$670,810 and \$713,282 at June 30, 2015 and 2014. The total fair value of share awards vested was \$138,368 and \$258,750 during the six months ended June 30, 2015 and 2014, respectively.

In February 2015 and 2014, the Company granted restricted stock to directors pursuant to the 2010 Equity Plan that was fully vested and thus, expensed in full on the date of the grants. The amount expensed was \$122,476 and \$122,538 for 2015 and 2014, respectively, which represents 8,281 shares of common stock at a market price of \$14.79 at the date of grant in 2015 and 11,242 shares of common stock at a market price of \$10.90 at the date of grant in 2014. In June 2015, the Company granted 966 shares of restricted stock to directors that have a cliff vesting at the end of three years. The expense is being recognized over the applicable vesting period. The amount expensed for the six months ended June 30, 2015 was \$77.

For the six months ended June 30, 2015 and 2014, the Company granted 19,204 and 23,320 shares of restricted stock to officers that have a cliff vesting at the end of three years. The expense is being recognized over the applicable vesting period. The total amount of expense for restricted stock grants during the six months ended June 30, 2015 and 2014 was \$85,943 and \$51,322, respectively.

Stock-based compensation expense, consisting of stock options and restricted stock awards, recognized for the three months ended June 30, 2015 and 2014 was \$43,580 and \$30,918, respectively. Stock-based compensation expense

recognized for the six months ended June 30, 2015 and 2014 was \$208,730 and \$190,490 respectively. As of June 30, 2015, there was \$402,816 of unrecognized compensation expense related to nonvested restricted stock awards, which will be recognized over the remaining vesting period.

**Note 6: Income Per Common Share**

	For three months ended June 30, 2015			For six months ended June 30, 2015		
	Income Available to Common Shareholders	Average Common Shares Outstanding	Per Common Share	Income Available to Common Shareholders	Average Common Shares Outstanding	Per Common Share
Basic Income Per Common Share	\$ 1,537,949	4,334,288	\$ 0.35	\$ 2,867,493	4,324,811	\$ 0.66
Effect of Dilutive Securities		54,038			56,405	
Diluted Income Per Common Share	\$ 1,537,949	4,388,326	\$ 0.35	\$ 2,867,493	4,381,216	\$ 0.65

	For three months ended June 30, 2014			For six months ended June 30, 2014		
	Income Available to Common Shareholders	Average Common Shares Outstanding	Per Common Share	Income Available to Common Shareholders	Average Common Shares Outstanding	Per Common Share
Basic Income Per Common Share	\$ 1,227,683	4,265,050	\$ 0.29	\$ 2,282,899	3,718,791	\$ 0.61
Effect of Dilutive Securities		72,430			72,988	
Diluted Income Per Common Share	\$ 1,227,683	4,337,480	\$ 0.28	\$ 2,282,899	3,791,779	\$ 0.60

Stock options to purchase 108,500 of common stock were outstanding during the three and six months ended June 30, 2015 and stock options to purchase 136,500 shares of common stock were outstanding during the three and six months ended June 30, 2014 but were not included in the computation of diluted income per common share because their exercise prices were greater than the average market price of the common shares.

**Note 7: New Accounting Pronouncements**

In February 2015, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2015-02, Consolidation (Topic 810): *Amendments to the Consolidation Analysis* (“ASU 2015-02”). ASU 2015-02 amends the consolidation requirements and significantly changes the consolidation analysis required under GAAP. The amendments are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015 for the public business entities with early adoption permitted (including during an interim period), provided that the guidance is applied as of the beginning of the annual period containing the adoption date. The Company does not expect the adoption of ASU 2015-02 to have a material impact on its financial position, results of operations or cash flows.

In January 2015, the Company adopted FASB ASU No. 2014-01, which amends FASB ASC Topic 323, *Investments – Equity Method and Joint Ventures*. The ASU impacts the Company’s accounting for investments in flow-through limited liability entities that manage or invest in affordable housing projects that qualify for the low-income housing tax credit. The amendments in the update permit reporting entities to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. Under the proportional amortization method, an entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognizes the net investment performance in the income statement as a component of income tax expense. The Company does have significant investments in such qualified affordable housing projects that meet the conditions for utilizing the proportional amortization method. As a result of the Company’s adoption of this ASU, the investment amortization expense of \$221,370 and \$442,740, respectively, for the three and six months ended June 30, 2014 which was included in Other Non-interest Expense in the Condensed Consolidated Statements of Income, is now included in Provision for Income Taxes in the Condensed Consolidated Statements of Income.

In June 2014, the FASB issued ASU No. 2014-11 “*Transfers and Servicing (Topic 860)-Repurchase to Maturity Transactions, Repurchase Financings, and Disclosures.*” ASU 2014-11 aligns the accounting for repurchase to maturity transactions and repurchase agreements executed as a repurchase financing with the accounting for other typical repurchase agreements. Going forward, these transactions would all be accounted for as secured borrowings. ASU 2014-11 is effective for the first interim or annual period beginning after December 15, 2014. In addition, the disclosure of certain transactions accounted for as a sale is effective for the first interim or annual period beginning on or after December 15, 2014 and the disclosure for transactions accounted for as secured borrowings is required for annual periods beginning after December 15, 2014, and interim periods beginning March 15, 2015. Early adoption is prohibited. The Company adopted ASU 2014-11 on January 1, 2015 and it did not have an impact on its accounting and disclosures.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606): *Revenue from Contracts with Customers* (“ASU 2014-09”). The scope of the guidance applies to revenue arising from contracts with customers, except for the following: lease contracts, insurance contracts, contractual rights and obligations within the scope of other guidance and nonmonetary exchanges between entities in the same line of business to facilitate sales to customers. The core principal of the new guidance is that an entity should recognize revenue to reflect the transfer of goods and services to customers in an amount equal to the consideration that the entity receives or expects to receive. ASU 2014-09 is not expected to impact the timing or approach to revenue recognition for financial institutions. The likely impact for financial institutions will relate only to disclosures. Initially, the amendments were effective for public entities for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. However, in July 2015, the FASB voted to defer the effective date of ASU 2014-09 by one year making the amendments effective for public entities for annual reporting periods beginning after December 15, 2017, including interim periods within those reporting periods. Companies have the option to apply ASU 2014-09 as of the original effective date. The Company does not expect the adoption of ASU 2014-09 to have a material impact on its financial position, results of operation or cash flows.

In January 2014, the FASB issued ASU No. 2014-04 to amend FASB ASC Topic 310, *Receivables – Troubled Debt Restructurings by Creditors*. The objective of the amendments in this update is to reduce diversity by clarifying when an in substance repossession or foreclosure occurs, that is, when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan receivable should be derecognized and the real estate property recognized. The amendments in this update clarify that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The update was effective for the Company beginning January 1, 2015, and did not have a material impact on the Company’s financial position or results of operations.



**Note 8: Disclosures about Fair Value of Assets and Liabilities**

ASC Topic 820, *Fair Value Measurements*, defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Topic 820 also specifies a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

**Level 1:** Quoted prices in active markets for identical assets or liabilities

**Level 2:** Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities

**Level 3:** Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities

The following is a description of the inputs and valuation methodologies used for assets measured at fair value on a recurring basis and recognized in the accompanying condensed consolidated balance sheets, as well as the general classification of such assets pursuant to the valuation hierarchy.

*Available-for-sale securities:* Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities include equity securities. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics or discounted cash flows. For these investments, the inputs used by the pricing service to determine fair value may include one or a combination of observable inputs such as benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bid offers and reference data market research publications and are classified within Level 2 of the valuation hierarchy. Level 2 securities include U.S. government agencies and government sponsored mortgage-backed securities. The Company has no Level 3 securities.

The following table presents the fair value measurements of assets recognized in the accompanying condensed consolidated balance sheets measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall at June 30, 2015 and December 31, 2014 (dollar amounts in thousands):

### **June 30, 2015**

Financial assets:

	Level 1 inputs	Level 2 inputs	Level 3 inputs	Total fair value
Equity securities	\$ 111	\$-	\$ -	\$ 111
Debt securities:				
U.S. government agencies	-	8,379	-	8,379
Municipals	-	15,818	-	15,818
Corporates				
Government sponsored mortgage-backed securities and SBA loan pools	-	3,899	-	3,899
Available-for-sale securities	\$ 111	\$83,298	\$ -	\$83,409

### **December 31, 2014**

Financial assets:

	Level 1 inputs	Level 2 inputs	Level 3 inputs	Total fair value
Equity securities	\$ 105	\$-	\$ -	\$ 105
Debt securities:				
U.S. government agencies	-	10,257	-	10,257
Municipals	-	15,590	-	15,590
Government sponsored mortgage-backed securities and SBA loan pools	-	60,516	-	60,516

Available-for-sale securities	\$ 105	\$ 86,363	\$ -	\$ 86,468
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The following is a description of the valuation methodologies used for assets measured at fair value on a nonrecurring basis and recognized in the accompanying balance sheets, as well as the general classification of such assets pursuant to the valuation hierarchy.

*Foreclosed Assets Held for Sale:* Fair value is estimated using recent appraisals, comparable sales and other estimates of value obtained principally from independent sources, adjusted for selling costs. Foreclosed assets held for sale are classified within Level 3 of the valuation hierarchy.

*Impaired loans (Collateral Dependent):* Loans for which it is probable that the Company will not collect all principal and interest due according to contractual terms are measured for impairment. Allowable methods for determining the amount of impairment include estimating fair value using the fair value of the collateral for collateral dependent loans.

If the impaired loan is identified as collateral dependent, then the fair value method of measuring the amount of impairment is utilized. This method requires obtaining a current independent appraisal of the collateral and applying a discount factor to the value. Impaired loans that are collateral dependent are classified within Level 3 of the fair value hierarchy when impairment is determined using the fair value method.

The following table presents the fair value measurement of assets measured at fair value on a nonrecurring basis and the level within the fair value hierarchy in which the fair value measurements fall at June 30, 2015 and December 31, 2014 (dollar amounts in thousands):

Impaired loans:

	Level 1 inputs	Level 2 inputs	Level 3 inputs	Total fair value
June 30, 2015	\$ -	\$ -	\$3,719	\$3,719
December 31, 2014	\$ -	\$ -	\$4,076	\$4,076

Foreclosed assets held for sale:

	Level 1 inputs	Level 2 inputs	Level 3 inputs	Total fair value
June 30, 2015	\$ -	\$ -	\$ 190	\$ 190
December 31, 2014	\$ -	\$ -	\$ 354	\$ 354

There were no transfers between valuation levels for any asset during the six months ended June 30, 2015 or 2014. If valuation techniques are deemed necessary, the Company considers those transfers to occur at the end of the period when the assets are valued.

The following table presents quantitative information about unobservable inputs used in recurring and nonrecurring Level 3 fair value measurement (dollar amounts in thousands):

	Fair Value	Valuation Technique	Unobservable Input	Range
	June 30, 2015			(Weighted Average)
Impaired loans (collateral dependent)	\$3,403	Market Comparable	Discount to reflect realizable value	0%-14% (10%)
Impaired loans	\$316	Discounted cash flow	Discount rate	0%-51% (50%)
Foreclosed assets held for sale	\$190	Market Comparable	Discount to reflect realizable value	0%

The following methods were used to estimate the fair value of all other financial instruments recognized in the accompanying condensed consolidated balance sheets at amounts other than fair value.

Cash and cash equivalents, interest-bearing deposits and Federal Home Loan Bank stock

The carrying amounts reported in the condensed consolidated balance sheets approximate those assets' fair value.

Held-to-maturity securities

Fair value is based on quoted market prices, if available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities.

Loans

The fair value of loans is estimated by discounting the future cash flows using the market rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. Loans with similar characteristics were aggregated for purposes of the calculations. The carrying amount of accrued interest approximates its fair value.

Deposits

Deposits include demand deposits, savings accounts, NOW accounts and certain money market deposits. The carrying amount approximates fair value. The fair value of fixed-maturity certificates of deposit is estimated by discounting the future cash flows using rates currently offered for deposits of similar remaining maturities.

Federal Home Loan Bank advances and securities sold under agreements to repurchase

The fair value of advances and securities sold under agreements to repurchase is estimated by using rates on debt with similar terms and remaining maturities.

Subordinated debentures

For these variable rate instruments, the carrying amount is a reasonable estimate of fair value. There is currently a limited market for similar debt instruments and the Company has the option to call the subordinated debentures at an amount close to its par value.

Interest payable

The carrying amount approximates fair value.

Commitments to originate loans, letters of credit and lines of credit

The fair value of commitments to originate loans is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present credit worthiness of the counterparties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates. The fair value of letters of credit and lines of credit are based on fees currently charged for similar agreements or on the estimated cost to terminate them or otherwise settle the obligations with the counterparties at the reporting date.

The following tables present estimated fair values of the Company's financial instruments at June 30, 2015 and December 31, 2014.

	June 30, 2015		Hierarchy Level
	Carrying	Fair Value	
	Amount		
Financial assets:			
Cash and cash equivalents	\$21,417,331	\$21,417,331	1
Held-to-maturity securities	51,341	52,720	2
Federal Home Loan Bank stock	2,837,500	2,837,500	2
Mortgage loans held for sale	1,618,290	1,618,290	2
Loans, net	504,632,124	504,621,172	3
Interest receivable	2,085,322	2,085,322	2
Financial liabilities:			
Deposits	519,547,082	516,151,059	2
Federal Home Loan Bank advances	52,100,000	53,565,166	2
Subordinated debentures	15,465,000	15,465,000	3
Interest payable	195,937	195,937	2
Unrecognized financial instruments (net of contractual value):			
Commitments to extend credit	-	-	-
Unused lines of credit	-	-	-

	December 31, 2014		Hierarchy Level
	Carrying	Fair Value	
	Amount		
Financial assets:			
Cash and cash equivalents	\$12,493,890	\$12,493,890	1
Held-to-maturity securities	60,993	62,619	2
Federal Home Loan Bank stock	3,156,900	3,156,900	2
Mortgage loans held for sale	1,214,632	1,214,632	2
Loans, net	486,586,636	487,244,753	3
Interest receivable	2,030,058	2,030,058	2
Financial liabilities:			
Deposits	479,818,282	476,519,750	2
Federal Home Loan Bank advances	60,350,000	61,615,252	2
Securities sold under agreements to repurchase	10,000,000	10,371,866	2
Subordinated debentures	15,465,000	15,465,000	3
Interest payable	242,145	242,145	2
Unrecognized financial instruments (net of contractual value):			



Commitments to extend credit	-	-	-
Unused lines of credit	-	-	-

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

### **General**

The primary function of the Company is to monitor and oversee its investment in the Bank. The Company engages in few other activities, and the Company has no significant assets other than its investment in the Bank. As a result, the results of operations of the Company are derived primarily from operations of the Bank. The Bank's results of operations are primarily dependent on net interest margin, which is the difference between interest income on interest-earning assets and interest expense on interest-bearing liabilities. The Bank's income is also affected by the level of its noninterest expenses, such as employee salaries and benefits, occupancy expenses and other expenses. The following discussion reviews material changes in the Company's financial condition as of June 30, 2015, and the results of operations for the three and six months ended June 30, 2015 and 2014.

The discussion set forth below, as well as other portions of this Form 10-Q, may contain forward-looking comments. Such comments are based upon the information currently available to management of the Company and management's perception thereof as of the date of this Form 10-Q. When used in this Form 10-Q, words such as "anticipates," "estimates," "believes," "expects," and similar expressions are intended to identify forward-looking statements but are not the exclusive means of identifying such statements. Such statements are subject to risks and uncertainties. Actual results of the Company's operations could materially differ from those forward-looking comments. The differences could be caused by a number of factors or combination of factors including, but not limited to: changes in demand for banking services; changes in portfolio composition; changes in management strategy; increased competition from both bank and non-bank companies; changes in the general level of interest rates; changes in general or local economic conditions; changes in federal or state regulations and legislation governing the operations of the Company or the Bank; and other factors set forth in reports and other documents filed by the Company with the SEC from time to time, including the risk factors described under Item 1A. of the Company's Form 10-K for the fiscal year ended December 31, 2014.

### **Financial Condition**

The Company's total assets increased \$24,178,666 (4%) from \$628,459,644 as of December 31, 2014, to \$652,638,310 as of June 30, 2015.

Cash and cash equivalents increased \$8,923,441 (71%) from \$12,493,890 as of December 31, 2014, to \$21,417,331 as of June 30, 2015. This was primarily due to the increase of \$39,728,800 in deposits as further described below offset by an increase in net loans receivable of \$18,045,488 and paydowns of FHLB and Federal Reserve advances and repurchase agreement of \$18,250,000.

Available-for-sale securities decreased \$3,059,190 (4%) from \$86,467,985 as of December 31, 2014, to \$83,408,795 as of June 30, 2015. The Company had purchases of \$19,740,808 offset by sales, maturities and principal payments received of \$22,204,451. The bank had unrealized losses of \$1,110,705 at June 30, 2015 compared to \$711,779 at December 31, 2014.

Net loans receivable increased by \$18,045,488 (4%) from \$486,586,636 as of December 31, 2014, to \$504,632,124 as of June 30, 2015. During the six month period, commercial real estate loans increased \$13,190,848 (6%) and construction loans decreased \$1,415,798 (4%). These changes were primarily due to two larger credits classified as construction being completed and transferred to the commercial real estate category along with two larger new commercial real estate loans. Permanent multi-family loans increased \$6,207,174 (18%) due to nine new credits and two credits increasing existing balances. Loans secured by owner occupied one to four unit residential real estate decreased \$1,998,305 (2%) due to various expected payoffs and principal reductions. Also, commercial loans decreased \$2,406,339 (3%) and installment loans increased \$4,576,355 (27%) primarily due to two larger credits previously classified as commercial being transferred to installment due to collateral changing. The Company continues to focus its lending efforts in the commercial and owner occupied real estate loan categories, and to reduce its concentrations in non-owner occupied commercial real estate.

Allowance for loan losses increased \$62,711 (1%) from \$6,588,597 as of December 31, 2014 to \$6,651,308 as of June 30, 2015. In addition to the provision for loan losses of \$150,000 recorded by the Company for the six months ended June 30, 2015, loan charge-offs of specific loans (classified as nonperforming at December 31, 2014) exceeded recoveries by \$87,289. The increase in the allowance is primarily due to the increase in loan balances. The allowance for loan losses, as a percentage of gross loans outstanding (excluding mortgage loans held for sale), as of June 30, 2015 and December 31, 2014 was 1.30% and 1.33%, respectively. The allowance for loan losses, as a percentage of nonperforming loans outstanding, as of June 30, 2015 and December 31, 2014 was 151.2% and 124.5%, respectively. Management believes the allowance for loan losses is at a level to be sufficient in providing for potential loan losses in the Bank's existing loan portfolio.

Deposits increased \$39,728,800 (8%) from \$479,818,282 as of December 31, 2014, to \$519,547,082 as of June 30, 2015. For the six months ended June 30, 2015, checking and savings accounts increased by \$39,790,239 and certificates of deposit decreased by \$61,439. The increase in checking and savings accounts was due to the Bank's continued efforts to increase core transaction deposits, including retail, commercial and public funds. See also the discussion under "Quantitative and Qualitative Disclosure about Market Risk – Asset/Liability Management."

Federal Home Loan Bank and Federal Reserve Bank advances decreased \$8,250,000 (14%) from \$60,350,000 as of December 31, 2014, to \$52,100,000 as of June 30, 2015 due to principal reductions.

Securities sold under agreements to repurchase decreased \$10,000,000 (100%) as of June 30, 2015. The Company executed a structured transaction during the quarter selling approximately \$4,000,000 of Small Business Administration ("SBA") guaranteed loans and approximately \$5,800,000 of investment securities for a combined gain of \$488,000. With those proceeds, the Company prepaid a \$10,000,000 repurchase agreement (bearing annual interest of 2.61%) incurring a prepayment penalty of \$464,000. This prepayment has allowed the Company to significantly reduce higher cost, non-core funding liabilities on its balance sheet and eliminate future annual interest expense of \$261,000. This transaction will improve the Company's cost of funds as well enhance other liquidity and capital performance measurements.

Stockholders' equity (including unrealized loss on available-for-sale securities, net of tax) increased \$2,485,777 (4%) from \$61,476,847 as of December 31, 2014, to \$63,962,624 as of June 30, 2015. The Company's net income during this period was \$2,867,493. On a per common share basis, stockholders' equity increased from \$14.30 as of December 31, 2014 to \$14.76 as of June 30, 2015.

#### **Average Balances, Interest and Average Yields**

The Company's profitability is primarily dependent upon net interest income, which represents the difference between interest and fees earned on loans and debt and equity securities, and the cost of deposits and borrowings. Net interest income is dependent on the difference between the average balances and rates earned on interest-earning assets and the average balances and rates paid on interest-bearing liabilities. Non-interest income, non-interest expense, and income taxes also impact net income.

The following table sets forth certain information relating to the Company's average consolidated statements of financial condition and reflects the average yield on assets and average cost of liabilities for the periods indicated. Such yields and costs are derived by dividing income or expense annualized by the average balance of assets or liabilities, respectively, for the periods shown. Average balances were derived from average daily balances. The average balance of loans includes loans on which the Company has discontinued accruing interest. The yields and costs include fees which are considered adjustments to yields. All dollar amounts are in thousands.

	Three months ended 6/30/2015			Three months ended 6/30/2014		
	Average Balance	Interest	Yield / Cost	Average Balance	Interest	Yield / Cost
<b>ASSETS</b>						
Interest-earning:						
Loans	\$505,704	\$5,989	4.75 %	\$458,046	\$5,576	4.88 %
Investment securities	89,817	351	1.57 %	103,058	415	1.62 %
Other assets	28,189	46	0.65 %	29,359	46	0.63 %
Total interest-earning	623,710	6,386	4.11 %	590,464	6,038	4.10 %
Noninterest-earning	37,201			33,598		
	\$660,911			\$624,062		
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>						
Interest-bearing:						
Savings accounts	\$24,696	12	0.19 %	\$24,629	12	0.20 %
Transaction accounts	329,182	331	0.40 %	256,558	215	0.34 %
Certificates of deposit	122,479	282	0.92 %	163,598	335	0.82 %
FHLB advances	52,487	297	2.27 %	52,362	299	2.29 %
Securities sold under agreements to repurchase	8,462	56	2.65 %	10,000	66	2.65 %
Subordinated debentures	15,465	134	3.48 %	15,465	133	3.45 %
Total interest-bearing	552,771	1,112	0.81 %	522,612	1,060	0.81 %
Noninterest-bearing	43,729			39,020		
Total liabilities	596,500			561,632		
Stockholders' equity	64,411			62,430		
	\$660,911			\$624,062		
Net earning balance	\$70,939			\$67,852		
Earning yield less costing rate			3.30 %			3.29 %
Net interest income, and net yield spread on interest earning assets		\$5,274	3.39 %		\$4,977	3.38 %
Ratio of interest-earning assets to interest-bearing liabilities		113 %			113 %	

	Six months ended 6/30/2015			Six months ended 6/30/2014		
	Average Balance	Interest	Yield / Cost	Average Balance	Interest	Yield / Cost
<b>ASSETS</b>						
Interest-earning:						
Loans	\$503,100	\$11,893	4.77 %	\$457,498	\$11,444	5.04 %
Investment securities	88,427	705	1.61 %	103,198	873	1.71 %
Other assets	27,201	76	0.56 %	31,359	81	0.52 %
Total interest-earning	618,728	12,674	4.13 %	592,055	12,398	4.22 %
Noninterest-earning	37,184			36,588		
	\$655,912			\$628,644		
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>						
Interest-bearing:						
Savings accounts	\$24,444	24	0.20 %	\$24,339	25	0.20 %
Transaction accounts	324,103	650	0.40 %	258,147	453	0.35 %
Certificates of deposit	121,508	546	0.91 %	168,455	692	0.83 %
FHLB advances	54,848	596	2.19 %	52,528	594	2.28 %
Securities sold under agreements to repurchase	9,227	121	2.64 %	10,000	131	2.65 %
Subordinated debentures	15,465	267	3.48 %	15,465	266	3.47 %
Total interest-bearing	549,595	2,204	0.81 %	528,934	2,161	0.82 %
Noninterest-bearing	42,595			40,295		
Total liabilities	592,190			569,229		
Stockholders' equity	63,722			59,415		
	\$655,912			\$628,644		
Net earning balance	\$69,133			\$63,122		
Earning yield less costing rate			3.32 %			3.40 %
Net interest income, and net yield spread on interest earning assets		\$10,470	3.41 %		\$10,236	3.49 %
Ratio of interest-earning assets to interest-bearing liabilities		113 %			112 %	

### Results of Operations - Comparison of Three and Six Month Periods Ended June 30, 2015 and 2014

Net income for the three and six months ended June 30, 2015 was \$1,537,949 and \$2,867,493, respectively, compared to \$1,338,683 and \$2,640,109 for the three and six months ended June 30, 2014, respectively, which represents an increase in net income of \$199,266 (15%) for the three month period, and an increase in net income of \$227,384 (9%) for the six month period.

### Interest Income

Total interest income for the three and six months ended June 30, 2015 increased \$348,927 (6%) and \$276,500 (2%), respectively, as compared to the three and six months ended June 30, 2014. For the three and six month periods ended June 30, 2015 compared to the same periods in 2014, the average yield on interest earning assets increased 1 basis point to 4.11% and fell 9 basis points to 4.13%, while the average balance of interest earning assets increased \$33,246,000 for the three month period and increased \$26,673,000 for the six month period. The Company has continued to experience strong loan volume during the second quarter of 2015, as well as over the last twelve months. This has allowed the Company to put more low yielding cash and investment funds into higher yielding loans. However, in this highly competitive rate environment, pricing on new and renewed loans remains difficult. This pricing pressure has adversely impacted the ability to maintain loan yield compared to 2014. Also impacting loan yield and loan income for the six month period, compared to one year ago, was the recognition of approximately \$335,000 of interest income during the first quarter of 2014 on the payoff of a credit relationship that had been classified as non-accrual.



### **Interest Expense**

Total interest expense for the three and six months ended June 30, 2015 increased \$52,030 (5%) and \$42,823 (2%), respectively, when compared to the three and six months ended June 30, 2014. For the three and six month periods ended June 30, 2015 compared to the same periods in 2014, the average cost of interest bearing liabilities remained the same for the three months at 0.81% and decreased 1 basis point to 0.81% for the six months, respectively, while the average balance of interest bearing liabilities increased \$30,159,000 for the three month period and increased \$20,661,000 for the six month period when compared to the same periods in 2014. The Company has made significant efforts over the last several years to grow lower cost core deposit relationships. The Company has been successful in these efforts and allowed for reductions in wholesale funding reducing the Company's cost of funds. During the last few quarters, however, opportunities to reduce the cost of funds have been limited. Going forward, the Company will utilize a cost effective mix of retail deposits and non-core, wholesale funding to fund its organic asset growth.

### **Net Interest Income**

Net interest income for the three and six months ended June 30, 2015 increased \$296,897 (6%) and increased \$233,677 (2%), respectively, when compared to the same periods in 2014. For the three and six month periods ended June 30, 2015, the average balance of net interest earning assets over liabilities increased by approximately \$3,087,000 and \$6,011,000, respectively, when compared to the same periods in 2014. For the three and six month periods ended June 30, 2015, the net interest margin increased 1 basis point to 3.39% and decreased 8 basis points to 3.41%, respectively, when compared to the same periods in 2014.

### **Provision for Loan Losses**

Provisions for loan losses are charged or credited to earnings to bring the total allowance for loan losses to a level considered adequate by the Company to provide for potential loan losses in the existing loan portfolio. When making its assessment, the Company considers prior loss experience, volume and type of lending, local banking trends and impaired and past due loans in the Company's loan portfolio. In addition, the Company considers general economic conditions and other factors related to collectibility of the Company's loan portfolio.

Based on its internal analysis and methodology, management recorded a provision for loan losses of \$0 and \$150,000 for the three months and six months ended June 30, 2015, respectively, compared to \$325,000 and \$525,000 for the same periods in 2014.

The Company's increase in overall loan balances during the first and second quarters has increased the general component of the allowance for loan loss reserve requirements. The Bank will continue to monitor its allowance for loan losses and make future additions based on economic and regulatory conditions. Management may need to increase the allowance for loan losses through charges to the provision for loan losses if anticipated growth in the Bank's loan portfolio increases or other circumstances warrant.

Although the Bank maintains its allowance for loan losses at a level which it considers to be sufficient to provide for potential loan losses in its existing loan portfolio, there can be no assurance that future loan losses will not exceed internal estimates. In addition, the amount of the allowance for loan losses is subject to review by regulatory agencies which can order the establishment of additional loan loss provisions.

### **Noninterest Income**

Noninterest income increased \$649,258 (75%) and \$833,274 (50%) for the three months and six months ended June 30, 2015, respectively, when compared to the three months and six months ended June 30, 2014. The increase is attributable to a few factors.

First, during the second quarter of 2015, the Company executed a structured transaction selling approximately \$4,000,000 of SBA guaranteed loans and approximately \$5,800,000 of investment securities for a combined gain of \$488,000. With those proceeds, the Company prepaid a \$10,000,000 repurchase agreement (bearing annual interest of 2.61%) incurring a prepayment penalty of \$463,992. This prepayment has allowed the Company to significantly reduce higher cost, non-core funding liabilities on its balance sheet and eliminate future annual interest expense of \$261,000. This transaction will improve the Company's cost of funds as well enhance other liquidity and capital performance measurements.

Secondly, gains on sale of mortgage loans held for sale increased \$114,042 (45%) and \$307,530 (70%) for the three months and six months ended June 30, 2015, respectively, when compared to the same periods in 2014. Fixed-rate mortgage volume of \$27,400,000 for the six months ended June 30, 2015 was an increase of 86% compared to the same time periods in 2014.

### **Noninterest Expense**

Noninterest expense increased \$890,167 (24%) and \$896,608 (12%) for the three months and six months ended June 30, 2015 when compared to the same periods in 2014. The increase is attributable to a few factors.

First, the Company paid \$463,992 prepayment penalty incurred on the prepayment of a repurchase agreement (further discussed above).

Secondly, salaries and employee benefits increased \$256,257 (11%) and \$404,581 (9%) for the three months and six months ended June 30, 2015 when compared to the same periods in 2014. This was primarily due to the addition of several key officers during the last two quarters. The Company continues to strengthen its depth in the areas of technology, marketing, commercial and retail production in order to position itself for future growth and expansion. Also impacting compensation were the mortgage commissions which have increased due to the increases in the mortgage loan volume noted above.

### **Provision for Income Taxes**

The provision for income taxes increased by \$181,722 (35%) and \$317,959 (33%) for the three months and six months ended June 30, 2015 when compared to the same periods in 2014. Effective during the first quarter of 2015, the Company adopted FASB ASU No. 2014-01 (see Note 7: New Accounting Pronouncements for further discussion). As a result of the Company's adoption of this ASU, the investment amortization expense of (\$221,370) for three months and (\$442,740) for six months ended June 30, 2015 which was previously included in Other Non-interest Expense in the Condensed Consolidated Statements of Income, is now included in Provision for Income Taxes in the Condensed Consolidated Statements of Income for the three and six months ended June 30, 2015. Investment amortization expense for the three and six months ended June 30, 2014, \$221,370 and \$442,740, respectively, was also reclassified from Other Noninterest Expense to Provision for Income Taxes.

### **Nonperforming Assets**

The allowance for loan losses is calculated based upon an evaluation of pertinent factors underlying the various types and quality of the Bank's existing loan portfolio. When making such evaluation, management considers such factors as the repayment status of its loans, the estimated net realizable value of the underlying collateral, borrowers' intent (to the extent known by the Bank) and ability to repay the loan, local economic conditions and the Bank's historical loss ratios. The allowance for loan losses, as a percentage of nonperforming loans outstanding, as of June 30, 2015 and December 31, 2014 was 151.2% and 124.5%, respectively. Total loans classified as substandard, doubtful or loss as of June 30, 2015, were \$18.1 million or 2.77% of total assets as compared to \$11.3 million, or 1.79% of total assets at December 31, 2014. This increase is primarily due to four larger customers previously identified as special mention being downgraded to substandard during the six months ended June 30, 2015. The individual loans are made up of commercial, commercial real estate and one to four family and total approximately \$5.6 million. Management considered nonperforming and total classified loans in evaluating the adequacy of the Bank's allowance for loan losses.

The ratio of nonperforming assets to total assets is another useful tool in evaluating exposure to credit risk. Nonperforming assets of the Bank include nonperforming loans and assets which have been acquired as a result of foreclosure or deed-in-lieu of foreclosure. All dollar amounts are in thousands.

	6/30/2015	12/31/2014	12/31/2013
Nonperforming loans	\$ 4,398	\$ 5,291	\$ 15,848
Troubled debt restructurings	-	-	-
Real estate acquired in settlement of loans	3,215	3,165	3,822
Total nonperforming assets	\$ 7,613	\$ 8,456	\$ 19,670
Total nonperforming assets as a percentage of total assets	1.17 %	1.35 %	3.17 %
Allowance for loan losses	\$ 6,651	\$ 6,589	\$ 7,802
Allowance for loan losses as a percentage of gross loans	1.30 %	1.33 %	1.65 %

### Liquidity and Capital Resources

Liquidity refers to the ability to manage future cash flows to meet the needs of depositors and borrowers and fund operations. Maintaining appropriate levels of liquidity allows the Company to have sufficient funds available for customer demand for loans, withdrawal of deposit balances and maturities of deposits and other liabilities. The Company's primary sources of liquidity include cash and cash equivalents, customer deposits and Federal Home Loan Bank of Des Moines borrowings. The Company also has established borrowing lines available from the Federal Reserve Bank which is considered a secondary source of funds.

The Company's most liquid assets are cash and cash equivalents, which are cash on hand, amounts due from financial institutions, and certificates of deposit with other financial institutions that have an original maturity of three months or less. The levels of such assets are dependent on the Bank's operating, financing, and investment activities at any given time. The Company's cash and cash equivalents totaled \$21,417,331 as of June 30, 2015 and \$12,493,890 as of December 31, 2014, representing an increase of \$8,923,441. The variations in levels of cash and cash equivalents are influenced by many factors but primarily loan originations and payments, deposit flows and anticipated future deposit flows, which are subject to, and influenced by, many factors. This increase was primarily due to the increase of \$39,728,800 in deposits as further described above offset by an increase in net loans receivable of \$18,045,488 and paydowns of FHLB and Federal Reserve advances and repurchase agreement of \$18,250,000.

In July 2013, the Board of Governors of the Federal Reserve Board and the FDIC approved the final rules implementing the Basel Committee on Banking Supervision's capital guidelines for U.S. banks (commonly known as Basel III). Under the final rules, which began for the Company and the Bank on January 1, 2015 and are subject to a phase-in period through January 1, 2019, minimum requirements will increase for both the quantity and quality of capital held by the Company and the Bank. The rules include a new common equity Tier 1 capital to risk-weighted assets ratio (CET1 ratio) of 4.5% and a capital conservation buffer of 2.5% of risk-weighted assets, which when fully

phased-in, effectively results in a minimum CET1 ratio of 7.0%. Basel III raises the minimum ratio of Tier 1 capital to risk-weighted assets from 4.0% to 6.0% (which, with the capital conservation buffer, effectively results in a minimum Tier 1 capital ratio of 8.5% when fully phased-in), effectively results in a minimum total capital to risk-weighted assets ratio of 10.5% (with the capital conservation buffer fully phased-in), and requires a minimum leverage ratio of 4.0%. Basel III also makes changes to risk weights for certain assets and off-balance-sheet exposures. We expect that the capital ratios for the Company and the Bank under Basel III will continue to exceed the well capitalized minimum capital requirements.

The Bank's capital ratios are above the levels required to be considered a well-capitalized financial institution. As of June 30, 2015, the Bank's common equity Tier 1 ratio was 13.19%, the Bank's Tier 1 leverage ratio was 11.41%, its Tier 1 risk-based capital ratio was 13.19% and the Bank's total risk-based capital ratio was 14.36% - all exceeding the minimums of 6.5%, 5.0%, 8.0% and 10.0%, respectively.

### Item 3. Quantitative and Qualitative Disclosures about Market Risk

#### Asset/Liability Management

The goal of the Bank's asset/liability policy is to manage interest rate risk so as to maximize net interest income over time in changing interest rate environments. Management monitors the Bank's net interest spreads (the difference between yields received on assets and paid on liabilities) and, although constrained by market conditions, economic conditions, and prudent underwriting standards, the Bank offers deposit rates and loan rates designed to maximize net interest income. Management also attempts to fund the Bank's assets with liabilities of a comparable duration to minimize the impact of changing interest rates on the Bank's net interest income. Since the relative spread between financial assets and liabilities is constantly changing, the Bank's current net interest income may not be an indication of future net interest income.

As a part of its asset and liability management strategy and throughout the past several years, the Bank has continued to emphasize the origination of short-term commercial real estate, commercial business and consumer loans, while originating fixed-rate, one- to four-family residential loans primarily for immediate resale in the secondary market.

The Bank constantly monitors its deposits in an effort to decrease their interest rate sensitivity. Rates of interest paid on deposits at the Bank are priced competitively in order to meet the Bank's asset/liability management objectives and spread requirements. The Bank believes, based on historical experience, that a substantial portion of such accounts represents non-interest rate sensitive core deposits.

#### Interest Rate Sensitivity Analysis

The following table sets forth as of June 30, 2015 management's estimates of the projected changes in net portfolio value ("NPV") in the event of 100 and 200 basis point ("bp") instantaneous and permanent increases and decreases in market interest rates. Dollar amounts are expressed in thousands.

BP Change in Rates	Estimated Net Portfolio Value			NPV as % of PV of Assets			
	\$ Amount	\$ Change	% Change	NPV Ratio	NPV Change	% Change	% Change
+200	\$62,587	\$(2,521)	-4	% 9.84	% -0.11	%	%
+100	63,096	(2,012)	-3	% 9.79	% -0.15	%	%

NC	65,108	-	-	9.95	%	-
-100	64,012	(1,096)	-2	%	9.69	% -0.26 %
-200	71,633	6,525	10	%	10.71	% 0.76 %

Computations of prospective effects of hypothetical interest rate changes are based on an internally generated model using actual maturity and repricing schedules for the Bank's loans and deposits, and are based on numerous assumptions, including relative levels of market interest rates, loan repayments and deposit run-offs, and should not be relied upon as indicative of actual results. Further, the computations do not contemplate any actions the Bank may undertake in response to changes in interest rates. For further discussion of the Company's market risk, see the Interest Rate Sensitivity Analysis Section of Management's Discussion and Analysis of Financial Condition and Results of Operations included in the Company's 2014 Annual Report on Form 10-K.



Management cannot predict future interest rates or their effect on the Bank's NPV in the future. Certain shortcomings are inherent in the method of analysis presented in the computation of NPV. For example, although certain assets and liabilities may have similar maturities or periods to repricing, they may react in differing degrees to changes in market interest rates. Additionally, certain assets, such as adjustable-rate loans, have an initial fixed rate period typically from one to five years, and over the remaining life of the asset changes in the interest rate are restricted. In addition, the proportion of adjustable-rate loans in the Bank's portfolio could decrease in future periods due to refinancing activity if market interest rates remain steady in the future. Further, in the event of a change in interest rates, prepayment and early withdrawal levels could deviate significantly from those assumed in the table. Finally, the ability of many borrowers to service their adjustable-rate debt may decrease in the event of an interest rate increase.

The Bank's Board of Directors (the "Board") is responsible for reviewing the Bank's asset and liability management policies. The Board meets quarterly to review interest rate risk and trends, as well as liquidity and capital ratios and requirements. The Bank's management is responsible for administering the policies and determinations of the Board with respect to the Bank's asset and liability goals and strategies.

#### **Item 4. Controls and Procedures**

(a) The Company maintains disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934 (the "Exchange Act")) that are designed to ensure that information required to be disclosed in the Company's Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

The Company conducted an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the Company's disclosure controls and procedures. Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of June 30, 2015.

(b) There have been no changes in the Company's internal control over financial reporting during the quarter ended June 30, 2015 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.



## **PART II**

### **Item 1. Legal Proceedings**

None.

### **Item 1A. Risk Factors**

Not applicable.

### **Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

#### **ISSUER PURCHASES OF EQUITY SECURITIES**

The Company has a repurchase plan which was announced on August 20, 2007. This plan authorizes the purchase by the Company of up to 350,000 shares of the Company's common stock. There is no expiration date for this plan. There are no other repurchase plans in effect at this time. The Company had no repurchase activity of the Company's common stock during the quarter ended June 30, 2015.

### **Item 3. Defaults Upon Senior Securities**

Not applicable.

### **Item 4. Mine Safety Disclosures**

Not applicable.

### **Item 5. Other Information**

None

**Item 6. Exhibits**

10. Guaranty Federal Bancshares, Inc. 2015 Equity Plan (1)  
11. Statement re: computation of per share earnings (set forth in “Note 6: Income Per Common Share” of the Notes to Condensed Consolidated Financial Statement (unaudited))  
31(i).1 Certification of the Principal Executive Officer pursuant to Rule 13a -14(a) of the Exchange Act  
31(i).2 Certification of the Principal Financial Officer pursuant to Rule 13a - 14(a) of the Exchange Act  
32 Officer certifications pursuant to 18 U.S.C. Section 1350  
101 The following materials from Guaranty Federal Bancshares, Inc.’s Quarterly Report on Form 10-Q for the quarter ended June 30, 2015 formatted in Extensible Business Reporting Language (XBRL): (i) Condensed Consolidated Balance Sheets (unaudited), (ii) Condensed Consolidated Statements of Income (unaudited), (iii) Condensed Consolidated Statements of Comprehensive Income (unaudited), (iv) Condensed Consolidated Statement of Stockholders’ Equity (unaudited), (v) the Condensed Consolidated Statements of Cash Flows (unaudited), and (vi) related notes.\*

Pursuant to Regulation S-T, the interactive data files on Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities and Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.

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(1) Filed as an exhibit to the Current Report on Form 8-K filed 5/28/2015 (SEC File No. 0-23325) and incorporated herein by reference.

**SIGNATURES**

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

Guaranty Federal Bancshares, Inc.

**Signature and Title**

**Date**

/s/ Shaun A. Burke  
Shaun A. Burke  
President and Chief Executive  
Officer  
(Principal Executive Officer  
and Duly Authorized Officer)

August 7, 2015

/s/ Carter Peters  
Carter Peters  
Executive Vice President and  
Chief Financial Officer  
(Principal Financial and  
Accounting Officer)

August 7, 2015