

SOUTHERN MISSOURI BANCORP INC  
Form 10-K  
September 24, 2012

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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FORM 10-K

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

For the fiscal year ended June 30, 2012 OR

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

Commission File Number: 0-23406

SOUTHERN MISSOURI BANCORP, INC.

(Exact name of registrant as specified in its charter)

Missouri 43-1665523  
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

531 Vine Street, Poplar Bluff, Missouri 63901  
(Address of principal executive offices) (Zip Code)

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

Securities registered pursuant to Section 12(b) of the Act:

| Title of each class:                     | Name of each exchange on which registered: |
|------------------------------------------|--------------------------------------------|
| Common Stock, par value \$0.01 per share | The NASDAQ Stock Market LLC                |

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
YES \_\_\_ NO

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES \_\_\_ NO

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 registration was required to submit

and post such files. YES  NO

Indicate by check mark whether disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or other information statements incorporated by reference in Part III of this Form 10-K or any amendments to this Form 10-K. X

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
(Do not check if a 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

The aggregate market value of the voting stock held by non-affiliates of the registrant, computed by reference to the average of the high and low traded price of such stock as of the last business day of the registrant's most recently completed second fiscal quarter, was \$63.3 million. (The exclusion from such amount of the market value of the shares owned by any person shall not be deemed an admission by the registrant that such person is an affiliate of the registrant.)

As of September 7, 2012, there were issued and outstanding 3,289,040 shares of the Registrant's common stock.

#### DOCUMENTS INCORPORATED BY REFERENCE

Part III of Form 10-K - Portions of the Proxy Statement for the 2012 Annual Meeting of Stockholders.

## PART I

### Item 1. Description of Business

#### General

Southern Missouri Bancorp, Inc. ("Company"), which changed its state of incorporation to Missouri on April 1, 1999, was originally incorporated in Delaware on December 30, 1993 for the purpose of becoming the holding company for Southern Missouri Savings Bank upon completion of Southern Missouri Savings Bank's conversion from a state chartered mutual savings and loan association to a state chartered stock savings bank. As part of the conversion in April 1994, the Company sold 1,803,201 shares of its common stock to the public. The Company's Common Stock is quoted on the NASDAQ Global Market under the symbol "SMBC".

Southern Missouri Savings Bank was originally chartered as a mutual Missouri savings and loan association in 1887. On June 20, 1995, it converted to a federally chartered stock savings bank and took the name Southern Missouri Savings Bank, FSB. On February 17, 1998, Southern Missouri Savings Bank converted from a federally chartered stock savings bank to a Missouri chartered stock savings bank and changed its name to Southern Missouri Bank & Trust Co. On June 4, 2004, Southern Missouri Bank & Trust Co. converted from a Missouri chartered stock savings bank to a Missouri state chartered trust company with banking powers ("Charter Conversion"). On June 1, 2009, the institution changed its name to Southern Bank ("Bank").

The primary regulator of the Bank is the Missouri Division of Finance. The Bank is a member of the Federal Reserve, and the Federal Reserve Board ("FRB") is the Bank's primary federal regulator. The Bank's deposits continue to be insured up to applicable limits by the Deposit Insurance Fund ("DIF") of the Federal Deposit Insurance Corporation ("FDIC"). With the Bank's conversion to a trust company with banking powers, the Company became a bank holding company regulated by the FRB.

The principal business of the Bank consists primarily of attracting retail deposits from the general public and using such deposits along with wholesale funding from the Federal Home Loan Bank of Des Moines ("FHLB"), and to a lesser extent, brokered deposits, to invest in one- to four-family residential mortgage loans, mortgage loans secured by commercial real estate, commercial non-mortgage business loans, and consumer loans. These funds are also used to purchase mortgage-backed and related securities ("MBS"), U.S. Government Agency obligations, municipal bonds, and other permissible investments.

At June 30, 2012, the Company had total assets of \$739.2 million, total deposits of \$584.8 million and stockholders' equity of \$94.7 million. The Company has not engaged in any significant activity other than holding the stock of the Bank. Accordingly, the information set forth in this report, including financial statements and related data, relates primarily to the Bank. The Company's revenues are derived principally from interest earned on loans, debt securities, MBS, CMOs and, to a lesser extent, banking service charges, bank card interchange fees, loan late charges, increases in the cash surrender value of bank owned life insurance, and other fee income.

#### Acquisitions

On December 17, 2010, the Bank entered into a Purchase and Assumption Agreement with the FDIC, as receiver, to acquire certain assets and assume certain liabilities of the former First Southern Bank, with headquarters in Batesville, Arkansas, and one branch location in Searcy, Arkansas. As a result of the transaction, the Company acquired loans recorded at a fair value of \$114.6 million and deposits recorded at a fair value of \$130.8 million, at December 17, 2010.

On July 17, 2009, the Company completed the acquisition of Southern Bank of Commerce headquartered in Paragould, Arkansas, with branches in Jonesboro, Leachville, and Brookland, Arkansas. As of June 30, 2009, the quarter-end immediately prior to the closing of the transaction, Southern Bank of Commerce had assets of \$30.3 million, loans of \$16.2 million, deposits of \$29.3 million, and total equity of \$916,000, all of which are prior to fair value adjustments. The purchase price was \$600,000.

## Capital Raising Transactions

On November 22, 2011, the Company completed an underwritten public offering of 1,150,000 shares of Common Stock at a price to the public of \$19.00 per share, for aggregate gross proceeds of \$21.9 million. The proceeds from the offering are being used for general corporate purposes, including the funding of loan growth and the purchase of securities.

On July 21, 2011, as part of the U.S. Treasury's Small Business Lending Fund ("SBLF") program, the Company entered into a Small Business Lending Fund-Securities Purchase Agreement ("SBLF Purchase Agreement") with the Secretary of the Treasury, pursuant to which the Company (i) sold 20,000 shares of the Company's Senior Non-Cumulative Perpetual Preferred Stock, Series A (the "SBLF Preferred Stock") to the Secretary of the Treasury for a purchase price of \$20,000,000. The SBLF program is a \$30 billion fund established under the Small Business Jobs Act of 2010 that was created to encourage lending to small business by providing capital to qualified community banks with assets of less than \$10 billion.

The SBLF Preferred Stock qualifies as Tier 1 capital. The SBLF Preferred Stock is entitled to receive non-cumulative dividends, payable quarterly, on each January 1, April 1, July 1 and October 1, beginning October 1, 2011. The dividend rate, as a percentage of the liquidation amount, can fluctuate on a quarterly basis during the first 10 quarters during which the SBLF Preferred Stock is outstanding, based upon changes in the level of "Qualified Small Business Lending" or "QBSL" (as defined in the SBLF Purchase Agreement) by the by the Bank. Based upon the increase in the Bank's level of QBSL over the baseline level calculated under the terms of the Purchase Agreement, the dividend rate has ranged from 1.00% to 2.82% during the first through the fifth calendar quarters since the SBLF issuance. For the sixth quarter, which will be the quarter ending September 30, 2012, the dividend rate will be 3.90%. For the seventh through ninth calendar quarters, the dividend rate may be adjusted to between one percent (1%) and five percent (5%) per annum, to reflect the amount of change in the Bank's level of QBSL. For the tenth calendar quarter through four and one half years after issuance, the dividend rate will be fixed at between one percent (1%) and seven percent (7%) based upon the increase in QBSL as compared to the baseline. After four and one half years from issuance, the dividend rate will increase to 9% (including a quarterly lending incentive fee of 0.5%).

The SBLF Preferred Stock is non-voting, except in limited circumstances. In the event that the Company misses five dividend payments, whether or not consecutive, the holder of the SBLF Preferred Stock will have the right, but not the obligation, to appoint a representative as an observer on the Company's Board of Directors. In the event that the Company misses six dividend payments, whether or not consecutive, and if the then outstanding aggregate liquidation amount of the SBLF Preferred Stock is at least \$20,000,000, then the holder of the SBLF Preferred Stock will have the right to designate two directors to the Board of Directors of the Company. The SBLF Preferred Stock may be redeemed at any time at the Company's option, at a redemption price of 100% of the liquidation amount plus accrued but unpaid dividends to the date of redemption for the current period, subject to the approval of its federal banking regulator. As required by the Purchase Agreement, \$9,635,000 of the proceeds from the sale of the SBLF Preferred Stock was used to redeem the 9,550 shares of the Company's CPP Series A Preferred Stock, Series A issued in 2008 to the Treasury, plus the accrued dividends owed on the TARP preferred shares, as described below.

On December 5, 2008, as part of the Troubled Asset Relief Program ("TARP") Capital Purchase Program ("CPP"), the Company issued a warrant (the "Warrant") to purchase 114,326 shares of the Company's common stock, par value \$0.01 per share (the "Common Stock"), for a per share price of \$12.53 per share. The Warrant has a 10-year term and was immediately exercisable upon its issuance. In July 2011, the CPP Series A Preferred Stock was redeemed by the Company simultaneously with its issuance to the Treasury of preferred stock under the terms of the Small Business Lending Fund (SBLF). The Warrant remains outstanding.

On December 5, 2008, as part of the Troubled Asset Relief Program ("TARP") Capital Purchase Program ("CPP"), the Company entered into a Letter Agreement and Securities Purchase Agreement (collectively, the "CPP Purchase Agreement") with the United States Department of the Treasury ("Treasury"), pursuant to which the Company (i) sold 9,550 shares of the Company's Fixed Rate Cumulative Perpetual Preferred Stock, Series A (the "CPP Series A Preferred Stock") for a purchase price of \$9,550,000 in cash and (ii) issued a ten-year warrant (the "Warrant") to purchase 114,326 shares of the Company's common stock, par value \$0.01 per share (the "Common Stock"), for a per share price of \$12.53 per share, subject to anti-dilution adjustments. The terms of the CPP Series A

Preferred Stock provided for cumulative dividends at a rate of 5% per annum for the first five years, and 9% per annum thereafter. In July 2011, the CPP Series A Preferred Stock was redeemed by the Company simultaneously with its issuance to the Treasury of the SBLF preferred stock. The Warrant remains outstanding.

#### Forward Looking Statements

This document contains statements about the Company and its subsidiaries which we believe are “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include, without limitation, statements with respect to anticipated future operating and financial performance, growth opportunities, interest rates, cost savings and funding advantages expected or anticipated to be realized by management. Words such as "may," "could," "should," "would," "believe," "anticipate," "estimate," "expect," "intend," "plan" and similar expressions are intended to identify these forward-looking statements. Forward-looking statements by the Company and its management are based on beliefs, plans, objectives, goals, expectations, anticipations, estimates and the intentions of management and are not guarantees of future performance. The Company disclaims any obligation to update or revise any forward-looking statements based on the occurrence of future events, the receipt of new information, or otherwise. The important factors we discuss below, as well as other factors discussed in this report under the captions “Risk Factors” and "Management's Discussion and Analysis of Financial Condition and Results of Operations" and identified in our other filings with the SEC and those presented elsewhere by our management from time to time, could cause actual results to differ materially from those indicated by the forward-looking statements made in this document:

- the strength of the United States economy in general and the strength of the local economies in which we conduct operations;
  - fluctuations in interest rates and in real estate values;
- monetary and fiscal policies of the FRB and the U.S. Government and other governmental initiatives affecting the financial services industry;
- the risks of lending and investing activities, including changes in the level and direction of loan delinquencies and write-offs and changes in estimates of the adequacy of the allowance for loan losses;
  - our ability to access cost-effective funding;
- the timely development of and acceptance of our new products and services and the perceived overall value of these products and services by users, including the features, pricing and quality compared to competitors' products and services;
- expected cost savings, synergies and other benefits from the Company's merger and acquisition activities might not be realized within the anticipated time frames or at all, and costs or difficulties relating to integration matters, including but not limited to customer and employee retention, might be greater than expected;
  - fluctuations in real estate values and both residential and commercial real estate market conditions;
    - demand for loans and deposits in our market area;
  - legislative or regulatory changes that adversely affect our business;
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results of examinations of us by our regulators, including the possibility that our regulators may, among other things, require us to increase our reserve for loan losses or to write-down assets;

- the impact of technological changes; and
- our success at managing the risks involved in the foregoing



The Company disclaims any obligation to update or revise any forward-looking statements based on the occurrence of future events, the receipt of new information, or otherwise.

#### Market Area

The Bank provides its customers with a full array of community banking services and conducts its business from its headquarters in Poplar Bluff, 17 additional full service offices located in Poplar Bluff (3), Van Buren, Dexter, Kennett, Doniphan, Sikeston, Qulin, Matthews, and Springfield, Missouri, and Paragould, Jonesboro, Leachville, Brookland, Batesville, and Searcy, Arkansas. At June 30, 2012, the Bank considered its primary market area to be as follows: the Bank operates ten branches in six southeast Missouri counties, with one branch in a municipality that straddles a county line and is mostly situated in a seventh county. Those seven counties have a population of roughly 183,000 persons. In northeast and north central Arkansas, the Bank's six full-service branches are located in five counties with a population of roughly 302,000 persons. The Bank also serves a few communities just outside these county borders, but without a notable impact on the demographics of the market area. Springfield, Missouri, is situated in Greene County, Missouri, with a population of 277,000, and anchors the surrounding Metropolitan Statistical Area (MSA), which boasted a population of nearly 440,000. The Bank's southeast Missouri and northeast and north central Arkansas markets are primarily rural in nature with economies supported by manufacturing activity, agriculture (livestock, rice, timber, soybeans, wheat, melons, corn, and cotton), healthcare, and education. Large employers include hospitals, manufacturers, school districts, and colleges. In the Springfield market, major employers include healthcare providers, educational institutions, federal, local, and state government, retailers, and transportation and distribution firms.

#### Competition

The Bank faces strong competition in attracting deposits (its primary source of lendable funds) and originating loans. At June 30, 2012, the Bank was one of 47 bank or saving association groups located in its southeast Missouri and northeast Arkansas market area, and one of 27 bank or saving association groups located in Springfield, Missouri (seven of these overlap with the Bank's southeast Missouri and northeast and north central Arkansas markets).

Competitors for deposits include commercial banks, credit unions, money market funds, and other investment alternatives, such as mutual funds, full service and discount broker-dealers, equity markets, brokerage accounts and government securities. The Bank's competition for loans comes principally from other financial institutions, mortgage banking companies, mortgage brokers and life insurance companies. The Bank expects competition to continue to increase in the future as a result of legislative, regulatory and technological changes within the financial services industry. Technological advances, for example, have lowered barriers to market entry, allowed banks to expand their geographic reach by providing services over the Internet and made it possible for non-depository institutions to offer products and services that traditionally have been provided by banks. The Gramm-Leach-Bliley Act, which permits affiliation among banks, securities firms and insurance companies, also has changed the competitive environment in which the Bank conducts business.

#### Internet Website

The Company maintains a website at [www.bankwithsouthern.com](http://www.bankwithsouthern.com). The information contained on that website is not included as part of, or incorporated by reference into, this Annual Report on Form 10-K. The Company currently makes available on or through its website at <http://investors.bankwithsouthern.com> its Annual Report on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K or amendments to these reports. These materials are also available free of charge on the Securities and Exchange Commission's website at [www.sec.gov](http://www.sec.gov).

### Lending Activities

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

Supervision of the loan portfolio is the responsibility of our Chief Lending Officer. Loan officers have varying amounts of lending authority depending upon experience and types of loans. Loans beyond their authority are presented to the next level of authority, which may include the Commercial Loan Committee or the Agricultural Loan Committee. The Commercial Loan Committee consists of several senior lending officers of the Bank and is responsible for approving commercial lending relationships up to \$1,000,000. The Agricultural Loan Committee consists of several senior lending officers of the Bank and is responsible for approving agricultural lending relationships of up to \$1,000,000. Loan requests above these approval authorities are presented to the Loan Officers Committee, comprised of our President, Chief Lending Officer, and Chief Credit Officer, along with various appointed loan officers. Loans to one borrower (or group of related borrowers), in aggregate, in excess of \$1.5 million require the approval of a majority of the Discount Committee, which consists of all Bank directors, prior to the closing of the loan. All loans are subject to ratification by the full Board of Directors.

The aggregate amount of loans that the Bank is permitted to make under applicable federal regulations to any one borrower, including related entities, or the aggregate amount that the Bank could have invested in any one real estate project, is based on the Bank's capital levels. See "Regulation - Loans to One Borrower." At June 30, 2012, the maximum amount which the Bank could lend to any one borrower and the borrower's related entities was approximately \$21.6 million. However, the Bank's internal lending limit established by the Board of Directors is \$10.0 million. On limited occasions and with board approval, the Bank has allowed exceptions to its internal lending limit. At June 30, 2012, the Bank's five largest credit relationships, as defined by loan to one borrower limitations, ranged from \$8.4 million to \$11.2 million, net of participation interests sold. Related to one of these larger relationships, a single party guarantees credit exposures totaling \$19.4 million, however, \$11.3 million of that total exposure is supported three independent repayment sources. As of June 30, 2012, the majority of these credits were commercial real estate, commercial, or multi-family real estate loans and all of them continued to perform according to their terms.

Loan Portfolio Analysis. The following table sets forth the composition of the Bank's loan portfolio by type of loan and type of security as of the dates indicated.

|                              | 2012                   |         | At June 30, |           |        |         | 2010      |         |   |
|------------------------------|------------------------|---------|-------------|-----------|--------|---------|-----------|---------|---|
|                              | Amount                 | Percent | Amount      | Percent   | Amount | Percent | Amount    | Percent |   |
|                              | (Dollars in thousands) |         |             |           |        |         |           |         |   |
| Type of Loan:                |                        |         |             |           |        |         |           |         |   |
| Mortgage Loans:              |                        |         |             |           |        |         |           |         |   |
| Residential real estate      | \$201,013              | 34.45   | %           | \$199,855 | 35.91  | %       | \$158,494 | 37.86   | % |
| Commercial real estate (1)   | 200,957                | 34.44   |             | 185,159   | 33.27  |         | 121,526   | 29.03   |   |
| Construction                 | 40,182                 | 6.89    |             | 29,921    | 5.38   |         | 27,951    | 6.68    |   |
| Total mortgage loans         | 442,152                | 75.78   |             | 414,965   | 74.56  |         | 307,971   | 73.56   |   |
| Other Loans:                 |                        |         |             |           |        |         |           |         |   |
| Automobile loans             | 7,552                  | 1.29    |             | 9,024     | 1.62   |         | 8,442     | 2.02    |   |
| Commercial business (2)      | 137,004                | 23.48   |             | 126,290   | 22.69  |         | 97,481    | 23.28   |   |
| Home equity                  | 15,856                 | 2.72    |             | 14,027    | 2.52   |         | 12,879    | 3.08    |   |
| Other                        | 5,578                  | 0.96    |             | 6,912     | 1.24   |         | 5,003     | 1.19    |   |
| Total other loans            | 165,990                | 28.45   |             | 156,253   | 28.07  |         | 123,805   | 29.56   |   |
| Total loans                  | 608,142                | 104.23  |             | 571,218   | 102.63 |         | 431,776   | 103.13  |   |
| Less:                        |                        |         |             |           |        |         |           |         |   |
| Undisbursed loans in process | 17,370                 | 2.98    |             | 8,330     | 1.50   |         | 8,705     | 2.08    |   |
| Deferred fees and discounts  | (185)                  | (0.02)  | )           | (126)     | (0.02) | )       | (121)     | (0.03)  | ) |
| Allowance for loan losses    | 7,492                  | 1.28    |             | 6,438     | 1.16   |         | 4,509     | 1.08    |   |
| Net loans receivable         | \$583,465              | 100.00  | %           | \$556,576 | 100.00 | %       | \$418,683 | 100.00  | % |
| Type of Security:            |                        |         |             |           |        |         |           |         |   |
| Residential real estate      |                        |         |             |           |        |         |           |         |   |
| One-to four-family           | \$189,313              | 32.45   |             | \$189,282 | 34.01  |         | \$167,622 | 40.04   |   |
| Multi-family                 | 36,513                 | 6.26    |             | 30,272    | 5.44   |         | 12,475    | 2.98    |   |
| Commercial real estate       | 162,478                | 27.85   |             | 145,453   | 26.13  |         | 96,601    | 23.07   |   |
| Land                         | 58,830                 | 10.08   |             | 52,933    | 9.51   |         | 34,518    | 8.24    |   |
| Commercial                   | 132,022                | 22.63   |             | 123,295   | 22.15  |         | 94,224    | 22.51   |   |
| Consumer and other           | 28,986                 | 4.97    |             | 29,983    | 5.39   |         | 26,336    | 6.29    |   |
| Total loans                  | 608,142                | 104.23  |             | 571,218   | 102.63 |         | 431,776   | 103.13  |   |
| Less:                        |                        |         |             |           |        |         |           |         |   |
| Undisbursed loans in process | 17,370                 | 2.98    |             | 8,330     | 1.50   |         | 8,705     | 2.08    |   |
| Deferred fees and discounts  | (185)                  | (0.02)  | )           | (126)     | (0.02) | )       | (121)     | (0.03)  | ) |
| Allowance for loan losses    | 7,492                  | 1.08    |             | 6,438     | 1.16   |         | 4,509     | 1.08    |   |
| Net loans receivable         | \$583,465              | 100.00  | %           | \$556,576 | 100.00 | %       | \$418,683 | 100.00  | % |

(1) Commercial real estate loan balances included farmland and other agricultural-related real estate loans of \$48.6 million, \$42.4 million and \$28.3 million as of June 30, 2012, 2011, and 2010, respectively.

(2)

Commercial business loan balances included agricultural equipment and production loans of \$50.8 million, \$45.3 million and \$35.9 million as of June 30, 2012, 2011, and 2010, respectively.

The following table shows the fixed and adjustable rate composition of the Bank's loan portfolio at the dates indicated.

|                              | 2012       |         | At June 30, |            |        |         | 2010       |         |   |
|------------------------------|------------|---------|-------------|------------|--------|---------|------------|---------|---|
|                              | Amount     | Percent | Amount      | Percent    | Amount | Percent | Amount     | Percent |   |
| (Dollars in thousands)       |            |         |             |            |        |         |            |         |   |
| Type of Loan:                |            |         |             |            |        |         |            |         |   |
| Fixed-Rate Loans:            |            |         |             |            |        |         |            |         |   |
| Residential real estate      | \$ 115,716 | 19.83   | %           | \$ 129,967 | 23.35  | %       | \$ 107,190 | 25.60   | % |
| Commercial real estate       | 128,954    | 22.10   |             | 120,327    | 21.62  |         | 70,643     | 16.87   |   |
| Construction                 | 35,886     | 6.15    |             | 27,947     | 5.02   |         | 21,467     | 5.13    |   |
| Consumer                     | 13,130     | 2.25    |             | 15,934     | 2.86   |         | 13,439     | 3.21    |   |
| Commercial business          | 75,910     | 13.01   |             | 77,154     | 13.86  |         | 50,747     | 12.12   |   |
| Total fixed-rate loans       | 369,596    | 63.34   |             | 371,329    | 66.72  |         | 263,486    | 62.93   |   |
| Adjustable-Rate Loans:       |            |         |             |            |        |         |            |         |   |
| Residential real estate      | 85,296     | 14.62   |             | 69,917     | 12.56  |         | 51,304     | 12.25   |   |
| Commercial real estate       | 72,005     | 12.34   |             | 64,831     | 11.65  |         | 50,883     | 12.15   |   |
| Construction                 | 4,296      | 0.74    |             | 1,975      | 0.35   |         | 6,484      | 1.55    |   |
| Consumer                     | 15,855     | 2.72    |             | 14,030     | 2.52   |         | 12,885     | 3.08    |   |
| Commercial business          | 61,094     | 10.47   |             | 49,136     | 8.83   |         | 46,734     | 11.16   |   |
| Total adjustable-rate loans  | 238,546    | 40.88   |             | 199,889    | 35.91  |         | 168,290    | 40.20   |   |
| Total loans                  | 608,142    | 104.23  |             | 571,218    | 102.63 |         | 431,776    | 103.13  |   |
| Less:                        |            |         |             |            |        |         |            |         |   |
| Undisbursed loans in process | 17,370     | 2.98    |             | 8,330      | 1.50   |         | 8,705      | 2.08    |   |
| Net deferred loan fees       | (185)      | (0.03)  | )           | (126)      | (0.02) | )       | (121)      | (0.03)  | ) |
| Allowance for loan loss      | 7,492      | 1.28    |             | 6,438      | 1.16   |         | 4,509      | 1.08    |   |
| Net loans receivable         | \$583,465  | 100.00  | %           | \$556,576  | 100.00 | %       | \$418,683  | 100.00  | % |

**Residential Mortgage Lending.** The Bank actively originates loans for the acquisition or refinance of one- to four-family residences. These loans are originated as a result of customer and real estate agent referrals, existing and walk-in customers and from responses to the Bank's marketing campaigns. At June 30, 2012, residential loans secured by one- to four-family residences totaled \$177.0 million, or 30.3% of net loans receivable.

The Bank currently offers both fixed-rate and adjustable-rate mortgage ("ARM") loans. During the year ended June 30, 2012, the Bank originated \$25.5 million of ARM loans and \$13.7 million of fixed-rate loans that were secured by one- to four-family residences, for retention in the Bank's portfolio. An additional \$7.9 million in fixed-rate one- to four-family residential loans were originated for sale on the secondary market. Substantially all of the one- to four-family residential mortgage originations in the Bank's portfolio are located within the Bank's primary market area.

The Bank generally originates one- to four-family residential mortgage loans in amounts up to 90% of the lower of the purchase price or appraised value of residential property. For loans originated in excess of 80%, the Bank charges an

additional 50 basis points, but does not require private mortgage insurance. At June 30, 2012, the remaining balance of loans originated with a loan-to-value ratio in excess of 80% was \$50.8 million. For fiscal years ended June 30, 2012, 2011, and 2010, originations of one- to four-family loans in excess of 80% loan-to-value have totaled \$12.7 million, \$6.7 million and \$7.9 million, respectively, a total of \$27.3 million. The remaining balance of those loans at June 30, 2012, was \$25.7 million. Originating loans with higher loan-to-value ratios presents additional credit risk to the Company. Consequently, the Company limits this product to borrowers with a favorable credit history and a demonstrable ability to service the debt. The majority of new residential mortgage loans originated by the Bank conform to secondary market underwriting standards, however, documentation of loans files may not be adequate to allow for immediate sale. The interest rates charged on these loans are competitively priced based on local market conditions, the availability of funding, and anticipated profit margins. Fixed and ARM loans originated by the Bank are amortized over periods as long as 30 years, but typically are repaid over shorter periods.

Fixed-rate loans secured by one- to four-family residences have contractual maturities up to 30 years, and are generally fully amortizing with payments due monthly. These loans normally remain outstanding for a substantially shorter period of time because of refinancing and other prepayments. A significant change in the interest rate environment can alter the average life of a residential loan portfolio. The one- to four-family fixed-rate loans do not contain prepayment penalties. At June 30, 2012, one- to four-family loans with a fixed rate totaled \$104.6 million, and had a weighted-average maturity of 176 months.

The Bank currently originates one- to four-family adjustable rate mortgage ("ARM") loans, which adjust annually, after an initial period of one, three, five, or seven years. Typically, originated ARM loans secured by owner occupied properties reprice at a margin of 2.75% to 3.00% over the weekly average yield on United States Treasury securities adjusted to a constant maturity of one year ("CMT"). Generally, ARM loans secured by non-owner occupied residential properties reprice at a margin of 3.75% over the CMT index. Current residential ARM loan originations are subject to annual and lifetime interest rate caps and floors. As a consequence of using interest rate caps, initial rates which may be at a premium or discount, and a "CMT" loan index, the interest earned on the Bank's ARMs will react differently to changing interest rates than the Bank's cost of funds. At June 30, 2012, one- to four-family loans tied to the CMT index totaled \$69.5 million. One- to four-family loans tied to other indices totaled \$2.9 million.

In underwriting one- to four-family residential real estate loans, the Bank evaluates the borrower's ability to meet debt service requirements at current as well as fully indexed rates for ARM loans, as well as the value of the property securing the loan. Most properties securing real estate loans made by the Bank during fiscal 2012 had appraisals performed on them by independent fee appraisers approved and qualified by the Board of Directors. The Bank generally requires borrowers to obtain title insurance and fire, property and flood insurance (if indicated) in an amount not less than the amount of the loan. Real estate loans originated by the Bank generally contain a "due on sale" clause allowing the Bank to declare the unpaid principal balance due and payable upon the sale of the security property.

The Company also originates loans secured by multi-family residential properties that are generally located in the Company's primary market area. At June 30, 2012, the Bank had \$24.1 million, or 4.1% of net loans receivable, in multi-family residential real estate. The majority of the multi-family residential loans that are originated by the Bank are amortized over periods generally up to 20 years, with balloon maturities up to five years. Both fixed and adjustable interest rates are offered and it is typical for the Company to include an interest rate "floor" in the loan agreement. Variable rate loans typically adjust daily, monthly, quarterly or annually based on the Wall Street prime interest rate. Generally, multi-family residential loans do not exceed 85% of the lower of the appraised value or purchase price of the secured property. The Company generally requires a Board-approved independent certified fee appraiser to be engaged in determining the collateral value. As a general rule, the Company requires the unlimited guaranty of all individuals (or entities) owning (directly or indirectly) 20% or more of the stock of the borrowing entity.

The primary risk associated with multifamily loans is the ability of the income-producing property that collateralizes the loan to produce adequate cash flow to service the debt. High unemployment or generally weak economic conditions may result in borrowers having to provide rental rate concessions to achieve adequate occupancy rates. In an effort to reduce these risks, the Bank will evaluate the guarantor's ability to inject personal funds as a tertiary source of repayment.

**Commercial Real Estate Lending.** The Bank actively originates loans secured by commercial real estate including land (improved and unimproved), strip shopping centers, retail establishments and other businesses generally located in the Bank's primary market area. At June 30, 2012, the Bank had \$201.0 million in commercial real estate loans, which represented 34.4% of net loans receivable. Of this amount, \$48.6 million were loans secured by agricultural properties. The increase over the last several fiscal years in agricultural lending is the result of an intentional focus by the Bank on that segment of our market, including the hiring of personnel with knowledge of agricultural lending and



experience in that type of business development. The Company expects to continue to grow its agricultural lending portfolio, but expects that the rate of growth experienced over the last several fiscal years is unlikely to be maintained. The Company expects to continue to maintain or increase the percentage of commercial real estate loans in its total portfolio.

Most commercial real estate loans originated by the Bank generally are based on amortization schedules of up to 20 years with monthly principal and interest payments. Generally, the interest rate received on these loans is fixed for a maturity for up to five years, with a balloon payment due at maturity. Alternatively, for some loans, the interest rate adjusts at least annually after an initial period up to five years, based upon the Wall Street prime rate. The Bank typically includes an interest rate "floor" in the loan agreement. The Bank's fixed-rate commercial real estate portfolio has a weighted average maturity of 38 months. Variable rate commercial real estate originations typically adjust daily, monthly, quarterly or annually based on the Wall Street prime rate. Generally, improved commercial real estate loan amounts do not exceed 80% of the lower of the appraised value or the purchase price of the secured property. Agricultural real estate terms offered differ slightly, with amortization schedules of up to 25 years with an 80% loan-to-value ratio, or 30 years with a 75% loan-to-value ratio. Agricultural real estate loans generally require an annual payment. Before credit is extended, the Bank analyzes the financial condition of the borrower, the borrower's credit history, and the reliability and predictability of the cash flow generated by the property and the value of the property itself. Generally, personal guarantees are obtained from the borrower in addition to obtaining the secured property as collateral for such loans. The Bank also generally requires appraisals on properties securing commercial real estate to be performed by a Board-approved independent certified fee appraiser.

Generally, loans secured by commercial real estate involve a greater degree of credit risk than one- to four-family residential mortgage loans. These loans typically involve large balances to single borrowers or groups of related borrowers. Because payments on loans secured by commercial real estate are often dependent on the successful operation or management of the secured property, repayment of such loans may be subject to adverse conditions in the real estate market or the economy. See "Asset Quality."

**Construction Lending.** The Bank originates real estate loans secured by property or land that is under construction or development. At June 30, 2012, the Bank had \$40.2 million, or 6.89% of net loans receivable in construction loans outstanding.

Construction loans originated by the Bank are generally secured by mortgage loans for the construction of owner occupied residential real estate or to finance speculative construction secured by residential real estate, land development, or owner-operated or non-owner occupied commercial real estate. At June 30, 2012, \$12.4 million of the Bank's construction loans were secured by one- to four-family residential real estate (of which \$6.2 million was for speculative construction), \$12.4 million of which were secured by multifamily residential real estate, and \$15.4 million of which were secured by commercial real estate. During construction, these loans typically require monthly interest-only payments and have maturities ranging from 6 to 12 months. Once construction is completed, permanent construction loans may be converted to monthly payments using amortization schedules of up to 30 years on residential and generally up to 20 years on commercial real estate.

Speculative construction and land development lending generally affords the Bank an opportunity to receive higher interest rates and fees with shorter terms to maturity than those obtainable from residential lending. Nevertheless, construction and land development lending is generally considered to involve a higher level of credit risk than one- to four-family residential lending due to (i) the concentration of principal among relatively few borrowers and development projects, (ii) the increased difficulty at the time the loan is made of accurately estimating building or development costs and the selling price of the finished product, (iii) the increased difficulty and costs of monitoring and disbursing funds for the loan, (iv) the higher degree of sensitivity to increases in market rates of interest and changes in local economic conditions, and (v) the increased difficulty of working out problem loans. Due in part to these risk factors, the Bank may be required from time to time to modify or extend the terms of some of these types of loans. In an effort to reduce these risks, the application process includes a submission to the Bank of accurate plans, specifications and costs of the project to be constructed. These items are also used as a basis to determine the appraised value of the subject property. Loan amounts are generally limited to 80% of the lesser of current appraised value and/or the cost of construction.

Consumer Lending. The Bank offers a variety of secured consumer loans, including home equity, direct and indirect automobile loans, second mortgages, mobile homes and loans secured by deposits. The Bank originates substantially all of its consumer loans in its primary market area. Usually, consumer loans are originated with fixed rates for terms of up to five years, with the exception of home equity lines of credit, which are variable, tied to the prime rate of interest, and are for a period of ten years. At June 30, 2012, the Bank's consumer loan portfolio totaled \$29.0 million, or 4.97% of net loans receivable.

Home equity loans represented 54.7% of the Bank's consumer loan portfolio at June 30, 2012, and totaled \$15.9 million, or 2.72% of net loans receivable.

Home equity lines of credit (HELOCs) are secured with a deed of trust and are issued up to 100% of the appraised or assessed value of the property securing the line of credit, less the outstanding balance on the first mortgage. Interest rates on the HELOCs are adjustable and are tied to the current prime interest rate, generally with an interest rate floor in the loan agreement. This rate is obtained from the Wall Street Journal and adjusts on a daily basis. Interest rates are based upon the loan-to-value ratio of the property with better rates given to borrowers with more equity. HELOCs, which are secured by residential properties, are secured by stronger collateral than automobile loans and because of the adjustable rate structure, contain less interest rate risk to the Bank. Lending up to 100% of the value of the property presents greater credit risk to the Bank. Consequently, the Bank limits this product to customers with a favorable credit history. At June 30, 2012, lines of credit up to 80% of the property value represented 85.0% of outstanding balances, and 87.7% of balances and commitments; lines of credit for more than 80%, but not exceeding 90%, of the property value represented 14.5% of outstanding balances and 11.8% of balances and commitments; and lines of credit in excess of 90% of the property value represented 0.5% of outstanding balances and 0.4% of balances and commitments.

Automobile loans represented 26.05% of the Bank's consumer loan portfolio at June 30, 2012, and totaled \$7.6 million, or 1.29% of net loans receivable. Of that total, \$55,000 represented loans originated by auto dealers. The Bank generally pays a negotiated fee back to the dealer for these loans. Typically, automobile loans are made for terms of up to 60 months for new and used vehicles. Loans secured by automobiles have fixed rates and are generally made in amounts up to 100% of the purchase price of the vehicle.

Consumer loan terms vary according to the type and value of collateral, length of contract and creditworthiness of the borrower. The underwriting standards employed for consumer loans include employment stability, an application, a determination of the applicant's payment history on other debts, and an assessment of ability to meet existing and proposed obligations. Although creditworthiness of the applicant is a primary consideration, the underwriting process also includes a comparison of the value of the security, if any, in relation to the proposed loan amount.

Consumer loans may entail greater credit risk than do residential mortgage loans, because they are generally unsecured or are secured by rapidly depreciable or mobile assets, such as automobiles. In the event of repossession or default, there may be no secondary source of repayment or the underlying value of the collateral could be insufficient to repay the loan. In addition, consumer loan collections are dependent on the borrower's continuing financial stability, and thus are more likely to be affected by adverse personal circumstances. Furthermore, the application of various federal and state laws, including bankruptcy and insolvency laws, may limit the amount which can be recovered on such loans. The Bank's delinquency levels for these types of loans are reflective of these risks. See "Asset Classification."

**Commercial Business Lending.** The Bank's commercial business lending activities encompass loans with a variety of purposes and security, including loans to finance accounts receivable, inventory, equipment and operating lines of credit. At June 30, 2012, the Bank had \$137.0 million in commercial business loans outstanding, or 23.5% of net loans receivable. Of this amount, \$50.8 million were loans related to agriculture, including amortizing equipment loans and annual production lines. The increase over the last several fiscal years in agricultural lending is the result of an intentional focus by the Bank on that segment of our market, including the hiring of personnel with knowledge of agricultural lending and experience in that type of business development. The Company expects to continue to grow its agricultural lending portfolio, but expects that the rate of growth experienced over the last several fiscal years is unlikely to be maintained. The Bank expects to continue to maintain or increase the current percentage of commercial business loans in its total loan portfolio.

The Bank currently offers both fixed and adjustable rate commercial business loans. At year end, the Bank had \$75.9 million in fixed rate and \$61.1 million of adjustable rate commercial business loans. The adjustable rate business loans typically reprice daily, monthly, quarterly, or annually, in accordance with the Wall Street prime rate of interest. The Bank typically includes an interest rate "floor" in the loan agreement.

Commercial business loan terms vary according to the type and value of collateral, length of contract and creditworthiness of the borrower. Generally, commercial loans secured by fixed assets are amortized over periods up to five years, while commercial operating lines of credit or agricultural production lines are generally for a one year

period. The Bank's commercial business loans are evaluated based on the loan application, a determination of the applicant's payment history on other debts, business stability and an assessment of ability to meet existing obligations and payments on the proposed loan. Although creditworthiness of the applicant is a primary consideration, the underwriting process also includes a comparison of the value of the security, if any, in relation to the proposed loan amount.