

CONSUMERS BANCORP INC /OH/
Form 10-K
September 24, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

(Mark one)

☒ **Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the fiscal year ended June 30, 2014

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 No. 033-79130

CONSUMERS BANCORP, INC.

(Exact name of registrant as specified in its charter)

OHIO 34-1771400
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

614 East Lincoln Way,

P.O. Box 256, Minerva, Ohio 44657

(330) 868-7701

(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

Securities registered pursuant Section 12(b) of the Act: None

Securities registered pursuant Section 12(g) of the Act: Common Shares, no par value

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 Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 229.405 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

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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 the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☐ Smaller reporting company ☒
(Do not check if small reporting company)

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

Based on the closing sales price on December 31, 2013, the aggregate market value of the voting stock held by non-affiliates of the Registrant was approximately \$35,129,182.

The number of shares outstanding of the Registrant’s common stock, without par value was 2,735,536 at September 12, 2014.

DOCUMENTS INCORPORATED BY REFERENCE

Certain specifically designated portions of Consumers Bancorp, Inc.’s definitive Proxy Statement dated September 24, 2014 for its 2014 Annual Meeting of Shareholders are incorporated by reference into Part III of this Form 10-K.

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PART I

ITEM 1—BUSINESS

Business

Consumers Bancorp, Inc. (Corporation), is a bank holding company under the Bank Holding Company Act of 1956, as amended and is a registered bank holding company, and was incorporated under the laws of the State of Ohio in 1994. In February 1995, the Corporation acquired all the issued and outstanding capital stock of Consumers National Bank (Bank), a bank chartered under the laws of the United States of America. The Corporation's activities have been limited primarily to holding the common stock of the Bank.

Since 1965, the Bank's main office has been serving the Minerva, Ohio area from its location at 614 East Lincoln Way, Minerva, Ohio. The Bank's business involves attracting deposits from businesses and individual customers and using such deposits to originate commercial, mortgage and consumer loans in its market area, consisting primarily of Stark, Columbiana, Carroll and contiguous counties in Ohio. The Bank currently has twelve branch locations. The Bank also invests in securities consisting primarily of obligations of U.S. government sponsored entities, municipal obligations and mortgage-backed securities issued by Fannie Mae, Freddie Mac and Ginnie Mae.

Supervision and Regulation

The Corporation is supervised by the Board of Governors of the Federal Reserve System (Federal Reserve Board) and the Bank is subject to supervision, regulation and periodic examination by the Office of the Comptroller of the Currency (OCC). Earnings of the Corporation are affected by state and federal laws and regulations and by policies of various regulatory authorities. Changes in applicable law or in the policies of various regulatory authorities could affect materially the business and prospects of the Corporation and the Bank. The following discussion of supervision and regulation is qualified in its entirety by reference to the statutory and regulatory provisions discussed.

Regulation of the Corporation:

The Bank Holding Company Act: As a bank holding company, the Corporation is subject to regulation under the Bank Holding Company Act of 1956, as amended (BHCA) and the examination and reporting requirements of the

Board of Governors of the Federal Reserve System (Federal Reserve Board). Under the BHCA, the Corporation is subject to periodic examination by the Federal Reserve Board and required to file periodic reports regarding its operations and any additional information that the Federal Reserve Board may require.

The BHCA generally limits the activities of a bank holding company to banking, managing or controlling banks, furnishing services to or performing services for its subsidiaries and engaging in any other activities that the Federal Reserve Board has determined to be so closely related to banking or to managing or controlling banks as to be a proper incident to those activities. In addition, the BHCA requires every bank holding company to obtain the approval of the Federal Reserve Board prior to acquiring substantially all the assets of any bank, acquiring direct or indirect ownership or control of more than 5% of the voting shares of a bank or merging or consolidating with another bank holding company.

Under Federal Reserve Board policy, a bank holding company is expected to act as a source of financial strength to each subsidiary bank and to commit resources to support those subsidiary banks. Under this policy, the Federal Reserve Board may require a bank holding company to contribute additional capital to an undercapitalized subsidiary bank and may disapprove of the payment of dividends to shareholders if the Federal Reserve Board believes the payment of such dividends would be an unsafe or unsound practice. The Federal Reserve Board has extensive enforcement authority over bank holding companies for violations of laws and regulations and unsafe or unsound practices.

Privacy Provisions of Gramm-Leach-Bliley Act: The Gramm-Leach-Bliley Act of 1999 contains extensive provisions on a customer's right to privacy of non-public personal information. Under these provisions, a financial institution must provide to its customers the institution's policies and procedures regarding the handling of customers' non-public personal information. Except in certain cases, an institution may not provide personal information to unaffiliated third parties unless the institution discloses that such information may be disclosed and the customer is given the opportunity to opt out of such disclosure. The Corporation and the Bank are also subject to certain state laws that deal with the use and distribution of non-public personal information.

Sarbanes-Oxley Act: The Sarbanes-Oxley Act of 2002 contains important requirements for public companies in the area of financial disclosure and corporate governance. In accordance with section 302(a) of the Sarbanes-Oxley Act, written certifications by the Corporation's Chief Executive Officer and Chief Financial Officer are required. These certifications attest that the Corporation's quarterly and annual reports filed with the Securities and Exchange Commission do not contain any untrue statement of a material fact or omit to state a material fact.

Regulation of the Bank:

As a national bank, Consumers National Bank is subject to regulation, supervision and examination by the OCC and by the Federal Deposit Insurance Corporation (FDIC). These examinations are designed primarily for the protection of the depositors of the Bank.

Dividend Restrictions: Dividends from the Bank are the primary source of funds for payment of dividends to our shareholders. However, there are statutory limits on the amount of dividends the Bank can pay without regulatory approval. Under regulations promulgated by the OCC, the Bank may not declare a dividend in excess of its undivided profits. Additionally, the Bank may not declare a dividend if the total amount of all dividends, including the proposed dividend, declared by the Bank in any calendar year exceeds the total of its retained net income of that year to date, combined with its retained net income of the two preceding years, unless the dividend is approved by the OCC. The Bank may not declare or pay any dividend if, after making the dividend, the Bank would be “undercapitalized,” as defined in the federal regulations.

FDIC: The FDIC is an independent federal agency, which insures the deposits of federally insured banks and savings associations up to certain prescribed limits and safeguards the safety and soundness of financial institutions. The deposits of the Bank are subject to the deposit insurance assessments of the Bank Insurance Fund of the FDIC. Under the FDIC’s deposit insurance assessment system, the assessment rate for any insured institution varies according to regulatory capital levels of the institution and other factors such as supervisory evaluations.

The FDIC is authorized to prohibit any insured institution from engaging in any activity that poses a serious threat to the insurance fund and may initiate enforcement actions against banks, after first giving the institution’s primary regulatory authority an opportunity to take such action. The FDIC may also terminate the deposit insurance of any institution that has engaged in or is engaging in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, order or condition imposed by the FDIC.

FHLB: The Bank is also a member of the Federal Home Loan Bank of Cincinnati (FHLB), which is a privately capitalized, government sponsored enterprise that expands housing and economic development opportunities throughout the nation by providing loans and other banking services to community-based financial institutions.

Risk-Based Capital Requirements: The Federal Reserve Board and the OCC employ similar risk-based capital guidelines in their examination and regulation of bank holding companies and national banks. As of the fiscal year-end 2013, the Corporation met the definition of a Small Bank Holding Company and, therefore, was exempt from consolidated risk-based and coverage capital adequacy guidelines for bank holding companies. The guidelines involve a process of assigning various risk weights to different classes of assets, then evaluating the sum of the

risk-weighted balance sheet structure against the capital base. If capital falls below the minimum levels established by the guidelines, the bank holding company or bank may be denied approval to acquire or establish additional banks or non-bank businesses or to open new facilities. In addition, failure to satisfy capital guidelines could subject a banking institution to a variety of enforcement actions by federal bank regulatory authorities, including the termination of deposit insurance by the FDIC and a prohibition on the acceptance of “brokered deposits.”

Under regulations adopted under these provisions, for an institution to be well capitalized it must have a total risk-based capital ratio of at least 10%, a Tier I risk-based capital ratio of at least 6% and a Tier I leverage ratio of at least 5% and not be subject to any specific capital order or directive. The OCC and the FDIC may take various corrective actions against any undercapitalized bank and any bank that fails to submit an acceptable capital restoration plan or fails to implement a plan accepted by the OCC or the FDIC. These powers include, but are not limited to, requiring the institution to be recapitalized, prohibiting asset growth, restricting interest rates paid, requiring prior approval of capital distributions by any bank holding company that controls the institution, requiring divestiture by the institution of its subsidiaries or by the holding company of the institution itself, requiring new election of directors, and requiring the dismissal of directors and officers. The OCC’s final supervisory judgment concerning an institution’s capital adequacy could differ significantly from the conclusions that might be derived from the absolute level of an institution’s risk-based capital ratios. Therefore, institutions generally are expected to maintain risk-based capital ratios that exceed the minimum ratios. At June 30, 2014, the Bank was in compliance with all regulatory capital requirements.

Basel III Capital Rules. In July 2013, the Federal Reserve Board published final rules (the Basel III Capital Rules) establishing a new comprehensive capital framework for U.S. banking organizations. The rules implement the Basel Committee’s December 2010 framework known as “Basel III” for strengthening international capital standards as well as certain provisions of the Dodd-Frank Act. The Basel III Capital Rules substantially revise the risk-based capital requirements applicable to the Bank compared to the current U.S. risk-based capital rules.

The Basel III Capital rules include new risk-based capital and leverage ratios, which are effective on January 1, 2015, and refine the definition of what constitutes “capital” for purposes of calculating those ratios. The new minimum capital level requirements will require the Bank to maintain: (i) a new common equity Tier 1 capital ratio of 4.5%; (ii) a Tier 1 capital ratio of 6% (increased from 4%); (iii) a total capital ratio of 8% (unchanged from current rules); and (iv) a Tier 1 leverage ratio of 4%. The rule also established a “capital conservation buffer” of 2.5% above the new regulatory minimum capital requirements, which must consist entirely of common equity Tier 1 capital and results in the following minimum ratios: (i) a common equity Tier 1 capital ratio of 7.0%, (ii) a Tier 1 capital ratio of 8.5%, and (iii) a total capital ratio of 10.5%. The new capital conservation buffer requirement will be phased in beginning in January 2016 at 0.625% of risk-weighted assets and increase by that amount each year until fully implemented in January 2019. The capital conservation buffer is designed to absorb losses during periods of economic stress. Banking institutions with a common equity Tier 1 ratio to risk-weighted assets above the minimum but below the conservation buffer will face constraints on dividends, equity repurchases and compensation based on the amount of the shortfall.

Dodd-Frank Act: Federal regulators continue to implement many provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), which was signed into law on July 21, 2010. The Dodd-Frank Act created many new restrictions and an expanded framework of regulatory oversight for financial institutions, including depository institutions. Currently, federal regulators are still in the process of implementing many portions of the Dodd-Frank Act. The Corporation is closely monitoring all relevant sections of the Dodd-Frank Act to ensure continued compliance with these regulatory requirements. The following discussion summarizes significant aspects of the Dodd-Frank Act that may affect the Corporation and the Bank:

- Centralize responsibility for consumer financial protection by creating a new agency, the Consumer Financial Protection Bureau, responsible for implementing, examining and enforcing compliance with federal consumer financial laws.

- Require the OCC to make its capital requirements for national banks, countercyclical so that capital requirements increase in times of economic expansion and decrease in times of economic contraction.

- Change the assessment base for federal deposit insurance from the amount of insured deposits to consolidated assets less tangible capital, eliminate the ceiling of the Deposit Insurance Fund (DIF) and increase the floor of the DIF, which generally will reduce the level of assessments for institutions with assets below \$10 billion and increase the level of assessments for institutions with assets in excess of \$10 billion.

- Implement corporate governance revisions, including with regard to executive compensation and proxy access by shareholders, which apply to all public companies, not just financial institutions.

- Permanently increases the federal deposit insurance limit to \$250,000.

- Repeal the federal prohibitions on the payment of interest on demand deposits, thereby permitting depository institutions to pay interest on business transaction and other accounts effective one year after the bill was signed into law.

- Amend the Electronic Fund Transfer Act to, among other things, give the Federal Reserve the authority to establish rules regarding interchange fees charged for electronic debit transactions by payment card issuers having assets over \$10 billion and to enforce a new statutory requirement that such fees be reasonable and proportional to the actual cost of a transaction to the issuer.

- Make permanent SOX 404 (B) exemption regarding auditor attestation requirements for companies with less than \$75 million in market capitalization.

Many aspects of the Dodd-Frank Act are subject to rulemaking and will take effect over several years, making it difficult to anticipate the overall financial impact on the Corporation, its customers or the financial industry more generally. We will continue to monitor legislative developments and assess their potential impact on our business.

Interstate Banking and Branching: The Interstate Banking and Branch Efficiency Act of 1995 has eased restrictions on interstate expansion and consolidation of banking operations by, among other things: (i) permitting interstate bank acquisitions regardless of host state laws, (ii) permitting interstate merger of banks unless specific states have opted out of this provision, and (iii) permitting banks to establish new branches outside the state provided the law of the host state specifically allows interstate bank branching.

Community Reinvestment Act: The Community Reinvestment Act requires depository institutions to assist in meeting the credit needs of their market areas, including low and moderate-income areas, consistent with safe and sound banking practices. Under this Act, each institution is required to adopt a statement for each of its market areas describing the depository institution's efforts to assist in its community's credit needs. Depository institutions are periodically examined for compliance and assigned ratings. Banking regulators consider these ratings when considering approval of a proposed transaction by an institution.

USA Patriot Act: In 2001, Congress enacted the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA Patriot Act) Act of 2001 (Patriot Act). The Patriot Act is designed to deny terrorists and criminals the ability to obtain access to the United States' financial system and has significant implications for depository institutions, brokers, dealers, and other businesses involved in the transfer of money. The Patriot Act mandates financial services companies to implement additional policies and procedures with respect to additional measures designed to address any or all of the following matters: money laundering, terrorist financing, identifying and reporting suspicious activities and currency transactions, and currency crimes.

Employees

As of June 30, 2014, the Bank employed 104 full-time and 24 part-time employees. None of the employees are represented by a collective bargaining group. Management considers its relations with employees to be good.

Statistical Disclosure

The following statistical information is included on the indicated pages of this Report:

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Available Information

The Corporation files annual, quarterly, and current reports, proxy statements, and other information with the Securities and Exchange Commission (SEC). These filings are available to the public over the Internet at the SEC's web site at www.sec.gov. Shareholders may also read and copy any document that the Corporation files at the SEC's public reference room located at 100 F Street, NE, Washington, DC 20549, on official business days during the hours of 10:00 a.m. and 3:00 p.m. Shareholders may call the SEC at 1-800-SEC-0330 for further information on the public reference room.

Shareholders may request a copy of any of the Corporation's filings at no cost by writing or e-mailing the Corporation at the following address or e-mail address: Consumers Bancorp, Inc., Attn: Theresa J. Linder, 614 East Lincoln Way, Minerva, Ohio 44657 or e-mail to shareholderrelations@consumersbank.com.

The Corporation's Code of Ethics Policy, which is applicable to all directors, officers and employees of the Corporation, and its Code of Ethics for Principal Financial Officers, which is applicable to the principal executive officer and the principal financial officer, are each available on the Investor Relations section under Corporate Governance of the Corporation's website (www.consumersbank.com). Copies of either of the Code of Ethics Policies are also available in print to shareholders upon request, addressed to the Corporate Secretary at Consumers Bancorp, Inc., 614 East Lincoln Way, Minerva, Ohio 44657. The Corporation intends to post amendments to or waivers from its Code of Ethics on its website.

ITEM 1A—RISK FACTORS

Not applicable for Smaller Reporting Companies.

ITEM 1B—UNRESOLVED STAFF COMMENTS

None.

ITEM 2—PROPERTIES

The Bank owns and maintains the premises in which nine banking facilities are located, and leases offices in Carrollton, Alliance and Malvern. The location of each of the twelve currently operating offices is as follows:

Minerva Office:	614 E. Lincoln Way, P.O. Box 256, Minerva, Ohio, 44657
Salem Office:	141 S. Ellsworth Ave., P.O. Box 798, Salem, Ohio, 44460
Waynesburg Office:	8607 Waynesburg Dr. SE, P.O. Box 746, Waynesburg, Ohio, 44688
Hanoverton Office:	30034 Canal St., P.O. Box 178, Hanoverton, Ohio, 44423
Carrollton Office:	1017 Canton Rd. NW, Carrollton, Ohio, 44615
Alliance Office:	610 West State St., Alliance, Ohio, 44601
Lisbon Office:	7985 Dickey Dr., Lisbon, Ohio 44432
Louisville Office:	1111 N. Chapel St., Louisville, Ohio 44641
East Canton Office:	440 W. Noble, East Canton, Ohio, 44730
Malvern Office:	4070 Alliance Rd., Malvern, Ohio 44644
Hartville Office:	1215 W. Maple Street, Hartville, OH 44632
Jackson-Belden Office:	4026 Dressler Road NW, Canton, Ohio 44718

In the opinion of management, the properties listed above are adequate for their present uses and the Bank's business requirements and are adequately covered by insurance. A new facility is being constructed at the Minerva, Ohio location to replace the existing branch and corporate headquarters.

ITEM 3—LEGAL PROCEEDINGS

The Corporation is not a party to any pending material legal or administrative proceedings, other than ordinary routine litigation incidental to the business of the Corporation. Further, there are no material legal proceedings in which any director, executive officer, principal shareholder or affiliate of the Corporation is a party or has a material interest that is adverse to the Corporation. No routine litigation in which the Corporation is involved is expected to have a material adverse impact on the financial position or results of operations of the Corporation.

ITEM 4—MINE SAFETY DISCLOSURES

None.

PART II**ITEM 5—MARKET FOR REGISTRANT’S COMMON EQUITY, RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

The Corporation had 2,735,536 common shares outstanding on June 30, 2014 with 785 shareholders of record and an estimated 345 additional beneficial holders whose stock was held in nominee name. Attention is directed to Item 12 in this Form 10-K for information regarding the Corporation’s equity incentive plans, which information is incorporated herein by reference.

The common shares of Consumers Bancorp, Inc. are traded on the over-the-counter bulletin board. The following quoted market prices reflect inter-dealer prices, without adjustments for retail markups, markdowns, or commissions and may not represent actual transactions. The market prices represent highs and lows reported during the quarterly period.

Quarter Ended	September 30, 2013	December 31, 2013	March 31, 2014	June 30, 2014
High	\$ 18.00	\$ 21.98	\$ 21.25	\$ 20.00
Low	15.35	16.30	18.10	18.75
Cash dividends paid per share	0.12	0.12	0.12	0.12

Quarter Ended	September 30, 2012	December 31, 2012	March 31, 2013	June 30, 2013
High	\$ 16.00	\$ 17.50	\$ 20.50	\$ 17.50
Low	14.55	14.75	15.51	15.55
Cash dividends paid per share	0.12	0.12	0.12	0.12

Management does not have knowledge of the prices paid in all transactions and has not verified the accuracy of those prices that have been reported. Because of the lack of an established market for the Corporation’s common shares, these prices may not reflect the prices at which the common shares would trade in an active market.

The Corporation’s management is currently committed to continuing to pay regular cash dividends; however, there can be no assurance as to future dividends because they are dependent on the Corporation’s future earnings, capital requirements and financial condition. The Corporation’s principal source of funds for dividend payment is dividends received from the Bank. Banking regulations limit the amount of dividends that may be paid without prior approval of regulatory agencies. Under these regulations, the amount of dividends that may be paid in any calendar year is limited

to the current year's net profits, combined with the retained net profits of the preceding two years, subject to the capital requirements described above. See Note 1 and Note 10 to the Consolidated Financial Statements and Management's Discussion and Analysis of Financial Condition and Results of Operation for dividend restrictions.

There were no repurchases of the Corporation's securities during the 2014 fiscal year.

ITEM 6—SELECTED FINANCIAL DATA

Not applicable for Smaller Reporting Companies.

ITEM 7—MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(Dollars in thousands, except per share data)

General

The following is management’s analysis of the Corporation’s financial condition and results of operations as of and for the years ended June 30, 2014 and 2013. This discussion is designed to provide a more comprehensive review of the operating results and financial position than could be obtained from an examination of the financial statements alone. This analysis should be read in conjunction with the consolidated financial statements and related footnotes and the selected financial data included elsewhere in this report.

Overview

Consumers Bancorp, Inc., a bank holding company incorporated under the laws of the State of Ohio, owns all of the issued and outstanding capital stock of Consumers National Bank, a bank chartered under the laws of the United States of America. The Corporation’s activities have been limited primarily to holding the common stock of the Bank. The Bank’s business involves attracting deposits from businesses and individual customers and using such deposits to originate commercial, mortgage and consumer loans in its market area, consisting primarily of Stark, Columbiana, Carroll and contiguous counties in Ohio. The Bank also invests in securities consisting primarily of U.S. government sponsored entities, municipal obligations, mortgage-backed and collateralized mortgage obligations issued by Fannie Mae, Freddie Mac and Ginnie Mae.

Comparison of Results of Operations for the Years Ended June 30, 2014 and June 30, 2013

Net Income. Net income increased by \$168, or 6.3%, from fiscal year 2013 to fiscal year 2014. The following key factors summarize our results of operations for the year ended June 30, 2014:

- net interest income increased by \$722, or 6.0%, in fiscal year 2014 from the same prior year period;
- loan loss provision expense in fiscal year 2014 totaled \$249 compared with \$337 in 2013; and
-

total other expenses increased \$581, or 5.2% in fiscal year 2014, principally as a result of higher salary and employee benefits due to staff hired in the lending area and an increase in professional and director expenses.

Return on average equity and return on average assets were 7.44% and 0.77%, respectively, for the 2014 fiscal year-to-date period compared with 9.21% and 0.78%, respectively, for the same period last year. The return on average equity declined from the same period last year due to a \$9.1 million increase in average equity mainly as a result of the \$9.2 million in net proceeds from the rights and public offering that were completed in July 2013.

Net Interest Income. Net interest income, the difference between interest income earned on interest-earning assets and interest expense incurred on interest-bearing liabilities, is the largest component of the Corporation's earnings. Net interest income is affected by changes in the volumes, rates and composition of interest-earning assets and interest-bearing liabilities. Net interest margin is calculated by dividing net interest income on a fully tax equivalent basis (FTE) by total interest-earning assets. FTE income includes tax-exempt income, restated to a pre-tax equivalent, based on the statutory federal income tax rate. All average balances are daily average balances. Non-accruing loans are included in average loan balances.

Net Interest Income Year ended June 30,	2014	2013
Net interest income	\$12,661	\$11,939
Taxable equivalent adjustments to net interest	716	647
Net interest income, fully taxable equivalent	\$13,377	\$12,586
Net interest margin	3.65 %	3.70 %
Taxable equivalent adjustment	0.21	0.20
Net interest margin, fully taxable equivalent	3.86 %	3.90 %

Net interest income for the 2014 fiscal year was \$12,661, an increase of \$722, or 6.0%, from \$11,939 in the 2013 fiscal year. The Corporation's tax equivalent net interest margin for the year ended June 30, 2014 was 3.86%, a decrease of 4 basis points from 2013. Interest income for the 2014 fiscal year was \$13,656, an increase of \$515, or 3.9%, from \$13,141 in the 2013 fiscal year. An increase of \$21,680, or 6.7%, in average interest-earning assets more than offset the impact the low interest rate environment has had on the yield of average interest-earning assets. Interest expense for the 2014 fiscal year was \$995, a decrease of \$207, or 17.2%, from \$1,202 in the 2013 fiscal year. This decrease was mainly the result of lower market rates affecting the rates paid on time deposits and due to an increase in lower costing interest bearing demand and savings deposit products as depositors shifted funds from time deposits. The Corporation offers an interest bearing demand checking account product that pays a higher rate of interest to customers who meet certain qualifications, with one of the main qualifications being the frequent use of a debit card. As a result, the rate paid on the interest bearing demand checking account product was 0.20% and 0.21% for the 2014 and 2013 periods, respectively.

Average Balance Sheet and Net Interest Margin

	2014			2013		
	Average Balance	Interest	Yield/ Rate	Average Balance	Interest	Yield/ Rate
Interest earning assets:						
Taxable securities	\$75,808	\$1,606	2.13 %	\$66,241	\$1,263	1.94 %
Nontaxable Securities (1)	44,813	2,032	4.54	40,469	1,888	4.87
Loans receivable (1)	217,547	10,687	4.91	205,934	10,577	5.14
Interest bearing deposits and federal funds sold	9,164	47	0.51	13,008	60	0.46
Total interest earning assets	347,332	14,372	4.14 %	325,652	13,788	4.27 %
Non-interest earning assets	19,982			18,084		
Total assets	\$367,314			\$343,736		
Interest bearing liabilities:						
Interest bearing demand	\$40,112	\$82	0.20 %	\$37,167	\$79	0.21 %
Savings	118,066	92	0.08	103,729	86	0.08
Time deposits	74,628	609	0.82	82,613	816	0.99
Short-term borrowings	15,888	26	0.16	13,457	22	0.16
FHLB advances	6,433	186	2.89	6,433	199	3.09
Total interest bearing liabilities	255,127	995	0.39 %	243,399	1,202	0.49 %
Non-interest bearing liabilities	74,065			71,350		
Total liabilities	329,192			314,749		
Shareholders' equity	38,122			28,987		
Total liabilities and shareholders' equity	\$367,314			\$343,736		