

GUARANTY FEDERAL BANCSHARES INC  
Form 10-Q  
August 08, 2014

**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, 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 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

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, 2014</u>
Common Stock, Par Value \$0.10 per share	4,274,348 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, 2014 (UNAUDITED) AND DECEMBER 31, 2013**

	<b>6/30/14</b>	<b>12/31/13</b>
<b>ASSETS</b>		
Cash	\$4,449,140	\$3,453,032
Interest-bearing deposits in other financial institutions	16,381,886	8,850,168
Cash and cash equivalents	20,831,026	12,303,200
Available-for-sale securities	100,414,541	97,692,685
Held-to-maturity securities	69,862	79,162
Stock in Federal Home Loan Bank, at cost	2,878,900	2,885,100
Mortgage loans held for sale	1,221,633	623,432
Loans receivable, net of allowance for loan losses of June 30, 2014 - \$6,788,409 - December 31, 2013 - \$7,801,600	454,151,996	464,379,854
Accrued interest receivable:		
Loans	1,474,218	1,462,881
Investments and interest-bearing deposits	365,020	389,760
Prepaid expenses and other assets	5,033,213	5,536,879
Foreclosed assets held for sale	3,644,396	3,821,976
Premises and equipment, net	10,733,726	10,886,720
Bank owned life insurance	14,228,666	14,043,697
Income taxes receivable	615,777	504,138
Deferred income taxes	4,090,202	5,278,651
	<b>\$619,753,176</b>	<b>\$619,888,135</b>

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

Deposits	\$481,152,569	\$487,318,939
Federal Home Loan Bank and Federal Reserve Bank advances	53,400,000	55,350,000
Securities sold under agreements to repurchase	10,000,000	10,000,000
Subordinated debentures	15,465,000	15,465,000
Advances from borrowers for taxes and insurance	345,262	149,668
Accrued expenses and other liabilities	1,047,288	998,934
Accrued interest payable	239,297	250,361

	561,649,416	569,532,902
<b>COMMITMENTS AND CONTINGENCIES</b>	-	-
<b>STOCKHOLDERS' EQUITY</b>		
Capital Stock:		
Series A preferred stock, \$0.01 par value; authorized 2,000,000 shares; issued and outstanding December 31, 2013 - 12,000 shares	-	11,983,790
Common stock, \$0.10 par value; authorized 10,000,000 shares; issued June 30, 2014 and December 31, 2013 - 6,799,903 and 6,783,603 shares, respectively	679,990	678,360
Additional paid-in capital	50,672,475	57,655,031
Retained earnings, substantially restricted	45,840,055	43,769,485
Accumulated other comprehensive income (loss)		
Unrealized gain (loss) on available-for-sale securities, net of income taxes	(916,796 )	(2,506,248 )
	96,275,724	111,580,418
Treasury stock, at cost; June 30, 2014 and December 31, 2013 - 2,525,555 and 4,051,248 shares, respectively	(38,171,964 )	(61,225,185 )
	58,103,760	50,355,233
	\$619,753,176	\$619,888,135

See Notes to Condensed Consolidated Financial Statements

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**GUARANTY FEDERAL BANCSHARES, INC.****CONDENSED CONSOLIDATED STATEMENTS OF INCOME****THREE MONTHS AND SIX MONTHS ENDED JUNE 30, 2014 AND 2013 (UNAUDITED)**

	Three months ended		Six months ended	
	6/30/2014	6/30/2013	6/30/2014	6/30/2013
<b>Interest Income</b>				
Loans	\$5,576,155	\$5,952,456	\$11,443,713	\$11,880,846
Investment securities	415,318	466,828	872,884	899,457
Other	46,110	47,736	81,050	106,138
	6,037,583	6,467,020	12,397,647	12,886,441
<b>Interest Expense</b>				
Deposits	562,700	731,420	1,169,493	1,492,594
Federal Home Loan Bank and Federal Reserve Bank advances	298,636	307,869	594,327	676,544
Subordinated debentures	133,035	134,322	266,198	268,672
Other	65,975	107,742	131,225	271,697
	1,060,346	1,281,353	2,161,243	2,709,507
<b>Net Interest Income</b>	4,977,237	5,185,667	10,236,404	10,176,934
<b>Provision for Loan Losses</b>	325,000	250,000	525,000	650,000
<b>Net Interest Income After Provision for Loan Losses</b>	4,652,237	4,935,667	9,711,404	9,526,934
<b>Noninterest Income</b>				
Service charges	318,434	292,049	631,419	553,834
Gain on sale of investment securities	7,603	116,182	10,691	204,983
Gain on sale of loans	250,667	592,086	436,245	1,024,019
Gain on sale of state low-income housing tax credits	-	1,441,012	-	1,441,012
Net loss on foreclosed assets	(61,182 )	(75,758 )	(76,965 )	(148,103 )
Other income	346,973	318,973	678,798	628,567
	862,495	2,684,544	1,680,188	3,704,312
<b>Noninterest Expense</b>				
Salaries and employee benefits	2,231,963	2,272,746	4,536,731	4,665,108
Occupancy	419,614	449,764	846,675	875,893
FDIC deposit insurance premiums	120,029	141,173	256,963	283,636
Prepayment penalty on securities sold under agreements to repurchase	-	1,510,000	-	1,510,000
Data processing	165,486	184,875	326,272	354,135
Advertising	106,251	106,251	212,502	212,502
Other expense	839,640	867,528	2,048,444	2,056,663
	3,882,983	5,532,337	8,227,587	9,957,937
<b>Income Before Income Taxes</b>	1,631,749	2,087,874	3,164,005	3,273,309
<b>Provision for Income Taxes</b>	293,066	520,134	523,896	752,916
<b>Net Income</b>	1,338,683	1,567,740	2,640,109	2,520,393
<b>Preferred Stock Dividends and Discount Accretion</b>	111,000	198,630	357,210	397,260

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<b>Net Income Available to Common Shareholders</b>	\$1,227,683	\$1,369,110	\$2,282,899	\$2,123,133
<b>Basic Income Per Common Share</b>	\$0.29	\$0.50	\$0.61	\$0.78
<b>Diluted Income Per Common Share</b>	\$0.28	\$0.49	\$0.60	\$0.76

See Notes to Condensed Consolidated Financial Statements

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**GUARANTY FEDERAL BANCSHARES, INC.****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)****THREE MONTHS AND SIX MONTHS ENDED JUNE 30, 2014 AND 2013 (UNAUDITED)**

	Three months ended		Six months ended	
	6/30/2014	6/30/2013	6/30/2014	6/30/2013
<b>NET INCOME</b>	\$1,338,683	\$1,567,740	\$2,640,109	\$2,520,393
<b>OTHER ITEMS OF COMPREHENSIVE INCOME (LOSS):</b>				
Change in unrealized gain (loss) on investment securities available-for-sale, before income taxes	1,248,693	(3,722,649)	2,533,631	(4,104,800)
Less: Reclassification adjustment for realized gains on investment securities included in net income, before income taxes	(7,603 )	(116,182 )	(10,691 )	(204,983 )
Total other items in comprehensive income (loss)	1,241,090	(3,838,831)	2,522,940	(4,309,783)
Income tax expense (benefit) related to other items of comprehensive income	459,203	(1,420,367)	933,488	(1,594,619)
Other comprehensive income (loss)	781,887	(2,418,464)	1,589,452	(2,715,164)
<b>TOTAL COMPREHENSIVE INCOME (LOSS)</b>	<b>\$2,120,570</b>	<b>\$(850,724 )</b>	<b>\$4,229,561</b>	<b>\$(194,771 )</b>

See Notes to Condensed Consolidated Financial Statements

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## GUARANTY FEDERAL BANCSHARES, INC.

## CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

## SIX MONTHS ENDED JUNE 30, 2014 (UNAUDITED)

	Preferred Stock	Common Stock	Additional Paid-In Capital	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Income (loss)	Total
<b>Balance, January 1, 2014</b>	\$11,983,790	\$678,360	\$57,655,031	\$(61,225,185)	\$43,769,485	\$(2,506,248)	\$50,355,233
Net income	-	-	-	-	2,640,109	-	2,640,109
Change in unrealized gain (loss) on available-for-sale securities, net of income taxes	-	-	-	-	-	1,589,452	1,589,452
Preferred stock redeemed	(12,000,000)	-	-	-	-	-	(12,000,000)
Preferred stock discount accretion	16,210	-	-	-	(16,210)	-	-
Preferred stock dividends	-	-	-	-	(338,000)	-	(338,000)
Dividends on common stock (\$0.05 per share)	-	-	-	-	(215,329)	-	(215,329)
Stock award plans	-	-	(215,059)	388,236	-	-	173,177
Stock options exercised	-	1,630	83,176	-	-	-	84,806
Proceeds from issuance of common stock	-	-	(6,850,673)	22,664,985	-	-	15,814,312
<b>Balance, June 30, 2014</b>	\$-	\$679,990	\$50,672,475	\$(38,171,964)	\$45,840,055	\$(916,796)	\$58,103,760

See Notes to Condensed Consolidated Financial Statements

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## GUARANTY FEDERAL BANCSHARES, INC.

## CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

## SIX MONTHS ENDED JUNE 30, 2013 (UNAUDITED)

	Preferred Stock	Common Stock	Common Stock Warrants	Additional Paid-In Capital	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Income (loss)	Total
<b>Balance, January 1, 2013</b>	\$11,789,276	\$678,180	\$1,377,811	\$58,267,529	\$(61,369,344)	\$39,324,292	\$800,826	\$50,866,449
Net income	-	-	-	-	-	2,520,393	-	2,520,393
Change in unrealized gain (loss) on available-for-sale securities, net of income taxes	-	-	-	-	-	-	(2,715,164)	(2,715,164)
Preferred stock discount accretion	97,257	-	-	-	-	(97,257)	-	-
Preferred stock dividends	-	-	-	-	-	(300,000)	-	(300,000)
Common stock warrants repurchased	-	-	(1,377,811)	(625,439)	-	-	-	(2,003,250)
Stock award plans	-	-	-	(63,520)	250,795	-	-	187,275
Stock options exercised	-	180	-	9,229	-	-	-	9,409
Treasury stock purchased	-	-	-	-	(105,782)	-	-	(105,782)
<b>Balance, June 30, 2013</b>	\$11,886,533	\$678,360	\$-	\$57,587,799	\$(61,224,331)	\$41,447,428	\$(1,914,338)	\$48,463,021

See Notes to Condensed Consolidated Financial Statements

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**GUARANTY FEDERAL BANCSHARES, INC****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****SIX MONTHS ENDED JUNE 30, 2014 AND 2013 (UNAUDITED)**

	<b>6/30/2014</b>	<b>6/30/2013</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$2,640,109	\$2,520,393
Items not requiring (providing) cash:		
Deferred income taxes	254,961	675,633
Depreciation	382,086	414,885
Provision for loan losses	525,000	650,000
Gain on sale of loans and investment securities	(446,936 )	(1,229,002 )
Loss on foreclosed assets held for sale	25,593	76,448
Gain on sale of state low-income housing tax credits	-	(1,441,012 )
Amortization of deferred income, premiums and discounts	313,135	274,385
Stock award plan expense	190,490	187,275
Origination of loans held for sale	(14,709,615)	(31,553,697)
Proceeds from sale of loans held for sale	14,547,659	34,000,714
Increase in cash surrender value of bank owned life insurance	(184,969 )	(194,895 )
Changes in:		
Prepaid FDIC deposit insurance premiums	-	1,438,636
Accrued interest receivable	13,403	51,533
Prepaid expenses and other assets	503,666	295,071
Accounts payable and accrued expenses	(103,039 )	179,869
Income taxes receivable	(128,952 )	77,283
Net cash provided by operating activities	3,822,591	6,423,519
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Net change in loans	9,451,794	5,081,769
Principal payments on held-to-maturity securities	9,300	91,829
Principal payments on available-for-sale securities	4,235,914	6,345,815
Proceeds from calls/maturities of available-for-sale securities	3,151,000	9,000,000
Purchase of premises and equipment	(229,092 )	(272,671 )
Purchase of available-for-sale securities	(25,995,159)	(44,309,342)
Proceeds from sale of available-for-sale securities	18,106,890	17,311,228
Redemption of Federal Home Loan Bank stock	6,200	658,100
Proceeds from sale of state low-income housing tax credits	-	1,441,012
Proceeds from sale of foreclosed assets held for sale	403,046	828,401
Net cash provided by (used in) investing activities	9,139,893	(3,823,859 )
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Net increase (decrease) in demand deposits, NOW and savings accounts	(4,450,772 )	25,921,950
Net decrease in certificates of deposit	(1,715,598 )	(14,047,207)
Net decrease of securities sold under agreements to repurchase	-	(15,000,000)
Proceeds from FHLB advances	1,050,000	-
Repayments of FHLB advances	(3,000,000 )	(15,100,000)

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Stock options exercised	84,806	9,409
Redemption of preferred stock	(12,000,000)	-
Repurchase of common stock warrants	-	(2,003,250 )
Proceeds from issuance of common stock	15,814,312	-
Advances from borrowers for taxes and insurance	195,594	217,003
Cash dividends paid on preferred stock	(413,000 )	(300,000 )
Treasury stock purchased	-	(105,782 )
Net cash used in financing activities	(4,434,658 )	(20,407,877)
<b>INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>8,527,826</b>	<b>(17,808,217)</b>
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD</b>	<b>12,303,200</b>	<b>41,663,405</b>
<b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>	<b>\$20,831,026</b>	<b>\$23,855,188</b>

See Notes to Condensed Consolidated Financial Statements

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## **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 10-01 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, 2013 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, 2013, 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, 2014</b>				
Equity Securities	\$ 102,212	\$ 18,270	\$(14,468 )	\$ 106,014
Debt Securities:				
U. S. government agencies	17,859,155	-	(521,929 )	17,337,226
Municipals	14,390,096	103,051	(210,367 )	14,282,780
Government sponsored mortgage-backed securities	69,518,311	303,267	(1,133,057)	68,688,521
	\$ 101,869,774	\$ 424,588	\$(1,879,821)	\$ 100,414,541

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Approximate Fair Value
<b>As of December 31, 2013</b>				
Equity Securities	\$ 102,212	\$ 16,007	\$(18,913 )	\$ 99,306
Debt Securities:				
U. S. government agencies	33,198,865	-	(1,437,478)	31,761,387
Municipals	14,133,821	18,827	(660,021 )	13,492,627
Corporates	990,663	3,609	-	994,272
Government sponsored mortgage-backed securities	53,245,297	265,038	(2,165,242)	51,345,093
	\$ 101,670,858	\$ 303,481	\$(4,281,654)	\$ 97,692,685

Maturities of available-for-sale debt securities as of June 30, 2014:

	Amortized Cost	Approximate Fair Value
1-5 years	\$9,514,806	\$9,337,173
6-10 years	14,984,811	14,576,895
After 10 years	7,749,634	7,705,938
Government sponsored mortgage-backed securities not due on a single maturity date	69,518,311	68,688,521
	\$101,767,562	\$100,308,527

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, 2014</b>				
Debt Securities:				
Government sponsored mortgage-backed securities	\$ 69,862	\$ 1,766	\$ -	\$ 71,628

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Approximate Fair Value
<b>As of December 31, 2013</b>				
Debt Securities:				
Government sponsored mortgage-backed securities	\$ 79,162	\$ 1,927	\$ -	\$ 81,089



Maturities of held-to-maturity securities as of June 30, 2014:

	Amortized Cost	Approximate Fair Value
Government sponsored mortgage-backed securities not due on a single maturity date	\$ 69,862	\$ 71,628

The book value of securities pledged as collateral, to secure public deposits and for other purposes, amounted to \$47,029,182 and \$44,717,470 as of June 30, 2014 and December 31, 2013, respectively. The approximate fair value of pledged securities amounted to \$46,098,539 and \$42,807,840 as of June 30, 2014 and December 31, 2013, 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 \$10,691 and \$204,983 as of June 30, 2014 and June 30, 2013, respectively, were realized from the sale of available-for-sale securities. The tax effect of these net gains was \$3,956 and \$75,844 as of June 30, 2014 and June 30, 2013, 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, 2014 and December 31, 2013, was \$82,234,766 and \$85,712,067, respectively, which is approximately 82% and 88% 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, 2014 and December 31, 2013.

June 30, 2014						
Description of Securities	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Equity Securities	\$-	\$-	\$33,459	\$(14,468 )	\$33,459	\$(14,468 )
U. S. government agencies	-	-	17,337,226	(521,929 )	17,337,226	(521,929 )
Municipals	2,729,915	(15,070 )	7,181,252	(195,297 )	9,911,167	(210,367 )
Government sponsored mortgage-backed securities	19,800,679	(111,552 )	35,152,236	(1,021,504)	54,952,914	(1,133,056)
	\$22,530,594	\$(126,622)	\$59,704,173	\$(1,753,199)	\$82,234,766	\$(1,879,821)

December 31, 2013						
Description of Securities	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Equity Securities	\$-	\$-	\$29,014	\$(18,913 )	\$29,014	\$(18,913 )
U. S. government agencies	24,731,730	(916,208 )	7,029,657	(521,270 )	31,761,387	(1,437,478)
Municipals	10,460,662	(534,440 )	1,701,215	(125,581 )	12,161,877	(660,021 )
Government sponsored mortgage-backed securities	32,074,646	(1,655,296)	9,685,143	(509,946 )	41,759,789	(2,165,242)
	\$67,267,038	\$(3,105,944)	\$18,445,029	\$(1,175,710)	\$85,712,067	\$(4,281,654)

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

Categories of loans at June 30, 2014 and December 31, 2013 include:

	June 30, 2014	December 31, 2013
Real estate - residential mortgage:		
One to four family units	\$95,356,636	\$93,797,650
Multi-family	31,969,145	46,188,434
Real estate - construction	39,159,239	43,266,130
Real estate - commercial	188,307,781	179,079,433
Commercial loans	89,248,153	92,721,783
Consumer and other loans	17,074,824	17,303,392
Total loans	461,115,778	472,356,822
Less:		
Allowance for loan losses	(6,788,409 )	(7,801,600 )
Deferred loan fees/costs, net	(175,373 )	(175,368 )
Net loans	\$454,151,996	\$464,379,854

Classes of loans by aging at June 30, 2014 and December 31, 2013 were as follows:

**As of June 30, 2014**

	30-59	60-89	90	Total	Current	Total	Total
	Days	Days	Days	Past		Loans	Loans >
	Past	Past	and	Due		Receivable	90 Days
	Due	Due	more				and
			Past				Accruing
			Due				
	<i>(In Thousands)</i>						
Real estate - residential mortgage:							
One to four family units	\$14	\$500	\$287	\$801	\$94,556	\$95,357	\$ -
Multi-family	-	-	-	-	31,969	31,969	-
Real estate - construction	-	-	-	-	39,159	39,159	-
Real estate - commercial	-	28	-	28	188,280	188,308	-
Commercial loans	-	1,152	-	1,152	88,096	89,248	-
Consumer and other loans	3	38	-	41	17,034	17,075	-
Total	\$17	\$1,718	\$287	\$2,022	\$459,094	\$461,116	\$ -

**As of December 31, 2013**

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	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	\$246	\$337	\$-	\$583	\$93,215	\$93,798	\$ -
Multi-family	-	-	-	-	46,188	46,188	-
Real estate - construction	-	-	536	536	42,730	43,266	-
Real estate - commercial	-	-	2,604	2,604	176,476	179,080	-
Commercial loans	-	2	3,628	3,630	89,092	92,722	-
Consumer and other loans	19	-	63	82	17,221	17,303	-
Total	\$265	\$339	\$6,831	\$7,435	\$464,922	\$472,357	\$ -

Nonaccruing loans are summarized as follows:

	June 30, 2014	December 31, 2013
Real estate - residential mortgage:		
One to four family units	\$1,209,618	\$815,746
Multi-family	-	-
Real estate - construction	3,430,492	4,529,410
Real estate - commercial	514,866	3,663,166
Commercial loans	2,651,340	6,776,230
Consumer and other loans	-	63,027
Total	\$7,806,316	\$15,847,579

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, 2014 and 2013:

<b>Three months ended</b>	Commercial		One to	Multi-family		Commercial	Consumer	Unallocated Total	
<b>June 30, 2014</b>	Construction	Real Estate	four family				and Other		
	<i>(In Thousands)</i>								
<b>Allowance for loan losses:</b>									
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	

<b>Six months ended</b>	Commercial		One to	Multi-family		Commercial	Consumer	Unallocated Total	
<b>June 30, 2014</b>	Construction	Real Estate	four family				and Other		
	<i>(In Thousands)</i>								
<b>Allowance for loan losses:</b>									
Balance, beginning of period	\$2,387	\$ 2,059	\$997	\$ 209	\$ 1,519	\$ 272	\$ 359	\$7,802	
	(304 )	234	114	(63 )	914	(11 )	(359 )	\$525	

Provision charged to  
expense

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

Three months ended June 30, 2013	Commercial		One to	Multi-family	Commercial	Consumer	Unallocated	Total
	Construction	Real Estate	four family			and Other		
<i>(In Thousands)</i>								
<b>Allowance for loan losses:</b>								
Balance, beginning of period	\$2,253	\$ 1,911	\$1,234	\$ 285	\$ 1,460	\$ 275	\$ 694	\$8,112
Provision charged to expense	(282 )	115	66	6	542	(3 )	(194 )	\$250
Losses charged off	-	-	(74 )	-	-	(20 )	-	\$(94 )
Recoveries	28	-	3	-	63	15	-	\$109
Balance, end of period	\$1,999	\$ 2,026	\$1,229	\$ 291	\$ 2,065	\$ 267	\$ 500	\$8,377

Six months ended June 30, 2013	Commercial		One to	Multi-family	Commercial	Consumer	Unallocated	Total
	Construction	Real Estate	four family			and Other		
<i>(In Thousands)</i>								
<b>Allowance for loan losses:</b>								
Balance, beginning of period	\$2,525	\$ 2,517	\$1,316	\$ 284	\$ 1,689	\$ 255	\$ 154	\$8,740
Provision charged to expense	(126 )	(305 )	40	7	651	37	346	\$650
Losses charged off	(438 )	(186 )	(134 )	-	(373 )	(53 )	-	\$(1,184)
Recoveries	38	-	7	-	98	28	-	\$171
Balance, end of period	\$1,999	\$ 2,026	\$1,229	\$ 291	\$ 2,065	\$ 267	\$ 500	\$8,377

The following tables present the recorded investment in loans based on portfolio segment and impairment method as of June 30, 2014 and December 31, 2013:

**As of June 30, 2014**

	Commercial		One to	Multi-family	Commercial	Consumer	Unallocated	Total
	Construction	Real Estate	four family			and Other		
<i>(In Thousands)</i>								
<b>Allowance for loan losses:</b>								
	\$515	\$ 185	\$48	\$ -	\$ -	\$ 10	\$ -	\$758



Ending balance: individually evaluated for impairment									
Ending balance: collectively evaluated for impairment	\$ 1,364	\$ 2,099	\$ 966	\$ 146	\$ 1,244	\$ 211	\$ -	\$ 6,030	
<b>Loans:</b>									
Ending balance: individually evaluated for impairment	\$ 3,430	\$ 515	\$ 1,210	\$ -	\$ 3,438	\$ 273	\$ -	\$ 8,866	
Ending balance: collectively evaluated for impairment	\$ 35,729	\$ 187,793	\$ 94,147	\$ 31,969	\$ 85,810	\$ 16,802	\$ -	\$ 452,250	

**December 31, 2013**

	Commercial Construction Real Estate	One to four family	Multi-family	Commercial	Consumer and Other	Unallocated	Total	
	<i>(In Thousands)</i>							
<b>Allowance for loan losses:</b>								
Ending balance: individually evaluated for impairment	\$ 890	\$ -	\$ 8	\$ -	\$ 601	\$ 102	\$ -	\$ 1,601
Ending balance: collectively evaluated for impairment	\$ 1,497	\$ 2,059	\$ 989	\$ 209	\$ 918	\$ 170	\$ 359	\$ 6,201
<b>Loans:</b>								
Ending balance: individually evaluated for impairment	\$ 4,530	\$ 3,663	\$ 886	\$ -	\$ 6,776	\$ 316	\$ -	\$ 16,171
Ending balance: collectively evaluated for impairment	\$ 38,736	\$ 175,417	\$ 92,912	\$ 46,188	\$ 85,946	\$ 16,987	\$ -	\$ 456,186

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, 2014 and December 31, 2013:

	June 30, 2014			December 31, 2013		
	Recorded Unpaid Principal Balance	Unpaid Principal Balance	Specific Allowance	Recorded Unpaid Principal Balance	Unpaid Principal Balance	Specific Allowance
<b>Loans without a specific valuation allowance</b>						
Real estate - residential mortgage:						
One to four family units	\$ 896	\$ 896	\$ -	\$ 620	\$ 620	\$ -
Multi-family	-	-	-	-	-	-
Real estate - construction	93	93	-	96	940	-
Real estate - commercial	28	37	-	3,663	3,663	-
Commercial loans	3,438	4,254	-	2,327	2,462	-
Consumer and other loans	-	-	-	-	-	-
<b>Loans with a specific valuation allowance</b>						
Real estate - residential mortgage:						
One to four family units	\$ 314	\$ 314	\$ 48	\$ 267	\$ 267	\$ 8
Multi-family	-	-	-	-	-	-
Real estate - construction	3,337	4,388	515	4,433	4,433	890
Real estate - commercial	487	487	185	-	-	-
Commercial loans	-	-	-	4,449	5,148	601
Consumer and other loans	273	273	10	316	316	102
<b>Total</b>						
Real estate - residential mortgage:						
One to four family units	\$ 1,210	\$ 1,210	\$ 48	\$ 887	\$ 887	\$ 8
Multi-family	-	-	-	-	-	-
Real estate - construction	3,430	4,481	515	4,529	5,373	890
Real estate - commercial	515	524	185	3,663	3,663	-
Commercial loans	3,438	4,254	-	6,776	7,610	601
Consumer and other loans	273	273	10	316	316	102
<b>Total</b>	<b>\$ 8,866</b>	<b>\$ 10,742</b>	<b>\$ 758</b>	<b>\$ 16,171</b>	<b>\$ 17,849</b>	<b>\$ 1,601</b>

The following table summarizes average impaired loans and related interest recognized on impaired loans for the three and six months ended June 30, 2014 and 2013:

	For the Three Months Ended June 30, 2014 Average		For the Three Months Ended June 30, 2013 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	\$823	\$ -	\$2,164	\$ 1
Multi-family	-	-	-	-
Real estate - construction	94	-	5,320	-
Real estate - commercial	264	-	5,095	13
Commercial loans	3,486	98	648	-
Consumer and other loans	-	-	96	-
<b>Loans with a specific valuation allowance</b>				
Real estate - residential mortgage:				
One to four family units	\$325	\$ -	\$181	\$ -
Multi-family	-	-	-	-
Real estate - construction	3,532	-	613	-
Real estate - commercial	574	-	-	-
Commercial loans	699	-	3,230	-
Consumer and other loans	272	-	305	-
<b>Total</b>				
Real estate - residential mortgage:				
One to four family units	\$1,148	\$ -	\$2,345	\$ 1
Multi-family	-	-	-	-
Real estate - construction	3,626	-	5,933	-
Real estate - commercial	838	-	5,095	13
Commercial loans	4,185	98	3,878	-
Consumer and other loans	272	-	401	-
<b>Total</b>	<b>\$10,069</b>	<b>\$ 98</b>	<b>\$17,652</b>	<b>\$ 14</b>

	For the Six Months Ended June 30, 2014 Average		For the Six Months Ended June 30, 2013 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	\$752	\$ 1	\$2,152	\$ 3
Multi-family	-	-	-	-
Real estate - construction	95	-	5,214	-
Real estate - commercial	408	-	4,142	36
Commercial loans	3,088	98	646	1
Consumer and other loans	-	-	99	-
<b>Loans with a specific valuation allowance</b>				
Real estate - residential mortgage:				
One to four family units	\$329	\$ -	\$144	\$ -
Multi-family	-	-	-	-
Real estate - construction	3,883	-	859	-
Real estate - commercial	412	-	1,122	-
Commercial loans	1,897	-	2,756	-
Consumer and other loans	375	-	339	-
<b>Total</b>				
Real estate - residential mortgage:				
One to four family units	\$1,081	\$ 1	\$2,296	\$ 3
Multi-family	-	-	-	-
Real estate - construction	3,978	-	6,073	-
Real estate - commercial	820	-	5,264	36
Commercial loans	4,985	98	3,402	1
Consumer and other loans	375	-	438	-
<b>Total</b>	<b>\$11,239</b>	<b>\$ 99</b>	<b>\$17,473</b>	<b>\$ 40</b>

At June 30, 2014, 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 summarizes, by class, loans that were newly classified as TDRs for the three months ended June 30, 2014:

	Number of Loans	Pre-Modification	Post-Modification
		Outstanding Recorded Balance	Outstanding Recorded Balance
Real estate - residential mortgage:			
One to four family units	1	\$ 287,500	\$ 287,500
Multi-family	-	-	-
Real estate - construction	-	-	-
Real estate - commercial	-	-	-
Commercial loans	-	-	-
Consumer and other loans	-	-	-
Total	1	\$ 287,500	\$ 287,500

The following table summarizes, by type of concession, loans that were newly classified as TDRs for the three months ended June 30, 2014:

	Interest Rate	Term	Combination	Total Modification
Real estate - residential mortgage:				
One to four family units	\$ -	\$ -	\$ 287,500	\$ 287,500
Multi-family	-	-	-	-
Real estate - construction	-	-	-	-
Real estate - commercial	-	-	-	-
Commercial loans	-	-	-	-
Consumer and other loans	-	-	-	-
Total	\$ -	\$ -	\$ 287,500	\$ 287,500

The following table presents the carrying balance of TDRs as of June 30, 2014 and December 31, 2013:

	June 30, 2014	December 31, 2013
Real estate - residential mortgage:		
One to four family units	\$790,476	\$519,718
Multi-family	-	-
Real estate - construction	3,411,014	4,507,190
Real estate - commercial	486,612	3,026,931
Commercial loans	2,285,821	3,699,243
Consumer and other loans	-	-
Total	\$6,973,923	\$11,753,082

The Bank has allocated \$742,651 and \$1,146,359 of specific reserves to customers whose loan terms have been modified in a TDR as of June 30, 2014 and December 31, 2013, respectively.

There was one commercial TDR totaling \$391,364 for which there was a payment default within twelve months following the modification during the three months ending June 30, 2014. There were two one to four family TDRs totaling \$330,000 for which there was a payment default within twelve months following the modification during the three months ending June 30, 2013. 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, 2014 and December 31, 2013:

**June 30, 2014**

	Commercial Construction Real Estate	One to four family	Multi-family	Commercial	Consumer and Other	Total	
<i>(In Thousands)</i>							
Rating:							
Pass	\$28,105	\$ 180,408	\$88,541	\$ 31,554	\$ 71,914	\$ 16,872	\$417,394
Special Mention	7,585	3,874	5,103	-	14,487	-	31,049
Substandard	3,469	3,539	1,713	415	2,847	203	12,186
Doubtful	-	487	-	-	-	-	487

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Total	\$39,159	\$ 188,308	\$95,357	\$ 31,969	\$ 89,248	\$ 17,075	\$461,116
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**December 31, 2013**

	Commercial Construction Real Estate	Commercial Real Estate	One to four family	Multi-family	Commercial	Consumer and Other	Total
	<i>(In Thousands)</i>						
Rating:							
Pass	\$31,433	\$ 169,135	\$83,341	\$ 45,768	\$ 78,622	\$ 16,743	\$425,042
Special Mention	7,253	4,721	8,954	420	9,161	107	30,616
Substandard	683	5,224	1,503	-	2,738	453	10,601
Doubtful	3,897	-	-	-	2,201	-	6,098
Total	\$43,266	\$ 179,080	\$93,798	\$ 46,188	\$ 92,722	\$ 17,303	\$472,357

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, 2013 Annual Report on Form 10-K.

The table below summarizes transactions under the Company's stock option plans for six months ended June 30, 2014:

	Incentive Stock Option	Non-Incentive Stock Option	Weighted Average Exercise Price
Balance outstanding as of January 1, 2014	168,100	121,000	\$ 16.54
Granted	-	-	-
Exercised	(11,800 )	(4,500 )	5.20
Forfeited	-	(21,500 )	18.00
Balance outstanding as of June 30, 2014	156,300	95,000	17.15
Options exercisable as of June 30, 2014	149,200	85,750	17.98

Stock-based compensation expense, consisting of stock options and restricted stock awards, recognized for the three months ended June 30, 2014 and 2013 was \$30,918 and \$35,461, respectively. Stock-based compensation expense recognized for the six months ended June 30, 2014 and 2013 was \$190,490 and \$187,275, respectively. As of June 30,

2014, there was \$5,525 of unrecognized compensation expense related to nonvested stock options and \$222,210 of unrecognized compensation expense related to nonvested restricted stock awards, which will be recognized over the remaining vesting period.

In February 2014 and January 2013, 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 \$122,538 and \$116,032 for 2014 and 2013, respectively, which represents 11,242 shares of common stock at a market price of \$10.90 at the date of grant in 2014 and 16,576 shares of common stock at a market price of \$7.00 at the date of grant in 2013.

In February 2014, the company granted 21,820 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 amount expensed during the six months ended June 30, 2014 was \$31,871.

**Note 6: Income Per Common Share**

	For three months ended June 30, 2014			For six months ended June 30, 2014		
	Income Available to Common Shareholders	Common Shares Outstanding	Per Common Share	Income Available to Common Shareholders	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

	For three months ended June 30, 2013			For six months ended June 30, 2013		
	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	\$ 1,369,110	2,731,727	\$ 0.50	\$ 2,123,133	2,735,533	\$ 0.78
Effect of Dilutive Securities		75,197			72,214	
Diluted Income Per Common Share	\$ 1,369,110	2,806,924	\$ 0.49	\$ 2,123,133	2,807,747	\$ 0.76

Stock options to purchase 136,500 of common stock were outstanding during the three and six months ended June 30, 2014, respectively, and stock options to purchase 197,500 shares of common stock were outstanding during the three and six months ended June 30, 2013, respectively, 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 January 2014, the FASB issued ASU No. 2014-01 to amend FASB ASC Topic 323, *Investments – Equity Method and Joint Ventures*. The objective of this update is to provide guidance on accounting for investments by a reporting entity 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 (benefit). The update will be effective for the Company beginning January 1, 2015; however, early adoption is permitted. The Company does have significant investments in such qualified affordable housing projects and is currently reviewing the provisions of this update to determine what, if any, impacts it may have on the Company's financial position or results of operations. The Company expects that there will be no material impact on the Company's financial position or results of operations, except that the investment amortization expense which is currently included in Other Non-interest Expense in the Consolidated Statements of Income would be removed from Other Non-interest Expense and included in Provision for Income Taxes in the Consolidated Statements of Income. This would have the effect of reducing Non-interest Expense and increasing Provision for Income Taxes, but is not expected to have any impact on Net Income.

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 will be effective for the Company beginning January 1, 2015, and is not expected to 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, 2014 and December 31, 2013 (dollar amounts in thousands):

**June 30, 2014**

Financial assets:

	Level 1 inputs	Level 2 inputs	Level 3 inputs	Total fair value
Equity securities	\$ 106	\$-	\$ -	\$ 106
Debt securities:				
U.S. government agencies	-	17,337	-	17,337
Municipals	-	14,283	-	14,283
Government sponsored mortgage-backed securities	-	68,689	-	68,689
Available-for-sale securities	\$ 106	\$ 100,309	\$ -	\$ 100,415

**December 31, 2013**

Financial assets:

	Level 1 inputs	Level 2 inputs	Level 3 inputs	Total fair value
Equity securities	\$ 99	\$-	\$ -	\$ 99
Debt securities:				
U.S. government agencies	-	31,762	-	31,762
Municipals	-	13,493	-	13,493
Corporate Bonds	-	994	-	994
Government sponsored mortgage-backed securities	-	51,345	-	51,345
Available-for-sale securities	\$ 99	\$ 97,594	\$ -	\$ 97,693

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, 2014 and December 31, 2013 (dollar amounts in thousands):

Impaired loans:

	Level 1 inputs	Level 2 inputs	Level 3 inputs	Total fair value
June 30, 2014	\$ -	\$ -	\$7,069	\$7,069
December 31, 2013	\$ -	\$ -	\$10,305	\$10,305

Foreclosed assets held for sale:

	Level 1 inputs	Level 2 inputs	Level 3 inputs	Total fair value
June 30, 2014	\$ -	\$ -	\$-	\$-
December 31, 2013	\$ -	\$ -	\$2,340	\$2,340

There were no transfers between valuation levels for any asset during the six months ended June 30, 2014 or 2013. 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 (Weighted Average)
Impaired loans (collateral dependent)	\$7,069	Market Comparable	Discount to reflect realizable value	0%-38% (12%)
Impaired loans	\$-	Discounted cash flow	Discount rate	0 %
Foreclosed assets held for sale	\$-	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, 2014 and December 31, 2013.

June 30, 2014			
Carrying	Fair Value	Hierarchy	
Amount		Level	

Financial assets:			
Cash and cash equivalents	\$20,831,026	\$20,831,026	1
Held-to-maturity securities	69,862	71,628	2
Federal Home Loan Bank stock	2,878,900	2,878,900	2
Mortgage loans held for sale	1,221,633	1,221,633	2
Loans, net	454,151,996	456,076,651	3
Interest receivable	1,839,238	1,839,238	2
Financial liabilities:			
Deposits	481,152,569	472,721,120	2
Federal Home Loan Bank advances	53,400,000	55,526,499	2
Securities sold under agreements to repurchase	10,000,000	10,529,097	2
Subordinated debentures	15,465,000	15,465,000	3
Interest payable	239,297	239,297	2
Unrecognized financial instruments (net of contractual value):			
Commitments to extend credit	-	-	-
Unused lines of credit	-	-	-

	December 31, 2013		
	Carrying Amount	Fair Value	Hierarchy Level
Financial assets:			
Cash and cash equivalents	\$12,303,200	\$12,303,200	1
Held-to-maturity securities	79,162	81,089	2
Federal Home Loan Bank stock	2,885,100	2,885,100	2
Mortgage loans held for sale	623,432	623,432	2
Loans, net	464,379,854	466,057,001	3
Interest receivable	1,852,641	1,852,641	2
Financial liabilities:			
Deposits	487,318,939	476,503,513	2
Federal Home Loan Bank advances	55,350,000	57,185,083	2
Securities sold under agreements to repurchase	10,000,000	7,978,555	2
Subordinated debentures	15,465,000	15,465,000	3
Interest payable	250,361	250,361	2
Unrecognized financial instruments (net of contractual value):			
Commitments to extend credit	-	-	-
Unused lines of credit	-	-	-

#### Note 9: Preferred Stock and Common Stock Warrants

On January 30, 2009, as part of the U.S. Department of the Treasury's Troubled Asset Relief Program's Capital Purchase Program ("CPP"), the Company entered into a Securities Purchase Agreement - Standard Terms with the United States Department of the Treasury (the "Treasury") pursuant to which the Company sold to the Treasury 17,000 shares of Fixed Rate Cumulative Perpetual Preferred Stock, Series A (the "Series A Preferred Stock") and issued a ten year warrant (the "Warrant") to purchase 459,459 shares of the Company's common stock (the "Common Stock") for \$5.55 per share for a total purchase price of \$17.0 million.

On June 13, 2012, with regulatory approval, the Company redeemed \$5 million of the Series A Preferred Stock, including accrued and unpaid dividends of \$19,444.

The Company entered into a Placement Agency Agreement with the Treasury on April 15, 2013 in connection with a private auction by the Treasury of the remaining 12,000 shares of Series A Preferred Stock conducted immediately thereafter. On April 29, 2013, the Treasury settled the sale of such shares of Series A Preferred Stock to the winning bidders in the private auction, consisting of six parties unrelated to the Company.



On May 8, 2013, the Company notified the Treasury of its intent to repurchase the Warrant at its fair market value. The Board of Directors of the Company had previously determined that it would be in the best interest of the Company and its stockholders to repurchase the Warrant and determined the Warrant's fair market value to be \$2,003,250 (the "Fair Market Value"). On May 10, 2013, the Treasury notified the Company that it had accepted the Company's offer to repurchase the Warrant at its Fair Market Value. Accordingly, on May 15, 2013, the Company entered into a Letter Agreement with Treasury pursuant to which the Company repurchased the Warrant for \$2,003,250 in cash. As a result of the aforementioned, the Warrant is no longer issued or outstanding and the Company's participation in the CPP is completed. In addition, as a result of the Treasury's sale of the Series A Preferred stock to third-party investors on April 29, 2013, the Treasury no longer possessed any securities issued by the Company.

On April 3, 2014, the Company received approval from the Board of Governors of the Federal Reserve System to redeem the Company's remaining \$12 million of Series A Preferred Stock that carried a coupon rate of 9.0% per annum. The Company provided the holders of the Series A Preferred Stock with a formal notice of redemption and thirty days thereafter redeemed the Series A Preferred Stock on May 7, 2014, including all accrued and unpaid dividends.

**Note 10: Common Stock Offering**

On March 7, 2014, the Company closed an underwritten offering of its common stock. The Company raised approximately \$17.2 million in gross proceeds by re-issuing 1,499,999 shares of its Treasury Stock, which includes the full exercise of the over-allotment option granted to the underwriters of 195,652 shares, at a price to the public of \$11.50 per share.

Net proceeds from the sale of the shares after underwriting discounts and estimated offering expenses were approximately \$15.8 million. The Company used the net proceeds from the offering to redeem the remaining 12,000 shares of the Company's Series A Preferred Stock on May 7, 2014 and intends to use the remaining net proceeds for working capital and for general corporate purposes, including potential future acquisitions.

## **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, 2014, and the results of operations for the three and six months ended June 30, 2014 and 2013.

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, 2013.

### **Financial Condition**

The Company's total assets decreased \$134,959 (less than 1%) from \$619,888,135 as of December 31, 2013, to \$619,753,176 as of June 30, 2014.

Available-for-sale securities increased \$2,721,856 (3%) from \$97,692,685 as of December 31, 2013, to \$100,414,541 as of June 30, 2014. The Company had purchases of \$25,995,159 offset by sales, maturities and principal payments received of \$25,493,804. The market rates on debt securities have improved in the first six months of 2014 resulting in a decline in unrealized losses of \$2,522,940.

Net loans receivable decreased by \$10,227,858 (2%) from \$464,379,854 as of December 31, 2013, to \$454,151,996 as of June 30, 2014. During the six month period, commercial real estate loans increased \$9,228,348 (5%) and construction loans decreased \$4,106,891 (9%). These changes were primarily due to one larger credit classified as construction being completed and transferred to the commercial real estate category. Also, commercial loans decreased \$3,473,630 (4%) which was due to various expected payoffs and principal reductions. Permanent multi-family loans decreased \$14,219,289 (31%) due to the expected payoff of one large credit. Loans secured by owner occupied one to four unit residential real estate increased \$1,558,986 (2%) and installment loans decreased \$228,568 (2%). 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 decreased \$1,013,191 (13%) from \$7,801,600 as of December 31, 2013 to \$6,788,409 as of June 30, 2014. In addition to the provision for loan loss of \$525,000 recorded by the Company for the six months ended June 30, 2014, loan charge-offs of specific loans (classified as nonperforming at December 31, 2013) exceeded recoveries by \$1,538,191. The Company's decline in overall loan balances during 2014 has reduced the allowance for loan loss reserve requirements. The allowance for loan losses, as a percentage of gross loans outstanding (excluding mortgage loans held for sale), as of June 30, 2014 and December 31, 2013 was 1.47% and 1.65%, respectively. The allowance for loan losses, as a percentage of nonperforming loans outstanding, as of June 30, 2014 and December 31, 2013 was 87.0% and 49.2%, 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 decreased \$6,166,370 (1%) from \$487,318,939 as of December 31, 2013, to \$481,152,569 as of June 30, 2014. For the six months ended June 30, 2014, checking and savings accounts decreased by \$4,450,771 and certificates of deposit decreased by \$1,715,598. See also the discussion under “Quantitative and Qualitative Disclosure about Market Risk – Asset/Liability Management.”

Stockholders’ equity (including unrealized appreciation on available-for-sale securities, net of tax) increased \$7,748,527 from \$50,355,233 as of December 31, 2013, to \$58,103,760 as of June 30, 2014. This increase was due to several factors. First, in an underwritten offering of its common stock, the Company raised approximately \$17,200,000 in gross proceeds by re-issuing 1,499,999 shares of its treasury stock. The Company utilized \$12.0 million of the net proceeds to redeem the remaining 12,000 shares of its Series A Preferred Stock on May 7, 2014. Secondly, equity increased due to the Company’s net income after preferred stock dividends and accretion of \$2,282,899 for the six month period. Finally, as a result of changes in market interest rates, the Company experienced an improvement in the value of its investment portfolio. The equity portion of the Company’s unrealized losses on available-for-sale securities improved by \$1,589,452. On a per common share basis, stockholders’ equity decreased from \$14.04 as of December 31, 2013 to \$13.59 as of June 30, 2014.

#### **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 6/30/2014			Three months ended 6/30/2013		
	Average Balance	Interest	Yield / Cost	Average Balance	Interest	Yield / Cost
<b>ASSETS</b>						
Interest-earning:						
Loans	\$458,046	\$5,576	4.88 %	\$466,387	\$5,952	5.12 %
Investment securities	103,058	415	1.62 %	112,567	467	1.66 %
Other assets	29,359	46	0.63 %	29,897	48	0.64 %
Total interest-earning	590,464	6,038	4.10 %	608,851	6,467	4.26 %
Noninterest-earning	33,598			39,969		
	\$624,062			\$648,820		
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>						
Interest-bearing:						
Savings accounts	\$24,629	12	0.20 %	\$24,135	14	0.23 %
Transaction accounts	256,558	215	0.34 %	267,882	265	0.40 %
Certificates of deposit	163,598	335	0.82 %	182,772	453	0.99 %
FHLB advances	52,362	299	2.29 %	52,983	308	2.33 %
Securities sold under agreements to repurchase	10,000	66	2.65 %	16,452	108	2.63 %
Subordinated debentures	15,465	133	3.45 %	15,465	134	3.48 %
Total interest-bearing	522,612	1,060	0.81 %	559,688	1,281	0.92 %
Noninterest-bearing	39,020			38,210		
Total liabilities	561,632			597,898		
Stockholders' equity	62,430			50,922		
	\$624,062			\$648,820		
Net earning balance	\$67,852			\$49,163		
Earning yield less costing rate			3.29 %			3.34 %
Net interest income, and net yield spread on interest earning assets		\$4,977	3.38 %		\$5,186	3.42 %
Ratio of interest-earning assets to interest-bearing liabilities		113 %			109 %	

	Six months ended 6/30/2014			Six months ended 6/30/2013		
	Average Balance	Interest	Yield / Cost	Average Balance	Interest	Yield / Cost
<b>ASSETS</b>						
Interest-earning:						
Loans	\$457,498	\$11,444	5.04 %	\$463,050	\$11,881	5.17 %
Investment securities	103,198	873	1.71 %	108,157	899	1.68 %
Other assets	31,359	81	0.52 %	37,515	106	0.57 %
Total interest-earning	592,055	12,398	4.22 %	608,722	12,886	4.27 %
Noninterest-earning	36,588			41,203		
	\$628,644			\$649,925		
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>						
Interest-bearing:						
Savings accounts	\$24,339	25	0.20 %	\$24,074	28	0.24 %
Transaction accounts	258,147	453	0.35 %	256,837	532	0.42 %
Certificates of deposit	168,455	692	0.83 %	184,234	933	1.02 %
FHLB advances	52,528	594	2.28 %	59,508	676	2.29 %
Securities sold under agreements to repurchase	10,000	131	2.65 %	20,726	272	2.64 %
Subordinated debentures	15,465	266	3.47 %	15,465	269	3.50 %
Total interest-bearing	528,934	2,161	0.82 %	560,844	2,709	0.97 %
Noninterest-bearing	40,295			37,729		
Total liabilities	569,229			598,573		
Stockholders' equity	59,415			51,352		
	\$628,644			\$649,925		
Net earning balance	\$63,122			\$47,878		
Earning yield less costing rate			3.40 %			3.29 %
Net interest income, and net yield spread on interest earning assets		\$10,236	3.49 %		\$10,177	3.37 %
Ratio of interest-earning assets to interest-bearing liabilities		112 %			109 %	

### Results of Operations - Comparison of Three and Six Month Periods Ended June 30, 2014 and 2013

Net income for the three and six months ended June 30, 2014 was \$1,338,683 and \$2,640,109, respectively, compared to \$1,567,740 and \$2,520,393 for the three and six months ended June 30, 2013, respectively, which represents a decrease in net income of \$229,057 (15%) for the three month period, and an increase in net income of \$119,716 (5%) for the six month period.

**Interest Income**

Total interest income for the three and six months ended June 30, 2014 decreased \$429,437 (7%) and \$488,794 (4%), respectively, as compared to the three and six months ended June 30, 2013. For the three and six month periods ended June 30, 2014 compared to the same periods in 2013, the average yield on interest earning assets decreased 16 basis points to 4.10% and 5 basis points to 4.22%, while the average balance of interest earning assets decreased \$18,387,000 for the three month period and decreased \$16,667,000 for the six month period. For the six month period, the Company recognized approximately \$335,000 of interest income on the payoff of a credit relationship that had been classified as non-accrual.

Generally, the Company's decrease in the average yield on interest earning assets was primarily due to the decline in loan balances for each period compared to the prior year period. Also, strong competition is causing a reduction in rates for new credits as well as maintaining existing credit relationships.



### **Interest Expense**

Total interest expense for the three and six months ended June 30, 2014 decreased \$221,007 (17%) and \$548,264 (20%), respectively, when compared to the three and six months ended June 30, 2013. For the three and six month periods ended June 30, 2014 compared to the same periods in 2013, the average cost of interest bearing liabilities decreased 11 basis points to 0.81% and 15 basis points to 0.82%, respectively, while the average balance of interest bearing liabilities decreased \$37,076,000 for the three month period and decreased \$31,910,000 for the six month period when compared to the same periods in 2013. The primary reason for the decrease in the average cost of interest bearing liabilities was the continued decline in higher cost certificates of deposits as well as reductions in the average rate paid on transaction deposit balances. Also, the Company reduced its FHLB advances and securities sold under agreements to repurchase during 2013. As a result, interest expense on these borrowings for the three and six months ended June 30, 2014 decreased \$51,000 and \$222,689, respectively, when compared to the same period in 2013.

### **Net Interest Income**

Net interest income for the three and six months ended June 30, 2014 decreased \$208,430 (4%) and increased \$59,470 (1%), respectively, when compared to the same periods in 2013. For the three and six month periods ended June 30, 2014, the average balance of net interest earning assets over liabilities increased by approximately \$18,689,000 and \$15,244,000, respectively, when compared to the same periods in 2013. For the three and six month periods ended June 30, 2014, the net interest margin decreased 4 basis points to 3.38% and increased 12 basis points to 3.49%, respectively, when compared to the same periods in 2013.

### **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 collectability of the Company's loan portfolio.

Based on its internal analysis and methodology, management recorded a provision for loan losses of \$325,000 and \$525,000 for the three months and six months ended June 30, 2014, respectively, compared to \$250,000 and \$650,000 for the same periods in 2013.

Generally, the overall decrease in the provision for loan losses for the six months ended June 30, 2014 has resulted primarily from declining historic loss rates, which are used to calculate the reserve for the homogenous pool of loans, and an overall decrease in the loan portfolio. 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 decreased \$1,822,049 (68%) and \$2,024,124 (55%) for the three months and six months ended June 30, 2014, respectively, when compared to the three months and six months ended June 30, 2013. These declines were attributable to a few factors.

First, during the second quarter of 2013, the Company recognized \$1.5 million in gains on its investment portfolio and certain tax credit assets in conjunction with a structured transaction to prepay a \$15 million repurchase agreement. Furthermore, gains on investment securities decreased \$108,579 (93%) and \$194,292 (95%) for the three months and six months ended June 30, 2014, respectively, when compared to the same periods in 2013.

Secondly, gains on sales of loans decreased \$341,419 (58%) and \$587,774 (57%) for the three months and six months ended June 30, 2014, respectively, when compared to the same periods in 2013. This was primarily due to long-term interest rates increasing significantly during 2013 and into the first quarter of 2014 which dramatically reduced consumer demand for long-term secondary market mortgage loans.

### **Noninterest Expense**

Noninterest expense decreased \$1,649,354 (30%) and \$1,730,350 (17%) for the three months and six months ended June 30, 2014 when compared to the same periods in 2013 primarily due to a \$1.5 million prepayment penalty incurred on the prepayment of a repurchase agreement (further discussed above).

Salaries and employee benefits decreased \$40,783 and \$128,377 for the three months and six months ended June 30, 2014 when compared to the same periods in 2013 due to a decline in the overall number of staff compared to the prior year periods and a decline in mortgage commissions from reduced mortgage volume.

### **Provision for Income Taxes**

The provision for income taxes decreased during the three and six month periods compared to the same periods in 2013 due to declines in taxable income. Furthermore, the actual effective tax rate (based on income before income taxes) also declined from the increased utilization of state low income housing tax credits.

**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, 2014 and December 31, 2013 was 87.0% and 49.2%, respectively. Total loans classified as substandard, doubtful or loss as of June 30, 2014, were \$12.7 million or 2.04% of total assets as compared to \$16.7 million, or 2.69% of total assets at December 31, 2013. 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.

	6/30/2014	12/31/2013	12/31/2012			
Nonperforming loans	\$ 7,806	\$ 15,848	\$ 15,331			
Troubled debt restructurings	787	-	-			
Real estate acquired in settlement of loans	3,644	3,822	4,530			
Total nonperforming assets	\$ 12,237	\$ 19,670	\$ 19,861			
Total nonperforming assets as a percentage of total assets	1.97	% 3.17	% 3.01			%
Allowance for loan losses	\$ 6,788	\$ 7,802	\$ 8,740			
Allowance for loan losses as a percentage of gross loans	1.47	% 1.65	% 1.83			%

## **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 \$20,831,026 as of June 30, 2014 and \$12,303,200 as of December 31, 2013, representing an increase of \$8,527,826. 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.

The Bank's capital ratios are above the levels required to be considered a well-capitalized financial institution. As of June 30, 2014, the Bank's Tier 1 leverage ratio was 10.93%, its Tier 1 risk-based capital ratio was 14.02% and the Bank's total risk-based capital ratio was 15.27% - all exceeding the minimums of 5%, 6% and 10%, respectively.

On March 7, 2014, the Company closed an underwritten offering of its common stock. The Company raised approximately \$17.2 million in gross proceeds by re-issuing 1,499,999 shares of treasury stock, which includes the full exercise of the over-allotment option granted to the underwriters of 195,652 shares, at a price to the public of \$11.50 per share. Net proceeds from the sale of the shares after underwriting discounts and estimated offering expenses were approximately \$15.8 million. The Company used the net proceeds from the offering to redeem the remaining 12,000 shares of the Company's Series A Preferred Stock on May 7, 2014 and intends to use the remaining net proceeds for working capital and for general corporate purposes, including potential future acquisitions.

## **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, 2014 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	Change
+200	\$62,235	\$(4,029)	-6	% 10.39%	-0.27 %
+100	63,692	(2,572)	-4	% 10.45%	-0.21 %
NC	66,264	-	-	10.66%	-
-100	68,919	2,655	4	% 10.85%	0.19 %
-200	75,424	9,161	14	% 11.64%	0.98 %

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 2013 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, 2014.

(b) There have been no changes in the Company's internal control over financial reporting during the quarter ended June 30, 2014 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, 2014.

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

Not applicable.

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

Not applicable.

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

None

**Item 6. Exhibits**

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

32.1 CEO certification pursuant to 18 U.S.C. Section 1350

32.2 CFO certification pursuant to 18 U.S.C. Section 135

101 The following materials from Guaranty Federal Bancshares, Inc.’s Quarterly Report on Form 10-Q for the quarter ended June 30, 2014 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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## 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.

<b>Signature and Title</b>	<b>Date</b>
/s/ Shaun A. Burke Shaun A. Burke President and Chief Executive Officer (Principal Executive Officer and Duly Authorized Officer)	August 8, 2014
/s/ Carter Peters Carter Peters Executive Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)	August 8, 2014

