

SOUTHERN MISSOURI BANCORP INC
Form 10-Q
November 09, 2015
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2015

OR

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

For the transition period from _____ to _____

Commission file number 0-23406
Southern Missouri Bancorp, Inc.
(Exact name of registrant as specified in its charter)

Missouri 43-1665523
(State or jurisdiction of incorporation) (IRS employer id. no.)

531 Vine Street Poplar Bluff, MO 63901
(Address of principal executive offices) (Zip code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data file required to be submitted and posted pursuant to Rule 405 of regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes X No

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

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company" in Rule 12b-2 of the Exchange Act (check one):

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 12 b-2 of the Exchange Act)

Yes No

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date:

Class	Outstanding at November 6, 2015
Common Stock, Par Value \$.01	7,424,666 Shares

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PART I: Item 1: Condensed Consolidated Financial StatementsSOUTHERN MISSOURI BANCORP, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
SEPTEMBER 30, 2015 AND JUNE 30, 2015

	September 30, 2015 (unaudited)	June 30, 2015
(dollars in thousands)		
Cash and cash equivalents	\$18,531	\$16,775
Interest-bearing time deposits	1,719	1,944
Available for sale securities	127,485	129,593
Stock in FHLB of Des Moines	4,823	4,127
Stock in Federal Reserve Bank of St. Louis	2,340	2,340
Loans receivable, net of allowance for loan losses of \$12,812 and \$12,298 at September 30, 2015 and June 30, 2015, respectively	1,069,087	1,053,146
Accrued interest receivable	5,663	5,168
Premises and equipment, net	42,788	39,726
Bank owned life insurance – cash surrender value	19,836	19,692
Goodwill	4,556	4,556
Intangible assets, net	3,915	4,201
Prepaid expenses and other assets	19,050	18,796
Total assets	\$1,319,793	\$1,300,064
Deposits	\$1,057,716	1,055,242
Securities sold under agreements to repurchase	24,429	27,332
Advances from FHLB of Des Moines	82,110	64,794
Accounts payable and other liabilities	4,285	4,618
Accrued interest payable	696	777
Subordinated debt	14,682	14,658
Total liabilities	1,183,918	1,167,421
Preferred stock, \$.01 par value, \$1,000 liquidation value; 500,000 shares authorized; 20,000 shares issued and outstanding at September 30 and June 30, 2015	20,000	20,000
Common stock, \$.01 par value; 10,000,000 shares authorized; 7,424,666 and 7,419,666 shares, respectively, issued at September 30, 2015 and June 30, 2015	74	74
Additional paid-in capital	34,019	33,948
Retained earnings	80,677	77,760
Accumulated other comprehensive income	1,105	861
Total stockholders' equity	135,875	132,643
Total liabilities and stockholders' equity	\$1,319,793	\$1,300,064

See Notes to Condensed Consolidated Financial Statements

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SOUTHERN MISSOURI BANCORP, INC
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
FOR THE THREE-MONTH PERIODS ENDED SEPTEMBER 30, 2015 AND 2014 (Unaudited)

(dollars in thousands except per share data)	Three months ended	
	September 30, 2015	September 30, 2014
INTEREST INCOME:		
Loans	\$13,098	\$12,225
Investment securities	495	544
Mortgage-backed securities	370	415
Other interest-earning assets	7	34
Total interest income	13,970	13,218
INTEREST EXPENSE:		
Deposits	1,785	1,601
Securities sold under agreements to repurchase	29	28
Advances from FHLB of Des Moines	317	339
Subordinated debt	135	121
Total interest expense	2,266	2,089
NET INTEREST INCOME	11,704	11,129
PROVISION FOR LOAN LOSSES	618	827
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	11,086	10,302
NONINTEREST INCOME:		
Deposit account charges and related fees	924	819
Bank card interchange income	636	503
Loan late charges	77	97
Loan servicing fees	35	15
Other loan fees	170	134
Net realized gains on sale of loans	133	178
Earnings on bank owned life insurance	145	143
Other income	82	91
Total noninterest income	2,202	1,980
NONINTEREST EXPENSE:		
Compensation and benefits	4,323	4,145
Occupancy and equipment, net	1,665	1,357
Deposit insurance premiums	161	162
Legal and professional fees	126	263
Advertising	254	131
Postage and office supplies	159	128
Intangible amortization	310	292
Bank card network expense	253	276
Other operating expense	737	848
Total noninterest expense	7,988	7,602
INCOME BEFORE INCOME TAXES	5,300	4,680
INCOME TAXES	1,665	1,381
NET INCOME	\$3,635	\$3,299

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Less: dividend on preferred shares	50	50
Net income available to common shareholders	\$3,585	\$3,249
Basic earnings per common share	\$0.48	\$0.46
Diluted earnings per common share	\$0.48	\$0.44
Dividends per common share	\$0.090	\$0.085

See Notes to Condensed Consolidated Financial Statements

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SOUTHERN MISSOURI BANCORP, INC
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
 FOR THE THREE-MONTH PERIODS ENDED SEPTEMBER 30, 2015 AND 2014 (Unaudited)

	Three months ended September 30, 2015 2014	
(dollars in thousands)		
Net income	\$3,635	\$3,299
Other comprehensive income:		
Unrealized gains on securities available-for-sale	391	194
Unrealized (losses) gains on available-for-sale securities for which a portion of an other-than-temporary impairment has been recognized in income	(4)	1
Tax (expense)	(143)	(77)
Total other comprehensive income	244	118
Comprehensive income	\$3,879	\$3,417

See Notes to Condensed Consolidated Financial Statements

SOUTHERN MISSOURI BANCORP, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 FOR THE THREE-MONTH PERIODS ENDED SEPTEMBER 30, 2015 AND 2014 (Unaudited)

(dollars in thousands)	Three months ended September 30,	
	2015	2014
Cash Flows From Operating Activities:		
Net income	\$3,635	\$3,299
Items not requiring (providing) cash:		
Depreciation	536	479
Gain on disposal of fixed assets	-	(4)
Stock option and stock grant expense	36	3
Amortization of intangible assets	310	292
Amortization of purchase accounting adjustments	(487)	(37)
Increase in cash surrender value of bank owned life insurance	(145)	(143)
(Gain) loss on sale of foreclosed assets	(5)	8
Provision for loan losses	618	827
Net amortization of premiums and discounts on securities	200	206
Originations of loans held for sale	(5,713)	(1,922)
Proceeds from sales of loans held for sale	5,413	2,207
Gain on sales of loans held for sale	(133)	(178)
Changes in:		
Accrued interest receivable	(495)	(654)
Prepaid expenses and other assets	225	526
Accounts payable and other liabilities	(280)	(751)
Deferred income taxes	(538)	(1)
Accrued interest payable	(81)	28
Net cash provided by operating activities	3,096	4,185
Cash flows from investing activities:		
Net increase in loans	(16,019)	(29,098)
Net change in interest-bearing deposits	225	4,477
Proceeds from maturities of available for sale securities	4,541	4,700
Net purchases of Federal Home Loan Bank stock	(696)	(263)
Purchases of available-for-sale securities	(2,247)	-
Purchases of premises and equipment	(3,598)	(642)
Net cash received in acquisitions	-	3,221
Investments in state & federal tax credits	(162)	-
Proceeds from sale of fixed assets	-	4
Proceeds from sale of foreclosed assets	266	269
Net cash used in investing activities	(17,690)	(17,332)
Cash flows from financing activities:		
Net increase in demand deposits and savings accounts	8,697	2,226
Net (decrease) increase in certificates of deposits	(6,162)	11,748
Net decrease in securities sold under agreements to repurchase	(2,903)	(1,448)
Proceeds from Federal Home Loan Bank advances	88,500	91,860
Repayments of Federal Home Loan Bank advances	(71,100)	(84,560)
Exercise of stock options	36	77
Dividends paid on preferred stock	(50)	(50)

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Dividends paid on common stock	(668)	(627)
Net cash provided by financing activities	16,350	19,226
Increase in cash and cash equivalents	1,756	6,079
Cash and cash equivalents at beginning of period	16,775	14,932
Cash and cash equivalents at end of period	\$18,531	\$21,011

Supplemental disclosures of cash flow information:

Noncash investing and financing activities:

Conversion of loans to foreclosed real estate	\$135	\$116
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Conversion of loans to repossessed assets	123	10
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Cash paid during the period for:

Interest (net of interest credited)	\$730	\$607
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Income taxes	1,615	917
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See Notes to Condensed Consolidated Financial Statements

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SOUTHERN MISSOURI BANCORP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 1: Basis of Presentation

The accompanying unaudited interim consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Securities and Exchange Commission (SEC) Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all material adjustments (consisting only of normal recurring accruals) considered necessary for a fair presentation have been included. The consolidated balance sheet of the Company as of June 30, 2015, has been derived from the audited consolidated balance sheet of the Company as of that date. Operating results for the three-month period ended September 30, 2015, are not necessarily indicative of the results that may be expected for the entire fiscal year. For additional information, refer to the audited consolidated financial statements included in the Company's June 30, 2015, Form 10-K, which was filed with the SEC.

The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, Southern Bank. All significant intercompany accounts and transactions have been eliminated in consolidation.

Note 2: Organization and Summary of Significant Accounting Policies

Organization. Southern Missouri Bancorp, Inc., a Missouri corporation (the Company) was organized in 1994 and is the parent company of Southern Bank (the Bank). Substantially all of the Company's consolidated revenues are derived from the operations of the Bank, and the Bank represents substantially all of the Company's consolidated assets and liabilities.

The Bank is primarily engaged in providing a full range of banking and financial services to individuals and corporate customers in its market areas. The Bank and Company are subject to competition from other financial institutions. The Bank and Company are subject to regulation by certain federal and state agencies and undergo periodic examinations by those regulatory authorities.

Basis of Financial Statement Presentation. The financial statements of the Company have been prepared in conformity with accounting principles generally accepted in the United States of America and general practices within the banking industry. In the normal course of business, the Company encounters two significant types of risk: economic and regulatory. Economic risk is comprised of interest rate risk, credit risk, and market risk. The Company is subject to interest rate risk to the degree that its interest-bearing liabilities reprice on a different basis than its interest-earning assets. Credit risk is the risk of default on the Company's investment or loan portfolios resulting from the borrowers' inability or unwillingness to make contractually required payments. Market risk reflects changes in the value of the investment portfolio, collateral underlying loans receivable, and the value of the Company's investments in real estate.

Principles of Consolidation. The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, the Bank. All significant intercompany accounts and transactions have been eliminated.

Use of Estimates. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ

from those estimates.

Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses, estimated fair values of purchased loans, other-than-temporary impairments (OTTI), and fair value of financial instruments.

Cash and Cash Equivalents. For purposes of reporting cash flows, cash and cash equivalents includes cash, due from depository institutions and interest-bearing deposits in other depository institutions with original maturities of three months or less. Interest-bearing deposits in other depository institutions were \$6.4 million and \$6.6 million at

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September 30 and June 30, 2015, respectively. The deposits are held in various commercial banks in amounts not exceeding the FDIC's deposit insurance limits, as well as at the Federal Reserve and the Federal Home Loan Bank of Des Moines.

Available for Sale Securities. Available for sale securities, which include any security for which the Company has no immediate plan to sell but which may be sold in the future, are carried at fair value. Unrealized gains and losses, net of tax, are reported in accumulated other comprehensive income, a component of stockholders' equity. All securities have been classified as available for sale.

Premiums and discounts on debt securities are amortized or accreted as adjustments to income over the estimated life of the security using the level yield method. Realized gains or losses on the sale of securities is based on the specific identification method. The fair value of securities is based on quoted market prices or dealer quotes. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities.

The Company does not invest in collateralized mortgage obligations that are considered high risk.

When the Company does not intend to sell a debt security, and it is more likely than not the Company will not have to sell the security before recovery of its cost basis, it recognizes the credit component of an other-than-temporary impairment of a debt security in earnings and the remaining portion in other comprehensive income. As a result, the Company's balance sheet as of the dates presented reflects the full impairment (that is, the difference between the security's amortized cost basis and fair value) on debt securities that the Company intends to sell or would more likely than not be required to sell before the expected recovery of the amortized cost basis. For available-for-sale debt securities that management has no intent to sell and believes that it more likely than not will not be required to sell prior to recovery, only the credit loss component of the impairment is recognized in earnings, while the noncredit loss is recognized in accumulated other comprehensive loss. The credit loss component recognized in earnings is identified as the amount of principal cash flows not expected to be received over the remaining term of the security as projected based on cash flow projections.

Federal Reserve Bank and Federal Home Loan Bank Stock. The Bank is a member of the Federal Home Loan Bank (FHLB) system, and the Federal Reserve Bank of St. Louis. Capital stock of the Federal Reserve and the FHLB is a required investment based upon a predetermined formula and is carried at cost.

Loans. Loans are generally stated at unpaid principal balances, less the allowance for loan losses and net deferred loan origination fees.

Interest on loans is accrued based upon the principal amount outstanding. The accrual of interest on loans is discontinued when, in management's judgment, the collectability of interest or principal in the normal course of business is doubtful. The Company complies with regulatory guidance which indicates that loans should be placed in nonaccrual status when 90 days past due, unless the loan is both well-secured and in the process of collection. A loan that is "in the process of collection" may be subject to legal action or, in appropriate circumstances, through other collection efforts reasonably expected to result in repayment or restoration to current status in the near future. A loan is considered delinquent when a payment has not been made by the contractual due date. Interest income previously accrued but not collected at the date a loan is placed on nonaccrual status is reversed against interest income. Cash receipts on a nonaccrual loan are applied to principal and interest in accordance with its contractual terms unless full payment of principal is not expected, in which case cash receipts, whether designated as principal or interest, are applied as a reduction of the carrying value of the loan. A nonaccrual loan is generally returned to accrual status when principal and interest payments are current, full collectability of principal and interest is reasonably assured, and a consistent record of performance has been demonstrated.

The allowance for losses on loans represents management's best estimate of losses probable in the existing loan portfolio. The allowance for losses on loans is increased by the provision for losses on loans charged to expense and reduced by loans charged off, net of recoveries. Loans are charged off in the period deemed uncollectible, based on management's analysis of expected cash flow (for non-collateral dependent loans) or collateral value (for collateral-dependent loans). Subsequent recoveries of loans previously charged off, if any, are credited to the allowance when received. The provision for losses on loans is determined based on management's assessment of several factors: reviews and evaluations of specific loans, changes in the nature and volume of the loan portfolio, current economic conditions and the related impact on specific borrowers and industry groups, historical loan loss experience, the level of classified and nonperforming loans and the results of regulatory examinations.

Loans are considered impaired if, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Depending on a particular loan's circumstances, we measure impairment of a loan based upon either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's observable market price, or the fair value of the collateral less estimated costs to sell if the loan is collateral dependent. Valuation allowances are established for collateral-dependent impaired loans for the difference between the loan amount and fair value of collateral less estimated selling costs. For impaired loans that are not collateral dependent, a valuation allowance is established for the difference between the loan amount and the present value of expected future cash flows discounted at the historical effective interest rate or the observable market price of the loan. Impairment losses are recognized through an increase in the required allowance for loan losses. Cash receipts on loans deemed impaired are recorded based on the loan's separate status as a nonaccrual loan or an accrual status loan.

Some loans are accounted for in accordance with ASC 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality. For these loans ("purchased credit impaired loans"), the Company recorded a fair value discount and began carrying them at book value less their face amount (see Note 4). For these loans, we determined the contractual amount and timing of undiscounted principal and interest payments (the "undiscounted contractual cash flows"), and estimated the amount and timing of undiscounted expected principal and interest payments, including expected prepayments (the "undiscounted expected cash flows"). Under acquired impaired loan accounting, the difference between the undiscounted contractual cash flows and the undiscounted expected cash flows is the nonaccretable difference. The nonaccretable difference is an estimate of the loss exposure of principal and interest related to the purchased credit impaired loans, and the amount is subject to change over time based on the performance of the loans. The carrying value of purchased credit impaired loans is initially determined as the discounted expected cash flows. The excess of expected cash flows at acquisition over the initial fair value of the purchased credit impaired loans is referred to as the "accretable yield" and is recorded as interest income over the estimated life of the acquired loans using the level-yield method, if the timing and amount of the future cash flows is reasonably estimable. The carrying value of purchased credit impaired loans is reduced by payments received, both principal and interest, and increased by the portion of the accretable yield recognized as interest income. Subsequent to acquisition, the Company evaluates the purchased credit impaired loans on a quarterly basis. Increases in expected cash flows compared to those previously estimated increase the accretable yield and are recognized as interest income prospectively. Decreases in expected cash flows compared to those previously estimated decrease the accretable yield and may result in the establishment of an allowance for loan losses and a provision for loan losses. Purchased credit impaired loans are generally considered accruing and performing loans, as the loans accrete interest income over the estimated life of the loan when expected cash flows are reasonably estimable. Accordingly, purchased credit impaired loans that are contractually past due are still considered to be accruing and performing as long as there is an expectation that the estimated cash flows will be received. If the timing and amount of cash flows is not reasonably estimable, the loans may be classified as nonaccrual loans.

Loan fees and certain direct loan origination costs are deferred, and the net fee or cost is recognized as an adjustment to interest income using the interest method over the contractual life of the loans.

Foreclosed Real Estate. Real estate acquired by foreclosure or by deed in lieu of foreclosure is initially recorded at fair value less estimated selling costs. Costs for development and improvement of the property are capitalized.

Valuations are periodically performed by management, and an allowance for losses is established by a charge to operations if the carrying value of a property exceeds its estimated fair value, less estimated selling costs.

Loans to facilitate the sale of real estate acquired in foreclosure are discounted if made at less than market rates. Discounts are amortized over the fixed interest period of each loan using the interest method.

Premises and Equipment. Premises and equipment are stated at cost less accumulated depreciation and include expenditures for major betterments and renewals. Maintenance, repairs, and minor renewals are expensed as incurred. When property is retired or sold, the retired asset and related accumulated depreciation are removed from the accounts and the resulting gain or loss taken into income. The Company reviews property and equipment for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If such assets are considered to be impaired, the impairment loss recognized is measured by the amount by which the carrying amount exceeds the fair value of the assets.

Depreciation is computed by use of straight-line and accelerated methods over the estimated useful lives of the assets. Estimated lives are generally seven to forty years for premises, three to seven years for equipment, and three years for software.

Intangible Assets. The Company's intangible assets at September 30, 2015 included gross core deposit intangibles of \$5.9 million with \$2.1 million accumulated amortization, gross other identifiable intangibles of \$3.8 million with accumulated amortization of \$3.8 million, and mortgage servicing rights of \$181,000. At June 30, 2015, the Company's intangible assets included gross core deposit intangibles of \$5.9 million with \$1.9 million accumulated amortization, and gross other identifiable intangibles of \$3.8 million with accumulated amortization of \$3.8 million, and mortgage servicing rights of \$157,000. The Company's core deposit and other intangible assets are being amortized using the straight line method, over periods ranging from five to fifteen years, with amortization expense expected to be approximately \$715,000 in the remainder of fiscal 2016, \$911,000 in fiscal 2017, \$911,000 in fiscal 2018, \$655,000 in fiscal 2019, \$500,000 in fiscal 2020 and \$42,000 thereafter.

Goodwill. The Company's goodwill is evaluated annually for impairment or more frequently if impairment indicators are present. A qualitative assessment is performed to determine whether the existence of events or circumstances leads to a determination that it is more likely than not the fair value is less than the carrying amount, including goodwill. If, based on the evaluation, it is determined to be more likely than not that the fair value is less than the carrying value, then goodwill is tested further for impairment. If the implied fair value of goodwill is lower than its carrying amount, a goodwill impairment is indicated and goodwill is written down to its implied fair value. Subsequent increases in goodwill value are not recognized in the financial statements.

Income Taxes. The Company accounts for income taxes in accordance with income tax accounting guidance (ASC 740, Income Taxes). The income tax accounting guidance results in two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to the taxable income or excess of deductions over revenues. The Company determines deferred income taxes using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax bases of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur.

Deferred income tax expense results from changes in deferred tax assets and liabilities between periods. Deferred tax assets are recognized if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term more likely than not means a likelihood of more than 50 percent; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50 percent likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more-likely-than-not recognition threshold considers the facts, circumstances, and information available at the reporting date and is subject to management's judgment. Deferred tax assets are reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized.

The Company recognizes interest and penalties on income taxes as a component of income tax expense.

The Company files consolidated income tax returns with its subsidiaries.

Incentive Plan. The Company accounts for its Management Recognition and Development Plan (MRP) and Equity Incentive Plan (EIP) in accordance with ASC 718, "Share-Based Payment." Compensation expense is based on the market price of the Company's stock on the date the shares are granted and is recorded over the vesting period. The difference between the aggregate purchase price and the fair value on the date the shares are considered earned

represents a tax benefit to the Company and is recorded as an adjustment to additional paid in capital

Outside Directors' Retirement. Southern Bank adopted a directors' retirement plan in April 1994 for outside directors. The directors' retirement plan provides that each non-employee director (participant) shall receive, upon termination of service on the Board on or after age 60, other than termination for cause, a benefit in equal annual installments over a five year period. The benefit will be based upon the product of the participant's vesting percentage and the total Board fees paid to the participant during the calendar year preceding termination of service on the Board. The vesting percentage shall be determined based upon the participant's years of service on the Board.

In the event that the participant dies before collecting any or all of the benefits, Southern Bank shall pay the participant's beneficiary. No benefits shall be payable to anyone other than the beneficiary, and benefits shall terminate on the death of the beneficiary.

Stock Options. The amount of compensation cost is measured based on the grant-date fair value of the equity instruments issued, and recognized over the vesting period during which an employee provides service in exchange for the award.

Earnings Per Share. Basic earnings per share available to common stockholders is computed using the weighted-average number of common shares outstanding. Diluted earnings per share available to common stockholders includes the effect of all weighted-average dilutive potential common shares (stock options and warrants) outstanding during each period.

Comprehensive Income. Comprehensive income consists of net income and other comprehensive income, net of applicable income taxes. Other comprehensive income includes unrealized appreciation (depreciation) on available-for-sale securities, unrealized appreciation (depreciation) on available-for-sale securities for which a portion of an other-than-temporary impairment has been recognized in income, and changes in the funded status of defined benefit pension plans.

Transfers Between Fair Value Hierarchy Levels. Transfers in and out of Level 1 (quoted market prices), Level 2 (other significant observable inputs) and Level 3 (significant unobservable inputs) are recognized on the period ending date.

Reclassification. Certain amounts included in the consolidated financial statements have been reclassified to conform to the 2015 presentation. These reclassifications had no effect on net income.

The following paragraphs summarize the impact of new accounting pronouncements:

In August 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-14, "Troubled Debt Restructurings by Creditors," to address the classification of certain foreclosed mortgage loans held by creditors that are either fully or partially guaranteed under government programs (e.g., FHA, VA, HUD). The ASU is effective for fiscal years, and interim periods within those years, beginning after December 15, 2014. The Company did not experience a significant impact on its financial statements with the adoption of ASU 2014-14.

In May 2014, the FASB issued ASU 2014-09, revenue from Contracts with Customers (Topic 606). The update provides a five-step revenue recognition model for all revenue arising from contracts with customers and affects all entities that enter into contracts to provide goods or services to their customers (unless the contracts are included in the scope of other standards). The guidance requires an entity to recognize the revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services. For public entities, the guidance is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period, and must be applied either retrospectively or using the modified retrospective approach. In April 2015, the FASB voted to propose a one-year deferral of the effective date of ASU 2014-09 and issued an exposure draft. Management is evaluating the new guidance, but does not expect the adoption of this guidance to have a material impact on the Company's consolidated financial statements. Early adoption would be permitted, but not before the original public entity effective date.

In June 2014, the FASB issued ASU 2014-11, Transfers and Servicing (Topic 860) – Repurchase to Maturity Transactions, Repurchase Financings, and Disclosures. ASU 2014-11 aligns the accounting for repurchase to maturity transactions and repurchase agreements executed as a repurchase financing with the accounting for other typical repurchase agreements. Going forward, these transactions would all be accounted for as secured borrowings. ASU 2014-11 is effective for the first interim or annual period beginning after December 15, 2014. In addition, the disclosure of certain transactions accounted for as a sale is effective for the first interim or annual period beginning on or after December 15, 2014, and the disclosure for transactions accounted for as secured borrowings is required for annual periods beginning after December 15, 2014, and interim periods beginning after March 15, 2015. The Company did not experience a significant impact on its financial statements with the adoption of ASU 2014-11.

In January 2014, the FASB issued ASU 2014-04, "Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure," to reduce diversity by clarifying 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 ASU is effective for fiscal years, and interim periods within those years, beginning after December 15, 2014. Adoption of the ASU did not have a significant effect on the Company's consolidated financial statements.

In January 2014, the FASB issued ASU 2014-01, "Accounting for Investments in Qualified Affordable Housing Projects," to permit 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. The ASU modifies the conditions that an entity must meet to be eligible to use a method other than the equity or cost methods to account for qualified affordable housing project investments. The ASU is effective for fiscal years, and interim periods within those years, beginning after December 15, 2014. Adoption of the ASU did not have a significant effect on the Company's consolidated financial statements.

Note 3: Securities

The amortized cost, gross unrealized gains, gross unrealized losses, and approximate fair value of securities available for sale consisted of the following:

(dollars in thousands)	September 30, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Investment and mortgage-backed securities:				
U.S. government-sponsored enterprises (GSEs)	\$ 13,939	\$ 54	\$ (53)	) \$ 13,940
State and political subdivisions	42,809	1,553	(48)	) 44,314
Other securities	3,170	177	(651)	) 2,696
Mortgage-backed: GSE residential	65,824	727	(16)	) 66,535
Total investments and mortgage-backed securities	\$ 125,742	\$ 2,511	\$ (768)	) \$ 127,485

(dollars in thousands)	June 30, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Investment and mortgage-backed securities:				
U.S. government-sponsored enterprises (GSEs)	\$ 14,924	\$ 49	\$ (159)	) \$ 14,814
State and political subdivisions	40,641	1,473	(93)	) 42,021
Other securities	3,189	184	(669)	) 2,704
Mortgage-backed GSE residential	69,483	597	(26)	) 70,054
Total investments and mortgage-backed securities	\$ 128,237	\$ 2,303	\$ (947)	) \$ 129,593

The amortized cost and estimated fair value of investment and mortgage-backed securities, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without penalties.

(dollars in thousands)	September 30, 2015	
	Amortized Cost	Estimated

		Fair Value
Within one year	\$1,920	\$1,923
After one year but less than five years	14,917	15,015
After five years but less than ten years	16,107	16,488
After ten years	26,974	27,524
Total investment securities	59,918	60,950
Mortgage-backed securities	65,824	66,535
Total investments and mortgage-backed securities	\$125,742	\$127,485

The carrying value of securities sold under agreement to repurchase amounted to \$24.4 million at September 30, 2015 and \$27.3 million at June 30, 2015. The securities, which are classified as borrowings, generally mature within one to four days. The securities underlying the agreements consist of marketable securities, including \$10.0 million and \$10.9 million U.S. Government and Federal Agency Obligations, \$15.0 million and \$15.6 million Mortgage-Backed Securities, and \$1.9 million and \$2.1 million Collateralized Mortgage Obligations, at September 30 and June 30, 2015,

respectively. The right of offset for a repurchase agreement resembles a secured borrowing, whereby the collateral pledged by the Company would be used to settle the fair value of the repurchase agreement should the Company be in default. The collateral is held by the Company in a segregated custodial account. In the event the collateral fair value falls below stipulated levels, the Company will pledge additional securities. The Company closely monitors collateral levels to ensure adequate levels are maintained.

The following tables show our investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at September 30 and June 30, 2015:

(dollars in thousands)	September 30, 2015					
	Less than 12 months		More than 12 months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. government-sponsored enterprises (GSEs)	\$996	\$ 3	\$6,942	\$ 50	\$7,938	\$ 53
Obligations of state and political subdivisions	2,447	31	1,523	17	3,970	48
Other securities	-	-	1,219	651	1,219	651
Mortgage-backed securities	3,757	16	-	-	3,757	16
Total investments and mortgage-backed securities	\$7,200	\$ 50	\$9,684	\$ 718	\$16,884	\$ 768

(dollars in thousands)	June 30, 2015					
	Less than 12 months		More than 12 months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. government-sponsored enterprises (GSEs)	\$2,970	\$ 28	\$6,862	\$ 131	\$9,832	\$ 159
Obligations of state and political subdivisions	3,872	59	1,507	34	5,379	93
Other securities	-	-	1,206	669	1,206	669
Mortgage-backed securities	6,787	26	-	-	6,787	26
Total investments and mortgage-backed securities	\$13,629	\$ 113	\$9,575	\$ 834	\$23,204	\$ 947

Other securities. At September 30, 2015, there were three pooled trust preferred securities with an estimated fair value of \$791,000 and unrealized losses of \$643,000 in a continuous unrealized loss position for twelve months or more. These unrealized losses were primarily due to the long-term nature of the pooled trust preferred securities, a lack of demand or inactive market for these securities, and concerns regarding the financial institutions that have issued the underlying trust preferred securities. Rules adopted by the federal banking agencies in December 2013 to implement Section 619 of the Dodd-Frank Act (the "Volcker Rule") generally prohibit banking entities from engaging in proprietary trading and from investing in, sponsoring, or having certain relationships with a hedge fund or private equity fund. The pooled trust preferred securities owned by the Company were included in a January 2014 listing of securities which the agencies considered to be grandfathered with regard to these prohibitions; as such, banking entities are permitted to retain their interest in these securities, provided the interest was acquired on or before December 10, 2013, or acquired after that date pursuant to a merger or acquisition with a banking entity holding the

security under similar grandfathered status.

The September 30, 2015, cash flow analysis for the three securities indicated it is probable the Company will receive all contracted principal and related interest projected. The cash flow analysis used in making this determination was based on anticipated default, recovery, and prepayment rates, and the resulting cash flows were discounted based on the yield anticipated at the time the securities were purchased. Other inputs include the actual collateral attributes, which include credit ratings and other performance indicators of the underlying financial institutions, including profitability, capital ratios, and asset quality. Assumptions for these three securities included annualized prepayments of 1.2 to 1.6 percent; no recoveries on issuers currently in default; recoveries of zero to 71 percent on currently deferred issuers within the next two years; new defaults of 50 basis points annually; and recoveries of 10% of new defaults.

One of these three securities has continued to receive cash interest payments in full since our purchase; the second of the three securities received principal-in-kind (PIK) for a period of time following the recession and financial crisis which began in 2008, but resumed cash interest payments during fiscal 2014. Our cash flow analysis indicates that interest payments are expected to continue for these two securities. Because the Company does not intend to sell these securities and it is not more-likely-than-not that the Company will be required to sell these securities prior to

recovery of their amortized cost basis, which may be maturity, the Company does not consider these investments to be other-than-temporarily impaired at September 30, 2015.

For the last of these three securities, the Company is receiving PIK in lieu of cash interest. Pooled trust preferred securities generally allow, under the terms of the issue, for issuers to defer interest for up to five consecutive years. After five years, if not cured, the issuer is considered to be in default and the trustee may demand payment in full of principal and accrued interest. Issuers are also considered to be in default in the event of the failure of the issuer or a subsidiary. Both deferred and defaulted issuers are considered non-performing, and the trustee calculates, on a quarterly or semi-annual basis, certain coverage tests prior to the payment of cash interest to owners of the various tranches of the securities. The tests must show that performing collateral is sufficient to meet requirements for senior tranches, both in terms of cash flow and collateral value, before cash interest can be paid to subordinate tranches. If the tests are not met, available cash flow is diverted to pay down the principal balance of senior tranches until the coverage tests are met, before cash interest payments to subordinate tranches may resume. The Company is receiving PIK for this security due to failure of the required coverage tests described above at senior tranche levels of the security. The risk to holders of a tranche of a security in PIK status is that the pool's total cash flow will not be sufficient to repay all principal and accrued interest related to the investment. The impact of payment of PIK to subordinate tranches is to strengthen the position of senior tranches, by reducing the senior tranches' principal balances relative to available collateral and cash flow, while increasing principal balances, decreasing cash flow, and increasing credit risk to the tranches receiving PIK. For our security in receipt of PIK, the principal balance is increasing, cash flow has stopped, and, as a result, credit risk is increasing. The Company currently expects this security to remain in PIK status for a period of less than one year. Despite these facts, because the Company does not intend to sell this security and it is not more-likely-than-not that the Company will be required to sell this security prior to recovery of its amortized cost basis, which may be maturity, the Company does not consider this investment to be other-than-temporarily impaired at September 30, 2015.

At December 31, 2008, analysis of a fourth pooled trust preferred security indicated other-than-temporary impairment (OTTI). The loss recognized at that time reduced the amortized cost basis for the security, and as of September 30, 2015, the estimated fair value of the security exceeds the new, lower amortized cost basis.

The Company does not believe any other individual unrealized loss as of September 30, 2015, represents OTTI. However, the Company could be required to recognize OTTI losses in future periods with respect to its available for sale investment securities portfolio. The amount and timing of any additional OTTI will depend on the decline in the underlying cash flows of the securities. Should the impairment of any of these securities become other-than-temporary, the cost basis of the investment will be reduced and the resulting loss recognized in the period the other-than-temporary impairment is identified.

Credit losses recognized on investments. As described above, one of the Company's investments in trust preferred securities experienced fair value deterioration due to credit losses, but is not otherwise other-than-temporarily impaired. During fiscal 2009, the Company adopted ASC 820, formerly FASB Staff Position 157-4, "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly." The following table provides information about the trust preferred security for which only a credit loss was recognized in income and other losses are recorded in other comprehensive income (loss) for the three-month periods ended September 30, 2015 and 2014.

Accumulated
Credit
Losses
Three-Month
Period

	Ended	
	September	
	30,	
(dollars in thousands)	2015	2014
Credit losses on debt securities held		
Beginning of period	\$ 365	\$ 375
Additions related to OTTI losses not previously recognized	-	-
Reductions due to sales	-	-
Reductions due to change in intent or likelihood of sale	-	-
Additions related to increases in previously-recognized OTTI losses	-	-
Reductions due to increases in expected cash flows	(3)	(2)
End of period	\$ 362	\$ 373

Note 4: Loans and Allowance for Loan Losses

Classes of loans are summarized as follows:

(dollars in thousands)	September 30, 2015	June 30, 2015
Real Estate Loans:		
Residential	\$383,681	\$377,465
Construction	75,902	69,204
Commercial	408,971	404,720
Consumer loans	46,581	46,770
Commercial loans	199,253	191,886
	1,114,388	1,090,045
Loans in process	(32,569)	(24,688)
Deferred loan fees, net	80	87
Allowance for loan losses	(12,812)	(12,298)
Total loans	\$1,069,087	\$1,053,146

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

Residential Mortgage Lending. The Company actively originates loans for the acquisition or refinance of one- to four-family residences. This category includes both fixed-rate and adjustable-rate mortgage ("ARM") loans amortizing over periods of up to 30 years, and the properties securing such loans may be owner-occupied or non-owner-occupied. Single-family residential loans do not generally exceed 90% of the lower of the appraised value or purchase price of the secured property. Substantially all of the one- to four-family residential mortgage originations in the Company's portfolio are located within the Company's primary lending area.

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

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

Most commercial real estate loans originated by the Company generally are based on amortization schedules of up to 20 years with monthly principal and interest payments. Generally, the interest rate received on these loans is fixed for a maturity for up to five years, with a balloon payment due at maturity. Alternatively, for some loans, the interest rate adjusts at least annually after an initial period up to five years. The Company typically includes an interest rate "floor" in the loan agreement. Generally, improved commercial real estate loan amounts do not exceed 80% of the lower of the appraised value or the purchase price of the secured property. Agricultural real estate terms offered differ slightly,

with amortization schedules of up to 25 years with an 80% loan-to-value ratio, or 30 years with a 75% loan-to-value ratio.

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

payments using amortization schedules of up to 30 years on residential and generally up to 20 years on commercial real estate.

While the Company typically utilizes maturity periods ranging from 6 to 12 months to closely monitor the inherent risks associated with construction loans for these loans, weather conditions, change orders, availability of materials and/or labor, and other factors may contribute to the lengthening of a project, thus necessitating the need to renew the construction loan at the balloon maturity. Such extensions are typically executed in incremental three month periods to facilitate project completion. The Company's average term of construction loans is approximately nine months. During construction, loans typically require monthly interest only payments which may allow the Company an opportunity to monitor for early signs of financial difficulty should the borrower fail to make a required monthly payment. Additionally, during the construction phase, the Company typically obtains interim inspections completed by an independent third party. This monitoring further allows the Company an opportunity to assess risk. At September 30, 2015, construction loans outstanding included 26 loans, totaling \$5.1 million, for which a modification had been agreed to. At June 30, 2015, construction loans outstanding included 49 loans, totaling \$8.2 million, for which a modification had been agreed to. All modifications were solely for the purpose of extending the maturity date due to conditions described above. None of these modifications were executed due to financial difficulty on the part of the borrower and, therefore, were not accounted for as TDRs.

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

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

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

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

The following tables present the balance in the allowance for loan losses and the recorded investment in loans (excluding loans in process and deferred loan fees) based on portfolio segment and impairment methods as of September 30 and June 30, 2015, and activity in the allowance for loan losses for the three-month periods ended September 30, 2015 and 2014:

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At period end and for the three months ended September 30, 2015						
(dollars in thousands)	Residential Construction		Commercial		Total	
	Real Estate	Real Estate	Real Estate	Consumer			Commercial
Allowance for loan losses:						
Balance, beginning of period	\$2,819	\$ 899	\$ 4,956	\$ 758	\$ 2,866	\$12,298
Provision charged to expense	539	(34)	114	1	(2)	618
Losses charged off	(64)	-	(21)	(10)	(12)	(107)
Recoveries	1	-	-	1	1	3
Balance, end of period	\$3,295	\$ 865	\$ 5,049	\$ 750	\$ 2,853	\$12,812
Ending Balance: individually evaluated for impairment	\$-	\$ -	\$ -	\$ -	\$ 144	\$144
Ending Balance: collectively evaluated for impairment	\$3,295	\$ 865	\$ 5,049	\$ 750	\$ 2,709	\$12,668
Ending Balance: loans acquired with deteriorated credit quality	\$-	\$ -	\$ -	\$ -	\$ -	\$-
Loans:						
Ending Balance: individually evaluated for impairment	\$-	\$ -	\$ -	\$ -	\$ 651	\$651
Ending Balance: collectively evaluated for impairment	\$380,541	\$ 41,501	\$ 398,354	\$ 46,581	\$ 197,532	\$1,064,509
Ending Balance: loans acquired with deteriorated credit quality	\$3,140	\$ 1,832	\$ 10,617	\$ -	\$ 1,070	\$16,659

For the three months ended September 30, 2014						
(dollars in thousands)	Residential Construction		Commercial		Total	
	Real Estate	Real Estate	Real Estate	Consumer			Commercial
Allowance for loan losses:						
Balance, beginning of period	\$2,462	\$ 355	\$ 4,143	\$ 519	\$ 1,780	\$9,259
Provision charged to expense	217	162	14	45	389	827
Losses charged off	(11)	-	-	(20)	-	(31)
Recoveries	8	-	18	26	3	55
Balance, end of period	\$2,676	\$ 517	\$ 4,175	\$ 570	\$ 2,172	\$10,110
Ending Balance: individually evaluated for impairment	\$-	\$ -	\$ -	\$ -	\$ -	\$-
Ending Balance: collectively evaluated for impairment	\$2,676	\$ 517	\$ 4,175	\$ 570	\$ 2,172	\$10,110
Ending Balance: loans acquired with deteriorated credit quality	\$-	\$ -	\$ -	\$ -	\$ -	\$-

June 30, 2015						
(dollars in thousands)	Residential Construction		Commercial		Total	
	Real Estate	Real Estate	Real Estate	Consumer		
Allowance for loan losses:						

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Balance, end of period	\$2,819	\$ 899	\$ 4,956	\$ 758	\$ 2,866	\$12,298
Ending Balance: individually evaluated for impairment	\$-	\$ -	\$ -	\$ -	\$ 160	\$160
Ending Balance: collectively evaluated for impairment	\$2,819	\$ 899	\$ 4,956	\$ 758	\$ 2,706	\$12,138
Ending Balance: loans acquired with deteriorated credit quality	\$-	\$ -	\$ -	\$ -	\$ -	\$-
Loans:						
Ending Balance: individually evaluated for impairment	\$-	\$ -	\$ -	\$ -	\$ 675	\$675
Ending Balance: collectively evaluated for impairment	\$374,186	\$ 42,655	\$ 394,028	\$ 46,560	\$ 190,128	\$1,047,557
Ending Balance: loans acquired with deteriorated credit quality	\$3,279	\$ 1,861	\$ 10,692	\$ 210	\$ 1,083	\$17,125

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

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

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

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

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

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

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

value of the collateral if the loan is collateral dependent.

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

The general component covers non-impaired loans and is based on quantitative and qualitative factors. The loan portfolio is stratified into homogeneous groups of loans that possess similar loss characteristics and an appropriate

loss ratio adjusted for qualitative factors is applied to the homogeneous pools of loans to estimate the incurred losses in the loan portfolio.

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

The following tables present the credit risk profile of the Company's loan portfolio (excluding loans in process and deferred loan fees) based on rating category and payment activity as of September 30, 2015 and June 30, 2015. These tables include purchased credit impaired loans, which are reported according to risk categorization after acquisition based on the Company's standards for such classification:

	September 30, 2015				
	Residential		Construction	Commercial	
	Real				
(dollars in thousands)	Estate	Real Estate	Real Estate	Consumer	Commercial
Pass	\$379,327	\$ 43,200	\$ 396,398	\$ 46,319	\$ 196,490
Watch	1,068	-	4,204	68	102
Special Mention	-	-	-	-	-
Substandard	3,286	133	8,369	194	2,661
Doubtful	-	-	-	-	-
Total	\$383,681	\$ 43,333	\$ 408,971	\$ 46,581	\$ 199,253

	June 30, 2015				
	Residential		Construction	Commercial	
	Real				
(dollars in thousands)	Estate	Real Estate	Real Estate	Consumer	Commercial
Pass	\$372,797	\$ 44,383	\$ 392,063	\$ 46,513	\$ 188,784
Watch	1,155	-	4,636	72	119
Special Mention	-	-	-	-	-
Substandard	3,513	133	8,021	185	2,983
Doubtful	-	-	-	-	-
Total	\$377,465	\$ 44,516	\$ 404,720	\$ 46,770	\$ 191,886

The above amounts include purchased credit impaired loans. At September 30, 2015, purchased credited impaired loans comprised \$6.4 million of credits rated "Pass"; \$3.6 million of credits rated "Watch"; none rated "Special Mention"; \$6.7 million of credits rated "Substandard"; and none rated "Doubtful". At June 30, 2015, purchased credit impaired loans accounted for \$6.4 million of credits rated "Pass"; \$4.0 million of credits rated "Watch"; none rated "Special Mention"; \$6.7 million of credits rated "Substandard"; and none rated "Doubtful".

Credit Quality Indicators. The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends among other factors. The Company analyzes loans individually by classifying the loans as to credit risk. This analysis is performed on all loans at origination, and is updated on a quarterly basis for loans risk rated "Special Mention", "Substandard", or "Doubtful". In addition, lending

relationships over \$250,000 are subject to an independent loan review following origination, and lending relationships in excess of \$1.0 million are subject to an independent loan review annually, in order to verify risk ratings. The Company uses the following definitions for risk ratings:

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

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

Substandard – Loans classified as substandard possess weaknesses that jeopardize the ultimate collection of the principal and interest outstanding. These loans exhibit continued financial losses, ongoing delinquency,

overall poor financial condition, and insufficient collateral. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

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

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

The following tables present the Company's loan portfolio aging analysis (excluding loans in process and deferred loan fees) as of September 30 and June 30, 2015. These tables include purchased credit impaired loans, which are reported according to aging analysis after acquisition based on the Company's standards for such classification:

September 30, 2015

(dollars in thousands)	30-59	60-89	Greater	Total	Current	Total	Total
	Days	Days	Than				
	Past	Past	90	Past		Loans	Loans >
	Due	Due	Days	Due		Receivable	90
							Days &
							Accruing
Real Estate Loans:							
Residential	\$1,339	\$ 61	\$1,755	\$3,155	\$380,526	\$383,681	\$ -
Construction	101	-	132	233	43,100	43,333	-
Commercial	450	-	344	794	408,177	408,971	-
Consumer loans	1,161	-	78	1,239	45,342	46,581	50
Commercial loans	250	-	6	256	198,997	199,253	-
Total loans	\$3,301	\$ 61	\$2,315	\$5,677	\$1,076,142	\$1,081,819	\$ 50

June 30, 2015

(dollars in thousands)	30-59	60-89	Greater	Total	Current	Total	Total
	Days	Days	Than				
	Past	Past	90	Past		Loans	Loans >
	Due	Due	Days	Due		Receivable	90
							Days &
							Accruing
Real Estate Loans:							
Residential	\$1,143	\$1,645	\$ 439	\$3,227	\$374,238	\$377,465	\$ -
Construction	113	-	132	245	44,271	44,516	-
Commercial	350	246	34	630	404,090	404,720	-
Consumer loans	260	11	48	319	46,451	46,770	34
Commercial loans	375	127	30	532	191,354	191,886	11
Total loans	\$2,241	\$2,029	\$ 683	\$4,953	\$1,060,404	\$1,065,357	\$ 45

At September 30, 2015, there were two purchased credit impaired loan totaling \$1.5 million that were greater than 90 days past due, and none at June 30, 2015.

A loan is considered impaired, in accordance with the impairment accounting guidance (ASC 310-10-35-16), when based on current information and events, it is probable the Company will be unable to collect all amounts due from the borrower in accordance with the contractual terms of the loan. Impaired loans include nonperforming loans, as well as performing loans modified in troubled debt restructurings where concessions have been granted to borrowers experiencing financial difficulties. These concessions could include a reduction in the interest rate on the loan, payment extensions, forgiveness of principal, forbearance or other actions intended to maximize collection.

The tables below present impaired loans (excluding loans in process and deferred loan fees) as of September 30 and June 30, 2015. These tables include purchased credit impaired loans. Purchased credit impaired loans are those for which it was deemed probable, at acquisition, that the Company would be unable to collect all contractually required payments receivable. In an instance where, subsequent to the acquisition, the Company determines it is probable, for a specific loan, that cash flows received will exceed the amount previously expected, the Company will recalculate the amount of accretable yield in order to recognize the improved cash flow expectation as additional interest income over the remaining life of the loan. These loans, however, will continue to be reported as impaired loans. In an instance where, subsequent to the acquisition, the Company determines it is probable, for a specific loan, that cash flows received will be less than the amount previously expected, the Company will allocate a specific allowance under the terms of ASC 310-10-35.

(dollars in thousands)	September 30, 2015		
	Recorded Balance	Unpaid Principal Balance	Specific Allowance
Loans without a specific valuation allowance:			
Residential real estate	\$3,458	\$ 3,714	\$ -
Construction real estate	1,832	2,783	-
Commercial real estate	12,689	14,473	-
Consumer loans	33	33	-
Commercial loans	1,890	1,981	-
Loans with a specific valuation allowance:			
Residential real estate	\$-	\$-	\$ -
Construction real estate	-	-	-
Commercial real estate	-	-	-
Consumer loans	-	-	-
Commercial loans	651	651	144
Total:			
Residential real estate	\$3,458	\$ 3,714	\$ -
Construction real estate	\$1,832	\$ 2,783	\$ -
Commercial real estate	\$12,689	\$ 14,473	\$ -
Consumer loans	\$33	\$ 33	\$ -
Commercial loans	\$2,541	\$ 2,632	\$ 144

(dollars in thousands)	June 30, 2015		
	Recorded Balance	Unpaid Principal Balance	Specific Allowance
Loans without a specific valuation allowance:			
Residential real estate	\$3,552	\$ 3,814	\$ -
Construction real estate	1,861	2,806	-
Commercial real estate	12,772	14,602	-
Consumer loans	245	241	-
Commercial loans	1,340	1,437	-
Loans with a specific valuation allowance:			
Residential real estate	\$-	\$-	\$ -
Construction real estate	-	-	-
Commercial real estate	-	-	-
Consumer loans	-	-	-
Commercial loans	675	675	160
Total:			
Residential real estate	\$3,552	\$ 3,814	\$ -
Construction real estate	\$1,861	\$ 2,806	\$ -
Commercial real estate	\$12,772	\$ 14,602	\$ -
Consumer loans	\$245	\$ 241	\$ -
Commercial loans	\$2,015	\$ 2,112	\$ 160

The above amounts include purchased credit impaired loans. At September 30, 2015, purchased credit impaired loans comprised \$16.7 million of impaired loans without a specific valuation allowance; none with a specific valuation allowance; and \$16.7 million of total impaired loans. At June 30, 2015, purchased credit impaired loans comprised

\$17.1 million of impaired loans without a specific valuation allowance; none with a specific valuation allowance; and \$17.1 million of total impaired loans.

The following tables present information regarding interest income recognized on impaired loans:

(dollars in thousands)	For the three-month period ended September 30, 2015	
	Average Investment in Impaired Loans	Interest Income Recognized
Residential Real Estate	\$3,210	\$ 28
Construction Real Estate	1,847	37
Commercial Real Estate	10,655	184
Consumer Loans	105	2
Commercial Loans	1,077	19
Total Loans	\$16,894	\$ 270

(dollars in thousands)	For the three-month period ended September 30, 2014	
	Average Investment in Impaired Loans	Interest Income Recognized
Residential Real Estate	\$2,952	\$ 69
Construction Real Estate	1,324	50
Commercial Real Estate	6,818	189
Consumer Loans	98	3
Commercial Loans	617	14
Total Loans	\$11,809	\$ 325

Interest income on impaired loans recognized on a cash basis in the three-month periods ended September 30, 2015 and 2014, was immaterial.

For the three-month period ended September 30, 2015, the amount of interest income recorded for impaired loans that represented a change in the present value of cash flows attributable to the passage of time was approximately \$49,000, as compared to \$30,000, for the three-month period ended September 30, 2014.

The following table presents the Company's nonaccrual loans at September 30 and June 30, 2015. The table excludes performing troubled debt restructurings.

(dollars in thousands)	June	
	September 30, 2015	September 30, 2015
Residential real estate	\$ 2,109	\$2,202
Construction real estate	133	133
Commercial real estate	1,664	1,271
Consumer loans	96	88

Commercial loans	20	63
Total loans	\$ 4,022	\$3,757

The above amounts include purchased credit impaired loans. At September 30 and June 30, 2015, these loans comprised \$2.8 million and \$2.4 million of nonaccrual loans, respectively.

Included in certain loan categories in the impaired loans are troubled debt restructurings (TDRs), where economic concessions have been granted to borrowers who have experienced financial difficulties. These concessions typically result from our loss mitigation activities, and could include reductions in the interest rate, payment extensions, forgiveness of principal, forbearance, or other actions. Certain TDRs are classified as nonperforming at the time of restructuring and typically are returned to performing status after considering the borrower's sustained repayment performance for a reasonable period of at least six months.

When loans and leases are modified into a TDR, the Company evaluates any possible impairment similar to other impaired loans based on the present value of expected future cash flows, discounted at the contractual interest rate of the original loan or lease agreement, and uses the current fair value of the collateral, less selling costs, for collateral dependent loans. If the Company determines that the value of the modified loan is less than the recorded investment in the loan (net of previous charge-offs, deferred loan fees or costs, and unamortized premium or discount), impairment is recognized through an allowance estimate or a charge-off to the allowance. In periods subsequent to

modification, the Company evaluates all TDRs, including those that have payment defaults, for possible impairment and recognizes impairment through the allowance.

During the three-month periods ended September 30, 2015 and 2014, certain loans were classified as TDRs. They are shown, segregated by class, in the table below:

(dollars in thousands)	For the three-month period ended			
	September 30, 2015		September 30, 2014	
	Number	Recorded Investment	Number	Recorded Investment
	of modifications	of modifications	of modifications	of modifications
Residential real estate	2	\$ 49	-	\$ -
Construction real estate	-	-	-	-
Commercial real estate	-	-	-	-
Consumer loans	-	-	-	-
Commercial loans	2	564	-	-
Total	4	\$ 613	-	\$ -

Performing loans classified as TDRs and outstanding at September 30 and June 30, 2015, segregated by class, are shown in the table below. Nonperforming TDRs are shown as nonaccrual loans.

(dollars in thousands)	September 30, 2015				June 30, 2015			
	Number	Recorded Investment	Number	Recorded Investment	Number	Recorded Investment	Number	Recorded Investment
	of modifications	of modifications	of modifications	of modifications	of modifications	of modifications	of modifications	of modifications
Residential real estate	7	\$ 488	7	\$ 602				
Construction real estate	-	-	-	-				
Commercial real estate	14	4,626	14	4,666				
Consumer loans	-	-	-	-				
Commercial loans	5	1,835	3	1,280				
Total	26	\$ 6,949	24	\$ 6,548				

Note 5: Accounting for Certain Loans Acquired in a Transfer

The Company acquired loans in transfers during the fiscal years ended June 30, 2011 and June 30, 2015. At acquisition, certain transferred loans evidenced deterioration of credit quality since origination and it was probable, at acquisition, that all contractually required payments would not be collected.

Loans purchased with evidence of credit deterioration since origination and for which it is probable that all contractually required payments will not be collected are considered to be credit impaired. Evidence of credit quality deterioration as of the purchase date may include information such as past-due and nonaccrual status, borrower credit scores and recent loan to value percentages. Purchased credit-impaired loans are accounted for under the accounting guidance for loans and debt securities acquired with deteriorated credit quality (ASC 310-30) and initially measured at fair value, which includes estimated future credit losses expected to be incurred over the life of the loan. Accordingly, an allowance for credit losses related to these loans is not carried over and recorded at the acquisition date. Management estimated the cash flows expected to be collected at acquisition using our internal risk models, which

incorporate the estimate of current key assumptions, such as default rates, severity and prepayment speeds.

The carrying amount of those loans is included in the balance sheet amounts of loans receivable at September 30 and June 30, 2015. The amount of these loans is shown below:

(dollars in thousands)	September 30, 2015	June 30, 2015
Residential real estate	\$ 3,397	\$3,542
Construction real estate	2,783	2,806
Commercial real estate	12,401	12,523
Consumer loans	-	207
Commercial loans	1,161	1,180
Outstanding balance	\$ 19,742	\$20,258
Carrying amount, net of fair value adjustment of \$3,083 and \$3,132 at September 30, 2015 and June 30, 2015, respectively	\$ 16,659	\$17,126

Accretable yield, or income expected to be collected, is as follows:

(dollars in thousands)	For the three-month period ending September	
	30, 2015	September 30, 2014
Balance at beginning of period	\$547	\$ 380
Additions	-	4
Accretion	(49)	(60)
Reclassification from nonaccretable difference	84	-
Disposals	-	-
Balance at end of period	\$582	\$ 324

During the three-month periods ended September 30, 2015 and September 30, 2014, the Company did not increase the allowance for loan losses related to these purchased credit impaired loans. During the same periods, the Company did not reverse the allowance for loan losses related to these loans.

Note 6: Deposits

Deposits are summarized as follows:

(dollars in thousands)	September 30, 2015	June 30, 2015
Non-interest bearing accounts	\$122,341	\$117,471
NOW accounts	348,014	336,097
Money market deposit accounts	68,348	67,752
Savings accounts	123,137	131,884
Certificates	395,876	402,038
Total Deposit Accounts	\$1,057,716	\$1,055,242

Note 7: Earnings Per Share

The following table sets forth the computation of basic and diluted earnings per share:

(dollars in thousands except per share data)	Three months ended September 30,	
	2015	2014
Net income	\$3,635	\$3,299
Charge for early redemption of preferred stock issued at discount	-	-
Dividend payable on preferred stock	50	50
Net income available to common shareholders	\$3,585	\$3,249

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Average Common shares – outstanding basic	7,422,354	7,113,872
Stock options under treasury stock method	31,503	194,070
Average Common shares – outstanding diluted	7,453,857	7,307,942
Basic earnings per common share	\$0.48	\$0.46
Diluted earnings per common share	\$0.48	\$0.44

At September 30, 2015 and 2014, no options outstanding had an exercise price exceeding the market price.

Note 8: Income Taxes

The Company and its subsidiary files income tax returns in the U.S. Federal jurisdiction and various states. The Company is no longer subject to U.S. federal and state examinations by tax authorities for fiscal years before 2011. The Company recognized no interest or penalties related to income taxes.

The Company's income tax provision is comprised of the following components:

(dollars in thousands)	For the three-month period ended September	
	30, 2015	September 30, 2014
Income taxes		
Current	\$2,203	\$ 2,316
Deferred	(538)	(935)
Total income tax provision	\$ 1,665	\$ 1,381

The components of net deferred tax assets are summarized as follows:

	September 30, 2015	June 30, 2015
Deferred tax assets:		
Provision for losses on loans	\$ 5,295	\$5,037
Accrued compensation and benefits	322	538
Other-than-temporary impairment on available for sale securities	136	137
NOL carry forwards acquired	745	768
Minimum Tax Credit	130	130
Unrealized loss on other real estate	6	6
Other	881	319
Total deferred tax assets	7,515	6,935
Deferred tax liabilities:		
FHLB stock dividends	5	39
Purchase accounting adjustments	2,022	1,985
Depreciation	1,006	992
Prepaid expenses	106	81
Unrealized gain on available for sale securities	645	502
Total deferred tax liabilities	3,784	3,599
Net deferred tax asset	\$ 3,731	\$3,336

As of September 30 and June 30, 2015, the Company had approximately \$1.8 and \$5.2 million in federal and state net operating loss carryforwards, which were acquired in the July 2009 acquisition of Southern Bank of Commerce, the February 2014 acquisition of Citizens State Bankshares of Bald Knob, Inc. and the August 2014 acquisition of Peoples Service Company. The amount reported is net of the IRC Sec. 382 limitation, or state equivalent, related to utilization of net operating loss carryforwards of acquired corporations. Unless otherwise utilized, the net operating losses will begin to expire in 2027.

A reconciliation of income tax expense at the statutory rate to the Company's actual income tax is shown below:

For the
three-month period

	ended	
	September	
(dollars in thousands)	30,	September
	2015	30, 2014
Tax at statutory rate	\$1,855	\$ 1,591
Increase (reduction) in taxes		
resulting from:		
Nontaxable municipal income	(143)	(131)
State tax, net of Federal benefit	150	120
Cash surrender value of		
Bank-owned life insurance	(51)	(49)
Tax credit benefits	(63)	(98)
Other, net	(83)	(53)
Actual provision	\$1,665	\$ 1,381

Tax credit benefits are recognized under the flow-through method of accounting for investments in tax credits.

Note 9: 401(k) Retirement Plan

The Bank has a 401(k) retirement plan that covers substantially all eligible employees. The Bank makes "safe harbor" matching contributions of up to 4% of eligible compensation, depending upon the percentage of eligible pay deferred into the plan by the employee. Additional profit-sharing contributions of 4% of eligible salary were accrued for the plan year ended June 30, 2015, based on the financial performance for fiscal 2015. During the three-month period ended September 30, 2015, retirement plan expenses recognized for the Plan totaled approximately \$213,000, as compared to \$166,000 for the same period of the prior fiscal year.

Note 10: Subordinated Debt

Southern Missouri Statutory Trust I issued \$7.0 million of Floating Rate Capital Securities (the "Trust Preferred Securities") with a liquidation value of \$1,000 per share in March 2004. The securities bear interest at a floating rate based on LIBOR, are now redeemable at par, and mature in 2034. The securities represent undivided beneficial interests in the trust, which was established by Southern Missouri for the purpose of issuing the securities. The Trust Preferred Securities were sold in a private transaction exempt from registration under the Securities Act of 1933, as amended (the "Act") and have not been registered under the Act. The securities may not be offered or sold in the United States absent registration or an applicable exemption from registration requirements.

Southern Missouri Statutory Trust I used the proceeds from the sale of the Trust Preferred Securities to purchase Junior Subordinated Debentures of Southern Missouri Bancorp. Southern Missouri Bancorp, Inc. used its net proceeds for working capital and investment in its subsidiaries.

In connection with its October 2013 acquisition of Ozarks Legacy Community Financial, Inc. (OLCF), the Company assumed \$3.1 million in floating rate junior subordinated debt securities. The debt securities had been issued in June 2005 by OLCF in connection with the sale of trust preferred securities, bear interest at a floating rate based on LIBOR, are now redeemable at par, and mature in 2035. The carrying value of the debt securities was approximately \$2.5 million at September 30, and June 30, 2015.

In connection with its August 2014 acquisition of Peoples Service Company, Inc. (PSC), the Company assumed \$6.5 million in floating rate junior subordinated debt securities. The debt securities had been issued in 2005 by PSC's subsidiary bank holding company, Peoples Banking Company, in connection with the sale of trust preferred securities, bear interest at a floating rate based on LIBOR, are now redeemable at par, and mature in 2035. The carrying value of the debt securities was approximately \$4.9 million at September 30, and June 30, 2015.

Note 11: Small Business Lending Fund

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

The SBLF Preferred Stock qualifies as Tier 1 capital. The SBLF Preferred Stock is entitled to receive non-cumulative dividends, payable quarterly, on each January 1, April 1, July 1 and October 1, beginning October 1, 2011. The dividend rate, as a percentage of the liquidation amount, can fluctuate on a quarterly basis during the first 10 quarters during which the SBLF Preferred Stock is outstanding, based upon changes in the Bank's level of Qualified Small

Business Lending (QBSL), as defined in the Purchase Agreement. Based upon the increase in the Bank's level of QBSL over the baseline level calculated under the terms of the Purchase Agreement, the dividend rate for the initial dividend period was set at 2.8155%. For the second through ninth calendar quarters, the dividend rate was adjusted to between one percent (1%) and five percent (5%) per annum, to reflect the amount of change in the Bank's level of QBSL. For the tenth calendar quarter through four and one half years after issuance, the dividend rate will be fixed at between one percent (1%) and seven percent (7%) based upon the increase in QBSL as compared to the baseline. The

dividend rate for the quarter ended September 30, 2015, was 1%. After four and one half years from issuance, the dividend rate increases to 9% (including a quarterly lending incentive fee of 0.5%).

The SBLF Preferred Stock is non-voting, except in limited circumstances. In the event that the Company misses five dividend payments, the holder of the SBLF Preferred Stock will have the right to appoint a representative as an observer on the Company's Board of Directors. In the event that the Company misses six dividend payments, the holder of the SBLF Preferred Stock will have the right to designate two directors to the Board of Directors of the Company.

The SBLF Preferred Stock may be redeemed at any time at the Company's option, at a redemption price of 100% of the liquidation amount plus accrued but unpaid dividends to the date of redemption for the current period, subject to the approval of its federal banking regulator.

As indicated in Note 14, Subsequent Events, the Company redeemed all 20,000 shares of SBLF Preferred stock on October 16, 2015, at their liquidation amount of \$1,000 per share plus accrued but unpaid dividends to the redemption date.

As required by the Purchase Agreement, \$9,635,000 of the proceeds from the sale of the SBLF Preferred Stock was used to redeem the 9,550 shares of the Company's Fixed Rate Cumulative Perpetual Preferred Stock, Series A issued in 2008 to the Treasury in the Troubled Asset Relief Program (TARP), plus the accrued dividends owed on those preferred shares. As part of the 2008 TARP transaction, the Company had issued a ten-year warrant to Treasury to purchase 228,652 shares (split-adjusted) of the Company's common stock at an exercise price (split-adjusted) of \$6.27 per share. The Company repurchased the warrant on May 29, 2015, for \$2.7 million. Immediately prior to repurchase, the warrant had been exercisable for the purchase of 231,891 shares (split-adjusted) at an exercise price of \$6.18 per share.

Note 12: Fair Value Measurements

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 establishes 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 active 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 supported by little or no market activity that are significant to the fair value of the assets or liabilities

Recurring Measurements. The following table presents the fair value measurements of assets recognized in the accompanying 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 September 30, 2015 and June 30, 2014:

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Fair Value Measurements at September 30, 2015,
Using:

(dollars in thousands)	Fair Value	Quoted	Significant	Significant
		Prices in Active Markets for Identical Assets	Other Observable Inputs	Unobservable Inputs
		(Level 1)	(Level 2)	(Level 3)
U.S. government sponsored enterprises (GSEs)	\$ 13,940	\$ -	\$ 13,940	\$ -
State and political subdivisions	44,314	-	44,314	-
Other securities	2,696	-	2,696	-
Mortgage-backed GSE residential	66,535	-	66,535	-

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Fair Value Measurements at June 30, 2015,
Using:

(dollars in thousands)	Fair Value	Quoted	Significant	Significant
		Prices in Active Markets for Identical Assets	Other Observable Inputs	Unobservable Inputs
		(Level 1)	(Level 2)	(Level 3)
U.S. government sponsored enterprises (GSEs)	\$ 14,814	\$ -	\$ 14,814	\$ -
State and political subdivisions	42,021	-	42,021	-
Other securities	2,704	-	2,478	226
Mortgage-backed GSE residential	70,054	-	70,054	-

Following is a description of the valuation methodologies and inputs used for assets measured at fair value on a recurring basis and recognized in the accompanying consolidated balance sheets, as well as the general classification of such assets pursuant to the valuation hierarchy. There have been no significant changes in the valuation techniques during the period ended September 30, 2015.

Available-for-sale Securities. When quoted market prices are available in an active market, securities are classified within Level 1. The Company does not have Level 1 securities. If quoted market prices are not available, then fair values are estimated using pricing models, or quoted prices of securities with similar characteristics. For these securities, our Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things. Level 2 securities include U.S. Government-sponsored enterprises, state and political subdivisions, other securities, mortgage-backed GSE residential securities and mortgage-backed other U.S. Government agencies. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy.

During fiscal 2011, a pooled trust preferred security was reclassified from Level 2 to Level 3 due to the unavailability of third-party vendor valuations determined by observable inputs – either quoted prices for similar assets; quoted prices in active markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full terms of the assets. During the three months ended September 30, 2015, that pooled trust preferred security was reclassified from Level 3 back to Level 2, as third-party vendor valuations are now available. The following table presents a reconciliation of activity for available for sale securities measured at fair value based on significant unobservable (Level 3) information for the three month periods ended September 30, 2015 and 2014:

(dollars in thousands)	For the three months ended	
	September 30, 2015	September 30, 2014
Available-for-sale securities, beginning of period	\$226	\$ 133
Total unrealized gains included in comprehensive income	26	29
Transferred from Level 3 to Level 2	(252)	-

Fair Value Measurements at June 30, 2015,
Using:

(dollars in thousands)	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)			Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans (collateral dependent)	\$515	\$	-	\$	-	\$ 515
Foreclosed and repossessed assets held for sale	4,504		-		-	4,504

The following table presents gains and (losses) recognized on assets measured on a non-recurring basis for the three-month periods ended September 30, 2015 and 2014:

(dollars in thousands)	For the three months ended September 30,	
	2015	September 30, 2014
Impaired loans (collateral dependent)	\$(144)	\$ -
Foreclosed and repossessed assets held for sale	(37)	3
Total (losses) gains on assets measured on a non-recurring basis	\$(181)	\$ 3

The following is a description of valuation methodologies and inputs used for assets measured at fair value on a nonrecurring basis and recognized in the accompanying consolidated balance sheets, as well as the general classification of such assets and liabilities pursuant to the valuation hierarchy. For assets classified within Level 3 of fair value hierarchy, the process used to develop the reported fair value process is described below.

Impaired Loans (Collateral Dependent). A collateral dependent loan is considered to be impaired when it is probable that all of the principal and interest due may not be collected according to its contractual terms. Generally, when a collateral dependent loan is considered impaired, the amount of reserve required is measured based on the fair value of the underlying collateral. The Company makes such measurements on all material collateral dependent loans deemed impaired using the fair value of the collateral for collateral dependent loans. The fair value of collateral used by the Company is determined by obtaining an observable market price or by obtaining an appraised value from an independent, licensed or certified appraiser, using observable market data. This data includes information such as selling price of similar properties and capitalization rates of similar properties sold within the market, expected future cash flows or earnings of the subject property based on current market expectations, and other relevant factors. In addition, management applies selling and other discounts to the underlying collateral value to determine the fair value. If an appraised value is not available, the fair value of the collateral dependent impaired loan is determined by an adjusted appraised value including unobservable cash flows.

On a quarterly basis, loans classified as special mention, substandard, doubtful, or loss are evaluated including the loan officer's review of the collateral and its current condition, the Company's knowledge of the current economic environment in the market where the collateral is located, and the Company's recent experience with real estate in the area. The date of the appraisal is also considered in conjunction with the economic environment and any decline in the

real estate market since the appraisal was obtained. For all loan types, updated appraisals are obtained if considered necessary. Of the Company's \$16.7 million (carrying value) in impaired loans (collateral-dependent and purchased credit-impaired), excluding TDR's at September 30, 2015, the Company utilized a real estate appraisal more than 12 months old to serve as the primary basis of our valuation for impaired loans with a carrying value of approximately \$15.7. The remaining \$1.0 million was secured by machinery, equipment and accounts receivable. In instances where the economic environment has worsened and/or the real estate market declined since the last appraisal, a higher distressed sale discount would be applied to the appraised value.

The Company records collateral dependent impaired loans based on nonrecurring Level 3 inputs. If a collateral dependent loan's fair value, as estimated by the Company, is less than its carrying value, the Company either records a charge-off of the portion of the loan that exceeds the fair value or establishes a specific reserve as part of the allowance for loan losses.

Foreclosed and Repossessed Assets Held for Sale. Foreclosed and repossessed assets held for sale are valued at the time the loan is foreclosed upon or collateral is repossessed and the asset is transferred to foreclosed or repossessed assets held for sale. The value of the asset is based on third party or internal appraisals, less estimated costs to sell and appropriate discounts, if any. The appraisals are generally discounted based on current and expected market conditions that may impact the sale or value of the asset and management's knowledge and experience with similar assets. Such discounts typically may be significant and result in a Level 3 classification of the inputs for determining fair value of these assets. Foreclosed and repossessed assets held for sale are continually evaluated for additional impairment and are adjusted accordingly if impairment is identified.

Unobservable (Level 3) Inputs. The following table presents quantitative information about unobservable inputs used in recurring and nonrecurring Level 3 fair value measurements.

(dollars in thousands)	Fair value at September 30, 2015	Valuation technique	Unobservable inputs	Range of inputs applied
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