

Simplicity Bancorp, Inc.  
Form 10-Q  
November 08, 2013  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 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, 2013

**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: 001-34979**

**SIMPLICITY BANCORP, INC.**

**(Exact name of registrant as specified in its charter)**

|  |  |
|--|--|
| <b>Maryland</b><br><b>(State or other jurisdiction</b>                                     | <b>26-1500698</b><br><b>(I.R.S. Employer</b> |
| <b>of incorporation)</b>   | <b>Identification No.)</b>                   |
| <b>1359 N. Grand Avenue, Covina, CA</b><br><b>(Address of principal executive offices)</b> | <b>91724</b><br><b>(Zip Code)</b>            |
| <b>(800) 524-2274</b>  |  |
| <b>(Registrant's telephone number, including area code)</b>                                |  |

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Sections 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (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 12b-2 of the Exchange Act). Yes  No

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

Common Stock, \$.01 par value 7,880,059 shares outstanding as of November 5, 2013.

**Table of Contents**

**Form 10-Q**

**SIMPLICITY BANCORP, INC.**

**Table of Contents**

|   | Page |
|---|------|
| <b>Part I. <u>FINANCIAL INFORMATION</u></b>   |      |
| Item 1: <u>Financial Statements (Unaudited)</u>   |      |
| <u>Consolidated Statements of Financial Condition at September 30, 2013 and June 30, 2013</u>                 | 1    |
| <u>Consolidated Statements of Income for the Three Months Ended September 30, 2013 and 2012</u>               | 2    |
| <u>Consolidated Statements of Comprehensive Income for the Three Months Ended September 30, 2013 and 2012</u> | 3    |
| <u>Consolidated Statements of Stockholders' Equity for the Three Months Ended September 30, 2013 and 2012</u> | 4    |
| <u>Consolidated Statements of Cash Flows for the Three Months Ended September 30, 2013 and 2012</u>           | 5    |
| <u>Notes to Consolidated Financial Statements</u>   | 6    |
| Item 2: <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>          | 26   |
| Item 3: <u>Quantitative and Qualitative Disclosures about Market Risk</u>                                     | 41   |
| Item 4: <u>Controls and Procedures</u>  | 42   |
| <b>Part II. <u>OTHER INFORMATION</u></b>  |      |
| Item 1: <u>Legal Proceedings</u>  | 43   |
| Item 1A: <u>Risk Factors</u>  | 43   |
| Item 2: <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>                                    | 43   |
| Item 3: <u>Defaults upon Senior Securities</u>  | 43   |
| Item 4: <u>Mine Safety Disclosures</u>  | 43   |
| Item 5: <u>Other Information</u>  | 44   |
| Item 6: <u>Exhibits</u>   | 44   |
| <b><u>SIGNATURES</u></b>  | 45   |

**Table of Contents****Part I FINANCIAL INFORMATION****Item 1. Financial Statements****SIMPLICITY BANCORP, INC. AND SUBSIDIARY****Consolidated Statements of Financial Condition****(Unaudited)****(Dollars in thousands, except per share data)**

|   | <b>September 30,<br/>2013</b> | <b>June 30,<br/>2013</b> |
|---|-------------------------------|--------------------------|
| <b>ASSETS</b>   |                               |                          |
| Cash and due from banks   | \$ 8,457                      | \$ 8,864                 |
| Federal funds sold  | 26,525                        | 76,810                   |
| Total cash and cash equivalents   | 34,982                        | 85,674                   |
| Securities available-for-sale, at fair value  | 48,128                        | 52,180                   |
| Securities held-to-maturity, fair value of \$489 and \$541 at September 30, 2013 and June 30, 2013, respectively                | 475                           | 525                      |
| Federal Home Loan Bank stock, at cost   | 5,902                         | 5,902                    |
| Loans held for sale   | 2,205                         | 4,496                    |
| Loans receivable, net of allowance for loan losses of \$5,487 and \$5,643 at September 30, 2013 and June 30, 2013, respectively | 713,830                       | 689,708                  |
| Accrued interest receivable   | 2,331                         | 2,439                    |
| Premises and equipment, net   | 3,940                         | 3,799                    |
| Goodwill  | 3,950                         | 3,950                    |
| Bank-owned life insurance   | 13,893                        | 13,784                   |
| Real estate owned (REO)   | 325                           |                          |
| Other assets  | 4,644                         | 4,920                    |
| Total assets  | \$ 834,605                    | \$ 867,377               |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>  |                               |                          |
| <b>Liabilities</b>  |                               |                          |
| Deposits  |                               |                          |
| Noninterest bearing   | \$ 57,119                     | \$ 65,694                |
| Interest bearing  | 569,754                       | 588,952                  |
| Total deposits  | 626,873                       | 654,646                  |
| Federal Home Loan Bank advances   | 60,000                        | 60,000                   |
| Accrued expenses and other liabilities  | 3,712                         | 7,293                    |

|   |   |            |
|---|---|------------|
| Total liabilities   | 690,585                                 | 721,939    |
| <b>Commitments and contingent liabilities</b>   |   |            |
| <b>Stockholders equity</b>  |   |            |
| Nonredeemable serial preferred stock, \$.01 par value; 25,000,000 shares authorized;<br>issued and outstanding none |   |            |
| Common stock, \$.01 par value; 100,000,000 authorized;  |   |            |
| September 30, 2013  | 7,998,265 shares issued and outstanding |            |
| June 30, 2013   | 8,121,415 shares issued and outstanding | 80 81      |
| Additional paid-in capital  | 77,694                                  | 79,800     |
| Retained earnings   | 70,857                                  | 70,326     |
| Accumulated other comprehensive loss, net of tax  | (436)                                   | (491)      |
| Unearned employee stock ownership plan (ESOP) shares  | (4,175)                                 | (4,278)    |
| Total stockholders equity   | 144,020                                 | 145,438    |
| Total liabilities and stockholders equity   | \$ 834,605                              | \$ 867,377 |

**The accompanying notes are an integral part of these unaudited consolidated financial statements**

Table of Contents**SIMPLICITY BANCORP, INC. AND SUBSIDIARY****Consolidated Statements of Income****(Unaudited)****(Dollars in thousands, except per share data)**

|  | <b>Three Months Ended<br/>September 30,</b> |              |
|--|---|--------------|
|  | <b>2013</b>                                 | <b>2012</b>  |
| <b>Interest income</b>                                     |   |              |
| Interest and fees on loans                                 | \$ 8,018                                    | \$ 9,718     |
| Interest on securities, taxable                            | 167   | 81           |
| Federal Home Loan Bank dividends                           | 80  | 10           |
| Other interest   | 29  | 32           |
| Total interest income                                      | 8,294                                       | 9,841        |
| <b>Interest expense</b>                                    |   |              |
| Interest on deposits                                       | 1,391                                       | 1,748        |
| Interest on borrowings                                     | 249   | 469          |
| Total interest expense                                     | 1,640                                       | 2,217        |
| <b>Net interest income</b>                                 | <b>6,654</b>                                | <b>7,624</b> |
| Provision for loan losses                                  |   | 850          |
| <b>Net interest income after provision for loan losses</b> | <b>6,654</b>                                | <b>6,774</b> |
| <b>Noninterest income</b>                                  |   |              |
| Service charges and fees                                   | 467   | 409          |
| ATM fees and charges                                       | 517   | 526          |
| Referral commissions                                       | 84  | 88           |
| Bank-owned life insurance                                  | 109   | 116          |
| Net gain on sales of loans                                 | 185   | 424          |
| Other noninterest income                                   | 97  | 4            |
| Total noninterest income                                   | 1,459                                       | 1,567        |
| <b>Noninterest expense</b>                                 |   |              |
| Salaries and benefits                                      | 3,016                                       | 3,222        |
| Occupancy and equipment                                    | 786   | 713          |
| ATM expense  | 578   | 521          |

Edgar Filing: Simplicity Bancorp, Inc. - Form 10-Q

|  |                 |                 |
|--|-----------------|-----------------|
| Advertising and promotional                          | 281             | 132             |
| Professional services                                | 555             | 495             |
| Federal deposit insurance premiums                   | 132             | 153             |
| Postage  | 52              | 63              |
| Telephone  | 195             | 228             |
| Loss on equity investment                            | 62              | 52              |
| REO foreclosure expenses and sales gains/losses, net | 28              | (15)            |
| Electronic services                                  | 125             | 100             |
| Other operating expense                              | 478             | 478             |
| <b>Total noninterest expense</b>                     | <b>6,288</b>    | <b>6,142</b>    |
| <b>Income before income tax expense</b>              | <b>1,825</b>    | <b>2,199</b>    |
| Income tax expense                                   | 676             | 806             |
| <b>Net income</b>                                    | <b>\$ 1,149</b> | <b>\$ 1,393</b> |
| <b>Earnings per common share:</b>                    |                 |                 |
| Basic  | \$ 0.15         | \$ 0.16         |
| Diluted  | \$ 0.15         | \$ 0.16         |

**The accompanying notes are an integral part of these unaudited consolidated financial statements**

**Table of Contents****SIMPLICITY BANCORP, INC. AND SUBSIDIARY****Consolidated Statements of Comprehensive Income****(Unaudited)****(Dollars in thousands)**

|   | <b>Three Months Ended<br/>September 30,</b> |                 |
|---|---|-----------------|
|   | <b>2013</b>                                 | <b>2012</b>     |
| Net income  | \$ 1,149                                    | \$ 1,393        |
| Other comprehensive income (loss):  |   |                 |
| Unrealized gain on securities available for sale                            | 93  | 219             |
| Postretirement medical benefit costs  |   |                 |
| Net loss arising during the period  | (17)  | (24)            |
| Reclassification adjustment for net periodic benefit cost and benefits paid | 17  | 24              |
| Income tax effect   | (38)  | (90)            |
| Other comprehensive income, net of tax                                      | 55  | 129             |
| <b>Comprehensive income</b>   | <b>\$ 1,204</b>                             | <b>\$ 1,522</b> |

**The accompanying notes are an integral part of these unaudited consolidated financial statements**



Table of Contents**SIMPLICITY BANCORP, INC. AND SUBSIDIARY****Consolidated Statements of Stockholders Equity****(Unaudited)****(Dollars in thousands, except per share data)**

|                                       | <b>Common Stock</b> |               |                         | <b>Accumulated Other Comprehensive Income</b> |            | <b>Unassigned ESOP</b> |            | <b>Total</b> |
|---------------------------------------|---------------------|---------------|-------------------------|---|------------|------------------------|------------|--------------|
|                                       | <b>Shares</b>       | <b>Amount</b> | <b>Capital Retained</b> | <b>Earnings</b>                               | <b>Net</b> | <b>Shares</b>          |            |              |
| Balance, July 1, 2012                 | 8,960,366           | \$ 90         | \$ 92,197               | \$ 66,723                                     | \$ (169)   | \$ (4,693)             | \$ 154,148 |              |
| Net income                            |                     |               |                         | 1,393   |            |                        | 1,393      |              |
| Other comprehensive income            |                     |               |                         |   | 129        |                        | 129        |              |
| Dividends declared (\$0.08 per share) |                     |               |                         | (685)   |            |                        | (685)      |              |
| Repurchase of common stock            | (193,533)           | (2)           | (2,911)                 |   |            |                        | (2,913)    |              |
| Stock options earned                  |                     |               | 11                      |   |            |                        | 11         |              |
| Allocation of stock awards            |                     |               | 69                      |   |            |                        | 69         |              |
| Issuance of stock awards              | 25,259              |               |                         |   |            |                        |            |              |
| Forfeiture of stock awards            | (800)               |               |                         |   |            |                        |            |              |
| Allocation of ESOP common stock       |                     |               | 52                      |   |            | 104                    | 156        |              |
| Balance, September 30, 2012           | 8,791,292           | \$ 88         | \$ 89,418               | \$ 67,431                                     | \$ (40)    | \$ (4,589)             | \$ 152,308 |              |
| Balance, July 1, 2013                 | 8,121,415           | \$ 81         | \$ 79,800               | \$ 70,326                                     | \$ (491)   | \$ (4,278)             | \$ 145,438 |              |
| Net income                            |                     |               |                         | 1,149   |            |                        | 1,149      |              |
| Other comprehensive income            |                     |               |                         |   | 55         |                        | 55         |              |
| Dividends declared (\$0.08 per share) |                     |               |                         | (618)   |            |                        | (618)      |              |
| Repurchase of common stock            | (148,575)           | (1)           | (2,242)                 |   |            |                        | (2,243)    |              |
| Stock options earned                  |                     |               | 9                       |   |            |                        | 9          |              |
| Allocation of stock awards            |                     |               | 75                      |   |            |                        | 75         |              |
| Issuance of stock awards              | 25,425              |               |                         |   |            |                        |            |              |
| Allocation of ESOP common stock       |                     |               | 52                      |   |            | 103                    | 155        |              |
| Balance, September 30, 2013           | 7,998,265           | \$ 80         | \$ 77,694               | \$ 70,857                                     | \$ (436)   | \$ (4,175)             | \$ 144,020 |              |

**The accompanying notes are an integral part of these unaudited consolidated financial statements**



Table of Contents**SIMPLICITY BANCORP, INC. AND SUBSIDIARY****Consolidated Statements of Cash Flows****(Unaudited)****(Dollars in thousands)**

|  | <b>Three Months Ended<br/>September 30,</b> |             |
|--|---|-------------|
|  | <b>2013</b>                                 | <b>2012</b> |
| <b>OPERATING ACTIVITIES</b>  |   |             |
| Net income   | \$ 1,149                                    | \$ 1,393    |
| Adjustments to reconcile net income to net cash provided by operating activities:  |   |             |
| Amortization of net premiums on securities   | 112   | 225         |
| Amortization of net premiums on loan purchases                                     | 121   | 98          |
| Amortization of net loan origination costs   | 17  | 34          |
| Provision for loan losses  |   | 850         |
| Net gain on sale of REO  |   | (16)        |
| Net gain on sales of loans held for sale   | (185)                                       | (424)       |
| Loans originated for sale  | (6,957)                                     | (16,656)    |
| Proceeds from sales of loans held for sale   | 9,519                                       | 11,322      |
| Decrease in valuation allowance for loans held for sale                            | (86)  |             |
| Depreciation and amortization  | 321   | 243         |
| Amortization of core deposit intangible  |   | 6           |
| Loss on equity investment  | 62  | 52          |
| Increase in cash surrender value of bank-owned life insurance                      | (109)                                       | (116)       |
| Allocation of ESOP common stock  | 155   | 156         |
| Allocation of stock awards   | 75  | 69          |
| Stock options earned   | 9   | 11          |
| Net change in accrued interest receivable  | 108   | (78)        |
| Net change in other assets   | 176   | (164)       |
| Net change in accrued expenses and other liabilities                               | (3,581)                                     | (1,080)     |
| Net cash provided by (used in) operating activities                                | 906   | (4,075)     |
| <b>INVESTING ACTIVITIES</b>  |   |             |
| Proceeds from maturities and principal repayments of available-for-sale securities | 4,033                                       | 4,829       |
| Proceeds from maturities and principal repayments of held-to-maturity securities   | 50  | 211         |
| Net change in loans  | (24,585)                                    | 20,297      |
| Proceeds from sale of real estate owned  |   | 686         |
| Redemption of FHLB stock   |   | 440         |
| Purchases of premises and equipment  | (462)                                       | (240)       |

|   |           |           |
|---|-----------|-----------|
| Net cash (used in) provided by investing activities | (20,964)  | 26,223    |
| <b>FINANCING ACTIVITIES</b>                         |           |           |
| Dividends paid on common stock                      | (618)     | (685)     |
| Repurchase of common stock                          | (2,243)   | (2,913)   |
| Net change in deposits                              | (27,773)  | (4,997)   |
| Net cash used in financing activities               | (30,634)  | (8,595)   |
| Net change in cash and cash equivalents             | (50,692)  | 13,553    |
| Cash and cash equivalents at beginning of period    | 85,674    | 66,018    |
| Cash and cash equivalents at end of period          | \$ 34,982 | \$ 79,571 |

**SUPPLEMENTAL CASH FLOW INFORMATION**

|  |          |          |
|--|----------|----------|
| Interest paid on deposits and borrowings | \$ 1,634 | \$ 2,211 |
| Income taxes paid                        | 1,600    | 1,000    |

**SUPPLEMENTAL NONCASH DISCLOSURES**

|  |        |    |
|--|--------|----|
| Transfer from loans to real estate owned | \$ 325 | \$ |
|--|--------|----|

**The accompanying notes are an integral part of these unaudited consolidated financial statements**

---

Table of Contents

**SIMPLICITY BANCORP, INC. AND SUBSIDIARY**

**Notes to Consolidated Financial Statements**

**(Unaudited)**

**Note 1 Nature of Business and Significant Accounting Policies**

**Nature of Business:** Simplicity Bancorp, Inc. (the Company), is a Maryland corporation that owns all of the outstanding common stock of Simplicity Bank (the Bank). In November, 2012, the Company changed its name to Simplicity Bancorp, Inc. from Kaiser Federal Financial Group, Inc. and its trading symbol to SMPL. Concurrently, the Bank was renamed Simplicity Bank from Kaiser Federal Bank as part of a broader business strategy to operate as a community bank serving the financial needs of all customers within its communities. The Company's primary activity is holding all of the outstanding shares of common stock of Simplicity Bank. The Bank is a federally chartered savings bank headquartered in Covina, California. The Bank's principal business activity consists of attracting retail deposits from the general public and originating or purchasing primarily loans secured by first mortgages on owner-occupied, one-to-four family residences and multi-family residences located in its market area, and to a lesser extent, commercial real estate, automobile and other consumer loans. The Bank also engages in mortgage banking activities and, as such, originates, sells and services one-to-four family residential mortgage loans. While the Bank originates many types of residential loans, the Bank also purchases, from time to time, using its own underwriting standards, first mortgages on owner-occupied, one-to-four family residences secured by properties located throughout California.

The Company's business activities generally are limited to passive investment activities and oversight of its investment in the Bank. Unless the context otherwise requires, all references to the Company include the Bank and the Company on a consolidated basis.

**Principles of Consolidation and Basis of Presentation:** The financial statements of Simplicity Bancorp, Inc. have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) and predominant practices followed by the financial services industry. The consolidated financial statements presented in this report include the accounts of Simplicity Bancorp, Inc. and its wholly-owned subsidiary, Simplicity Bank. All material intercompany balances and transactions have been eliminated in consolidation. In the opinion of the Company's management, all adjustments consisting of normal recurring accruals necessary for a fair presentation of the financial condition and results of operations for the interim periods included herein have been made.

The results of operations for the three months ended September 30, 2013 are not necessarily indicative of the results of operations that may be expected for any other interim period or for the fiscal year ending June 30, 2014. Certain information and note disclosures normally included in the Company's annual financial statements have been condensed or omitted. Therefore, these consolidated financial statements and notes thereto should be read in conjunction with the consolidated financial statements and notes included in the 2013 Annual Report on Form 10-K filed with the Securities and Exchange Commission.

**Use of Estimates in the Preparation of Consolidated Financial Statements:** The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of income and expenses during the reporting period. Changes in these estimates and assumptions are considered reasonably possible and may have a material impact on the consolidated financial statements and thus actual results could differ from the amounts reported and disclosed herein.

Edgar Filing: Simplicity Bancorp, Inc. - Form 10-Q

Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the valuation of real estate owned, mortgage servicing assets ( MSAs ), mortgage banking derivatives, deferred tax assets and fair values of financial instruments.

**Table of Contents****Recent Accounting Pronouncements:****Adoption of New Accounting Standards:**

In February 2012, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) 2013-02, *Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*. The amendments do not change the current requirements for reporting net income or other comprehensive income in financial statements. However, the amendments require an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required under U.S. GAAP that provide additional detail about those amounts. For public entities, the amendments are effective prospectively for fiscal years, and interim periods within those years, beginning after December 15, 2012. The adoption of this guidance did not have a material effect on the Company's result of operations or financial position.

**Note 2 Earnings Per Share**

The following table sets forth earnings per share calculations for the three months ended September 30, 2013 and 2012:

|   | <b>Three months ended<br/>September 30,</b>              |             |
|---|--|-------------|
|   | <b>2013</b>  | <b>2012</b> |
|   | <b>(Dollars in thousands, except per<br/>share data)</b> |             |
| <b><u>Basic</u></b>                                   |  |             |
| Net income  | \$ 1,149   | \$ 1,393    |
| Less: Net income allocated to restricted stock awards | 9  | 10          |
| Net income allocated to common shareholders           | \$ 1,140   | \$ 1,383    |
| Weighted average common shares outstanding            | 7,625,978  | 8,433,462   |
| Basic earnings per common share                       | \$ 0.15  | \$ 0.16     |
| <b><u>Diluted</u></b>                                 |  |             |
| Net income  | \$ 1,149   | \$ 1,393    |
| Less: Net income allocated to restricted stock awards | 9  | 10          |
| Net income allocated to common shareholders           | \$ 1,140   | \$ 1,383    |

Edgar Filing: Simplicity Bancorp, Inc. - Form 10-Q

|   |           |           |
|---|-----------|-----------|
| Weighted average common shares outstanding          | 7,625,978 | 8,433,462 |
| Add: Dilutive effect of stock options               | 19,453    | 17,404    |
| Average shares and dilutive potential common shares | 7,645,431 | 8,450,866 |
| Diluted earnings per common share                   | \$ 0.15   | \$ 0.16   |

The two-class method is used in the calculation of basic and diluted earnings per share. Under the two-class method, earnings per share is determined for each class of common stock and participating securities according to dividends declared (or accumulated) and participation rights in undistributed earnings. Restricted stock contains rights to non-forfeitable dividends and qualifies as a participating security. Employee Stock Ownership Plan ( ESOP ) shares are considered outstanding for this calculation unless unearned. For the three months ended September 30, 2013, 10,355 ESOP shares were allocated and 372,787 ESOP shares remained unearned.

Basic earnings per common share is net income divided by the weighted average number of common shares outstanding during the period. Diluted earnings per common share includes the dilutive effect of additional potential common shares issuable under stock options. For the three months ended September 30, 2013 and 2012, outstanding stock options to purchase 87,691 shares and 199,935 shares, respectively, were anti-dilutive and not considered in computing diluted earnings per common share. Stock options are not considered participating securities as they do not contain rights to non-forfeitable dividends.



**Table of Contents**

**Note 3 Fair Value Measurements**

FASB ASC 820-10 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 (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

**Level 2:** Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

**Level 3:** Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

There were no financial or nonfinancial instruments transferred in or out of Level 1, 2, or 3 input categories during the three month ended September 30, 2013 and 2012.

**Investment Securities:** The fair values for investment securities are determined by quoted market prices, if available (Level 1). For securities where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3).

**Impaired Loans:** At the time a loan is considered impaired, it is valued at the lower of cost or fair value. Impaired loans carried at fair value generally receive allocations of the allowance for loan losses that are individually evaluated. For collateral dependent loans, fair value is commonly based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business, resulting in a Level 3 fair value classification. Impaired loans are evaluated on a monthly basis for additional impairment and adjusted accordingly.

**Mortgage Servicing Assets:** MSAs are evaluated for impairment based upon the fair value of the rights as compared to carrying amount. The fair value is determined at a tranche level, based on a valuation model that calculates the present value of estimated future net servicing income. If the carrying amount of an individual tranche exceeds fair value, impairment is recorded on that tranche so that the servicing asset is carried at fair value. The valuation model utilizes assumptions that market participants would use in estimating future net servicing income and that can be validated against available market data such as prepayment speeds, ancillary income, servicing costs, delinquency rates. The significant assumptions also include discount rate incorporated into the valuation model that reflect management's best estimate resulting in a level 3 classification.

**Table of Contents**

Assets and liabilities measured at fair value on a recurring basis are summarized in the following tables (dollars in thousands):

|   | Fair Value Measurements Using                                       |  |                                  |  |
|---|---|--|----------------------------------|--|
|   | Quoted Prices in<br>Active Markets for<br>Identical Assets<br>Total | Significant<br>Observable<br>(Level 1) | Other<br>Observable<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| <b>September 30, 2013:</b>                        |   |  |                                  |  |
| <b>Assets</b>                                     |   |  |                                  |  |
| <b>Available-for-sale securities</b>              |   |  |                                  |  |
| Mortgage-backed securities (residential)          | \$ 28,611   | \$                                     | \$ 28,611                        | \$   |
| Collateralized mortgage obligations (residential) | 19,517  |  | 19,517                           |  |
| Total available-for-sale securities               | \$ 48,128   | \$                                     | \$ 48,128                        | \$   |
| <b>June 30, 2013:</b>                             |   |  |                                  |  |
| <b>Assets</b>                                     |   |  |                                  |  |
| <b>Available-for-sale securities</b>              |   |  |                                  |  |
| Mortgage-backed securities (residential)          | \$ 30,075   | \$                                     | \$ 30,075                        | \$   |
| Collateralized mortgage obligations (residential) | 22,105  |  | 22,105                           |  |
| Total available-for-sale securities               | \$ 52,180   | \$                                     | \$ 52,180                        | \$   |

Nonrecurring fair value measurements typically involve assets that are periodically evaluated for impairment and for which any impairment is recorded in the period in which the remeasurement is performed. The following assets were measured at fair value on a non-recurring basis (dollars in thousands):

|                                      | Fair Value Measurements Using                                       |  |                                  |  |
|--------------------------------------|---|--|----------------------------------|--|
|                                      | Quoted Prices in<br>Active Markets for<br>Identical Assets<br>Total | Significant<br>Observable<br>(Level 1) | Other<br>Observable<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| <b>Assets at September 30, 2013:</b> |   |  |                                  |  |
| <b>Impaired Loans</b>                |   |  |                                  |  |
| One-to-four family residential       | \$ 1,025  | \$                                     | \$                               | \$ 1,025   |
| Multi-family residential             | 197   |  |                                  | 197  |
| Total impaired loans                 | \$ 1,222  | \$                                     | \$                               | \$ 1,222   |
| <b>MSAs</b>                          | \$ 200  | \$                                     | \$                               | \$ 200   |

**Assets at June 30, 2013:**

Impaired Loans

|                                |          |    |    |          |
|--------------------------------|----------|----|----|----------|
| One-to-four family residential | \$ 1,495 | \$ | \$ | \$ 1,495 |
|--------------------------------|----------|----|----|----------|

|                            |          |    |    |       |    |
|----------------------------|----------|----|----|-------|----|
| <u>Loans Held for Sale</u> | \$ 4,496 | \$ | \$ | 4,496 | \$ |
|----------------------------|----------|----|----|-------|----|

|             |        |    |    |        |
|-------------|--------|----|----|--------|
| <u>MSAs</u> | \$ 195 | \$ | \$ | \$ 195 |
|-------------|--------|----|----|--------|

At September 30, 2013 and 2012, no nonfinancial assets were measured at fair value on a non-recurring basis.

**Table of Contents**

Loans are considered impaired when it is probable that the Company will be unable to collect all amounts due as scheduled according to the contractual terms of the loan agreement, including contractual interest and principal payments. Impaired loans are measured for impairment using the fair value of the collateral for collateral dependent loans. The fair value of collateral is calculated using an independent third party appraisal. Impaired loans measured at fair value had a recorded investment balance of \$1.2 million at September 30, 2013 as compared to \$1.5 million at June 30, 2013. The valuation allowance for these loans was \$9,000 at September 30, 2013 as compared to \$32,000 at June 30, 2013. The reduction of the balance of impaired loans measured at fair value and the associated valuation allowance was primarily attributable to principal reduction due to continuous payments on impaired loans individually evaluated during the three months ended September 30, 2013.

Impairment of MSAs is determined at the tranche level and recognized through a valuation allowance for each individual grouping, to the extent that fair value is less than the carrying amount. The impairment amount was \$27,000 as of September 30, 2013 as compared to \$31,000 as of June 30, 2013.

The following table presents quantitative information about level 3 fair value measurements for financial instruments measured at fair value on a recurring and non-recurring basis at September 30, 2013 (dollars in thousands):

| <b>September 30, 2013</b>      | <b>Fair Value</b> | <b>Valuation Techniques</b>             | <b>Unobservable Inputs</b>                                  | <b>Range<br/>(Weighted Avg)</b> |
|--------------------------------|-------------------|---|---|---------------------------------|
| <b><u>Impaired Loans</u></b>   |                   |   |   |                                 |
| One-to-four family residential | \$ 1,025          | Sales Comparison Approach               | Adjustment for the differences between the comparable sales | -6.4% to 8.5% (2.3%)            |
| Multi-family residential       | \$ 197            | Sales Comparison Approach               | Adjustment for the differences between the comparable sales | -31.8%                          |
| <b><u>MSAs</u></b>             | \$ 200            | Income Approach<br>Discounted Cash Flow | Capitalization rate<br>Discount Rate                        | 10.3% to 11.8% (11.1%)<br>7.5%  |

| <b>June 30, 2013</b>           | <b>Fair Value</b> | <b>Valuation Techniques</b> | <b>Unobservable Inputs</b>                                  | <b>Range<br/>(Weighted Avg)</b> |
|--------------------------------|-------------------|-----------------------------|---|---------------------------------|
| <b><u>Impaired Loans</u></b>   |                   |                             |   |                                 |
| One-to-four family residential | \$ 1,495          | Sales Comparison Approach   | Adjustment for the differences between the comparable sales | -8.7% to 8.5% (-1.45%)          |
| <b><u>MSAs</u></b>             | \$ 195            | Discounted Cash Flow        | Discount Rate   | 7.5%                            |

## Table of Contents

### **Fair Value of Financial Instruments**

The estimated fair value amounts have been determined by the Company using available market information and appropriate valuation methodologies. However, considerable judgment is required to interpret market data to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Company could realize in a market exchange. The use of different assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

The following methods and assumptions were used to estimate fair value of each class of financial instruments for which it is practicable to estimate fair value:

#### Cash and Cash Equivalents

The carrying amounts of cash and cash equivalents approximate fair values. Cash on hand and non-interest due from bank accounts are classified as Level 1 and federal funds sold are classified as Level 2.

#### Investments

Estimated fair values for securities held-to-maturity are obtained from quoted market prices where available and are classified as Level 1. Where quoted market prices are not available, estimated fair values are based on quoted market prices of comparable instruments and are classified as Level 2.

Securities available-for-sale that are previously reported are excluded from the fair value disclosure below.

#### FHLB Stock

It is not practical to determine the fair value of FHLB stock due to restrictions placed on its transferability.

#### Loans Held for Sale

Fair value for loans held for sale is determined using quoted secondary-market prices such as loan sale commitments and is classified as Level 2.

#### Loans

Fair value for loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality resulting in a Level 3 classification. Impaired loans are valued at the lower of cost or fair value as described previously and are excluded from the fair value disclosure below. The methods utilized to estimate the fair value of loans do not necessarily represent an exit price.

#### MSAs

The Company uses the amortization method for its MSAs and assesses the MSAs for impairment based on fair value. The fair value of MSAs is determined at tranche level using significant assumptions such as discount rate and is classified as Level 3. MSAs tranches with impairment recorded as described previously are excluded from the fair value disclosure below.

#### Accrued Interest Receivable

Consistent with the asset or liability they are associated with, the carrying amounts of accrued interest receivable approximate fair value resulting in a either Level 2 or Level 3 classification.

Deposits

The fair values disclosed for demand deposits are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts) resulting in a Level 2 classification. The carrying amounts of variable rate, fixed-term money market accounts and certificates of deposit approximate their fair values at the reporting date resulting in a Level 2 classification. Fair values for fixed rate certificates of deposit are estimated using a discounted cash flows calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits resulting in a Level 2 classification.

**Table of Contents**

**FHLB Advances**

The fair values of the Company's FHLB advances are estimated using discounted cash flow analyses based on the current borrowing rates for similar types of borrowing arrangements resulting in a Level 2 classification.

**Off-Balance Sheet Financial Instruments**

The fair values for the Company's off-balance sheet loan commitments are estimated based on fees charged to others to enter into similar agreements taking into account the remaining terms of the agreements and credit standing of the Company's customers. The estimated fair value of these commitments is not significant.

**Table of Contents**

The carrying amounts and estimated fair values of the Company's financial instruments are summarized as follows (in thousands):

|   | Fair Value Measurements at<br>September 30, 2013 Using: |  |  |  | Fair<br>Value |
|---|---|--|--|--|---------------|
|   | Carrying<br>Amount                                      | Quoted Prices in Active<br>Markets for Identical<br>Assets (Level 1) | Significant<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |               |
| <b>Financial assets:</b>                  |   |  |  |  |               |
| Cash on hand                              | \$ 8,457  | \$ 8,457   | \$   | \$   | \$ 8,457      |
| Federal funds sold                        | 26,525  |  | 26,525   |  | 26,525        |
| Securities held-to-maturity               | 475   |  | 489  |  | 489           |
| Federal Home Loan Bank Stock              | 5,902   |  |  |  |               |
| Loans held for sale                       | 2,205   |  | 2,324  |  | 2,324         |
| Loans receivable, net                     | 712,608   |  |  | 729,797  | 729,797       |
| MSAs                                      | 455   |  |  | 564  | 564           |
| Accrued interest receivable - loans       | 2,246   |  |  | 2,246  | 2,246         |
| Accrued interest receivable - investments | 85  |  | 85   |  | 83            |
| <b>Financial liabilities:</b>             |   |  |  |  |               |
| Deposits                                  | 626,873   |  | 632,027  |  | 632,027       |
| FHLB Advances                             | 60,000  |  | 61,024   |  | 61,024        |

|   | Fair Value Measurements at<br>June 30, 2013 Using: |  |  |  | Fair<br>Value |
|---|--|--|--|--|---------------|
|   | Carrying<br>Amount                                 | Quoted Prices in Active<br>Markets for Identical<br>Assets (Level 1) | Significant<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |               |
| <b>Financial assets:</b>                  |  |  |  |  |               |
| Cash on hand                              | \$ 8,864   | \$ 8,864   | \$   | \$   | \$ 8,864      |
| Federal funds sold                        | 76,810   |  | 76,810   |  | 76,810        |
| Securities held-to-maturity               | 525  |  | 541  |  | 541           |
| Federal Home Loan Bank Stock              | 5,902  |  |  |  |               |
| Loans held for sale                       | 4,496  |  | 4,496  |  | 4,496         |
| Loans receivable, net                     | 688,213  |  |  | 710,219  | 710,219       |
| MSAs                                      | 407  |  |  | 494  | 494           |
| Accrued interest receivable - loans       | 2,344  |  |  | 2,344  | 2,344         |
| Accrued interest receivable - investments | 93   |  | 93   |  | 93            |
| <b>Financial liabilities:</b>             |  |  |  |  |               |
| Deposits                                  | 654,646  |  | 660,995  |  | 660,995       |
| FHLB Advances                             | 60,000   |  | 61,451   |  | 61,451        |



**Table of Contents****Note 4 Investments**

The amortized cost and fair value of available-for-sale securities and the related gross unrealized gains and losses recognized in accumulated other comprehensive income were as follows (in thousands):

|  | Fair<br>Value | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Amortized<br>Cost |
|--|---------------|------------------------------|-------------------------------|-------------------|
| <b>September 30, 2013</b>                          |               |                              |                               |                   |
| Mortgage-backed (residential):                     |               |                              |                               |                   |
| Fannie Mae   | \$ 7,938      | \$ 69                        | \$                            | \$ 7,869          |
| Freddie Mac  | 20,673        | 13                           | (607)                         | 21,267            |
| Collateralized mortgage obligations (residential): |               |                              |                               |                   |
| Fannie Mae   | 11,319        | 10                           | (20)                          | 11,329            |
| Freddie Mac  | 8,198         | 35                           |                               | 8,163             |
| Total  | \$ 48,128     | \$ 127                       | \$ (627)                      | \$ 48,628         |
| <b>June 30, 2013</b>                               |               |                              |                               |                   |
| Mortgage-backed (residential):                     |               |                              |                               |                   |
| Fannie Mae   | \$ 8,510      | \$ 9                         | \$ (17)                       | \$ 8,518          |
| Freddie Mac  | 21,565        |                              | (662)                         | 22,227            |
| Collateralized mortgage obligations (residential): |               |                              |                               |                   |
| Fannie Mae   | 13,125        | 59                           | (39)                          | 13,105            |
| Freddie Mac  | 8,980         | 57                           |                               | 8,923             |
| Total  | \$ 52,180     | \$ 125                       | \$ (718)                      | \$ 52,773         |

The carrying amount, unrecognized gains and losses, and fair value of securities held-to-maturity were as follows (in thousands):

|  | Carrying<br>Amount | Gross<br>Unrecognized<br>Gains | Gross<br>Unrecognized<br>Losses | Fair<br>Value |
|--|--------------------|--------------------------------|---------------------------------|---------------|
| <b>September 30, 2013</b>                          |                    |                                |                                 |               |
| Mortgage-backed (residential):                     |                    |                                |                                 |               |
| Fannie Mae   | \$ 115             | \$ 4                           | \$                              | \$ 119        |
| Freddie Mac  | 70                 | 4                              |                                 | 74            |
| Ginnie Mae   | 35                 | 1                              |                                 | 36            |
| Collateralized mortgage obligations: (residential) |                    |                                |                                 |               |
| Fannie Mae   | 255                | 5                              |                                 | 260           |
| Freddie Mac  |                    |                                |                                 |               |

Edgar Filing: Simplicity Bancorp, Inc. - Form 10-Q

|       |        |       |        |
|-------|--------|-------|--------|
| Total | \$ 475 | \$ 14 | \$ 489 |
|-------|--------|-------|--------|

**June 30, 2013**

Mortgage-backed (residential):

|            |        |      |        |
|------------|--------|------|--------|
| Fannie Mae | \$ 119 | \$ 4 | \$ 123 |
|------------|--------|------|--------|

|             |    |   |    |
|-------------|----|---|----|
| Freddie Mac | 74 | 5 | 79 |
|-------------|----|---|----|

|            |    |   |    |
|------------|----|---|----|
| Ginnie Mae | 36 | 2 | 38 |
|------------|----|---|----|

Collateralized mortgage obligations: (residential)

|            |     |   |     |
|------------|-----|---|-----|
| Fannie Mae | 296 | 5 | 301 |
|------------|-----|---|-----|

|             |  |  |  |
|-------------|--|--|--|
| Freddie Mac |  |  |  |
|-------------|--|--|--|

|       |        |       |        |
|-------|--------|-------|--------|
| Total | \$ 525 | \$ 16 | \$ 541 |
|-------|--------|-------|--------|

**Table of Contents**

There were no sales of securities during the three months ended September 30, 2013 and September 30, 2012.

All mortgage-backed securities and collateralized mortgage obligations have varying contractual maturity dates at September 30, 2013. Expected maturities may differ from contractual maturities because borrowers may have the right to call or repay obligations with or without call or repayment penalties. There were no mortgage-backed securities called prior to the maturity date during the three months ended September 30, 2013.

Securities with unrealized losses at September 30, 2013 and June 30, 2013, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, are as follows (in thousands):

|   | Less than 12 months |                 | 12 months or more |                 | Total      |                 |
|---|---------------------|-----------------|-------------------|-----------------|------------|-----------------|
|   | Fair Value          | Unrealized Loss | Fair Value        | Unrealized Loss | Fair Value | Unrealized Loss |
| <b><u>September 30, 2013</u></b>                  |                     |                 |                   |                 |            |                 |
| <b><u>Description of Securities</u></b>           |                     |                 |                   |                 |            |                 |
| Mortgage-backed securities                        | \$ 17,679           | \$ (607)        | \$                | \$              | \$ 17,679  | \$ (607)        |
| Collateralized mortgage obligations (residential) | 6,145               | (5)             | 2,066             | (15)            | 8,211      | (20)            |
| Total temporarily impaired                        | \$ 23,824           | \$ (612)        | \$ 2,066          | \$ (15)         | \$ 25,890  | \$ (627)        |
| <b><u>June 30, 2013</u></b>                       |                     |                 |                   |                 |            |                 |
| <b><u>Description of Securities</u></b>           |                     |                 |                   |                 |            |                 |
| Mortgage-backed securities                        | \$ 25,476           | \$ (680)        | \$                | \$              | \$ 25,476  | \$ (680)        |
| Collateralized mortgage obligations (residential) |                     |                 | 2,508             | (39)            | 2,508      | (39)            |
| Total temporarily impaired                        | \$ 25,476           | \$ (680)        | \$ 2,508          | \$ (39)         | \$ 27,984  | \$ (719)        |

The Company evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to the length of time and the extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer, and the Company does not have the intent to sell these securities and it is not more likely than not that it will be required to sell the securities before their anticipated recovery. In analyzing an issuer's financial condition, the Company may consider whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's financial condition.

At September 30, 2013, nine debt securities had an aggregate unrealized loss of 2.4% of the Company's amortized cost basis. At June 30, 2013, ten debt securities had an unrealized loss of 2.6% of the Company's amortized cost basis. We do not own any non-agency mortgage-backed securities (MBSs) or collateralized mortgage obligations (CMOs). All MBSs and CMOs were issued by U.S. government-sponsored entities and agencies, primarily Fannie Mae and Freddie Mac, institutions which the government has affirmed its commitment to support. The unrealized losses relate principally to the general change in interest rates and liquidity, and not credit quality, that has occurred since the

securities purchase dates, and such unrecognized losses or gains will continue to vary with general interest rate level fluctuations in the future. As management has the intent and ability to hold debt securities until recovery, which may be maturity, and it is not more likely than not that it will be required to sell the securities before their anticipated recovery, no declines in fair value are deemed to be other-than-temporary as of September 30, 2013 and June 30, 2013.

There were no investments in any one issuer, other than the U.S. Government and its agencies, in an amount greater than 10% of stockholders' equity.

**Table of Contents****Note 5 Loans**

The composition of loans consists of the following (in thousands):

|  | <b>September 30,<br/>2013</b> | <b>June 30,<br/>2013</b> |
|--|-------------------------------|--------------------------|
| <b>Real Estate:</b>                        |                               |                          |
| One-to-four family residential             | \$ 308,308                    | \$ 319,631               |
| Multi-family residential                   | 317,566                       | 280,771                  |
| Commercial real estate                     | 51,733                        | 55,621                   |
|  | <b>677,607</b>                | <b>656,023</b>           |
| <b>Consumer:</b>                           |                               |                          |
| Automobile                                 | 30,591                        | 26,711                   |
| Home equity                                | 662                           | 682                      |
| Other consumer loans, primarily secured    | 9,671                         | 10,917                   |
|  | <b>40,924</b>                 | <b>38,310</b>            |
| <b>Total loans</b>                         | <b>718,531</b>                | <b>694,333</b>           |
| Deferred net loan origination costs        | 395                           | 506                      |
| Net premium (discounts) on purchased loans | 391                           | 512                      |
| Allowance for loan losses                  | (5,487)                       | (5,643)                  |
| <b>Loans receivable, net</b>               | <b>\$ 713,830</b>             | <b>\$ 689,708</b>        |

Loans held for sale totaled \$2.2 million as of September 30, 2013 as compared to \$4.5 million as of June 30, 2013. Loans held for sale are recorded at the lower of cost or fair value. Fair value, if lower than cost, is determined by outstanding commitments from the investor. Proceeds from sales of loans held for sale were \$9.5 million and \$11.3 million during the three months ended September 30, 2013 and 2012, resulting in net gain on sales of \$185,000 and \$424,000, respectively.

**Table of Contents**

The following is an analysis of the changes in the allowance for loan losses (in thousands):

| <b>Allowance for loan losses for the<br/>Three months ended September 30, 2013</b> |                               |                                     |                                   |                   |                        |              |              |
|--|-------------------------------|-------------------------------------|-----------------------------------|-------------------|------------------------|--------------|--------------|
|  | <b>One-to-four<br/>family</b> | <b>Multi-family<br/>residential</b> | <b>Commercial<br/>real estate</b> | <b>Automobile</b> | <b>Home<br/>equity</b> | <b>Other</b> | <b>Total</b> |
| Balance, beginning of period   | \$ 3,009                      | \$ 839                              | \$ 1,654                          | \$ 83             | \$ 4                   | \$ 54        | \$ 5,643     |
| Provision for loan losses  | (352)                         | 548                                 | (247)                             | 47                |                        | 4            |              |
| Recoveries   | 4                             |                                     | 1                                 | 8                 |                        | 1            | 14           |
| Loans charged-off  | (33)                          | (100)                               |                                   | (26)              |                        | (11)         | (170)        |
| Balance, end of period   | \$ 2,628                      | \$ 1,287                            | \$ 1,408                          | \$ 112            | \$ 4                   | \$ 48        | \$ 5,487     |

| <b>Allowance for loan losses for the<br/>Three months ended September 30, 2012</b> |                               |                                     |                                   |                   |                        |              |              |
|--|-------------------------------|-------------------------------------|-----------------------------------|-------------------|------------------------|--------------|--------------|
|  | <b>One-to-four<br/>family</b> | <b>Multi-family<br/>residential</b> | <b>Commercial<br/>real estate</b> | <b>Automobile</b> | <b>Home<br/>equity</b> | <b>Other</b> | <b>Total</b> |
| Balance, beginning of period   | \$ 4,692                      | \$ 1,519                            | \$ 1,131                          | \$ 62             | \$ 63                  | \$ 35        | \$ 7,502     |
| Provision for loan losses  | 964                           | (238)                               | 68                                | 40                | 19                     | (3)          | 850          |
| Recoveries   | 41                            |                                     |                                   | 7                 |                        | 1            | 49           |
| Loans charged-off  | (1,176)                       | (224)                               | (527)                             | (21)              | (56)                   | (5)          | (2,009)      |
| Balance, end of period   | \$ 4,521                      | \$ 1,057                            | \$ 672                            | \$ 88             | \$ 26                  | \$ 28        | \$ 6,392     |

**Table of Contents**

The following tables present the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of September 30, 2013 and June 30, 2013 (in thousands):

| <b>September 30, 2013</b>                     | <b>One-to-four<br/>family</b> | <b>Multi-family<br/>residential</b> | <b>Commercial<br/>real estate</b> | <b>Automobile</b> | <b>Home<br/>equity</b> | <b>Other</b> | <b>Total</b> |
|---|-------------------------------|-------------------------------------|-----------------------------------|-------------------|------------------------|--------------|--------------|
| <b>Allowance for loan losses:</b>             |                               |                                     |                                   |                   |                        |              |              |
| Ending allowance balance attributed to loans: |                               |                                     |                                   |                   |                        |              |              |
| Periodically evaluated for impairment         | \$ 991                        | \$ 1                                | \$ 61                             | \$ 19             | \$                     | \$ 3         | \$           |
| Nonperiodically evaluated for impairment      | 1,637                         | 1,286                               | 1,347                             | 93                | 4                      | 45           | 4            |
| Ending allowance balance                      | \$ 2,628                      | \$ 1,287                            | \$ 1,408                          | \$ 112            | \$ 4                   | \$ 48        | \$           |
| <b>Recorded investment in loans:</b>          |                               |                                     |                                   |                   |                        |              |              |
| Ending loan balance                           |                               |                                     |                                   |                   |                        |              |              |
| Periodically evaluated for impairment         | \$ 13,980                     | \$ 1,655                            | \$ 5,767                          | \$ 19             | \$                     | \$ 3         | \$ 2         |
| Nonperiodically evaluated for impairment      | 294,328                       | 315,911                             | 45,966                            | 30,572            | 662                    | 9,668        | 69           |
| Ending loan balance                           | \$ 308,308                    | \$ 317,566                          | \$ 51,733                         | \$ 30,591         | \$ 662                 | \$ 9,671     | \$ 71        |
| <b>June 30, 2013</b>                          |                               |                                     |                                   |                   |                        |              |              |
| <b>Allowance for loan losses:</b>             |                               |                                     |                                   |                   |                        |              |              |
| Ending allowance balance attributed to loans: |                               |                                     |                                   |                   |                        |              |              |
| Periodically evaluated for impairment         | \$ 941                        | \$                                  | \$ 64                             | \$                | \$                     | \$ 4         | \$           |
| Nonperiodically evaluated for impairment      | 2,068                         | 839                                 | 1,590                             | 83                | 4                      | 50           | 4            |
| Ending allowance balance                      | \$ 3,009                      | \$ 839                              | \$ 1,654                          | \$ 83             | \$ 4                   | \$ 54        | \$           |
| <b>Recorded investment in loans:</b>          |                               |                                     |                                   |                   |                        |              |              |
| Ending loan balance                           |                               |                                     |                                   |                   |                        |              |              |
| Periodically evaluated for impairment         | \$ 14,790                     | \$ 1,547                            | \$ 6,136                          | \$                | \$                     | \$ 4         | \$ 2         |
| Nonperiodically evaluated for impairment      | 304,841                       | 279,224                             | 49,485                            | 26,711            | 682                    | 10,913       | 67           |
| Ending loan balance                           | \$ 319,631                    | \$ 280,771                          | \$ 55,621                         | \$ 26,711         | \$ 682                 | \$ 10,917    | \$ 69        |

**Table of Contents**

A loan is impaired when it is probable, based on current information and events, the Company will be unable to collect all contractual principal and interest payments due in accordance with the terms of the loan agreement. When it is determined that a loss is probable, a valuation allowance is established and included in the allowance for loan losses. The amount of impairment is determined by the difference between the recorded investment in the loan and the present value of expected cash flows, or estimated net realizable value of the underlying collateral on collateral dependent loans.

The difference between the recorded investment and unpaid principal balance of loans relates to net deferred origination costs, net premiums on purchased loans, charge-offs and interest payments received on impaired loans that are recorded as a reduction of principal. Included in the real estate loans individually evaluated for impairment with an allowance recorded as of September 30, 2013, \$1.2 million were collateral dependent loans measured at fair value with a valuation allowance of \$9,000 and \$8.3 million were evaluated based on the loans' present value of expected cash flows with a valuation allowance of \$1.0 million. This compares to \$1.5 million collateral dependent loans measured at fair value with a valuation allowance of \$32,000 and \$7.7 million evaluated based on the loans' present value of expected cash flows with a valuation allowance of \$974,000 at June 30, 2013.

The following tables present loans individually evaluated for impairment by class of loans as of September 30, 2013 and June 30, 2013 (in thousands):

| <b>September 30, 2013</b>                         | <b>Unpaid Principal<br/>Balance</b> | <b>Recorded<br/>Investment</b> | <b>Allowance for Loan<br/>Losses<br/>Allocated</b> |
|---|-------------------------------------|--------------------------------|--|
| <b><u>With no related allowance recorded:</u></b> |                                     |                                |  |
| <b><u>Real estate loans:</u></b>                  |                                     |                                |  |
| One-to-four family                                | \$ 6,709                            | \$ 5,787                       | \$   |
| Multi-family residential                          | 1,899                               | 1,458                          |  |
| Commercial real estate                            | 5,364                               | 4,577                          |  |
|   | 13,972                              | 11,822                         |  |
| <b><u>With an allowance recorded:</u></b>         |                                     |                                |  |
| <b><u>Real estate loans:</u></b>                  |                                     |                                |  |
| One-to-four family                                | 8,607                               | 8,193                          | 991  |
| Multi-family residential                          | 301                                 | 197                            | 1  |
| Commercial real estate                            | 1,190                               | 1,190                          | 61   |
| <b><u>Other loans:</u></b>                        |                                     |                                |  |
| Automobile  | 19                                  | 19                             | 19   |
| Other   | 3                                   | 3                              | 3  |
|   | 10,120                              | 9,602                          | 1,075  |
| <b>Total</b>                                      | <b>\$ 24,092</b>                    | <b>\$ 21,424</b>               | <b>\$ 1,075</b>                                    |



**Table of Contents**

| <b>June 30, 2013</b>                              | <b>Unpaid Principal<br/>Balance</b> | <b>Recorded<br/>Investment</b> | <b>Allowance for Loan<br/>Losses<br/>Allocated</b> |
|---|-------------------------------------|--------------------------------|--|
| <b><u>With no related allowance recorded:</u></b> |                                     |                                |  |
| <u>Real estate loans:</u>                         |                                     |                                |  |
| One-to-four family                                | \$ 7,909                            | \$ 6,796                       | \$   |
| Multi-family residential                          | 1,961                               | 1,547                          |  |
| Commercial real estate                            | 5,704                               | 4,940                          |  |
|   | 15,574                              | 13,283                         |  |
| <b><u>With an allowance recorded:</u></b>         |                                     |                                |  |
| <u>Real estate loans:</u>                         |                                     |                                |  |
| One-to-four family                                | 8,227                               | 7,994                          | 941  |
| Multi-family residential                          |                                     |                                |  |
| Commercial real estate                            | 1,196                               | 1,196                          | 64   |
| <u>Other loans:</u>                               |                                     |                                |  |
| Automobile  |                                     |                                |  |
| Home equity                                       |                                     |                                |  |
| Other   | 4                                   | 4                              | 4  |
|   | 9,427                               | 9,194                          | 1,009  |
| <b>Total</b>                                      | <b>\$ 25,001</b>                    | <b>\$ 22,477</b>               | <b>\$ 1,009</b>                                    |

The following table presents monthly average of individually impaired loans by class for the three months ended September 30, 2013 and September 30, 2012 (in thousands):

|                          | <b>Three months<br/>ended<br/>September 30,<br/>2013      2012</b> |                  |
|--------------------------|--|------------------|
| <u>Real estate loan:</u> |  |                  |
| One-to-four family       | \$ 14,385  | \$ 19,347        |
| Multi-family residential | 1,601  | 2,312            |
| Commercial real estate   | 5,952  | 4,620            |
| <u>Other loans:</u>      |  |                  |
| Home Equity              |  | 19               |
| <b>Total</b>             | <b>\$ 21,938</b>   | <b>\$ 26,298</b> |

Payments received on impaired loans are recorded as a reduction of principal. Interest payments collected on non-accrual loans are characterized as payments of principal rather than payments of the outstanding accrued interest on the loans until the remaining principal on the non-accrual loans is considered to be fully collectible.

The following table presents interest payments recorded as reduction of principal on impaired loans by class (in thousands).

|                          | <b>Three months ended<br/>September 30,</b> |              |
|--------------------------|---|--------------|
|                          | <b>2013</b>                                 | <b>2012</b>  |
| <u>Real estate loan:</u> |   |              |
| One-to-four family       | \$ 23                                       | \$ 53        |
| Multi-family residential | 13  | 9            |
| Commercial real estate   | 8   | 30           |
| <b>Total</b>             | <b>\$ 44</b>                                | <b>\$ 92</b> |

**Table of Contents**

The following table presents nonaccrual loans by class of loans (in thousands):

| <b>Non-accrual loans:</b>      | <b>September 30, 2013</b> | <b>June 30, 2013</b> |
|--------------------------------|---------------------------|----------------------|
| <b>Real estate loans:</b>      |                           |                      |
| One-to-four family             | \$ 8,152                  | \$ 10,310            |
| Multi-family residential       | 1,655                     | 1,547                |
| Commercial                     | 3,689                     | 4,045                |
| <b>Other loans:</b>            |                           |                      |
| Automobile                     | 19                        | 14                   |
| Home Equity                    |                           |                      |
| Other                          | 3                         | 4                    |
| <b>Total non-accrual loans</b> | <b>\$ 13,518</b>          | <b>\$ 15,920</b>     |

The following tables present the aging of past due loans by class of loans (in thousands):

| <b>September 30, 2013</b> | <b>30-59 Days<br/>Delinquent</b> | <b>60-89 Days<br/>Delinquent</b> | <b>90 Days or<br/>More<br/>Delinquent</b> | <b>Total<br/>Delinquent<br/>Loans</b> | <b>Total<br/>Current<br/>Loans</b> | <b>Total Loans</b> |
|---------------------------|----------------------------------|----------------------------------|---|---------------------------------------|------------------------------------|--------------------|
| <b>Real estate loans:</b> |                                  |                                  |   |                                       |                                    |                    |
| One-to-four family        | \$ 340                           | \$ 2,067                         | \$ 1,505                                  | \$ 3,912                              | \$ 304,396                         | \$ 308,308         |
| Multi-family              |                                  |                                  | 197                                       | 197                                   | 317,369                            | 317,566            |
| Commercial                |                                  |                                  | 2,545                                     | 2,545                                 | 49,188                             | 51,733             |
| <b>Other loans:</b>       |                                  |                                  |   |                                       |                                    |                    |
| Automobile                | 73                               | 16                               | 19  | 108                                   | 30,483                             | 30,591             |
| Home Equity               |                                  |                                  |   |                                       | 662                                | 662                |
| Other                     | 17                               | 10                               | 1   | 28                                    | 9,643                              | 9,671              |
| <b>Total loans</b>        | <b>\$ 430</b>                    | <b>\$ 2,093</b>                  | <b>\$ 4,267</b>                           | <b>\$ 6,790</b>                       | <b>\$ 711,741</b>                  | <b>\$ 718,531</b>  |

| <b>June 30, 2013</b>      | <b>30-59 Days<br/>Delinquent</b> | <b>60-89 Days<br/>Delinquent</b> | <b>90 Days or<br/>More<br/>Delinquent</b> | <b>Total<br/>Delinquent<br/>Loans</b> | <b>Total<br/>Current<br/>Loans</b> | <b>Total Loans</b> |
|---------------------------|----------------------------------|----------------------------------|---|---------------------------------------|------------------------------------|--------------------|
| <b>Real estate loans:</b> |                                  |                                  |   |                                       |                                    |                    |
| One-to-four family        | \$ 389                           | \$ 970                           | \$ 1,751                                  | \$ 3,110                              | \$ 316,521                         | \$ 319,631         |
| Multi-family              |                                  | 198                              |   | 198                                   | 280,573                            | 280,771            |
| Commercial                |                                  | 2,545                            |   | 2,545                                 | 53,076                             | 55,621             |
| <b>Other loans:</b>       |                                  |                                  |   |                                       |                                    |                    |
| Automobile                | 32                               |                                  | 14  | 46                                    | 26,665                             | 26,711             |
| Home Equity               | 143                              |                                  |   | 143                                   | 539                                | 682                |
| Other                     | 20                               | 2                                | 4   | 26                                    | 10,891                             | 10,917             |

|             |        |          |          |          |            |            |
|-------------|--------|----------|----------|----------|------------|------------|
| Total loans | \$ 584 | \$ 3,715 | \$ 1,769 | \$ 6,068 | \$ 688,265 | \$ 694,333 |
|-------------|--------|----------|----------|----------|------------|------------|

## **Table of Contents**

### **Troubled Debt Restructurings:**

Troubled debt restructurings totaled \$15.5 million and \$15.7 million at September 30, 2013 and June 30, 2013, respectively. Troubled debt restructurings of \$7.6 million and \$9.1 million are included in the non-accrual loans at September 30, 2013 and June 30, 2013. The Bank has allocated \$291,000 and \$393,000 of valuation allowance to customers whose loan terms have been modified in troubled debt restructurings and were on non-accrual status as of September 30, 2013 and June 30, 2013 respectively. Troubled debt restructured loans are included in non-accrual loans until there is a sustained period of payment performance (usually six months or longer and determined on a case by case basis) and there is a reasonable assurance that the timely payment will continue. During the three months ended September 30, 2013, four troubled debt restructurings with an aggregate outstanding balance of \$1.4 million were returned to accrual status as a result of the borrowers paying the modified terms as agreed for a sustained period of more than six months and the Bank believes there is reasonable assurance that timely payment will continue. This compares to no troubled debt restructurings returning to accrual status during the same period last year. There were no further commitments to customers whose loans were troubled debt restructurings at September 30, 2013 and June 30, 2013.

During the three months ended September 30, 2013, there were no new loans that were modified as troubled debt restructurings. This compares to three one-to-four family loans with an aggregate outstanding balance of \$1.1 million whose terms were modified as troubled debt restructurings during the three months ended September 30, 2012. There was a temporary reduction of the stated interest rates of these loans for a period of 24 months. There was no modification of terms involving an extension of the maturity dates or a permanent reduction of the recorded investment in the loans.

At September 30, 2013 and September 30, 2012, there were no loans modified as a troubled debt restructurings within the previous 12 months for which there was a payment default. A loan is considered to be in payment default once it is 30 days contractually past due under the modified terms.

The terms of certain other loans were modified during the three months ended September 30, 2013 and 2012 that did not meet the definition of a troubled debt restructuring. During the three months ended September 30, 2013 and 2012, six loans in the amount of \$2.4 million and twenty-two loans in the amount of \$11.3 million were modified and not accounted for as troubled debt restructurings. The modifications were made to refinance the credits to maintain the borrowing relationships and generally consisted of term or rate modifications. The borrowers were not experiencing financial difficulty or delay in loan payments and the modifications were made at market terms.

In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification. This evaluation is performed under the Company's internal underwriting policy.

### **Credit Quality Indicators**

The Company categorizes loans into risk categories based on relevant information about the ability of the borrowers to service their debt such as: current financial information, historical payment experience, credit documentation and current economic trends among other factors. This analysis is performed monthly. The Company uses the following definitions for risk ratings:

**Special Mention.** Loans are classified as special mention when it is determined a loan relationship should be monitored more closely. Loans that are 60 days to 89 days past due are generally classified as special mention. In addition, loans are classified as special mention for a variety of reasons including changes in recent borrower financial

conditions, changes in borrower operations, changes in value of available collateral, concerns regarding changes in economic conditions in a borrower's industry, and other matters. A loan classified as special mention in many instances may be performing in accordance with the loan terms.

**Table of Contents**

Substandard. Loans that are 90 days or more past due are generally classified as substandard. A loan is also considered substandard if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Substandard assets include those characterized by the distinct possibility that the insured institution will sustain some loss if the deficiencies are not corrected.

Doubtful. Assets classified as doubtful have all of the weaknesses inherent in those classified substandard with the added characteristic that the weaknesses present make collection or liquidation in full highly questionable and improbable.

Loss. Assets classified as loss are considered uncollectible and of such little value that continuance as an asset, without establishment of a valuation allowance individually evaluated or charge-off, is not warranted.

Loans not meeting the criteria as part of the above described process are considered to be Pass rated loans. Pass rated loans are generally well protected by the current net worth and paying capacity of the obligor or by the value of the underlying collateral. Pass rated assets are not more than 59 days past due and are generally performing in accordance with the loan terms.

As of September 30, 2013 and June 30, 2013, and based on the most recent analysis performed, the risk category of loans by class of loans is as follows (in thousands):

| <b>September 30, 2013</b> | <b>Pass</b>       | <b>Special Mention</b> | <b>Substandard</b> | <b>Doubtful</b> | <b>Loss</b>  |
|---------------------------|-------------------|------------------------|--------------------|-----------------|--------------|
| <b>Real estate loans:</b> |                   |                        |                    |                 |              |
| One-to-four family        | \$ 287,641        | \$ 11,087              | \$ 9,580           | \$              | \$           |
| Multi-family              | 304,084           | 4,066                  | 9,416              |                 |              |
| Commercial                | 39,760            | 3,019                  | 8,954              |                 |              |
| <b>Other loans:</b>       |                   |                        |                    |                 |              |
| Automobile                | 30,310            | 156                    | 103                | 3               | 19           |
| Home equity               | 662               |                        |                    |                 |              |
| Other                     | 9,624             | 27                     | 15                 | 2               | 3            |
| <b>Total loans</b>        | <b>\$ 672,081</b> | <b>\$ 18,355</b>       | <b>\$ 28,068</b>   | <b>\$ 5</b>     | <b>\$ 22</b> |

| <b>June 30, 2013</b>      | <b>Pass</b>       | <b>Special Mention</b> | <b>Substandard</b> | <b>Doubtful</b> | <b>Loss</b> |
|---------------------------|-------------------|------------------------|--------------------|-----------------|-------------|
| <b>Real estate loans:</b> |                   |                        |                    |                 |             |
| One-to-four family        | \$ 296,434        | \$ 10,973              | \$ 12,224          | \$              | \$          |
| Multi-family              | 275,143           | 3,094                  | 2,534              |                 |             |
| Commercial                | 43,246            | 3,895                  | 8,480              |                 |             |
| <b>Other loans:</b>       |                   |                        |                    |                 |             |
| Automobile                | 26,454            | 102                    | 137                | 18              |             |
| Home equity               | 682               |                        |                    |                 |             |
| Other                     | 10,848            | 36                     | 23                 | 6               | 4           |
| <b>Total loans</b>        | <b>\$ 652,087</b> | <b>\$ 18,100</b>       | <b>\$ 23,398</b>   | <b>\$ 24</b>    | <b>\$ 4</b> |





**Table of Contents****Note 6 - Real Estate Owned**

Changes in real estate owned are summarized as follows (in thousands):

|                          | <b>September 30, 2013</b> | <b>June 30, 2013</b> |
|--------------------------|---------------------------|----------------------|
| Beginning of period      | \$                        | \$ 1,280             |
| Transfers in             | 325                       | 521                  |
| Capitalized improvements |                           | 4                    |
| Sales                    |                           | (1,805)              |
| End of period            | \$ 325                    | \$                   |

Net income (expenses) related to foreclosed assets are as follows and are included in other operating expense (in thousands):

|                                | <b>September 30, 2013</b> | <b>September 30, 2012</b> |
|--------------------------------|---------------------------|---------------------------|
| Net gain on sales              | \$                        | \$ 16                     |
| Net operating income (expense) | (28)                      | (1)                       |
| Total                          | \$ (28)                   | \$ 15                     |

The company has no valuation allowance or activity in the valuation allowance account during the three months ended September 30, 2013 and 2012.

**Note 7 Federal Home Loan Bank Advances**

FHLB advances were \$60.0 million at September 30, 2013 and June 30, 2013. At September 30, 2013, the stated interest rates on the Bank's advances from the FHLB ranged from 0.85% to 2.43% with a weighted average stated rate of 1.64%. The range of the stated interest rates and the weighted average stated rate remain unchanged from June 30, 2013.

The contractual maturities by fiscal year of the Bank's FHLB advances over the next five years and thereafter are as follows (in thousands):

| <b>Fiscal Year of Maturity</b> | <b>September 30, 2013</b> | <b>June 30, 2013</b> |
|--------------------------------|---------------------------|----------------------|
| 2014                           | \$                        | \$                   |
| 2015                           | 20,000                    | 20,000               |
| 2016                           |                           |                      |

Edgar Filing: Simplicity Bancorp, Inc. - Form 10-Q

|            |           |           |
|------------|-----------|-----------|
| 2017       | 20,000    | 20,000    |
| 2018       |           |           |
| Thereafter | 20,000    | 20,000    |
| Total      | \$ 60,000 | \$ 60,000 |

**Table of Contents****Note 8 Change in Accumulated Other Comprehensive Loss**

Accumulated other comprehensive income includes unrealized gain and losses on securities available-for-sale and actuarial gains and losses, net periodic benefit cost and benefits paid for postretirement medical benefit. Changes in accumulated other comprehensive income are presented net of tax effect as a component of equity. Reclassifications out of accumulated other comprehensive are recorded on the consolidated statement of income either as a noninterest income or expense.

The following tables present a summary of the accumulated other comprehensive income balances, net of tax, as of September 30, 2013 and 2012.

| <b>(Dollars in Thousands)</b>                                    | <b>Unrealized Gain<br/>and losses<br/>on<br/>securities<br/>available-for-sale</b> | <b>Postretirement<br/>medical benefits<br/>costs items</b> | <b>Total</b> |
|--|--|--|--------------|
| Balance, June 30, 2013   | \$ (362)   | \$ (129)   | \$ (491)     |
| Other comprehensive income before reclassifications              | 93   | (17)   | 76           |
| Amounts reclassified from accumulated other comprehensive income |  | 17   | 17           |
| Tax effect of current period changes                             | (38)   |  | (38)         |
| Net current period other comprehensive income                    | 55   |  | 55           |
| Balance, September 30, 2013                                      | \$ (307)   | \$ (129)   | \$ (436)     |

| <b>(Dollars in Thousands)</b>                                    | <b>Unrealized<br/>Gain<br/>and losses<br/>on<br/>securities<br/>available-for-sale</b> | <b>Postretirement<br/>medical benefits<br/>costs items</b> | <b>Total</b> |
|--|--|--|--------------|
| Balance, June 30, 2012   | \$ 83  | \$ (252)   | \$ (169)     |
| Other comprehensive income before reclassifications              | 219  | 24   | 243          |
| Amounts reclassified from accumulated other comprehensive income |  | (24)   | (24)         |
| Tax effect of current period changes                             | (90)   |  | (90)         |
| Net current period other comprehensive income                    | 129  |  | 129          |

|                             |    |     |    |       |    |      |
|-----------------------------|----|-----|----|-------|----|------|
| Balance, September 30, 2012 | \$ | 212 | \$ | (252) | \$ | (40) |
|-----------------------------|----|-----|----|-------|----|------|

**Note 9 Repurchase of Common Stock**

Since November 2011, the Company has repurchased 1,666,242 shares under four previously announced stock repurchase programs. The shares were repurchased at prices ranging from \$12.00 to \$15.55 per share with a weighted average cost of \$14.44 per share. On September 30, 2013, there were 118,206 shares remaining to be repurchased under these programs.

For the three months ended September 30, 2013, the Company repurchased 148,575 shares at an aggregate cost of \$2.2 million, including commissions. The shares were repurchased at prices between \$14.75 and \$15.55 per share with a weighted average cost of \$15.10.

**Note 10 Subsequent Events**

On November 4, 2013, the Company announced that its Board of Directors authorized the fifth stock repurchase program pursuant to which the Company intends to repurchase up to 5% of its issued and outstanding shares, or up to approximately 394,003 shares. The timing of the repurchases will depend on certain factors, including but not limited to, market conditions and prices, the Company's liquidity requirements and alternative uses of capital. The stock repurchase program may be carried out through open-market purchases, block trades, negotiated private transactions and pursuant to a trading plan that may be adopted in accordance with Rule 10b5-1 of the SEC's rules. Any repurchased shares will be available for general corporate purposes.

**Table of Contents**

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

**Forward-Looking Statements**

This Quarterly Report on Form 10-Q contains certain forward-looking statements and information relating to the Company and the Bank that are based on the beliefs of management as well as assumptions made by and information currently available to management. Forward-looking statements can be identified by the fact that they do not relate strictly to historical or current facts. They often include words like believe, expect, anticipate, estimate, and intend, and future or conditional verbs such as will, should, could, or may and similar expressions or the negative thereof. Certain factors that could cause actual results to differ materially from expected results include, changes in the interest rate environment, changes in general economic conditions, legislative and regulatory changes that adversely affect the business of Simplicity Bancorp, Inc. and Simplicity Bank, and changes in the securities markets. Should one or more of these risks or uncertainties materialize or should underlying assumptions prove incorrect, actual results may vary materially from those described herein. We caution readers not to place undue reliance on forward-looking statements. The Company disclaims any obligation to revise or update any forward-looking statements contained in this Form 10-Q to reflect future events or developments.

**Market Area**

Our success depends primarily on the general economic conditions in the California counties of Los Angeles, Orange, San Diego, San Bernardino, Riverside, Santa Clara and Alameda, as nearly all of our loans are to customers in this market area. There have been positive developments in current economic conditions since the end of the recession. Improving financial conditions, increasing credit availability, accommodative monetary policy, and healthier labor and housing markets all support the economic growth in our market area. According to the Beige Book published by the Federal Reserve in September 2013, economic activity continued to expand at a modest to moderate pace from early July to August 2013. In the Twelfth Federal Reserve District (San Francisco), demand for housing strengthened further, and commercial real estate activity was stable or improved. Although levels remained significantly lower than in the pre-recession period, both home sales and house prices climbed further relative to the prior reporting period in our market area of California. However, lenders continue to face margin compression due to the low interest rate environment, ample liquidity and generally stiff competition over well-qualified borrowers. Future growth opportunities will be influenced by the stability of the nation and the regional economy and other trends within California, including unemployment rates and housing market conditions.

Both California and national unemployment rates remain at historically high levels. In particular, California continues to experience elevated unemployment rates as compared to the national average. Unemployment rates in California rose from 8.5% in June 2013 to 8.9% in August 2013. This compares to the national unemployment rate which trended down from 7.6% in June 2013 to 7.2% in September 2013.

**Comparison of Financial Condition at September 30, 2013 and June 30, 2013.**

**Assets.** Total assets declined to \$834.6 million, or 3.8%, at September 30, 2013 from \$867.4 million at June 30, 2013 due primarily to a decrease in cash and cash equivalents and securities available-for-sale, partially offset by an increase in gross loans receivable.

Cash and cash equivalents decreased by \$50.7 million, or 59.2% to \$35.0 million at September 30, 2013 from \$85.7 million at June 30, 2013. The decrease was primarily due to cash deployed to fund the net growth in loans receivable and a decline in deposits.

Securities available-for-sale decreased by \$4.1 million, or 7.8%, to \$48.1 million at September 30, 2013 from \$52.2 million at June 30, 2013 due to maturities, principal repayments and amortization.

Gross loans receivable increased by \$24.2 million, or 3.5%, to \$718.5 million at September 30, 2013 from \$694.3 million at June 30, 2013. The increase was primarily attributable to organic loan growth in multi-family residential loans and consumer loans, offset in part by principal repayments and payoffs in addition to the sale of conforming fixed rate one-to-four family residential loans in the secondary market. Multi-family loans increased \$36.8 million, or 13.1%, to \$317.6 million at September 30, 2013 from \$280.8 million at June 30, 2013 due to \$51.5 million in loan originations during the three months ended September 30, 2013.

---

**Table of Contents**

Commercial real estate loans decreased \$3.9 million, or 7.0%, to \$51.7 million at September 30, 2013 from \$55.6 million at June 30, 2013 due to principal prepayments and payoffs as there have been no new commercial real estate loan originations since January 2009. One-to-four family residential real estate loans decreased \$11.3 million, or 3.5%, to \$308.3 million at September 30, 2013 from \$319.7 million at June 30, 2013 due primarily to principal prepayments and payoffs and sales of newly originated conforming fixed rate loans held for sale. Consumer loans which were comprised primarily of automobile loans increased \$2.6 million, or 6.8%, to \$40.9 million at September 30, 2013 from \$38.3 million at June 30, 2013 due to \$7.0 million in automobile loan originations during the three months ended September 30, 2013.

The allowance for loan losses decreased by \$156,000, or 2.8%, to \$5.5 million at September 30, 2013 from \$5.6 million at June 30, 2013 due primarily to net charge-offs as well as improved asset quality of the loan portfolio and a decline in the historical loss factors for criticized and classified assets. Non-performing assets decreased to \$13.8 million, or 1.66% of total assets at September 30, 2013 as compared to \$16.0 million, or 1.84% of total assets at June 30, 2013.

**Deposits.** Total deposits decreased \$27.8 million, or 4.2%, to \$626.9 million at September 30, 2013 from \$654.6 million at June 30, 2013. The decline was comprised of a \$19.2 million decrease in interest-bearing deposits and a \$8.6 million decrease in non-interest bearing demand deposits.

The decrease in interest bearing deposits consisted of a \$17.2 million, or 6.1%, decrease in certificates of deposit from \$280.1 million at June 30, 2013 to \$262.9 million at September 30, 2013, a \$2.6 million, or 1.9%, decrease in savings accounts from \$134.9 million at June 30, 2013 to \$132.3 million at September 30, 2013, and a \$697,000, or 4.8% decrease in interest-bearing checking from \$14.5 million at June 30, 2013 to \$13.8 million at September 30, 2013. These decreases were partially offset by a \$1.2 million, or 0.8%, increase in money market accounts from \$159.6 million at June 30, 2013 to \$160.8 million at September 30, 2013. The decrease in certificates of deposit was attributable to non-relationship customers seeking higher yields as accounts repriced to lower offering rates. Savings accounts decreased primarily due to the discontinuation of certain savings products which had lower offering rates. Non-interest bearing demand deposits decreased \$8.6 million, or 13.1% from \$65.6 million at June 30, 2013 to \$57.1 million at September 30, 2013. The decline in non-interest bearing demand and interest-bearing checking was primarily a result of the timing of customer payroll deposits as compared to June 30, 2013. The slight growth in money market balances was attributable to customers preferring the short-term flexibility of non-certificate accounts in a low interest rate environment.

**Borrowings.** FHLB advances were \$60.0 million at September 30, 2013 and June 30, 2013. The weighted average cost of FHLB advances of 1.64% remained unchanged from June 30, 2013.

**Stockholders Equity.** Total stockholders equity, represented 17.3% of total assets and decreased to \$144.0 million at September 30, 2013 from \$145.4 million at June 30, 2013. The decrease in stockholders equity was primarily attributable to shares repurchased during the three months ended September 30, 2013 pursuant to the stock repurchase program previously announced of \$2.2 million as well as cash dividends paid of \$618,000, partially offset by net income of \$1.1 million.

**Table of Contents****Average Balances, Net Interest Income, Yields Earned and Rates Paid**

The following table sets forth certain information for the three months ended September 30, 2013 and 2012, respectively.

|                                     | For the three months ended September 30, |          |   |                     |          |                           |
|-------------------------------------|--|----------|---|---------------------|----------|---------------------------|
|                                     | 2013 <sup>(1)</sup>                      |          |   | 2012 <sup>(1)</sup> |          |                           |
|                                     | Average<br>Balance                       | Interest | Average<br>Yield/<br>Cost<br>(Dollars in thousands) | Average<br>Balance  | Interest | Average<br>Yield/<br>Cost |
| <b>INTEREST-EARNING ASSETS</b>      |  |          |   |                     |          |                           |
| Loans receivable <sup>(2)</sup>     | \$ 706,331                               | \$ 8,018 | 4.54%   | \$ 762,251          | \$ 9,718 | 5.10%                     |
| Securities <sup>(3)</sup>           | 50,456                                   | 167      | 1.32  | 52,165              | 81       | 0.62                      |
| Federal funds sold                  | 49,269                                   | 29       | 0.24  | 57,838              | 32       | 0.22                      |
| Federal Home Loan Bank stock        | 5,962                                    | 80       | 5.37  | 8,305               | 10       | 0.48                      |
| Total interest-earning assets       | 812,018                                  | 8,294    | 4.09  | 880,559             | 9,841    | 4.47                      |
| Noninterest earning assets          | 37,586                                   |          |   | 38,019              |          |                           |
| Total assets                        | \$ 849,604                               |          |   | \$ 918,578          |          |                           |
| <b>INTEREST-BEARING LIABILITIES</b> |  |          |   |                     |          |                           |
| Interest-bearing checking           | \$ 14,211                                | \$ 2     | 0.06%   | \$ 9,050            | \$ 2     | 0.09%                     |
| Money market                        | 160,510                                  | 92       | 0.23  | 160,170             | 128      | 0.32                      |
| Savings deposits                    | 133,495                                  | 31       | 0.09  | 139,998             | 49       | 0.14                      |
| Certificates of deposit             | 270,323                                  | 1,266    | 1.87  | 305,622             | 1,569    | 2.05                      |
| Borrowings                          | 60,000                                   | 249      | 1.66  | 80,000              | 469      | 2.35                      |
| Total interest-bearing liabilities  | 638,539                                  | 1,640    | 1.03  | 694,840             | 2,217    | 1.28                      |
| Noninterest bearing liabilities     | 66,353                                   |          |   | 70,123              |          |                           |
| Total liabilities                   | 704,892                                  |          |   | 764,963             |          |                           |
| Equity                              | 144,712                                  |          |   | 153,615             |          |                           |
| Total liabilities and equity        | \$ 849,604                               |          |   | \$ 918,578          |          |                           |
| Net interest/spread                 |  | \$ 6,654 | 3.06%   |                     | \$ 7,624 | 3.19%                     |
| Margin <sup>(4)</sup>               |  |          | 3.28%   |                     |          | 3.46%                     |
|                                     | 127.17%                                  |          |   | 126.73%             |          |                           |



Ratio of interest-earning assets to interest  
bearing liabilities

- (1) Yields earned and rates paid have been annualized.
- (2) Calculated net of deferred fees, loss reserves and includes non-accrual loans.
- (3) Calculated based on amortized cost of held-to-maturity securities and fair value of available-for-sale securities.
- (4) Net interest income divided by interest-earning assets.

---

**Table of Contents****Comparison of Results of Operations for the Three Months Ended September 30, 2013 and September 30, 2012.**

**General.** Net income for the three months ended September 30, 2013 was \$1.1 million, a decrease of \$244,000 as compared to net income of \$1.4 million for the three months ended September 30, 2012. Earnings per basic and diluted common share were \$0.15 for the three months ended September 30, 2013, compared to \$0.16 for the three months ended September 30, 2012. The decrease in net income was due primarily to a decrease in net interest income and noninterest income and an increase in noninterest expense, partially offset by a decrease in provision for loan losses.

**Interest Income.** Interest income decreased \$1.5 million, or 15.7%, to \$8.3 million for the three months ended September 30, 2013 from \$9.8 million for the three months ended September 30, 2012. The decline in interest income was primarily due to decreases in interest and fees on loans.

Interest and fees on loans decreased \$1.7 million to \$8.0 million for the three months ended September 30, 2013 from \$9.7 million for the three months ended September 30, 2012. The primary reason for the decrease was a decline of 56 basis points in the average yield on loans from 5.10% for the three months ended September 30, 2012 to 4.54% for the three months ended September 30, 2013 and a decrease of \$55.9 million in the average balance of loans receivable to \$706.3 million for the three months ended September 30, 2013 from \$762.3 million for the three months ended September 30, 2012. The decrease in the average yield on loans was primarily caused by lower yields earned on new loan originations and payoffs of higher yielding seasoned loans during the period as a result of the low interest rate environment. The decrease in the average loan receivable balance was attributable to loan principal repayments, sales and payoffs.

**Interest Expense.** Interest expense decreased \$577,000, or 26.0% to \$1.6 million for the three months ended September 30, 2013 from \$2.2 million for the three months ended September 30, 2012. The decline reflected a reduction in the average cost of funds on deposits and borrowings as a result of the continuing low interest rates during the three months ended September 30, 2013.

Interest expense on deposits decreased \$357,000, or 20.4% to \$1.4 million during the three months ended September 30, 2013 as compared to \$1.7 million for the same period last year. The primary reason for the decrease was a 16 basis point decline in the average cost of deposits from 1.03% for the three months ended September 30, 2012 to 0.87% for the three months ended September 30, 2013 due to the downward repricing of deposits in the low interest rate environment as well as a decrease of \$36.6 million in the average balance of deposits to \$578.5 million for the three months ended September 30, 2013 from \$614.8 million for the three months ended September 30, 2012.

Interest expense on borrowings decreased \$220,000 or 46.9% to \$249,000 during the three months ended September 30, 2013 as compared to \$469,000 for the same period last year. The decline was primarily attributable to a 69 basis point decrease in the average cost of borrowings from 2.35% for the three months ended September 30, 2012 to 1.66% for the three months ended September 30, 2013 as a result of the pay down of \$20.0 million in scheduled maturities of higher costing borrowings during December 2012.

**Provision for Loan Losses.** There was no provision for loan losses for the three months ended September 30, 2013 as compared to \$850,000 for the same period last year. The decline in the provision during the current quarter was primarily a result of a decline in net charge-offs and loss factors on loans collectively evaluated for impairment. Annualized net charge-offs decreased to 0.09% of average outstanding loans for the three months ended September 30, 2013 as compared to 0.29% of average outstanding loans for the year ended June 30, 2013. Non-performing loans decreased to \$13.5 million, or 1.88% of total loans at September 30, 2013 as compared to \$15.9

million, or 2.29% of total loans at June 30, 2013 while delinquent loans, 60 days or more, increased slightly to \$6.4 million or 0.89% of total loans at September 30, 2013 as compared to \$5.5 million, or 0.79% of total loans at June 30, 2013.

Although the provision for loan losses was zero during the three months ended September 30, 2013, it was comprised of a \$352,000 reduction in provision on one-to-four family loans, a \$548,000 provision on multi-family loans, a \$247,000 reduction in provision on commercial real estate loans, a \$47,000 provision on automobile loans, no provision on home equity loans and a \$4,000 provision on other loans. The decrease in provision on one-to-four family loans was primarily due to a decline in the overall historical loss factors on loans collectively evaluated for impairment. The increase in provision on multi-family loans was primarily due to an increase in the balance of multi-family loans collectively evaluated for impairment partially offset by a decline in the overall loss factors on loans collectively evaluated for impairment.

---

## Table of Contents

There was also a charge-off of approximately \$100,000 on a multi-family loan that exhibited weakness during the first fiscal quarter of 2014 but remained current on its loan payments. The reduction in provision on commercial real estate loans was primarily due to a decline in the overall loss factors and a reduction in the balance of commercial real estate loans collectively evaluated for impairment. The provision reflects management's continuing assessment of the credit quality of the Company's loan portfolio, which is affected by various trends, including current economic conditions.

**Noninterest Income.** Our noninterest income decreased \$108,000, or 6.9%, to \$1.5 million for the three months ended September 30, 2013 as compared to \$1.6 million for the three months ended September 30, 2012 due primarily to a \$239,000 decline in pre-tax gains on one-to-four family mortgage loans sold reflecting the impact of a lower loan sale volume and reduced gain on loan sale margins driven by the recent increase in interest rates.

**Noninterest Expense.** Our noninterest expense increased \$146,000, or 2.4% to \$6.3 million for the three months ended September 30, 2013 as compared to \$6.1 million for the three months ended September 30, 2012 primarily due to an increase in advertising and promotional expenses, occupancy and equipment costs, professional services and ATM expenses, partially offset by a decrease in salaries and benefits expense.

Advertising and promotional expenses increased \$149,000, or 112.9%, to \$281,000 for the three months ended September 30, 2013 as compared to \$132,000 for the three months ended September 30, 2012. The increase was primarily due to expenses incurred related to continuing branding and marketing campaign efforts. Occupancy and equipment costs increased \$73,000, or 10.2%, to \$786,000 for the three months ended September 30, 2013 as compared to \$713,000 for the three months ended September 30, 2012 due to leasehold improvement resulting from branch relocation and remodeling. Professional services expenses increased \$60,000, or 12.1%, to \$555,000 for the three months ended September 30, 2013 as compared to \$495,000 for the three months ended September 30, 2012 due to higher information technology network consulting services, e-commerce initiatives, and legal services. ATM expenses increased \$57,000, or 10.9%, to \$578,000 for the three months ended September 30, 2013 as compared to \$521,000 for the three months ended September 30, 2012 due to costs associated with ATM support and ATM card issuance and maintenance.

Salaries and benefits expense decreased \$206,000, or 6.4%, to \$3.0 million for the three months ended September 30, 2013 as compared to \$3.2 million for the three months ended September 30, 2012 due primarily to lower estimated accruals for the annual incentive plan.

**Income Tax Expense.** Income tax expense decreased \$130,000, or 16.1% to \$676,000 for the three months ended September 30, 2013 compared to \$806,000 for the three months ended September 30, 2012. This decrease was primarily the result of lower pretax income for the three months ended September 30, 2013 compared to the three months ended September 30, 2012. The effective tax rates were 37.0% and 36.7% for the three months ended September 30, 2013 and 2012, respectively.

## **Asset Quality**

**General.** We continue our disciplined lending practices including our strict adherence to a long standing regimented credit culture that emphasizes the consistent application of underwriting standards to all loans. In this regard, we fully underwrite all loans based on an applicant's employment history, credit history and an appraised value of the subject property. With respect to loans we purchase, we underwrite each loan based upon our own underwriting standards prior to making the purchase except for loans purchased with a credit guarantee. The credit guarantee requires the seller to substitute or repurchase any loans sold to the Bank that become 60 days or more delinquent at the Bank's option. The credit quality of the loans purchased in fiscal 2012 was to our satisfaction and did not result in substitution or repurchase of any loans purchased.



**Table of Contents**

The following underwriting guidelines, among other things, have been used by us as underwriting tools to further limit our potential loss exposure:

All variable rate one-to-four family residential loans are underwritten using the fully indexed rate.

We only lend up to 80% of the lesser of the appraised value or purchase price for one-to-four family residential loans without private mortgage insurance ( PMI ), and up to 97% with PMI.

We only lend up to 75% of the lesser of the appraised value or purchase price for multi-family residential loans.

We only lend up to 65% of the lesser of the appraised value or purchase price for commercial real estate loans.

Additionally, our portfolio has remained strongly anchored in traditional mortgage products. We do not originate or purchase construction and development loans, teaser option-ARM loans, negatively amortizing loans or high loan-to-value loans.

All of our real estate loans are secured by properties located in California. The following tables set forth our real estate loans and non-accrual real estate loans by county (dollars in thousands):

**Real Estate Loans by County as of September 30, 2013**

| County         | Multi-family       |                   |                        | Total             | Percent        |
|----------------|--------------------|-------------------|------------------------|-------------------|----------------|
|                | One-to-four family | residential       | Commercial real estate |                   |                |
| Los Angeles    | \$ 129,897         | \$ 270,731        | \$ 24,733              | \$ 425,361        | 62.78%         |
| Orange         | 45,096             | 15,509            | 12,375                 | 72,980            | 10.77          |
| San Diego      | 21,016             | 10,926            | 2,545                  | 34,487            | 5.09           |
| San Bernardino | 19,472             | 10,227            | 3,316                  | 33,015            | 4.87           |
| Riverside      | 14,322             | 3,003             | 6,117                  | 23,442            | 3.46           |
| Santa Clara    | 18,378             | 493               |                        | 18,871            | 2.78           |
| Alameda        | 13,866             | 1,643             | 445                    | 15,954            | 2.35           |
| Other          | 46,261             | 5,034             | 2,202                  | 53,497            | 7.90           |
| <b>Total</b>   | <b>\$ 308,308</b>  | <b>\$ 317,566</b> | <b>\$ 51,733</b>       | <b>\$ 677,607</b> | <b>100.00%</b> |

**Real Estate Loans by County as of June 30, 2013**

| County      | Multi-family       |             |            | Total      | Percent |
|-------------|--------------------|-------------|------------|------------|---------|
|             | One-to-four family | residential | Commercial |            |         |
| Los Angeles | \$ 131,290         | \$ 232,353  | \$ 27,124  | \$ 390,767 | 59.56%  |

Edgar Filing: Simplicity Bancorp, Inc. - Form 10-Q

|                |                   |                   |                  |                   |                |
|----------------|-------------------|-------------------|------------------|-------------------|----------------|
| Orange         | 47,146            | 17,646            | 13,489           | 78,281            | 11.93          |
| San Diego      | 23,457            | 11,760            | 2,545            | 37,762            | 5.76           |
| San Bernardino | 20,404            | 10,288            | 3,333            | 34,025            | 5.19           |
| Riverside      | 15,060            | 3,125             | 6,151            | 24,336            | 3.71           |
| Santa Clara    | 17,471            | 501               |                  | 17,972            | 2.74           |
| Alameda        | 13,814            | 25                | 447              | 14,286            | 2.18           |
| Other          | 50,989            | 5,073             | 2,532            | 58,594            | 8.93           |
| <b>Total</b>   | <b>\$ 319,631</b> | <b>\$ 280,771</b> | <b>\$ 55,621</b> | <b>\$ 656,023</b> | <b>100.00%</b> |

**Table of Contents****Non-accrual Real Estate Loans by County as of September 30, 2013**

| County         | One-to-four family | Multi-family residential | Commercial real estate | Total     | Percent of Non-accrual to Loans in Each Category |
|----------------|--------------------|--------------------------|------------------------|-----------|--|
| Los Angeles    | \$ 3,034           | \$                       | \$ 1,144               | \$ 4,178  | 0.98%  |
| Orange         | 386                |                          |                        | 386       | 0.53   |
| San Diego      | 707                | 498                      | 2,545                  | 3,750     | 10.87  |
| San Bernardino | 1,593              | 701                      |                        | 2,294     | 6.95   |
| Riverside      | 298                | 456                      |                        | 754       | 3.22   |
| Santa Clara    | 1,744              |                          |                        | 1,744     | 9.24   |
| Alameda        | 390                |                          |                        | 390       | 2.44   |
| Total          | \$ 8,152           | \$ 1,655                 | \$ 3,689               | \$ 13,496 | 1.99   |

**Non-accrual Real Estate Loans by County as of June 30, 2013**

| County         | One-to-four family | Multi-family residential | Commercial | Total     | Percent of Non-accrual to Loans in Each Category |
|----------------|--------------------|--------------------------|------------|-----------|--|
| Los Angeles    | \$ 4,407           | \$                       | \$ 1,179   | \$ 5,586  | 1.43%  |
| Orange         | 785                |                          |            | 785       | 1.00   |
| San Diego      | 724                | 511                      | 2,545      | 3,780     | 10.01  |
| San Bernardino | 1,929              | 717                      |            | 2,646     | 7.78   |
| Riverside      | 305                | 319                      |            | 624       | 2.56   |
| Santa Clara    | 1,763              |                          |            | 1,763     | 9.81   |
| Alameda        | 397                |                          |            | 397       | 2.78   |
| Other          |                    |                          | 321        | 321       | 0.54   |
| Total          | \$ 10,310          | \$ 1,547                 | \$ 4,045   | \$ 15,902 | 2.42   |

The following table presents information concerning the composition of the one-to-four family residential loan portfolio by servicer at September 30, 2013:

|   | Amount                 | Percent | Non-accrual | Percent of Non-accrual to Loans in Each Category |
|---|------------------------|---------|-------------|--|
|   | (Dollars in thousands) |         |             |  |
| Purchased and serviced by others          | \$ 37,536              | 12.18%  | \$          | %  |
| Purchased and servicing transferred to us | 99,060                 | 32.13   | 6,644       | 6.71   |
| Originated and serviced by us             | 171,712                | 55.69   | 1,508       | 0.88   |
| Total                                     | \$ 308,308             | 100.00% | \$ 8,152    | 2.64   |





**Table of Contents**

**Delinquent Loans.** The following table sets forth certain information with respect to our loan portfolio delinquencies at the dates indicated.

|                               | <b>Loans Delinquent:</b>   |               |                            |               |                               |               |
|-------------------------------|----------------------------|---------------|----------------------------|---------------|-------------------------------|---------------|
|                               | <b>60-89 Days</b>          |               | <b>90 Days or More</b>     |               | <b>Total Delinquent Loans</b> |               |
|                               | <b>Number of<br/>Loans</b> | <b>Amount</b> | <b>Number of<br/>Loans</b> | <b>Amount</b> | <b>Number of<br/>Loans</b>    | <b>Amount</b> |
| <b>(Dollars in thousands)</b> |                            |               |                            |               |                               |               |
| <b>At September 30, 2013</b>  |                            |               |                            |               |                               |               |
| <b>Real estate loans:</b>     |                            |               |                            |               |                               |               |
| One-to-four family            | 5                          | \$ 2,067      | 4                          | \$ 1,504      | 9                             | \$ 3,571      |
| Multi-family                  |                            |               | 1                          | 198           | 1                             | 198           |
| Commercial                    |                            |               | 1                          | 2,545         | 1                             | 2,545         |
| <b>Other loans:</b>           |                            |               |                            |               |                               |               |
| Automobile                    | 1                          | 16            | 1                          | 19            | 2                             | 35            |
| Home equity                   |                            |               |                            |               |                               |               |
| Other                         | 5                          | 10            | 1                          | 1             | 6                             | 11            |
| Total loans                   | 11                         | \$ 2,093      | 8                          | \$ 4,267      | 19                            | \$ 6,360      |
| <b>At June 30, 2013</b>       |                            |               |                            |               |                               |               |
| <b>Real estate loans:</b>     |                            |               |                            |               |                               |               |
| One-to-four family            | 3                          | \$ 970        | 5                          | \$ 1,751      | 8                             | \$ 2,721      |
| Multi-family                  | 1                          | 198           |                            |               | 1                             | 198           |
| Commercial                    | 1                          | 2,545         |                            |               | 1                             | 2,545         |
| <b>Other loans:</b>           |                            |               |                            |               |                               |               |
| Automobile                    |                            |               | 1                          | 14            | 1                             | 14            |
| Home equity                   |                            |               |                            |               |                               |               |
| Other                         | 1                          | 2             | 2                          | 4             | 3                             | 6             |
| Total loans                   | 6                          | \$ 3,715      | 8                          | \$ 1,769      | 14                            | \$ 5,484      |

Delinquent loans 60 days or more past due totaled \$6.4 million or 0.89% of total loans at September 30, 2013 as compared to \$5.5 million or 0.79% of total loans at June 30, 2013. Delinquent one-to-four family residential loans slightly increased to \$3.6 million at September 30, 2013 from \$2.7 million at June 30, 2013. Delinquent multi-family loans of \$198,000 and delinquent commercial real estate loans of \$2.5 million at September 30, 2013 remained unchanged from the balances at June 30, 2013. In addition, there were six one-to-four family loans totaling \$2.5 million, one multi-family loan of \$198,000 and one commercial real estate loan of \$2.5 million that were over 90 days delinquent at September 30, 2013 and in the process of foreclosure.

**Non-Performing Assets.** Non-performing assets consist of non-accrual loans and foreclosed assets. Loans to a customer whose financial condition has deteriorated are considered for non-accrual status whether or not the loan is 90 days and over past due. All loans past due 90 days and over are classified as non-accrual. At the time the loan is placed on non-accrual status, interest previously accrued but not collected is reversed and charged against current

income. Payments received on non-accrual loans are recorded as a reduction of principal. Non-accrual loans also include troubled debt restructurings that are on non-accrual status. At September 30, 2013 and June 30, 2013, there were no loans past due more than 90 days and still accruing interest. Included in non-accrual loans were troubled debt restructurings of \$7.6 million and \$9.1 million as of September 30, 2013 and June 30, 2013, with specific valuation allowances of \$291,000 and \$393,000 respectively.

Although asset quality improved as a result of our efforts in working through problem assets, non-accrual loans continue to remain at historically elevated levels as a result of the general decline in the housing market as well as the prolonged levels of high unemployment in our market area as compared with the pre-recession periods. During the three months ended September 30, 2013, there were no new loans that were modified as troubled debt restructurings. At September 30, 2013, there were fifteen non-accrual restructured loans, consisting of twelve one-to-four family residential loans, two multi-family loans, and one commercial real estate loan with an aggregate balance of \$7.6 million of which ten loans with an aggregate balance of \$3.6 million were performing in accordance with their revised contractual terms.

**Table of Contents**

At June 30, 2013, there were nineteen non-accrual restructured loans, consisting of sixteen one-to-four family residential loans, two multi-family loans, and one commercial real estate loan with an aggregate balance of \$9.1 million of which twelve loans with an aggregate balance of \$4.3 million were performing in accordance with their revised contractual terms. Troubled debt restructured loans are included in non-accrual loans until there is a sustained period of payment performance (usually six months or longer and determined on a case by case basis) and there is reasonable assurance that timely payment will continue. During the three months ended September 30, 2013, four troubled debt restructurings with an aggregate outstanding balance of \$1.4 million were returned to accrual status as a result of the borrowers paying the modified terms as agreed for a sustained period of more than six months and reasonable assurance that timely payment will continue. This compares to no troubled debt restructurings were returned to accrual status during the same period last year. There were no further commitments to customers whose loans were troubled debt restructurings at September 30, 2013 and June 30, 2013.

Any changes or modifications made to loans are carefully reviewed to determine whether they are troubled debt restructurings. The modification of the terms of loans that are reported as troubled debt restructurings included one or a combination of the following: a reduction of the stated interest rate of the loan; an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk; or a permanent reduction of the recorded investment in the loan. There are other changes or modifications made for borrowers who are not experiencing financial difficulties. During the three months ended September 30, 2013, there were six loans in the amount of \$2.4 million which were modified and not accounted for as troubled debt restructurings. The modifications were made to refinance the credits to maintain the borrowing relationships and generally consisted of term or rate modifications. The borrowers were not experiencing financial difficulty and the modifications were made at market terms.

**Table of Contents**

The following table sets forth the amounts and categories of our non-performing assets at the dates indicated (in thousands).

|   | At September 30,<br>2013 | At June 30,<br>2013 |
|---|--------------------------|---------------------|
| <b><u>Non-accrual loans:</u></b>                              |                          |                     |
| <b><u>Real estate loans:</u></b>                              |                          |                     |
| One-to-four family  | \$ 3,678                 | \$ 4,372            |
| Multi-family  | 1,041                    | 914                 |
| Commercial  | 1,144                    | 1,500               |
| <b><u>Other loans:</u></b>                                    |                          |                     |
| Automobile  | 19                       | 14                  |
| Home equity   |                          |                     |
| Other   | 3                        | 4                   |
| <b><u>Troubled debt restructurings:</u></b>                   |                          |                     |
| One-to-four family  | 4,474                    | 5,938               |
| Multi-family  | 614                      | 633                 |
| Commercial  | 2,545                    | 2,545               |
| <br>Total non-accrual loans                                   | <br>\$ 13,518            | <br>\$ 15,920       |
| <b><u>Other real estate owned and repossessed assets:</u></b> |                          |                     |
| <b><u>Real estate:</u></b>                                    |                          |                     |
| One-to-four family  | \$ 325                   | \$                  |
| Commercial  |                          |                     |
| <b><u>Other loans:</u></b>                                    |                          |                     |
| Automobile  | 3                        | 35                  |
| <br>Total other real estate owned and repossessed assets      | <br>\$ 328               | <br>\$ 35           |
| <br>Total non-performing assets                               | <br>\$ 13,846            | <br>\$ 15,955       |
| <b><u>Ratios:</u></b>   |                          |                     |
| Non-performing loans to total loans <sup>(1)</sup>            | 1.88%                    | 2.29%               |
| Non-performing assets to total assets                         | 1.66%                    | 1.84%               |
| Non-accrued interest <sup>(2)</sup>                           | \$ 219                   | \$ 225              |

(1) Total loans are net of deferred fees and costs.

(2) If interest on the loans classified as non-accrual had been accrued, interest income in these amounts would have been recorded.

Non-performing loans decreased to \$13.5 million, or 1.88% of total loans at September 30, 2013 as compared to \$15.9 million, or 2.29% of total loans at June 30, 2013. The decrease in non-performing loans was primarily attributable to non-performing troubled debt restructuring of \$1.4 million returned to accruing status after the borrowers demonstrated a sustained period of performance, generally six consecutive months of timely payments, loans transferred to real estate owned of \$325,000, and pay-offs of \$321,000 during the quarter ended September 30, 2013.

At September 30, 2013, there were \$8.2 million of one-to-four family residential mortgage loans on non-accrual for which valuation allowances individually evaluated totaling \$293,000 have been applied. Of the \$8.2 million in one-to-four family residential mortgage loans on non-accrual status, the terms or rates of \$4.5 million in loans were modified as troubled debt restructurings.

At September 30, 2013, there were \$5.3 million of multi-family residential and commercial real estate loans ( income property ) on non-accrual for which valuation allowances individually evaluated totaling \$1,000 have been applied. Included in the \$5.3 million of income property loans on non-accrual status were five multi-family residential loans totaling \$1.7 million and two commercial real estate loans totaling \$3.7 million.

**Table of Contents**

**Real Estate Owned.** Real estate owned and repossessed assets consist of real estate and other assets which have been acquired through foreclosure on loans. At the time of foreclosure, assets are recorded at fair value less estimated selling costs, with any write-down charged against the allowance for loan losses. The fair value of real estate owned is determined by a third party appraisal of the property. As of September 30, 2013, there was one real estate owned property in the amount of \$325,000. This compared to no real estate owned properties at June 30, 2013.

**Classified and Criticized Assets.** We regularly review potential problem assets in our portfolio to determine whether any assets require classification in accordance with applicable regulations. The total amount of classified and criticized assets represented 32.3% of our equity capital and 5.6% of our total assets at September 30, 2013, as compared to 28.6% of our equity capital and 4.8% of our total assets at June 30, 2013. The level of substandard assets increased primarily due to the addition of two multi-family residential loans of \$6.8 million that were inadequately protected by paying capacity of the collateral pledged during the three months ended September 30, 2013 but remained current on the loan payments. At September 30, 2013 and June 30, 2013, there were \$13.5 million and \$15.9 million in non-accrual loans included in classified assets, respectively.

The aggregate amount of our classified and special mention assets at the dates indicated were as follows (in thousands):

|   | September 30,<br>2013 | June 30,<br>2013 |
|---|-----------------------|------------------|
| <b><u>Classified and Criticized Assets:</u></b> |                       |                  |
| Loss  | \$ 22                 | \$ 4             |
| Doubtful  | 5                     | 24               |
| Substandard                                     | 28,068                | 23,398           |
| Special Mention                                 | 18,355                | 18,100           |
| Total   | \$ 46,450             | \$ 41,526        |

**Allowance for Loan Losses.** We maintain an allowance for loan losses to absorb probable incurred losses inherent in the loan portfolio. The allowance is based on ongoing, quarterly assessments of the probable losses inherent in the loan portfolio. In accordance with generally accepted accounting principles the allowance is comprised of general valuation allowances and valuation allowances on loans individually evaluated for impairment.

The general component covers non-impaired loans and is based both on our historical loss experience as well as significant factors that, in management's judgment, affect the collectability of the portfolio as of the evaluation date. Loans that are classified as impaired are individually evaluated. We consider a loan impaired when it is probable that we will be unable to collect all amounts due according to the terms of the loan agreement and determine impairment by computing a fair value either based on discounted cash flows using the loan's initial interest rate or the fair value of the collateral, less estimated selling costs, if the loan is collateral dependent.

The overall appropriateness of the general valuation allowance is determined based on a loss migration model and qualitative considerations. The migration analysis looks at pools of loans having similar characteristics and analyzes their loss rates over a historical period. Historical loss factors derived from trends and losses associated with each pool over a specific period of time are utilized. The loss factors are applied to the outstanding loans to each loan grade within each pool of loans. Loss rates derived by the migration model are based predominantly on historical loss trends

that may not be indicative of the actual or inherent loss potential. As such, qualitative and environmental factors are utilized as adjusting mechanisms to supplement the historical results of the classification migration model. Significant factors reviewed in determining the allowance for loan losses included loss ratio trends by loan product; levels of and trends in delinquencies and impaired loans; levels of and trends in classified assets; levels of and trends in charge-offs and recoveries; trends in volume of loans by loan product; effects of changes in lending policies and practices; industry conditions and effects of concentrations in geographic regions. Qualitative and environmental factors are reflected as percent adjustments and are added to the historical loss rates derived from the classified asset migration model to determine the appropriate allowance amount for each loan pool.



---

**Table of Contents**

Valuation allowances on real estate loans that are individually evaluated for impairment are charged-off when management believes a loan or part of a loan is deemed uncollectible. Subsequent recoveries, if any, are credited to the allowance when received. A loan is generally considered uncollectible when the borrower's payment is six months or more delinquent.

Senior management reviews these conditions quarterly in discussions with our senior credit officers. To the extent that any of these conditions is evidenced by a specifically identifiable problem credit or portfolio segment as of the evaluation date, management's estimate of the effect of such conditions may be reflected as an allowance specifically applicable to such credit or portfolio segment. Where any of these conditions is not evidenced by a specifically identifiable problem credit or portfolio segment as of the evaluation date, management's evaluation of the loss related to this condition is reflected in the general allowance. The evaluation of the inherent loss with respect to these conditions is subject to a higher degree of uncertainty because they are not identified with specific problem credits or portfolio segments.

Given that management evaluates the adequacy of the allowance for loan losses based on a review of individual loans, historical loan loss experience, the value and adequacy of collateral and economic conditions in our market area, this evaluation is inherently subjective as it requires material estimates, including the amounts and timing of future cash flows expected to be received on impaired loans that may be susceptible to significant change. Large groups of smaller balance homogeneous loans that are collectively evaluated for impairment and are excluded from loans individually evaluated for impairment; their allowance for loan losses is calculated in accordance with the allowance for loan losses policy described above.

Because the allowance for loan losses is based on estimates of losses inherent in the loan portfolio, actual losses can vary significantly from the estimated amounts. Our methodology as described above permits adjustments to any loss factor used in the computation of the formula allowance in the event that, in management's judgment, significant factors which affect the collectability of the portfolio as of the evaluation date are not reflected in the loss factors. By assessing the estimated losses inherent in the loan portfolio on a quarterly basis, we are able to adjust individual and inherent loss estimates based upon any more recent information that has become available. We continue to review our allowance for loan losses methodology for appropriateness to keep pace with the size and composition of the loans and the changing economic conditions and credit environment. We believe that our methodologies continue to be appropriate given our size and level of complexity. In addition, management's determination as to the amount of our allowance for loan losses is subject to review by the Office of the Comptroller of the Currency ( OCC ) and the FDIC, which may require the establishment of additional general allowances or allowances on loans individually evaluated for impairment based upon their judgment of the information available to them at the time of their examination of our Bank.

There was no provision for loan losses for the quarter ended September 30, 2013 as compared to \$850,000 for the same quarter last year. The decline in the provision was primarily a result of a decline in net charge-offs and loss factors on loans collectively evaluated for impairment. Annualized net charge-offs decreased to 0.09% of average outstanding loans for the three months ended September 30, 2013 as compared to 0.29% of average outstanding loans for the year ended June 30, 2013. Non-performing loans decreased to \$13.5 million, or 1.88% of total loans at September 30, 2013 as compared to \$15.9 million, or 2.29% of total loans at June 30, 2013. The decrease in non-performing loans was primarily attributable to pay-offs of \$321,000, loans transferred to real estate owned of \$325,000, and non-performing loans of \$1.4 million returned to accruing status after the borrowers demonstrated a sustained period of performance, generally six consecutive months of timely payments, during the quarter ended September 30, 2013. Delinquent loans, 60 days or more increased to \$6.4 million or 0.89% of total loans at September 30, 2013 as compared to \$5.5 million, or 0.79% of total loans at June 30, 2013. The increase was a result of a slight increase in one-to-four family loans 60-89 days past due. The allowance for loan losses to non-performing

loans was 40.59% at September 30, 2013 as compared to 35.45% at June 30, 2013. The increase in the allowance for loan losses to non-performing loans was a result of the decrease in non-performing loans, partially offset by a decrease in the allowance for loan losses for the quarter ended September 30, 2013. The provision reflected management's continuing assessment of the credit quality of the Company's loan portfolio, which is affected by various trends, including current economic conditions.

**Table of Contents**

The distribution of the allowance for losses on loans at the dates indicated is summarized as follows.

|  | September 30,<br>2013 |   | June 30,<br>2013 |   |
|--|-----------------------|---|------------------|---|
|  | Amount                | Percent of<br>Loans in Each<br>Category<br>to<br>Total<br>Loans<br>(Dollars in thousands) | Amount           | Percent of<br>Loans in Each<br>Category<br>to<br>Total<br>Loans |
| <b>Real estate loans:</b>              |                       |   |                  |   |
| One-to-four family                     | \$ 2,628              | 42.91%  | \$ 3,009         | 46.03%  |
| Multi-family                           | 1,287                 | 44.20   | 839              | 40.44   |
| Commercial                             | 1,408                 | 7.20  | 1,654            | 8.01  |
| <b>Other loans:</b>                    |                       |   |                  |   |
| Automobile                             | 112                   | 4.26  | 83               | 3.85  |
| Home equity                            | 4                     | 0.09  | 4                | 0.10  |
| Other                                  | 48                    | 1.34  | 54               | 1.57  |
| <b>Total allowance for loan losses</b> | <b>\$ 5,487</b>       | <b>100.00%</b>  | <b>\$ 5,643</b>  | <b>100.00%</b>  |

**Liquidity, Capital Resources and Commitments**

Liquidity may increase or decrease depending upon the availability of funds and comparative yields on investments in relation to the return on loans. Historically, we have maintained liquid assets at levels above the minimum requirements previously imposed by our regulator and above levels believed to be adequate to meet the requirements of normal operations, including potential deposit outflows. Cash flow projections are regularly reviewed and updated to assure that adequate liquidity is maintained.

Our liquidity, represented by cash and cash equivalents, interest earning accounts and mortgage-backed and related securities, is a product of our operating, investing and financing activities. Our primary sources of funds are deposits, amortization, prepayments and maturities of outstanding loans and mortgage-backed and related securities, and other short-term investments and funds provided from operations. While scheduled payments from the amortization of loans and mortgage-backed related securities and maturing investment securities and short-term investments are relatively predictable sources of funds, deposit flows and loan prepayments are greatly influenced by general interest rates, economic conditions, and competition. In addition, we invest excess funds in short-term interest earning assets, which provide liquidity to meet lending requirements. We also generate cash through borrowings. We utilize FHLB advances to leverage our capital base and provide funds for our lending and investment activities as well as enhance our interest rate risk management.

Liquidity management is both a daily and long-term function of business management. Excess liquidity is generally invested in short-term investments such as overnight deposits. On a longer-term basis, we maintain a strategy of investing in various investment securities and lending products. We use our sources of funds primarily to meet ongoing commitments, to pay maturing certificates of deposit and savings withdrawals, to fund loan commitments and to maintain our portfolio of mortgage-backed and related securities. At September 30, 2013, total approved loan

commitments amounted to \$6.1 million and the unadvanced portion of loans was \$2.2 million.

Certificates of deposit and advances from the FHLB of San Francisco scheduled to mature in one year or less at September 30, 2013, totaled \$108.7 million and \$20.0 million, respectively. Based on historical experience, management believes that a significant portion of maturing deposits will remain with the Bank and we anticipate that we will continue to have sufficient funds, through deposits and borrowings, to meet our current commitments.

At September 30, 2013, we had available additional advances from the FHLB of San Francisco in the amount of \$286.9 million. We also had a short-term line of credit with the Federal Reserve Bank of San Francisco of \$47.4 million at September 30, 2013, which has not been drawn upon.

**Table of Contents****Contractual Obligations**

In the normal course of business, we enter into contractual obligations that meet various business needs. These contractual obligations include certificates of deposit to customers, borrowings from the FHLB, lease obligations for facilities, and commitments to purchase, sale and/or originate loans.

The following table summarizes our long-term contractual obligations at September 30, 2013 (in thousands).

|  | <b>Total</b> | <b>Less<br/>than<br/>1 year</b> | <b>1 3<br/>Years</b> | <b>Over 3<br/>Years</b> | <b>5 More than 5<br/>years</b> |
|--|--------------|---------------------------------|----------------------|-------------------------|--------------------------------|
| FHLB advances  | \$ 60,000    | \$ 20,000                       | \$ 20,000            | \$ 20,000               | \$                             |
| Operating lease obligations                          | 2,556        | 1,051                           | 1,010                | 145                     | 350                            |
| Loan commitments to originate                        | 6,097        | 6,097                           |                      |                         |                                |
| Available home equity and unadvanced lines of credit | 1,952        | 1,952                           |                      |                         |                                |
| Certificates of deposit                              | 262,924      | 108,653                         | 132,363              | 21,803                  | 105                            |
| Total commitments and contractual obligations        | \$ 333,529   | \$ 137,753                      | \$ 153,373           | \$ 41,948               | \$ 455                         |

**Off-Balance Sheet Arrangements**

As a financial service provider, we routinely are a party to various financial instruments with off-balance sheet risks, such as commitments to extend credit and unused lines of credit. While these contractual obligations represent our future cash requirements, a significant portion of commitments to extend credit may expire without being drawn upon. Such commitments are subject to the same credit policies and approval process accorded to loans we make.

**Table of Contents****Capital**

The table below sets forth Simplicity Bank's capital position relative to its regulatory capital requirements at September 30, 2013 and June 30, 2013. The definitions of the terms used in the table are those provided in the capital regulations issued by the OCC.

| September 30, 2013                                  | Actual                 |        | Minimum Capital Requirements |       | Minimum required to be Well Capitalized Under Prompt Corrective Actions Provisions |        |
|---|------------------------|--------|------------------------------|-------|--|--------|
|   | Amount                 | Ratio  | Amount                       | Ratio | Amount   | Ratio  |
|   | (Dollars in thousands) |        |                              |       |  |        |
| Total capital (to risk-weighted assets)             | \$ 124,040             | 21.12% | \$ 46,988                    | 8.00% | \$ 58,734  | 10.00% |
| Tier 1 capital (to risk-weighted assets)            | 118,553                | 20.18  | 23,494                       | 4.00  | 35,241   | 6.00   |
| Tier 1 (core) capital (to adjusted tangible assets) | 118,553                | 14.25  | 33,278                       | 4.00  | 41,598   | 5.00   |

| June 30, 2013                                       | Actual                 |        | Minimum Capital Requirements |       | Minimum required to be Well Capitalized Under Prompt Corrective Actions Provisions |        |
|---|------------------------|--------|------------------------------|-------|--|--------|
|   | Amount                 | Ratio  | Amount                       | Ratio | Amount   | Ratio  |
|   | (Dollars in thousands) |        |                              |       |  |        |
| Total capital (to risk-weighted assets)             | \$ 137,788             | 23.85% | \$ 46,222                    | 8.00% | \$ 57,777  | 10.00% |
| Tier 1 capital (to risk-weighted assets)            | 132,145                | 22.87  | 23,111                       | 4.00  | 34,666   | 6.00   |
| Tier 1 (core) capital (to adjusted tangible assets) | 132,145                | 15.28  | 34,591                       | 4.00  | 43,238   | 5.00   |

Consistent with our goal to operate a sound and profitable financial organization, we actively seek to continue as a well-capitalized institution in accordance with regulatory standards. At September 30, 2013, Simplicity Bank was a well-capitalized institution under regulatory standards.

**Impact of Inflation**

The unaudited consolidated financial statements presented herein have been prepared in accordance with GAAP. These principles require the measurement of financial position and operating results in terms of historical dollars, without considering changes in the relative purchasing power of money over time due to inflation.

Our primary assets and liabilities are monetary in nature. As a result, interest rates have a more significant impact on our performance than the effects of general levels of inflation. Interest rates, however, do not necessarily move in the same direction or with the same magnitude as the price of goods and services, since such prices are affected by inflation. In a period of rapidly rising interest rates, the liquidity and maturity structure of our assets and liabilities are critical to the maintenance of acceptable performance levels.

The principal effect of inflation, as distinct from levels of interest rates, on earnings is in the area of noninterest expense. Such expense items as employee compensation, employee benefits and occupancy and equipment costs may be subject to increases as a result of inflation.

**Table of Contents**

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

**Our Risk When Interest Rates Change.** The rates of interest we earn on assets and pay on liabilities generally are established contractually for a period of time. Market interest rates change over time. Our fixed rate loans generally have longer maturities than our fixed rate deposits. Accordingly, our results of operations, like those of other financial institutions, are impacted by changes in interest rates and the interest rate sensitivity of our assets and liabilities. The risk associated with changes in interest rates and our ability to adapt to these changes is known as interest rate risk and is our most significant market risk.

**How We Measure Our Risk of Interest Rate Changes.** As part of our attempt to manage our exposure to changes in interest rates and comply with applicable regulations, we monitor our interest rate risk. In monitoring interest rate risk we continually analyze and manage assets and liabilities based on their payment streams and interest rates, the timing of their maturities, and their sensitivity to actual or potential changes in market interest rates.

In order to minimize the potential for adverse effects of material and prolonged increases in interest rates on our results of operations, we have adopted investment/asset and liability management policies to better match the maturities and repricing terms of our interest-earning assets and interest-bearing liabilities. The board of directors sets and recommends the asset and liability policies of Simplicity Bank, which are implemented by the asset/liability management committee.

The purpose of the asset/liability management committee is to communicate, coordinate and control asset/liability management consistent with our business plan and board approved policies. The committee establishes and monitors the volume and mix of assets and funding sources taking into account relative costs and spreads, interest rate sensitivity and liquidity needs. The objectives are to manage assets and funding sources to produce results that are consistent with liquidity, capital adequacy, growth, risk, and profitability goals.

The asset/liability management committee generally meets at least monthly to review, among other things, economic conditions and interest rate outlook, current and projected liquidity needs and capital position, anticipated changes in the volume and mix of assets and liabilities and interest rate risk exposure limits versus current projections pursuant to net present value of portfolio equity analysis and income simulations. The asset/liability management committee recommends appropriate strategy changes based on this review. The chairman or his designee is responsible for reviewing and reporting on the effects of the policy implementations and strategies to the board of directors at least monthly.

In order to manage our assets and liabilities and achieve the desired liquidity, credit quality, interest rate risk, profitability and capital targets, we have focused our strategies on: (1) maintaining an adequate level of adjustable rate loans; (2) originating a reasonable volume of short-term and intermediate-term loans; (3) managing our deposits to establish stable deposit relationships; and (4) using FHLB advances, and pricing on fixed-term non-core deposits to align maturities and repricing terms.

At times, depending on the level of general interest rates, the relationship between long-term and short-term interest rates, market conditions and competitive factors, the asset/liability management committee may determine to increase our interest rate risk position somewhat in order to maintain our net interest margin.

The asset/liability management committee regularly reviews interest rate risk by forecasting the impact of alternative interest rate environments on net interest income and economic value of portfolio equity, which is defined as the net present value of an institution's existing assets, liabilities and off-balance sheet instruments, and evaluating such impacts against the maximum potential changes in net interest income and economic value of portfolio equity that are



authorized by the board of directors of Simplicity Bank.

**Table of Contents**

An independent third party provides the Bank with the information presented in the following tables, which are based on information provided by the Bank. The tables present the sensitivity of net interest income for the 12-month period subsequent to the three months ended September 30, 2013 and the year ended June 30, 2013, and the immediate, permanent and parallel movements in interest rates of +/-100, +200 and +300 basis points, as well as the change in the Bank's net portfolio value at September 30, 2013 that would occur upon an immediate change in interest rates without giving effect to any steps that management might take to counteract that change.

| September 30, 2013 |                               | June 30, 2013    |                               |
|--------------------|-------------------------------|------------------|-------------------------------|
| Basis Point (bp)   | Change in Net Interest Income | Basis Point (bp) | Change in Net Interest Income |
| Change in Rates    |                               | Change in Rates  |                               |
| +300 bp            | (2.81)%                       | +300 bp          | 6.26%                         |
| +200               | (1.95)                        | +200             | 1.59                          |
| +100               | (1.11)                        | +100             | 0.69                          |
| -100               | 0.74                          | -100             | 0.20                          |

| Change in Interest Rates (basis points) <sup>(1)</sup> | September 30, 2013           |                                      |          | NPV as a percentage of Present Value of Assets <sup>(3)</sup> |                                    |
|--|------------------------------|--------------------------------------|----------|---|------------------------------------|
|  | Estimated NPV <sup>(2)</sup> | Estimated Increase (Decrease) in NPV |          | NPV ratio <sup>(4)</sup>                                      | Increase (Decrease) (basis points) |
|  |                              | Amount                               | Percent  |   |                                    |
| (Dollars in thousands)                                 |                              |                                      |          |   |                                    |
| +400   | \$ 83,652                    | \$ (47,956)                          | (36.44)% | 11.14%  | (431)                              |
| +300   | 96,519                       | (35,088)                             | (26.66)  | 12.46   | (299)                              |
| +200   | 109,052                      | (22,555)                             | (17.14)  | 13.64   | (182)                              |
| +100   | 120,749                      | (10,858)                             | (8.25)   | 14.63   | (82)                               |
|  | 131,608                      |                                      |          | 15.45   |                                    |
| -100   | 138,972                      | 7,365                                | 5.60     | 15.88   | 43                                 |

(1) Assumes an instantaneous uniform change in interest rates at all maturities.

(2) NPV is the discounted present value of expected cash flows from assets, liabilities and off-balance sheet contracts.

(3) Present value of assets represents the discounted present value of incoming cash flows on interest-earning assets.

(4) NPV Ratio represents NPV divided by the present value of assets.

The analysis uses certain assumptions in assessing interest rate risk. These assumptions relate to interest rates, loan prepayment rates, deposit decay rates, and the fair values of certain assets under differing interest rate scenarios, among other things.

As with any method of measuring interest rate risk, shortcomings are inherent in the method of analysis presented in the foregoing tables. For example, although assets and liabilities may have similar maturities or periods to repricing,

they may react in different degrees to changes in the market interest rates. Also, the interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types may lag behind changes in market rates. Additionally, certain assets, such as adjustable rate mortgage loans, have features, that restrict changes in interest rates on a short-term basis and over the life of the asset. Further, if interest rates change, expected rates of prepayments on loans and early withdrawals from certificates of deposit could deviate significantly from those assumed in calculating the table.

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

Our management evaluated, with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the Act )) as of the end of the period covered by this report. The Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures as of the end of the period covered by this report are effective in ensuring that the information required to be disclosed by the Company in the reports it files or submits under the Act is (i) accumulated and communicated to the Company's management (including the Chief Executive Officer and Chief Financial Officer) in a timely manner, and (ii) recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms.

**Table of Contents**

There have been no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Act) that occurred during the quarter ended September 30, 2013 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Part II. OTHER INFORMATION****Item 1. Legal Proceedings**

From time to time, we are involved as plaintiff or defendant in various legal actions arising in the normal course of business. We do not anticipate incurring any material liability as a result of this litigation or any material impact on our financial position, results of operations or cash flows.

**Item 1A. Risk Factors**

There have been no material changes to the risk factors that were previously disclosed in the Company's annual report on Form 10-K for the fiscal year ended June 30, 2013.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds****Purchases of Equity Securities by the Issuer**

| <b>Period</b>      | <b>Total Number of Shares Purchased</b> | <b>Weighted Average Price Paid Per Share</b> | <b>Total Number of Shares Purchased as Part of Publicly Announced Plans*</b> | <b>Maximum Number of Shares That May Yet be Purchased Under the Plan</b> |
|--------------------|---|--|--|--|
| 07/1/13 - 07/31/13 | 35,000                                  | \$ 14.81                                     | 35,000   | 231,781  |
| 08/1/13 - 08/31/13 | 50,000                                  | 15.11  | 50,000   | 181,781  |
| 09/1/13 - 09/30/13 | 63,575                                  | 15.24  | 63,575   | 118,206  |
| <b>Total</b>       | <b>148,575</b>                          | <b>\$ 15.10</b>                              | <b>148,575</b>   |  |

\* Since November 2011, the Company has repurchased 1,666,242 shares under previously announced stock repurchase programs.

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. Mine Safety Disclosures**

Not applicable



**Table of Contents**

**Item 5. Other Information**

None.

**Item 6. Exhibits**

|         |  |
|---------|--|
| 31.1    | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act |
| 31.2    | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act |
| 32.1    | Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act |
| 32.2    | Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act |
| 101.INS | XBRL Instance Document   |
| 101.SCH | XBRL Taxonomy Extension Schema Document  |
| 101.CAL | XBRL Taxonomy Calculation Linkbase Document  |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document                                       |
| 101.LAB | XBRL Taxonomy Label Linkbase Document  |
| 101.PRE | XBRL Taxonomy Presentation Linkbase Document   |

**Table of Contents**

**SIMPLICITY BANCORP, INC. AND SUBSIDIARY**

**SIGNATURES**

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

SIMPLICITY BANCORP, INC.

Dated: November 8, 2013

/s/ Dustin Luton  
Dustin Luton  
President and Chief Executive Officer

/s/ Jean M. Carandang  
Jean M. Carandang  
Chief Financial Officer