

Hamilton Bancorp, Inc.
Form 10-Q
February 14, 2017
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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant To Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended December 31, 2016

OR

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from _____ to _____

Commission File No. 001-35693

Hamilton Bancorp, Inc.

(Exact name of registrant as specified in its charter)

Maryland

(State or other jurisdiction of incorporation or organization)

46-0543309

(I.R.S. Employer Identification Number)

501 Fairmount Avenue, Suite 200, Towson, Maryland

(Address of Principal Executive Offices)

21286

Zip Code

(410) 823-4510

(Registrant's telephone number)

N/A

(Former name or former address, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such 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 the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one)

Large accelerated filer]

Accelerated filer]

Non-accelerated filer]

Smaller reporting company]

(Do not check if 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]

3,409,243 shares of the Registrant's common stock, par value \$0.01 per share, were issued and outstanding as of February 14, 2017.

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Table of Contents**Part I. – Financial Information****Item 1. Financial Statements****HAMILTON BANCORP, INC. AND SUBSIDIARY****Consolidated Statements of Financial Condition****December 31, 2016 and March 31, 2016**

	December 31, 2016 (Unaudited)	March 31, 2016 (Audited)
Assets		
Assets		
Cash and due from banks	\$ 15,703,886	\$47,101,688
Federal funds sold	2,611,864	20,346,848
Cash and cash equivalents	18,315,750	67,448,536
Certificates of deposit held as investment	499,303	3,968,229
Securities available for sale, at fair value	106,754,363	70,484,400
Federal Home Loan Bank stock, at cost	1,640,100	1,042,500
Loans held for sale	-	259,450
Loans	331,398,269	221,859,056
Allowance for loan losses	(2,063,569)	(1,702,365)
Net loans and leases	329,334,700	220,156,691
Premises and equipment, net	4,228,766	3,555,474
Premises and equipment held for sale	-	405,000
Foreclosed real estate	460,220	443,015
Accrued interest receivable	1,481,388	948,166
Bank-owned life insurance	18,132,876	12,709,908
Deferred income taxes	7,408,268	2,353,141
Income taxes refundable	-	228,920
Goodwill and other intangible assets	9,393,243	7,386,111
Other assets	2,186,102	1,527,014
Total Assets	\$ 499,835,079	\$ 392,916,555
Liabilities and Shareholders' Equity		
Liabilities		
Noninterest-bearing deposits	\$ 22,397,875	\$ 19,747,437
Interest-bearing deposits	385,927,067	294,246,214
Total deposits	408,324,942	313,993,651
Borrowings	26,194,142	14,805,237

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Advances by borrowers for taxes and insurance	1,112,278	1,079,794
Other liabilities	3,529,827	1,493,290
Total liabilities	439,161,189	331,371,972
Commitments and contingencies	-	-
Shareholders' Equity		
Common stock, \$.01 par value, 100,000,000 shares authorized. Issued: 3,413,646 shares at December 31, 2016 and March 31, 2016	34,136	34,136
Additional paid in capital	31,631,868	31,242,731
Retained earnings	32,707,101	32,659,455
Unearned ESOP shares	(2,221,800)	(2,369,920)
Accumulated other comprehensive loss	(1,477,415)	(21,819)
Total shareholders' equity	60,673,890	61,544,583
Total Liabilities and Shareholders' Equity	\$499,835,079	\$392,916,555

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

Table of Contents**HAMILTON BANCORP, INC. AND SUBSIDIARY****Consolidated Statements of Operations (Unaudited)****Three and Nine Months Ended December 31, 2016 and 2015**

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2016	2015	2016	2015
Interest revenue				
Loans, including fees	\$3,878,223	\$2,805,851	\$11,026,020	\$6,906,069
U.S. treasuries, government agencies and FHLB stock	33,022	91,940	182,130	276,415
Municipal and corporate bonds	107,564	31,722	226,230	94,145
Mortgage-backed securities	310,709	272,751	829,437	848,181
Federal funds sold and other bank deposits	28,065	18,005	147,504	31,650
Total interest revenue	4,357,583	3,220,269	12,411,321	8,156,460
Interest expense				
Deposits	673,348	458,024	1,959,630	1,241,457
Borrowed funds	74,336	38,191	192,977	64,487
Total interest expense	747,684	496,215	2,152,607	1,305,944
Net interest income				
	3,609,899	2,724,054	10,258,714	6,850,516
Provision for loan losses	780,000	70,000	1,040,006	190,000
Net interest income after provision for loan losses	2,829,899	2,654,054	9,218,708	6,660,516
Noninterest revenue				
Service charges	104,882	102,979	319,489	304,951
Gain on sale of investment securities	23,720	20,497	23,720	42,212
Gain on sale of loans held for sale	1,438	7,826	23,047	43,395
(Loss) gain on sale of property and equipment	(11,043)	-	(11,043)	407,188
Earnings on bank-owned life insurance	126,302	87,616	364,928	264,062
Other	42,784	14,675	119,937	49,194
Total noninterest revenue	288,083	233,593	840,078	1,111,002
Noninterest expenses				
Salaries	1,354,327	1,102,598	4,092,481	3,018,168
Employee benefits	359,987	293,260	1,056,741	809,583
Occupancy	234,310	195,155	709,081	548,817
Advertising	16,305	43,295	91,635	89,109
Furniture and equipment	93,058	85,077	290,818	237,752
Data processing	206,596	154,977	583,407	439,989
Legal services	47,831	52,100	161,278	110,091
Other professional services	284,979	131,353	808,309	291,260

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Merger related expenses	-	196,645	219,417	828,225
Branch consolidation expense	-	-	437,424	-
Deposit insurance premiums	63,571	63,105	251,759	151,970
Foreclosed real estate expense and losses (gains)	(1,578)	3,270	6,530	17,157
Other operating	457,466	459,817	1,367,726	1,114,428
Total noninterest expenses	3,116,852	2,780,652	10,076,606	7,656,549
Income (loss) before income taxes	1,130	106,995	(17,820)	114,969
Income tax (benefit) expense	(58,239)	234,176	(65,466)	324,830
Net income (loss)	\$59,369	\$(127,181)	\$47,646	\$(209,861)
Net income (loss) per common share:				
Basic	\$0.02	\$(0.04)	\$0.01	\$(0.07)
Diluted	\$0.02	\$(0.04)	\$0.01	\$(0.07)

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

Table of Contents**HAMILTON BANCORP, INC. AND SUBSIDIARY****Consolidated Statements of Comprehensive (Loss) Income (Unaudited)****Three and Nine Months Ended December 31, 2016 and 2015**

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2016	2015	2016	2015
Net income (loss)	\$59,369	\$(127,181)	\$47,646	\$(209,861)
Other comprehensive income:				
Unrealized loss on investment securities available for sale	(2,467,108)	(801,265)	(2,380,040)	(716,655)
Reclassification adjustment for realized gain on investment securities available for sale included in net income	(23,720)	(20,497)	(23,720)	(42,212)
Total unrealized loss on investment securities available for sale	(2,490,828)	(821,762)	(2,403,760)	(758,867)
Income tax benefit relating to investment securities available for sale	(982,508)	(324,144)	(948,164)	(299,335)
Other comprehensive income (loss)	(1,508,320)	(497,618)	(1,455,596)	(459,532)
Total comprehensive loss	\$(1,448,951)	\$(624,799)	\$(1,407,950)	\$(669,393)

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

Table of Contents**HAMILTON BANCORP, INC AND SUBSIDIARY****Consolidated Statements of Changes in Shareholders' Equity (Unaudited)****Nine Months Ended December 31, 2016 and 2015**

	Common stock	Additional paid-in capital	Retained earnings	Unearned ESOP shares	Accumulated other comprehensive loss	Total shareholders' equity
Balance March 31, 2015	\$ 34,177	\$30,832,815	\$32,752,071	\$(2,518,040)	\$(301,315)) \$ 60,799,708
Net loss	-	-	(209,861)	-	-	(209,861)
Unrealized loss on available for sale securities, net of tax effect of \$ (299,335)	-	-	-	-	(459,532)	(459,532)
Stock based compensation - options	-	156,907	-	-	-	156,907
Restricted stock - compensation and activity	4	168,995	-	-	-	168,999
ESOP shares allocated for release	-	38,210	-	148,120	-	186,330
Balance December 31, 2015	\$ 34,181	\$31,196,927	\$32,542,210	\$(2,369,920)	\$(760,847)) \$ 60,642,551
Balance March 31, 2016	\$ 34,136	\$31,242,731	\$32,659,455	\$(2,369,920)	\$(21,819)) \$ 61,544,583
Net income	-	-	47,646	-	-	47,646
Unrealized loss on available for sale securities, net of tax effect of \$ (948,164)	-	-	-	-	(1,455,596)	(1,455,596)
Stock based compensation - options	-	156,907	-	-	-	156,907
Stock based compensation - restricted stock	-	169,279	-	-	-	169,279
ESOP shares allocated for release	-	62,951	-	148,120	-	211,071
Balance December 31, 2016	\$ 34,136	\$31,631,868	\$32,707,101	\$(2,221,800)	\$(1,477,415)) \$ 60,673,890

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

Table of Contents**HAMILTON BANCORP, INC. AND SUBSIDIARY****Consolidated Statements of Cash Flows (Unaudited)****Nine Months Ended December 31, 2016 and 2015**

	Nine Months Ended	
	December 31,	2015
	2016	2015
Cash flows from operating activities		
Interest received	\$12,443,330	\$8,379,943
Fees and commissions received	428,385	761,333
Interest paid	(3,005,077)	(1,397,455)
Cash paid to suppliers and employees	(8,881,370)	(7,160,562)
Origination of loans held for sale	(2,397,825)	(4,486,900)
Proceeds from sale of loans held for sale	2,680,322	4,955,978
Increase in deferred tax asset and income tax refundable	(1,479,473)	(204,030)
Net cash (used) provided by operating activities	(211,708)	848,307
Cash flows from investing activities		
Acquisition, net of cash acquired	(11,006,813)	(12,723,871)
Proceeds from sale of securities available for sale	4,273,234	9,985,335
Proceeds from maturing and called securities available for sale, including principal pay downs	24,634,898	14,067,458
Proceeds from sale of certificates of deposit	2,228,273	-
Proceeds from maturing and called certificates of deposit	1,724,000	514,510
Redemption of Federal Home Loan Bank stock	185,000	-
Purchase of investment securities available for sale	(50,585,898)	-
Loans made, net of principal repayments	(1,442,039)	(13,728,071)
Purchase of premises and equipment	(190,682)	(47,219)
Proceeds from sale of premises and equipment	429,177	463,839
Proceeds from sale of foreclosed real estate	-	11,752
Net cash used by investing activities	(29,750,850)	(1,456,267)
Cash flows from financing activities		
Net increase (decrease) in		
Deposits	(15,202,712)	13,308,083
Advances by borrowers for taxes and insurance	32,484	(95,546)
Proceeds from borrowings	-	2,000,000
Payments of borrowings	(4,000,000)	(2,000,000)
Issuance of restricted stock	-	4
Net cash (used) provided by financing activities	(19,170,228)	13,212,541
Net (decrease) increase in cash and cash equivalents	(49,132,786)	12,604,581

Cash and cash equivalents at beginning of period	67,448,536	16,643,888
Cash and cash equivalents at end of period	\$18,315,750	\$29,248,469
Supplemental Disclosures of Cash Flow Information:		
Total cash consideration paid for Fraternity acquisition	\$25,704,871	\$-
Total cash consideration paid for Fairmount acquisition	-	14,192,370
Less cash acquired	14,698,058	1,468,499
Acquisition, net of cash acquired	\$11,006,813	\$12,723,871

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

Table of Contents**HAMILTON BANCORP, INC. AND SUBSIDIARY****Consolidated Statements of Cash Flows (Unaudited)****(Continued)**

	Nine Months Ended	
	December 31,	
	2016	2015
Reconciliation of net income (loss) to net cash (used) provided by operating activities		
Net income (loss)	\$47,646	\$(209,861)
Adjustments to reconcile net income (loss) to net cash provided (used) by operating activities		
Amortization of premiums on securities	600,201	311,204
Amortization of premiums on certificates of deposit	12,927	7,043
Gain on sale of investment securities	(23,720)	(42,212)
Loan discount accretion	(103,330)	25,811
Deposit premium amortization	(455,107)	(52,656)
Borrowing premium amortization	(404,632)	(41,955)
Core deposit intangible asset amortization	89,506	38,620
Premises and equipment depreciation and amortization	251,976	200,092
Loss (gain) on disposal of premises and equipment	11,043	(407,188)
Stock based compensation	326,186	325,902
Provision for loan losses	1,040,006	190,000
ESOP shares allocated for release	211,071	186,330
Decrease (increase) in		
Accrued interest receivable	(533,222)	(161,838)
Loans held for sale	259,450	425,683
Cash surrender value of life insurance	(364,927)	(264,062)
Income taxes refundable and deferred income taxes	(1,544,939)	120,800
Other assets	2,300,101	374,756
Increase (decrease) in		
Accrued interest payable	7,269	3,100
Deferred loan origination fees	55,433	41,263
Other liabilities	(1,994,646)	(222,525)
Net cash (used) provided by operating activities	\$ (211,708)	\$848,307
Noncash investing activity		
Real estate acquired through foreclosure	\$17,205	\$12,560

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

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HAMILTON BANCORP, INC AND SUBSIDIARY

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Notes to Consolidated Financial Statements (Unaudited)

December 31, 2016

Note 1: Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations

Hamilton Bancorp, Inc. (the “Company”) was incorporated on September 7, 2012 to serve as the stock holding company for Hamilton Bank (the “Bank”), a federally chartered savings bank. On October 10, 2012, the Bank converted from a mutual savings bank to a stock savings bank and became the wholly owned subsidiary of the Company. In connection with the conversion, the Company sold 3,703,000 shares of common stock at a price of \$10.00 per share, through which the Company received proceeds of approximately \$35,580,000, net of offering expenses of approximately \$1,450,000. The Bank’s employee stock ownership plan (the “ESOP”) purchased 8.0% of the shares sold in the offering, or 296,240 common shares. The purchase of shares by the ESOP was funded by a loan from the Company. The Company’s common stock began trading on the NASDAQ Capital Market under the trading symbol “HBK” on October 12, 2012.

In accordance with Office of the Comptroller of the Currency (the “OCC”) regulations, upon the completion of the conversion, the Bank restricted retained earnings by establishing a liquidation account. The liquidation account will be maintained for the benefit of eligible account holders who continue to maintain their accounts at the Bank after conversion. The liquidation account will be reduced annually to the extent that eligible account holders have reduced their qualifying deposits. Subsequent increases will not restore an eligible account holder’s interest in the liquidation account. In the event of a complete liquidation of the Bank, and only in such event, each account holder will be entitled to receive a distribution from the liquidation account in an amount proportionate to the adjusted qualifying account balances then held. The Bank may not pay dividends if those dividends would reduce equity capital below the required liquidation account amount.

On May 13, 2016, the Company completed its acquisition of Fraternity Community Bancorp, Inc. (“Fraternity”) through the merger of Fraternity, the parent company of Fraternity Federal Savings and Loan, with and into the Company pursuant to the Agreement and Plan of Merger dated as of October 12, 2015, by and between the Company and Fraternity. As a result of the merger, each shareholder of Fraternity received a cash payment equal to nineteen dollars

and twenty-five cents (\$19.25) for each share of Fraternity common stock, or an aggregate of approximately \$25.7 million. Immediately following the merger of Fraternity into the Company, Fraternity Federal Savings and Loan was merged with and into the Bank, with the Bank as the surviving entity.

On September 11, 2015, the Company completed its acquisition of Fairmount Bancorp, Inc. (“Fairmount”) through the merger of Fairmount, the parent company of Fairmount Bank, with and into the Company pursuant to the Agreement and Plan of Merger dated as of April 15, 2015, by and between the Company and Fairmount. As a result of the merger, each shareholder of Fairmount received a cash payment equal to thirty dollars (\$30.00) for each share of Fairmount common stock, or an aggregate of approximately \$14.2 million. Immediately following the merger of Fairmount into the Company, Fairmount Bank was merged with and into the Bank, with the Bank as the surviving entity.

Hamilton Bancorp is a holding company that operates a community bank with seven branches in the Baltimore-metropolitan area. Its primary deposit products are certificates of deposit and demand, savings, NOW, and money market accounts. Its primary lending products consist of real estate mortgages, along with commercial and consumer loans. Hamilton Bancorp’s primary source of revenue is derived from loans to customers, who are predominately small and middle-market business and middle-income individuals.

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HAMILTON BANCORP, INC AND SUBSIDIARY

Notes to Consolidated Financial Statements (Unaudited)

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial reporting and with instructions for Form 10-Q and Regulation S-X as promulgated by the Securities and Exchange Commission (the “SEC”). Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. In the opinion of management, the preceding unaudited consolidated financial statements contain all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of the financial condition and results of operations for the periods presented. We derived the balances as of March 31, 2016 from audited financial statements. Operating results for the three and nine months ended December 31, 2016 are not necessarily indicative of the results that may be expected for the fiscal year ending March 31, 2017, or any other period. For further information, refer to the consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended March 31, 2016. Certain amounts from prior period financial statements have been reclassified to conform to the current period’s presentation.

Summary of Significant Accounting Policies

The accounting and reporting policies of Hamilton Bancorp, Inc. and Subsidiary (“Hamilton”) conform to GAAP and to general practices in the banking industry. The more significant policies follow:

Principles of Consolidation. The accompanying consolidated financial statements include the accounts of the parent company and its wholly owned subsidiary, Hamilton Bank. All significant intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, deferred income tax valuation allowances, the fair value of investment securities and other temporary impairment of investment securities.

Loans Receivable. The Bank makes mortgage, commercial, and consumer loans to customers. A substantial portion of the loan portfolio is represented by mortgage loans throughout the Baltimore metropolitan area. The ability of the

Bank's debtors to repay their loans is dependent upon the real estate and general economic conditions in this area.

Loans are reported at their outstanding unpaid principal balance adjusted for the allowance for loan loss, premiums on loans acquired, and/or any deferred fees or costs on originated loans. Interest revenue is accrued on the unpaid principal balance. Loan origination fees and the direct costs of underwriting and closing loans are recognized over the life of the related loan as an adjustment to yield using a method that approximates the interest method. Any differences that arise from prepayment will result in a recalculation of the effective yield.

Loans are generally placed on nonaccrual status when they are 90 days past due. Past due status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual status at an earlier date if the collection of principal or interest is considered doubtful. All interest accrued but not collected for loans that are placed on nonaccrual status are reversed against interest revenue. The interest on nonaccrual loans is accounted for on the cash basis method, until the loans qualify for return to accrual status. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and, in management's judgment, future payments are reasonably assured.

Loans are generally placed on nonaccrual status when they are 90 days past due. Past due status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual status at an earlier date if the collection of principal or interest is considered doubtful. All interest accrued but not collected for loans that are placed on nonaccrual status are reversed against interest revenue. The interest on nonaccrual loans is accounted for on the cash basis method, until the loans qualify for return to accrual status. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and, in management's judgment, future payments are reasonably assured.

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HAMILTON BANCORP, INC AND SUBSIDIARY

Notes to Consolidated Financial Statements (Unaudited)

Loans are considered impaired when, based on current information, management considers it unlikely that collection of principal and interest payments will be made according to contractual terms. If collection of principal is evaluated as doubtful, all payments are applied to principal. Impaired loans are measured: (i) at the present value of expected cash flows discounted at the loan's effective interest rate; (ii) at the observable market price; or (iii) at the fair value of the collateral if the loan is collateral dependent. If the measure of the impaired loan is less than the recorded investment in the loan, impairment is recognized through an allocation of the allowance for loan losses and corresponding provision for loan losses. Generally, identified impairments are charged-off against the allowance for loan losses.

Troubled debt restructurings are loans for which Hamilton, for legal or economic reasons related to a debtor's financial difficulties, has granted a concession to the debtor that it otherwise would not have considered. Concessions that result in the categorization of a loan as a troubled debt restructuring include:

Reduction of the stated interest rate;

Extension of the maturity date or dates at a stated interest rate lower than the current market rate for new debt with similar risk;

Reduction of the face amount or maturity amount of the debt as stated in the instrument or other agreement; or

Reduction of accrued interest

Accounting for Certain Loans or Debt Securities Acquired in a Transfer. The loans acquired from the Company's acquisition of Fraternity on May 13, 2016 (see Note 3 "*Acquisitions*") were recorded at fair value at the acquisition date and no separate valuation allowance was established. The initial fair values were determined by management, with the assistance of an independent valuation specialist, based on estimated expected cash flows discounted at appropriate rates. The discount rates were based on market rates for new originations of comparable loans and did not include a separate factor for loan losses as that was included in the estimated cash flows.

Accounting Standards Codification ("ASC") Topic 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality*, applies to loans acquired in a transfer with evidence of deterioration of credit quality for which it is

probable, at acquisition, that the investor will be unable to collect all contractually required payments receivable. If both conditions exist, the Company determines whether to account for each loan individually or whether such loans will be assembled into pools based on common risk characteristics such as credit score, loan type, and origination date.

The Company considered expected prepayments and estimated the total expected cash flows, which included undiscounted expected principal and interest. The excess of that amount over the fair value of the loan is referred to as accretable yield. Accretable yield is recognized as interest income on a constant yield basis over the expected life of the loan. The excess of the contractual cash flows over expected cash flows is referred to as nonaccretable difference and is not accreted into income. Over the life of the loan, the Company continues to estimate expected cash flows. Subsequent decreases in expected cash flows are recognized as impairments in the current period through the allowance for loan losses. Subsequent increases in cash flows to be collected are first used to reverse any existing valuation allowance and any remaining increase are recognized prospectively through an adjustment of the loan's yield over its remaining life.

ASC Topic 310-20, *Nonrefundable Fees and Other Costs*, was applied to loans not considered to have deteriorated credit quality at acquisition. Under ASC Topic 310-20, the difference between the loan's principal balance at the time of purchase and the fair value is recognized as an adjustment of yield over the life of the loan.

Allowance for Loan Losses. The allowance for loan losses represents an amount which, in management's judgment, will be adequate to absorb probable future losses on existing loans. The allowance for loan losses is established, as loan losses are estimated to have occurred, through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Recoveries on previously charged-off loans are credited to the allowance for loan losses.

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HAMILTON BANCORP, INC AND SUBSIDIARY

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The allowance for loan losses is increased by provisions charged to income and reduced by charge-offs, net of recoveries. Management's periodic evaluation of the adequacy of the allowance is based on the Bank's past loan loss experience, known and inherent risks in the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and current economic conditions. The look back period for historical losses consists of reviewing both a 36 and 48 month look back period for net charge-offs. Both of these periods are used individually to develop a range in which the allowance for loan losses should be within.

Management considers a number of factors in estimating the required level of the allowance. These factors include: historical loss experience in the loan portfolios; the levels and trends in past-due and nonaccrual loans; the status of nonaccrual loans and other loans identified as having the potential for further deterioration; credit risk and industry concentrations; trends in loan volume; the effects of any changes in lending policies and procedures or underwriting standards; and a continuing evaluation of the economic environment. Management modified the analysis during the quarter ended September 30, 2016 by keeping our net charge-off history as a percentage of loans, as it pertains to each loan segment, constant across all risk ratings and altering our qualitative factors either up or down based upon the respective risk rating for each loan segment. The change in methodology did not have a material impact on the amount of the allowance for loan and lease losses at September 30, 2016 as compared to the prior methodology.

Accumulated Other Comprehensive Income (Loss). The Bank records unrealized gains and losses on available for sale securities in accumulated other comprehensive income, net of taxes. Unrealized gains and losses on available for sale securities are reclassified into earnings as the gains or losses are realized upon sale of the securities. The credit component of unrealized losses on available for sale securities that are determined to be other-than-temporarily impaired are reclassified into earnings at the time the determination is made.

Stock Based Compensation. Compensation cost is recognized for stock options and restricted stock awards issued to employees and directors, based on the fair value of these awards at the date of grant. A Black-Scholes model is utilized to estimate the fair value of stock options, while the market price of the Company's common stock at the date of grant is used for restricted stock awards. Compensation cost is recognized over the required service period, generally defined as the vesting period. For awards with graded vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award.

Note 2: New Accounting Pronouncements

Recent Accounting Pronouncements

ASU No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments. This update made the following changes that may affect the Company: (1) Debt Prepayment or Debt Extinguishment Costs: Cash payments for debt prepayment or debt extinguishment costs should be classified as cash flows for financing activities. (2) Proceeds from the settlement of Bank-Owned Life Insurance Policies: Cash proceeds received from the settlement of bank-owned life insurance policies should be classified as cash flows from investing activities. The cash payments for premiums on bank-owned policies may be classified as cash flows from investing activities, operating activities, or a combination of investing and operating activities. The amendments in this Update will be effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. The Company does not expect the guidance to have a material impact on its financial statements.

ASU 2016-13, Financial Instruments – Credit Losses. The ASU sets forth a “current expected credit loss” (CECL) model which requires the Company to measure all expected credit losses for financial instruments held at the reporting date based on historical experience, current conditions and reasonable supportable forecasts. This replaces the existing incurred loss model and is applicable to the measurement of credit losses on financial assets measured at amortized cost and applies to some off-balance sheet credit exposures. This ASU is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The Company is currently assessing the impact of the adoption of this ASU on its consolidated financial statements.

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ASU 2016-09, Improvements to Employee share-Based Payment Accounting (Topic 718). This ASU includes provisions intended to simplify various aspects related to how share-based payments are accounted for and presented in the financial statements. Some of the key provisions of this new ASU include: (1) companies will no longer record excess tax benefits and certain tax deficiencies in additional paid-in capital (“APIC”). Instead, they will record all excess tax benefits and tax deficiencies as income tax expense or benefit in the income statement, and APIC pools will be eliminated. The guidance also eliminates the requirement that excess tax benefits be realized before companies can recognize them. In addition, the guidance requires companies to present excess tax benefits as an operating activity on the statement of cash flows rather than as a financing activity; (2) increase the amount an employer can withhold to cover income taxes on awards and still qualify for the exception to liability classification for shares used to satisfy the employer’s statutory income tax withholding obligation. The new guidance will also require an employer to classify the cash paid to a tax authority when shares are withheld to satisfy its statutory income tax withholding obligation as a financing activity on its statement of cash flows (current guidance did not specify how these cash flows should be classified); and (3) permit companies to make an accounting policy election for the impact of forfeitures on the recognition of expense for share-based payment awards. Forfeitures can be estimated, as required today, or recognized when they occur. ASU No. 2016-09 is effective for interim and annual reporting periods beginning after December 15, 2016. Early adoption is permitted, but all of the guidance must be adopted in the same period. The Company is currently evaluating the provisions of ASU No. 2016-09 to determine the potential impact the new standard will have on the Company's Consolidated Financial Statements.

ASU 2016-02, Leases (Topic 842). This ASU guidance requires lessees to recognize lease assets and lease liabilities related to certain operating leases on the balance sheet by lessees and disclose key information about leasing arrangements. This guidance is effective for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years. The Company is currently evaluating this guidance to determine the impact on its consolidated financial statements.

ASU No. 2016-01, Financial Instruments – Recognition and Measurement of Financial Assets and Liabilities. This ASU requires equity investments to be measured at fair value with changes in fair value recognized in net income, excluding equity investments that are consolidated or accounted for under the equity method of accounting. The amendment allows equity investments without readily determinable fair values to be measured at cost minus impairment, with a qualitative assessment required to identify impairment. The amendment also requires public companies to use exit prices to measure the fair value of financial instruments purposes; requiring separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statement; it eliminates the disclosure requirements related to measurement assumptions for the fair value of instruments measured at amortized cost. In addition, for liabilities measured at fair value under the fair value option, to present in other comprehensive income changes in fair value due to changes in instrument specific credit risk. ASU No. 2016-01 is effective for fiscal years beginning after December

15, 2017 and interim periods within those fiscal years. The Company is currently evaluating the impact of adopting the new guidance on its consolidated financial statements.

ASU No. 2015-16, Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period

Adjustments. This update eliminates the requirement to retrospectively adjust the provisional amounts recognized at the acquisition date with a corresponding adjustment to goodwill. These adjustments are required when new information is obtained about facts and circumstances that existed as of the acquisition date that if known, would have affected the measurement of the amounts initially recognized or would have resulted in the recognition of additional assets or liabilities. The update also requires the nature of and reason for the business combination, to be disclosed in the consolidated financial statements. ASU 2015-16 became effective for fiscal years beginning after December 15, 2015, and was not material to the consolidated financial statements. All measurement period adjustments related to the acquisition of Fairmount and Fraternity were recorded in the period in which the adjustments were determined.

ASU 2014-09, Revenue from Contracts with Customers (Topic 606). ASU 2014-09 implements a common revenue standard that clarifies the principles for recognizing revenue. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve that core principle, an entity should apply the following steps: (i) identify the contract(s) with a customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract and (v) recognize revenue when (or as) the entity satisfies a performance obligation. ASU 2014-09 is effective on January 1, 2017 and is not expected to have a significant impact on our financial statements.

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Note 3: Acquisitions**Fraternity Community Bancorp, Inc.**

On May 13, 2016, Hamilton Bancorp acquired Fraternity Community Bancorp, Inc. (“Fraternity”), the parent company of Fraternity Federal Savings and Loan. Under the terms of the Merger Agreement, shareholders of Fraternity received a cash payment equal to nineteen dollars and twenty-five cents (\$19.25) for each share of Fraternity common stock. The total merger consideration was \$25.7 million.

In connection with the acquisition, Fraternity Federal Savings and Loan was merged with and into Hamilton Bank, with Hamilton Bank as the surviving bank. The results of the Fraternity acquisition are included with Hamilton’s results as of and from May 13, 2016.

As required by the acquisition method of accounting, we have adjusted the acquired assets and liabilities of Fraternity to their estimated fair value on the date of acquisition and added them to those of Hamilton Bancorp. Based on management’s preliminary valuation of the fair value of tangible and intangible assets acquired and liabilities assumed, which we have based on level 3 valuation estimates and assumptions that are subject to change, we have allocated the preliminary purchase price for Fraternity as follows:

	As recorded by Fraternity Community Bancorp, Inc.	Fair Value Adjustments	As recorded by Hamilton Bancorp, Inc.
Identifiable assets:			
Cash and cash equivalents	\$15,196,058	\$-	\$15,196,058
Investment securities available for sale	17,570,712	-	17,570,712
FHLB Bank Stock	782,600	-	782,600
Loans	108,872,041	(126,757)A	108,745,284

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Allowance For Loan Loss	(1,550,000)	1,550,000	A	-
Premises and equipment	691,095	78,711	B	769,806
Bank-Owned Life Insurance	5,058,041	-		5,058,041
Deferred income taxes	2,743,481	(410,377)	C	2,333,104
Other assets	2,877,665	-		2,877,665
Total identifiable assets	\$152,241,693	\$1,091,577		\$153,333,270

Identifiable liabilities: