HOPFED BANCORP INC
Form 10-Q
August 08, 2018
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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 June 30, 2018

OR

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

Commission File Number: 000-23667

HOPFED BANCORP, INC.

(Exact name of registrant as specified in its charter)

Delaware	**61-1322555**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
4155 Lafayette Road, Hopkinsville, Kentucky	**42240**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code: (270) 885-1171

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Date File required and posted pursuant to Rule 405 of Regulation S-T (subsection 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated file or a non-accelerated filer. See definition of accelerated filer , large accelerated filer , smaller reporting company and emerging growth company Rule12b-2 of the Exchange Act: (Check one)

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company filer
Emerging growth company	

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of August 8, 2018, the Registrant had outstanding 6,649,493 shares of the Registrant s Common stock, $0.01 par value per share, issued and outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

HOPFED BANCORP, INC.

Interim Consolidated Condensed Statements of Financial Condition

(Dollars in Thousands)

	June 30, 2018 (unaudited)	December 31, 2017
Assets		
Cash and due from banks	$ 16,399	37,965
Interest-bearing deposits in banks	2,955	7,111
Cash and cash equivalents	19,354	45,076
Federal Home Loan Bank stock, at cost	4,428	4,428
Securities available for sale	168,983	184,791
Loans held for sale	1,126	1,539
Loans receivable, net of allowance for loan losses of $4,637 at June 30, 2018 and $4,826 at December 31, 2017	672,254	637,102
Accrued interest receivable	3,253	3,589
Foreclosed assets	3,427	3,369
Bank owned life insurance	10,512	10,368
Premises and equipment, net	22,365	22,700
Deferred tax assets	2,320	1,764
Other assets	4,640	2,784
Total assets	$ 912,662	917,510
Liabilities and Stockholders Equity		
Liabilities:		
Deposits:		
Non-interest-bearing accounts	$ 136,004	136,197
Interest-bearing accounts		
Checking accounts	198,691	208,496
Savings and money market accounts	97,552	104,347
Other time deposits	300,941	304,969
Total deposits	733,188	754,009
Advances from Federal Home Loan Bank	38,000	23,000
Repurchase agreements	39,648	38,353
Subordinated debentures	10,310	10,310

Advances from borrowers for taxes and insurance	1,256	808
Accrued expenses and other liabilities	3,091	3,618
Total liabilities	825,493	830,098

See accompanying Notes to Unaudited Interim Consolidated Condensed Financial Statements.

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HOPFED BANCORP, INC.

Interim Consolidated Condensed Statements of Financial Condition, Continued

(Dollars in Thousands)

	June 30, 2018 (unaudited)	December 31, 2017
Stockholders equity		
Preferred stock, par value $0.01 per share; authorized - 500,000 shares; no shares issued and outstanding at June 30, 2018 and December 31, 2017		
Common stock, par value $.01 per share; authorized 15,000,000 shares; 7,989,655 issued and 6,647,675 outstanding at June 30, 2018 and 7,976,131 issued and 6,637,711 outstanding at December 31, 2017	80	80
Additional paid-in-capital	58,948	58,825
Retained earnings	53,179	51,162
Treasury stock, at cost (1,341,980 shares at June 30, 2018 and 1,338,360 shares at December 31, 2017)	(16,706)	(16,655)
Unearned Employee Stock Ownership Plan (ESOP) shares, at cost (412,091 shares at June 30 2018 and 434,548 share at December 31, 2017)	(5,606)	(5,901)
Accumulated other comprehensive income	(2,726)	(99)
Total stockholders equity	87,169	87,412
Total liabilities and stockholders equity	$ 912,662	917,510

See accompanying Notes to Unaudited Interim Consolidated Condensed Financial Statements.

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HOPFED BANCORP, INC.

Interim Consolidated Condensed Statements of Income

(Dollars in Thousands)

(Unaudited)

	For the Three Month Periods Ended June 30,		For the Six Month Periods Ended June 30,	
	2018	2017	2018	2017
Interest and dividend income:				
Loans	7,858	6,963	15,335	13,699
Investment in securities, taxable	1,033	1,155	2,112	2,273
Nontaxable securities available for sale	208	280	421	563
Interest-bearing deposits	16	21	45	44
Total interest and dividend income	9,115	8,419	17,913	16,579
Interest expense:				
Deposits	1,392	1,197	2,636	2,364
FHLB borrowings	134	30	226	62
Repurchase agreements	171	119	325	222
Subordinated debentures	138	108	260	212
Total interest expense	1,835	1,454	3,447	2,860
Net interest income	7,280	6,965	14,466	13,719
Provision for loan losses	62	59	130	350
Net interest income after provision for loan losses	7,218	6,906	14,336	13,369
Non-interest income:				
Service charges	727	800	1,433	1,604
Merchant card	330	315	638	617
Mortgage origination revenue	489	278	808	612
Gain on sale of investments	481	14	508	16
Income from bank owned life insurance	73	72	144	307
Income from financial services	177	145	315	285
Other operating income	87	212	262	691
Total non-interest income	2,364	1,836	4,108	4,132

See accompanying Notes to Unaudited Interim Consolidated Condensed Financial Statements.

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HOPFED BANCORP, INC.

Interim Consolidated Condensed Statements of Income, Continued

(Dollars in Thousands, Except Per Share Amounts)

(Unaudited)

	For the Three Month Periods Ended June 30, 2018	For the Three Month Periods Ended June 30, 2017	For the Six Month Periods Ended June 30, 2018	For the Six Month Periods Ended June 30, 2017
Non-interest expenses:				
Salaries and benefits	4,116	3,977	8,233	8,213
Occupancy	747	729	1,529	1,504
Data processing	765	546	1,549	1,310
State deposit tax	160	200	329	431
Professional services	499	464	965	812
Advertising	338	368	646	749
Foreclosure, net	21	6	15	114
Loss on sale of asset	9	3	9	3
Other	919	940	1,839	1,786
Total non-interest expense	7,574	7,233	15,114	14,922
Income before income tax expense	2,008	1,509	3,330	2,579
Income tax expense	323	368	519	503
Net income	1,685	1,141	2,811	2,076
Net income per share:				
Basic	$ 0.28	$ 0.18	$ 0.46	$ 0.33
Diluted	$ 0.28	$ 0.18	$ 0.46	$ 0.33
Dividend per share	$ 0.07	$ 0.05	$ 0.12	$ 0.09

See accompanying Notes to Unaudited Interim Consolidated Condensed Financial Statements.

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HOPFED BANCORP, INC.

Interim Consolidated Condensed Statements of Comprehensive Income (Loss)

(Dollars in Thousands)

(Unaudited)

	For the Three Month Periods Ended June 30, 2018	2017	For the Six Month Periods Ended June 30, 2018	2017
Net income	$ 1,685	1,141	2,811	2,076
Other comprehensive income, net of tax:				
Unrealized gain on non-other than temporary impaired investment securities available for sale, net of taxes of of $168 and ($126) for the three month periods ended June 30, 2018 and June 30, 2017, respectively; and $654 and ($247) for the six month periods ended June 30, 2018 and June 30, 2017, respectively.	(629)	240	(2,459)	475
Unrealized gain on OTTI securites, net of taxes of none and ($43) for the three month periods ended June 30, 2018 and June 30, 2017; and ($61) and ($14) for the six month periods ended June 30, 2018 and June 30, 2017, respectively.		83	233	26
Reclassification adjustment for gains included in net net income, net of taxes of $100 and $5 for the three month periods ended June 30, 2018 and June 30, 2017, respectively; and $106 and $6 for the six month periods ended June 30, 2018 and June 30, 2017, respectively.	(380)	(9)	(401)	(10)
Total other comprehensive income	(1,009)	314	(2,627)	491
Comprehensive income	$ 676	1,455	184	2,567

See accompanying Notes to Unaudited Interim Consolidated Condensed Financial Statements.

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HOPFED BANCORP, INC.

Interim Consolidated Condensed Statement of Stockholders Equity

For the Six Month Period Ended June 30, 2018

(Dollars in Thousands, Except Share Amounts)

(Unaudited)

	Common Shares	Common Stock	Additional Paid in Capital	Retained Earnings	Common Treasury Shares	Unearned ESOP Shares	Accumulated Other Comprehensive Income	Total Stockholders Equity
Balance December 31, 2017	6,637,771	$ 80	58,825	51,162	(16,655)	(5,901)	(99)	87,412
Restricted stock awards	13,524							
Net income				2,811				2,811
Repurchase of treasury stock	(3,620)				(51)			(51)
ESOP shares committed to be released						295		295
Change in price of ESOP shares			75					75
Compensation expense, restricted stock awards			48					48
Net change in unrealized gain on securities available for sale, net of income taxes of $699							(2,627)	(2,627)
Cash dividend declared to common shareholders				(794)				(794)
Balance June 30, 2018	6,647,675	$ 80	58,948	53,179	(16,706)	(5,606)	(2,726)	87,169

See accompanying Notes to Unaudited Interim Consolidated Condensed Financial Statements.

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HOPFED BANCORP, INC.

Interim Consolidated Condensed Statements of Cash Flows

(Dollars in Thousands)

(Unaudited)

	For the Six Month Periods Ended June 30, 2018	2017
Cash flows from operating activities:		
Net cash provided by operating activities	$ 4,660	4,662
Cash flows from investing activities:		
Proceeds from sales, calls and maturities of securities available for sale	16,994	27,362
Purchase of securities available for sale	(7,042)	(23,047)
Net increase in loans	(35,207)	(27,474)
Proceeds from sale of foreclosed assets	88	1,136
Proceeds from sale of premises and equipment		
Purchase of premises and equipment	(292)	(251)
Net cash provided by (used in) investing activities	(25,459)	(22,274)
Cash flows from financing activities:		
Net (decrease) increase in demand deposits	(16,793)	7,027
Net (decrease) increase in time and other deposits	(4,028)	6,035
Increase in advances from borrowers for taxes and insurance	448	218
Advances from Federal Home Loan Bank	45,000	32,000
Repayment of advances from Federal Home Loan Bank	(30,000)	(22,000)
Net increase (decrease) in repurchase agreements	1,295	(5,835)
Cash used to repurchase treasury stock	(51)	(14)
Dividends paid on common stock	(794)	(559)
Net cash (used in) provided by financing activities	(4,923)	16,872
Increase (decrease) in cash and cash equivalents	(25,772)	(740)
Cash and cash equivalents, beginning of period	45,076	25,749
Cash and cash equivalents, end of period	$ 19,354	$ 25,009
Supplemental disclosures of cash flow information:		
Interest paid	3,396	2,840
Income taxes paid		388

See accompanying Notes to Unaudited Interim Consolidated Condensed Financial Statements.

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NOTES TO UNAUDITED INTERIM CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(1) BASIS OF PRESENTATION

The accompanying unaudited interim consolidated condensed financial statements include the accounts of HopFed Bancorp, Inc. (the Corporation or HopFed) and its subsidiaries (collectively, the Company). The Corporation is a parent holding company of Heritage Bank USA, Inc. (the Bank). The Banks owns JBMM, LLC, a wholly owned, limited liability company, which owns and manages the Bank s foreclosed assets. The Bank also owns Heritage USA Title, LLC, which sells title insurance to the Bank s real estate loan customers. The Bank owns Fort Webb LP, LLC, which owns a limited partnership interest in Fort Webb Elderly Housing LLLP, a low income senior citizen housing facility in Bowling Green, Kentucky. All significant intercompany accounts have been eliminated.

The Bank is a Kentucky commercial bank regulated by the Kentucky Department of Financial Institutions (KDFI) and the Federal Deposit Insurance Corporation (FDIC). HopFed Bancorp is regulated by the Federal Reserve Bank of Saint Louis (FED).

The accompanying unaudited interim consolidated condensed financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of only normal recurring accruals) necessary for fair presentation have been included. The results of operations and other data for the six month period ended June 30, 2018 are not necessarily indicative of results that may be expected the entire fiscal year ending December 31, 2018.

The accompanying unaudited interim consolidated condensed financial statements should be read in conjunction with the Consolidated Financial Statements and the Notes thereto included in the Company s Annual Report on Form 10-K as of and for the year ended December 31, 2017. The accounting policies followed by the Company are set forth in the Summary of Significant Accounting Policies in the Company s December 31, 2017 Consolidated Financial Statements.

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(2) EARNINGS PER SHARE

Basic earnings per share (EPS) is computed by dividing net income by the weighted average number of common stock shares outstanding. Diluted EPS is computed by dividing net income by the weighted average number of common stock shares outstanding, adjusted for the effect of potentially dilutive stock awards outstanding during the period. For the three and six month periods ended June 30, 2018 and June 30, 2017, the Company has excluded all unearned shares held by the ESOP.

	For the three month periods Ended June 30,	
	2018	2017
Basic EPS:		
Net income	$ 1,685,000	$ 1,141,000
Average common shares outstanding	6,142,680	6,228,894
Earnings per share	$ 0.28	$ 0.18
Diluted EPS		
Net income	$ 1,685,000	$ 1,141,000
Average common shares outstanding	6,142,680	6,228,894
Dilutive effect of unvested restricted stock		
Average diluted shares outstanding	6,142,680	6,228,894
Earnings per share, diluted	$ 0.28	$ 0.18

	For the six month periods Ended June 30,	
	2018	2017
Basic EPS:		
Net income	$ 2,811,000	$ 2,076,000
Average common shares outstanding	6,165,415	6,223,802
Earnings per share	$ 0.46	$ 0.33
Diluted EPS		
Net income	$ 2,811,000	$ 2,076,000
Average common shares outstanding	6,165,415	6,223,802
Dilutive effect of unvested restricted stock		
Average diluted shares outstanding	6,165,415	6,223,802
Earnings per share, diluted	$ 0.46	$ 0.33

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(3) SECURITIES

The carrying amount of securities and their estimated fair values at June 30, 2018 and December 31, 2017 were as follows:

	June 30, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(Dollars in Thousands)			
Restricted:				
FHLB stock	$ 4,428			4,428
Available for sale:				
U.S. Agency securities	$ 77,769	141	(1,756)	76,154
Taxable municipal bonds	962		(7)	955
Tax free municipal bonds	24,555	227	(165)	24,617
Mortgage backed securities	69,147	80	(1,970)	67,257
	$ 172,433	448	(3,898)	168,983

	December 31, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(Dollars in Thousands)			
Restricted:				
FHLB stock	$ 4,428			4,428
Available for sale:				
U.S. Agency securities	84,210	536	(653)	84,093
Taxable municipal bonds	1,279	5	(1)	1,283
Tax free municipal bonds	26,412	637	(83)	26,966
Trust preferred securities	1,650	35		1,685
Mortgage-backed securities	71,389	201	(826)	70,764
	$ 184,940	1,414	(1,563)	184,791

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The scheduled maturities of debt securities available for sale at June 30, 2018 were as follows:

	Amortized Cost	Estimated Fair Value
	(Dollars in Thousands)	
Due within one year	$ 1,570	$ 1,586
Due in one to five years	29,252	28,735
Due in five to ten years	13,297	12,995
Due after ten years	7,252	7,273
	51,371	50,589
Amortizing agency bonds	51,915	51,137
Mortgage-backed securities	69,147	67,257
Total securities available for sale	$ 172,433	$ 168,983

The estimated fair value and unrealized loss amounts of temporarily impaired investments as of June 30, 2018 were as follows:

	Less than 12 months		12 months or longer		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
			(Dollars in Thousands)			
Available for sale						
U.S. Agency securities	$ 45,588	(1,219)	15,434	(537)	61,022	(1,756)
Taxable municipal bonds	955	(7)			955	(7)
Tax free municipal bonds	6,817	(132)	732	(33)	7,549	(165)
Mortgage-backed securities	41,653	(1,103)	20,722	(867)	62,375	(1,790)
Total available for sale	$ 95,013	(2,461)	36,888	(1,437)	131,901	(3,898)

The estimated fair value and unrealized loss amounts of temporarily impaired investments as of December 31, 2017 were as follows:

	Less than 12 months		12 months or longer		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
			(Dollars in Thousands)			
Available for sale						
U.S. Agency securities	$ 41,501	(431)	9,846	(222)	51,347	(653)
Taxable municipal bonds	521	(1)			521	(1)

Tax free municipal bonds	4,860	(51)	913	(32)	5,773	(83)
Mortgage-backed securities	40,441	(289)	21,566	(537)	62,007	(826)
Total available for sale	$ 87,323	(772)	32,325	(791)	119,648	(1,563)

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluations. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

At June 30, 2018, the Company has 103 securities with unrealized losses. The losses for all securities are considered to be a direct result of the effect that the prevailing interest rate environment had on the value of debt securities and are not related to the credit worthiness of the issuers. Furthermore, the Company has the intent and ability to retain its investments in the issuers for a period of time that management believes to be sufficient to allow for any anticipated recovery in fair value. Therefore, the Company did not recognize any other-than-temporary impairments as of June 30, 2018.

At June 30, 2018 and December 31, 2017, securities with a book value of approximately $105.5 million and $119.8 million and a market value of approximately $105.1 million and $118.0 million, respectively, were pledged to various municipalities for deposits in excess of FDIC limits as required by law. At June 30, 2018 and December 31, 2017, securities with a market value of $39.6 million and $38.4 million were sold to customers as part of overnight repurchase agreements.

(4) LOANS

The Company uses the following loan segments as described below:

One-to-four family first mortgages are closed-end loans secured by residential housing. Loans may be either owner or non-owner occupied properties. If the loan is owner-occupied, the loan is analyzed and under-written as a consumer loan. Loan terms may be up to 30 years.

Home equity lines of credit may be first or second mortgages secured by one-to-four family properties. Home equity loans carry a variable rate and typically are open ended for a period not to exceed ten years with a fifteen year final maturity. Loans secured by home equity lines of credit are under-written under the Company s consumer loan guidelines.

Junior liens are closed-end loans secured by one-to-four family residences with a fixed or variable rate. Typically, the collateral for these loans are owner occupied units with a subordinate lien. Loans secured by junior liens are under-written under the Company s consumer loan guidelines.

Multi-family loans are closed-end loans secured by residential housing with five or more units in a single building. Multi-family loans may carry a variable rate of interest or the interest rate on the loan is a fixed rate (usually five years). After the initial fixed rate period, the loan reverts to a variable rate or has balloon maturity. Multi-family loans have amortization terms of up to twenty years and are under-written under the Company s commercial loan underwriting guidelines.

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Constructions loans may consist of residential or commercial properties and carry a fixed or variable rate for the term of the construction period. Construction loans have a maturity of between twelve and twenty-four months depending on the type of property. After the construction period, loans are amortized over a twenty-year period. All construction loans are under written under the Company s commercial loan underwriting guidelines for the type of property being constructed.

Land loans consist of properties currently under development, land held for future development and land held for recreational purposes. Land loans used for recreational purposes are amortized for twenty years and typically carry a fixed rate of interest for one-to-five years with a balloon maturity or floating rate period to follow and are under-written under the Company s commercial loan underwriting guidelines.

Loans classified as farmland by the Company include properties that are used exclusively for the production of grain, livestock, poultry or swine. Loans secured by farmland have a maturity of up to twenty years and carry a fixed rate of interest for five to ten years. Loans secured by farmland are under-written under the Company s commercial loan underwriting guidelines.

Non-residential real estate loans are secured by commercial real estate properties and may be either owner or non-owner occupied. The loans typically have a twenty year maturity and may be fixed for a period of five to ten years. After the initial fixed rate period, the note will either revert to a one year adjustable rate loan or have a balloon maturity. Loans secured by non-residential real estate are under-written under the Company s commercial loan underwriting standards.

The Company originates secured and unsecured consumer loans. Collateral for consumer loans may include deposits, brokerage accounts, automobiles and other personal items. Consumer loans are typically fixed for a term of one to five years and are under-written using the Company s consumer loan policy.

The Company originates unsecured and secured commercial loans. Secured commercial loans may have business inventory, accounts receivable and equipment as collateral. The typical customer may include all forms of manufacturing, retail and wholesale sales, professional services and various forms of agri-business interest. Commercial loans may be fixed or variable rate and typically have terms between one and five years.

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Set forth below is selected data relating to the composition of the loan portfolio by type of loan at June 30, 2018 and December 31, 2017.

	June 30, 2018	December 31, 2017
	(Dollars in Thousands)	
Real estate loans:		
One-to-four family first mortgages	$ 171,725	$ 163,565
Home equity lines of credit	34,262	35,697
Junior liens	1,109	1,184
Multi-family	37,742	37,445
Construction	40,759	30,246
Land	9,033	14,873
Non-residential real estate	244,769	224,952
Farmland	33,271	36,851
Total mortgage loans	572,670	544,813
Consumer loans	8,525	8,620
Commercial loans	96,214	88,938
Total other loans	104,739	97,558
Total loans	677,409	642,371
Deferred loan fees, net of cost	(518)	(443)
Less allowance for loan losses	(4,637)	(4,826)
Total loans, net	$ 672,254	$ 637,102

Although the Company has a diversified loan portfolio, 84.5% and 84.8% of the portfolio was concentrated in loans secured by real estate at June 30, 2018 and December 31, 2017, respectively. At June 30, 2018 and December 31, 2017, the majority of these loans are located within the Company s general operating area.

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Risk Grade Classifications

The Company utilizes a credit grading system that provides a uniform framework for establishing and monitoring credit risk in the loan portfolio. Under this system, each loan is graded based on pre-determined risk metrics and categorized into one of the risk grades discussed below. The Company uses the following risk grade definitions for commercial loans:

Excellent - Loans in this category are to persons or entities of unquestioned financial strength, a highly liquid financial position, with collateral that is liquid and well margined. These borrowers have performed without question on past obligations, and the Bank expects their performance to continue. Internally generated cash flow covers current maturities of long-term debt by a substantial margin. Loans secured by Bank certificates of deposit and savings accounts, with appropriate holds placed on the accounts, are to be rated in this category.

Very Good - These are loans to persons or entities with strong financial condition and above-average liquidity who have previously satisfactorily handled their obligations with the Bank. Collateral securing the Bank s debt is margined in accordance with policy guidelines. Internally generated cash flow covers current maturities of long-term debt more than adequately. Unsecured loans to individuals supported by strong financial statements and on which repayment is satisfactory may be included in this classification.

Satisfactory - Assets of this grade conform to substantially all the Bank s underwriting criteria and evidence an average level of credit risk; however, such assets display more susceptibility to economic, technological or political changes since they lack the above average financial strength of credits rated Very Good. Borrower s repayment capacity is considered to be adequate. Credit is appropriately structured and serviced; payment history is satisfactory.

Acceptable - Assets of this grade conform to most of the Bank s underwriting criteria and evidence an acceptable, though higher than average, level of credit risk; however, these loans have certain risk characteristics which could adversely affect the borrower s ability to repay given material adverse trends. Loans in this category require an above average level of servicing and show more reliance on collateral and guaranties to preclude a loss to the Bank should material adverse trends develop. If the borrower is a company, its earnings, liquidity and capitalization are slightly below average when compared to its peers.

Watch - These loans are characterized by borrowers who have marginal cash flow, marginal profitability, or have experienced an unprofitable year and a declining financial condition. The borrower has in the past satisfactorily handled debts with the Bank, but in recent months has either been late, delinquent in making payments, or made sporadic payments. While the Bank continues to be adequately secured, margins have decreased or are decreasing, despite the borrower s continued satisfactory condition. Other characteristics of borrowers in this class include inadequate credit information, weakness of financial statement and repayment capacity, but with collateral that appears to limit exposure. This classification includes loans to established borrowers that are reasonably margined by collateral, but where potential for improvement in financial capacity appears limited.

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Special Mention - Loans in this category have potential weaknesses that deserve management s close attention. If left uncorrected, these potential weaknesses may result in deteriorating prospects for the asset or in the institution s credit position at some future date. Borrowers may be experiencing adverse operating trends or market conditions. Non-financial reasons for rating a credit exposure Special Mention include, but are not limited to: management problems, pending litigations, ineffective loan agreement and/or inadequate loan documentation, structural weaknesses and/or lack of control over collateral.

Substandard - A substandard asset is inadequately protected by the current sound worth or paying capacity of the debtor or the collateral pledged. There exists one or more well defined weaknesses that jeopardize the liquidation of the debt. There is a distinct possibility the Bank will experience some loss if the deficiencies are not corrected.

Doubtful - A loan classified as doubtful has all the weaknesses inherent in a loan classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. These are poor quality loans in which neither the collateral, if any, nor the financial condition of the borrower presently ensure collectability in full in a reasonable period of time; in fact, there is permanent impairment in the collateral securing the Bank s loan. These loans are in a work-out status and have a defined work-out strategy.

Loss - Loans classified as loss are considered uncollectible and of such little value that their continuance as Bankable assets is not warranted. The Bank takes losses in the period in which they become uncollectible.

The following credit risk standards are assigned to consumer loans:

Satisfactory - All consumer open-end and closed-end retail loans shall have an initial risk grade assigned of 3 - Satisfactory.

Substandard - All consumer open-end and closed-end retail loans past due 90 cumulative days from the contractual date will be classified as 7 - Substandard. If a consumer/retail loan customer files bankruptcy, the loan will be classified as 7 - Substandard regardless of payment history.

Loss - All closed-end retail loans that become past due 120 cumulative days and open-end retail loans that become past due 180 cumulative days from the contractual due date will be charged off as loss assets. The charge off will be taken by the end of the month in which the 120-day or 180-day time period elapses. All losses in retail credit will be recognized when the affiliate becomes aware of the loss, but in no case should the charge off exceed the time frames stated within this policy.

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The following table provides a detail of the Company s activity in the allowance for loan loss account by loan type for the six month period ended June 30, 2018:

	Balance 12/31/2017	Charge offs 2018	Recoveries 2018	Provision 2018	Ending Balance 6/30/2018
	(Dollars in Thousands)				
One-to-four family mortgages	$ 747	(6)	6	147	894
Home equity line of credit	189		5	(33)	161
Junior liens	5				5
Multi-family	314			(26)	288
Construction	161			23	184
Land	1,223	(40)		(581)	602
Non-residential real estate	789		9	539	1,337
Farmland	367	(2)	1	(180)	186
Consumer loans	184	(137)	41	76	164
Commercial loans	847	(200)	4	165	816
Total	$ 4,826	(385)	66	130	4,637

The following table provides a detail of the Company s activity in the allowance for loan loss account by loan type for the year ended December 31, 2017:

	Balance 12/31/2016	Charge offs 2017	Recoveries 2017	Provision 2017	Ending Balance 12/31/2017
	(Dollars in Thousands)				
One-to-four family mortgages	$ 852	(66)	13	(52)	747
Home equity line of credit	260		12	(83)	189
Junior liens	8		4	(7)	5
Multi-family	412		417	(515)	314
Construction	277			(116)	161
Land	1,760	(2,608)	559	1,512	1,223
Non-residential real estate	964		16	(191)	789
Farmland	778		10	(421)	367
Consumer loans	208	(261)	87	150	184
Commercial loans	593	(224)	278	200	847
Total	$ 6,112	(3,159)	1,396	477	4,826

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The table below presents past due and non-accrual balances, excluding loan fees of $518,000, at June 30, 2018 by loan classification allocated between performing and non-performing:

	Currently Performing	30 - 89 Days Past Due	Past due more than 90 days and Accruing	Non-accrual Loans	Special Mention	Substandard	Total
One-to-four family mortgages	$ 169,579	884		367		895	171,725
Home equity line of credit	33,875			347		40	34,262
Junior liens	1,092	13		4			1,109
Multi-family	37,742						37,742
Construction	40,759						40,759
Land	8,535					498	9,033
Non-residential real estate	233,294	366		322	5,317	5,470	244,769
Farmland	33,271						33,271
Consumer loans	8,252	15		6		252	8,525
Commercial loans	91,790	327		556	807	2,734	96,214
Total	$ 658,189	1,605		1,602	6,124	9,889	677,409

The table below presents past due and non-accrual balances, excluding loan fees of $443,000, at December 31, 2017 by loan classification allocated between performing and non-performing:

	Currently Performing	30 - 89 Days Past Due	Past due more than 90 days and Accruing	Non-accrual Loans	Special Mention	Substandard	Total
		(Dollars in Thousands)					
One-to-four family mortgages	$ 162,724	181	88	266		306	163,565
Home equity line of credit	35,285			402		10	35,697
Junior liens	1,180			4			1,184
Multi-family	37,445						37,445
Construction	30,246						30,246
Land	14,322			40		511	14,873
Non-residential real estate	216,692	209			979	7,072	224,952
Farmland	35,253			111	1,147	340	36,851
Consumer loans	8,373	3		3		241	8,620
Commercial loans	83,892			459	3,572	1,015	88,938
Total	$ 625,412	393	88	1,285	5,698	9,495	642,371

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The following table presents the balance in the allowance for loan losses and the recorded investment in loans as of June 30, 2018 and December 31, 2017 by portfolio segment and based on the impairment method.

	Commercial	Land Development / Construction	Commercial Real Estate	Residential Real Estate	Consumer	Total
			(Dollars in Thousands)			
June 30, 2018:						
Allowance for loan losses:						
Ending allowance balance attributable to loans:						
Individually evaluated for impairment	$ 162				62	$ 224
Collectively evaluated for impairment	654	786	1,811	1,060	102	4,413
Total ending allowance balance	$ 816	786	1,181	1,060	164	$ 4,637
Loans:						
Loans individually evaluated for impairment	$ 3,019	498	5,394	277	247	$ 9,435
Loans collectively evaluated for impairment	93,195	49,294	310,388	206,819	8,278	$ 667,974
Total ending loans balance	$ 96,214	49,792	315,782	207,096	8,525	$ 677,409

	Commercial	Land Development / Construction	Commercial Real Estate	Residential Real Estate	Consumer	Total
			(Dollars in Thousands)			
December 31, 2017:						
Allowance for loan losses:						
Ending allowance balance attributable to loans:						
Individually evaluated for impairment	$ 233		2		54	$ 289
Collectively evaluated for impairment	614	1,384	1,468	941	130	$ 4,537
Total ending allowance balance	$ 847	1,384	1,470	941	184	$ 4,826
Loans:						
Loans individually evaluated for impairment	$ 1,416	515	7,532	257	217	$ 9,937
Loans collectively evaluated for impairment	87,522	44,604	291,716	200,189	8,403	$ 632,434
Total ending loans balance	$ 88,938	45,119	299,248	200,446	8,620	$ 642,371

The determination of the allowance for loan losses is based on management s analysis, performed on a quarterly basis. Various factors are considered, including the growth and composition of the loan portfolio, the relationship of the allowance for loan losses to outstanding loans, historical loss experience, delinquency trends and prevailing economic conditions and the market value of the underlying collateral. Although management believes its allowance for loan losses is adequate, there can be no assurance that additional allowances will not be required or that losses on loans will not be incurred.

A loan is considered to be impaired when management determines that it is probable that the Company will be unable to collect all principal and interest payments due in accordance with the contractual terms of the loan agreement. The value of individually impaired loans is measured based on the present value of expected payments or using the fair value of the collateral less cost to sell if the loan is collateral dependent. Currently, it is management s practice to classify all substandard or doubtful loans as impaired.

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Loans by classification type and credit risk indicator at June 30, 2018 and December 31, 2017 were as follows:

June 30, 2018	Pass	Special Mention	Substandard	Doubtful	Total
		(Dollars in Thousands)			
One-to-four family mortgages	$ 170,463		1,262		171,725
Home equity line of credit	33,875		387		34,262
Junior liens	1,105		4		1,109
Multi-family	37,742				37,742
Construction	40,759				40,759
Land	8,535		498		9,033
Non-residential real estate	233,660	5,317	5,792		244,769
Farmland	33,271				33,271
Consumer loans	8,267		258		8,525
Commercial loans	92,117	807	3,290		96,214
Total	$ 659,794	6,124	11,491		677,409

December 31, 2017	Pass	Special Mention	Substandard	Doubtful	Total
		(Dollars in Thousands)			
One-to-four family mortgages	$ 162,993		572		163,565
Home equity line of credit	35,285		412		35,697
Junior liens	1,184				1,184
Multi-family	37,445				37,445
Construction	30,246				30,246
Land	14,318		555		14,873
Non-residential real estate	216,901	979	7,072		224,952
Farmland	35,253	1,147	451		36,851
Consumer loans	8,376		244		8,620
Commercial loans	83,892	3,572	1,474		88,938
Total	$ 625,893	5,698	10,780		642,371

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Impaired loans by classification type and the related valuation allowance amounts at June 30, 2018 were as follows:

	At June 30, 2018			For the six month period ended June 30, 2018	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
	(Dollars in Thousands)				
Impaired loans with no specific allowance					
One-to-four family mortgages	$ 1,262	1,262		843	31
Home equity line of credit	387	387		314	11
Junior liens	4	4		3	
Multi-family					
Construction					
Land	498	498		519	15
Non-residential real estate	5,792	5,792		6,722	150
Farmland				278	
Consumer loans	11	11		5	
Commercial loans	3,079	3,079		2,650	86
Total	$ 11,033	11,033		11,334	293
Impaired loans with a specific allowance					
One-to-four family mortgages	$				
Home equity line of credit					
Junior liens					
Multi-family					
Construction					
Land					
Non-residential real estate				1	
Farmland					
Consumer loans	247	247	62	299	
Commercial loans	211	411	162	297	12
Total	458	658	224	597	
Total	$ 11,491	11,691	224	11,931	305

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Impaired loans by classification type and the related valuation allowance amounts at December 31, 2017 were as follows:

	At December 31, 2017			For the year ended December 31, 2017	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
	(Dollars in Thousands)				
Impaired loans with no specific allowance					
One-to-four family mortgages	$ 257	257		1,235	35
Home equity line of credit				447	26
Junior liens				6	
Multi-family				1,135	
Construction					
Land	515	515		837	44
Non-residential real estate	7,086	7,086		8,979	395
Farmland	444	444		1,094	35
Consumer loans				8	2
Commercial loans	875	875		1,571	46
Total	9,177	9,177		15,312	583
Impaired loans with a specific allowance					
One-to-four family mortgages					
Home equity line of credit					
Junior liens					
Multi-family					
Construction					
Land				4,006	
Non-residential real estate	2	2	2	88	2
Farmland				195	
Consumer loans	217	217	54	248	
Commercial loans	541	541	233	479	13
Total	760	760	289	5,016	15
Total impaired loans	$ 9,937	9,937	289	20,328	598

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At June 30, 2018, all non-accrual loans with the exception of $4,000 in junior loans are classified as substandard. At June 30, 2018, the Company is not obligated to lend additional funds to borrowers who have been placed in non-accrual status. There are no loans accruing interest that are past due more than 90 days at June 30, 2018. At December 31, 2017, there was one loan, totaling $88,000 that was past due more than 90 days and accruing interest. At June 30, 2018 and December 31, 2017, the Company s balances in non-accrual loans by loan type is as follows:

	June 30, 2018	December 31, 2017
	(Dollars in Thousands)	
One-to-four family mortgages	367	266
Home equity line of credit	347	402
Junior Lien	4	4
Land		40
Non-residential real estate	322	
Farmland		111
Consumer loans	6	3
Commercial loans	556	459
Total non-accrual loans	1,602	1,285
Non-accrual loans / Total loans	0.24%	0.20%

The following table provides the number of loans remaining in each category as of June 30, 2018 and December 31, 2017 that the Company had previously modified in a TDR:

	Number of Loans	Pre-Modification Outstanding Record Investment	Post Modification Outstanding Record Investment, net of related allowance
June 30, 2018			
Non-residential real estate	2	$ 3,162,197	3,162,197
Commercial	1	90,327	90,327
December 31, 2017			
Non-residential real estate	2	3,163,435	3,163,435

In the six month period ended June 30, 2018, the Company identified one additional commercial loan as a TDR. The loan is secured by equipment and inventory. The TDR classification is the result of the borrower s declining financial condition, prompting the Company to lengthen the amortization period of the loan to twelve years. The length of the current amortization period is outside of our loan policy and results in a TDR classification. The loan has a one year balloon feature and the borrower s financial condition will be re-evaluated at that time. There were no loans as of June 30, 2018 that have been modified as TDRs and that subsequently defaulted within twelve months on their modified terms. At June 30, 2018, there are no commitments to lend additional funds to any borrower whose loan terms have been modified in a TDR.

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(5) FORECLOSED ASSETS

The Company s foreclosed assets have been acquired through customer loan defaults. The property is recorded at the lower of cost or fair value less estimated cost to sell and carrying cost at the date acquired. Any difference between the book value and estimated market value is recognized as a charge off through the allowance for loan loss account. Additional losses on foreclosed assets may be determined on individual properties at specific intervals or at the time of disposal. In general, the Company will obtain a new appraisal on all foreclosed assets with a book balance in excess of $250,000 on an annual basis. Additional losses are recognized as a non-interest expense.

For the six month period ended June 30, 2018, the Company s activity in foreclosed property included the following:

		Activity During 2018				
	Balance 12/31/2017	Foreclosure	Sales	Reduction in Values	Gain (Loss) on Sale	Balance 6/30/2018
			(Dollars in Thousands)			
One-to-four family mortgages	$ 169	130	(88)		16	$ 227
Land	3,200					3,200
Total	$ 3,369	130	(88)		16	$ 3,427

The Company s activity in foreclosed assets for the twelve month period ended December 31, 2017 is as follows:

		Activity During 2017				
	Balance 12/31/2016	Foreclosure	Sales	Reduction in Values	Gain (Loss) on Sale	Balance 12/31/2017
		(Dollars in Thousands)				
One-to-four family mortgages	$ 135	1,069	(1,182)		147	$ 169
HELOC	28		(18)	(10)		
Land		3,200				3,200
Multi-family	1,775		(1,761)		(14)	
Non-residential	459	43	(500)		(2)	
Total	$ 2,397	4,312	(3,461)	(10)	131	$ 3,369

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(6) FAIR VALUE OF ASSETS AND LIABILITIES

Accounting Standards Codification Topic (ASC) 820*, Fair Value Measurements,* defines fair value, establishes a framework for measuring fair value and expands disclosure about fair value. The statement establishes a fair value hierarchy which requires an entity to maximize the use of observable input 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 is for assets and liabilities that management has obtained quoted prices (unadjusted for transaction cost) or identical assets or liabilities in active markets that the Company has the ability to access as of the measurement date.

Level 2 is for assets and liabilities in which significant unobservable inputs other than Level 1 prices such as quoted prices for similar assets and 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 is for assets and liabilities in which 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.

The following are the significant methods and assumptions used by the Company in estimating its fair value disclosures for financial instruments:

Cash and due from banks

The carrying amounts reported in the consolidated balance sheets for cash and cash equivalents approximate those assets fair values, because they mature within 90 days or less and do not present credit risk concerns.

Interest-bearing deposits in banks

The carrying amounts reported in the consolidated balance sheets for interest earning deposits approximate those assets fair values, because they are considered overnight deposits and may be withdrawn at any time without penalty and do not present credit risk concerns.

Available-for-sale securities

Fair values for investment securities available-for-sale are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments provided by a third-party pricing service. The Company reviews all securities in which the book value is greater than the market value for impairment that is other than temporary. For securities deemed to be other than temporarily impaired, the Company reduces the book value of the security to its market value by recognizing an impairment charge on its income statement.

FHLB stock

The fair value of FHLB stock is recognized at cost.

Loans held for sale

Mortgage loans originated and intended to be sold are carried at the lower of cost or estimated fair value as determined on a loan by loan basis. Gains or losses are recognized at the time of ownership transfer. Net unrealized losses, if any, are recognized through a valuation allowance and charged to income.

Loans receivable

The fair values of fixed-rate loans and variable rate loans that re-price on an infrequent basis is estimated using discounted cash flow analysis which considers future re-pricing dates and estimated repayment dates, and further using interest rates currently being offered for loans of similar type, terms to borrowers of similar credit quality. Loan fair value estimates include judgments regarding future expected loss experience and risk characteristics. The estimated fair value of variable-rate loans that re-price frequently and have no significant change in credit risk is approximately the carrying value of the loan.

Accrued interest receivable

Fair value is estimated to approximate the carrying amount because such amounts are expected to be received within 90 days or less and any credit concerns have been previously considered in the carrying value.

Deposits

The fair values disclosed for deposits with no stated maturity such as demand deposits, interest-bearing checking accounts and savings accounts are, by definition, equal to the amount payable on demand at the reporting date (that is, their carrying amounts). The fair values for certificates of deposit and other fixed maturity time deposits are estimated using a discounted cash flow calculation that applies interest rates currently being offered on such type accounts or similar accounts to a schedule of aggregated contractual maturities or similar maturities on such time deposits.

Advances from borrowers for taxes and insurance

The carrying amount of advances from borrowers for taxes and insurance approximates its fair value.

Advances from the Federal Home Loan Bank (FHLB)

The fair value of these advances is estimated by discounting the future cash flows of these advances using the current rates at which similar advances or similar financial instruments could be obtained.

Repurchase agreements

Overnight repurchase agreements have a fair value at book, given that they mature overnight. The fair values of longer date repurchase agreements is estimated using discounted cash flow analysis which considers the current market pricing for repurchase agreements of similar final maturities and collateral requirements.

Subordinated debentures

The book value of subordinated debentures is cost. The subordinated debentures re-price quarterly at a rate equal to three month libor plus 3.10%.

Fair Value Measurements on a Recurring Basis

Where quoted prices are available for identical securities in an active market, securities available for sale are classified within Level 1 of the valuation hierarchy. Level 1 securities include highly liquid government securities and certain other financial products. If quoted market prices are not available, then fair values are estimated by using pricing models that use observable inputs or quoted prices of securities with similar characteristics and are classified within

Level 2 of the valuation hierarchy. In certain cases where there is limited activity or less transparency around inputs to the valuation and more complex pricing models or discounted cash flows are used, securities are classified within Level 3 of the valuation hierarchy.

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Assets and Liabilities Measured on a Recurring Basis

The assets and liabilities measured at fair value on a recurring basis at June 30, 2018 are summarized below:

Description	Total carrying value in the consolidated balance sheet at 6/30/2018	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		(Dollars in Thousands)		
Securities available for sale				
U.S. Agency securities	$ 76,154		76,154	
Taxable municipals	955		954	
Tax-free municipals	24,617		24,617	
Mortgage backed securities	67,257		67,257	
Total	$ 168,983		168,983	

The assets and liabilities measured at fair value on a recurring basis at December 31, 2017 are summarized below:

Description	Total carrying value in the consolidated balance sheet at 12/31/2017	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		(Dollars in Thousands)		
Securities available for sale				
U.S. Agency securities	84,093		84,093	
Taxable municipals	1,283		1,283	
Tax-free municipals	26,966		26,966	
Trust preferred securities	1,685			1,685
Mortgage backed securities	70,764		70,764	
Total	$ 184,791		183,106	1,685

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The assets and liabilities measured at fair value on a non-recurring basis are summarized below for June 30, 2018:

Description	Total carrying value in the consolidated balance sheet at June 30, 2018	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets	(Dollars in Thousands)			
Foreclosed assets	$ 3,427			$ 3,427
Impaired loans, net of allowance of $224	$ 234			$ 234

The assets and liabilities measured at fair value on a non-recurring basis are summarized below for December 31, 2017:

Description	Total carrying value in the consolidated balance sheet at December 31, 2017	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets	(Dollars in Thousands)			
Foreclosed assets	$ 3,369			$ 3,369
Impaired loans, net of allowance of $289	$ 473			$ 473

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The following table presents quantitative information about level 3 fair value measurements for assets measured at fair value on a recurring and non-recurring basis at June 30, 2018 and December 31, 2017:

		Level 3 Significant Unobservable Input Assumptions		
	Fair Value	Valuation Technique	Unobservable Input	Quantitative Range of Unobservable Inputs
		(Dollars in Thousands)		
June 30, 2018				
Assets measured on a non-recurring basis				
Foreclosed assets	$ 3,427	Discount to appraised value of collateral. Auction results	Appraisal comparability adjustments	5% to 10%
Impaired loans	458	Discount to appraised value of collateral	Appraisal comparability adjustments	10% to 25%
Asset measured on a recurring basis				
December 31, 2017				
Assets measured on a non-recurring basis				
Foreclosed assets	$ 3,369	Discount to appraised value of collateral	Appraisal comparability adjustments	30% to 55%
Impaired loans	760	Discount to appraised value of collateral	Appraisal comparability adjustments	10% to 15%
Asset measured on a recurring basis				
Trust preferred securities	1,685	Discounted cash flow Spread to Libor swap curve	Compare to quotes for sale when available	One month libor 4% to 6%

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The estimated fair values of financial instruments were as follows at June 30, 2018:

	Carrying Amount	Estimated Fair Value	In Active Markets for Identical Assets Level 1	Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
			(Dollars in Thousands)		
Financial Assets:					
Cash and due from banks	$ 16,399	16,399	16,399		
Interest-bearing deposits	2,955	2,955	2,955		
Securities available for sale	168,983	168,983		168,983	
Federal Home Loan Bank stock	4,428	4,428			4,428
Loans held for sale	1,126	1,126		1,126	
Loans receivable	676,891	641,814			641,814
Accrued interest receivable	3,253	3,253			3,253
Financial liabilities:					
Deposits	733,188	733,317		733,317	
Advances from borrowers for taxes and insurance	1,256	1,256		1,256	
Advances from Federal Home Loan Bank	38,000	37,790		37,790	
Repurchase agreements	39,648	39,648		39,648	
Subordinated debentures	10,310	10,310			10,310

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The estimated fair values of financial instruments were as follows at December 31, 2017:

	Carrying Amount	Estimated Fair Value	Quoted Prices In Active Markets for Identical Assets Level 1	Using Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
	(Dollars in Thousands)				
Financial Assets:					
Cash and due from banks	$ 21,779	21,779	21,779		
Interest-bearing deposits	3,970	3,970	3,970		
Securities available for sale	209,480	209,480	2,001	205,662	1,817
Federal Home Loan Bank stock	4,428	4,428			4,428
Loans held for sale	1,094	1,094		1,094	
Loans receivable	604,286	593,257			593,257
Accrued interest receivable	3,799	3,799			3,799
Financial liabilities:					
Deposits	732,882	732,942		732,942	
Advances from borrowers for taxes and insurance	766	766		766	
Advances from Federal Home Loan Bank	11,000	10,979		10,979	
Repurchase agreements	47,655	47,655		47,655	
Subordinated debentures	10,310	10,099			10,099

(7) EFFECT OF NEW ACCOUNTING PRONOUNCEMENTS

In May 2014, the FASB issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers*. This guidance supersedes the revenue recognition requirements in ASC Topic 605, *Revenue Recognition*, and most industry-specific guidance throughout the ASC. The guidance requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. This guidance is effective for interim and annual reporting periods beginning after December 15, 2016; however, the FASB deferred the effective date reporting periods beginning after December 15, 2017. The implementation of ASC Topic 605 did not have a material impact on the Company s Consolidated Financial Statements.

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ASU 2016-01, Financial Instruments Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. ASU 2016-01, among other things, (i) requires equity investments, with certain exceptions, to be measured at fair value with changes in fair value recognized in net income, (ii) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment, (iii) eliminates the requirement for public business entities to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet, (iv) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes, (v) requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments, (vi) requires 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 statements and (vii) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale. ASU 2016-01 was effective on January 1, 2018 and did not have a material effect on the Company s Consolidated Financial Statements.

ASU 2016-02, *Leases (Topic 842).* ASU 2016-02 will, among other things, require lessees to recognize a lease liability, which is a lessee s obligation to make lease payments arising from a lease, measured on a discounted basis; and a right-of-use asset, which is an asset that represents the lessee s right to use, or control the use of, a specified asset for the lease term. ASU 2016-02 does not significantly change lease accounting requirements applicable to lessors; however, certain changes were made to align, where necessary, lessor accounting with the lessee accounting model and ASC Topic 606, Revenue from Contracts with Customers. ASU 2016-02 will be effective for us on January 1, 2019, and will require transition using a modified retrospective approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. We are currently evaluating the potential impact of ASU 2016-02 on the Company s Consolidated Financial Statements.

ASU 2016-09, Compensation Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. Under ASU 2016-09 all excess tax benefits and tax deficiencies related to share-based payment awards should be recognized as income tax expense or benefit in the income statement during the period in which they occur. Previously, such amounts were recorded in the pool of excess tax benefits included in additional paid-in capital, if such pool was available. Because excess tax benefits are no longer recognized in additional paid-in capital, the assumed proceeds from applying the treasury stock method when computing earnings per share should exclude the amount of excess tax benefits that would have previously been recognized in additional paid-in capital. Additionally, excess tax benefits should be classified along with other income tax cash flows as an operating activity rather than a financing activity, as was previously the case. ASU 2016-09 also provides that an entity can make an entity-wide accounting policy election to either estimate the number of awards that are expected to vest (current GAAP) or account for forfeitures when they occur. ASU 2016-09 changes the threshold to qualify for equity classification (rather than as a liability) to permit withholding up to the maximum statutory tax rates (rather than the minimum as was previously the case) in the applicable jurisdictions. ASU 2016-09 was effective on January 1, 2017. The implementation of ASU 2016-09 did not have a material effect on the Company s Consolidated Financial Statements.

On June 16, 2016, the FASB released its finalized ASU 2016-13, *Financial Instruments Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments* . The amendments to U.S. GAAP require businesses and other organization to measure the expected credit losses on financial assets, such as loans, securities, bond insurance, and many receivables, the FASB said. The accounting changes apply to instruments recorded on balance sheets at their historical cost, although there are some limited changes to the accounting for debt instruments classified as available-for-sale. The accounting board added that the write-downs will be based on historical information, current business conditions, and forecasts, and it expects the forecasts to improve the loss estimates on financial assets that are losing value. The board also said the techniques that are employed today to write down loans and other instruments can still be used, although it expects the variables for calculating the losses to change. ASU 2016-13 will become effective for fiscal years beginning after December 15, 2020, and interim periods within fiscal years beginning after December 15, 2021. Companies are permitted to adopt ASU 2016-13 in fiscal years beginning after December 15, 2018. The Company is currently evaluating the potential impact of ASU 2016-13.

ASU 2016-15 *Statement of Cash Flows (Topic 230)* (ASU 2016-15) is intended to reduce the diversity in practice around how certain transactions are classified within the statement of cash flows. ASU 2016-15 is effective for public companies for annual periods beginning after December 15, 2017 including interim periods within those fiscal years. Early adoption is permitted with retrospective application. The application of ASU 2016-15 did not have a material impact on the Company s Consolidated Financial Statements.

In January 2017, the FASB issued ASU 2017-01, Business Combinations (Topic 805): Clarifying the Definition of a Business, (ASU 2017-01) to improve such definition and, as a result, assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or as business combinations. The definition of a business impacts many areas of accounting including acquisitions, disposals, goodwill and consolidation. ASU 2017-01 was effective for the Company on January 1, 2018 and is to be applied under a prospective approach. The Company expects the adoption of this new guidance to impact the determination of whether future acquisitions are considered business combinations.

ASU 2017-08, *Receivables Nonrefundable Fees and Other Cost (Topic 310)* amends the amortization period for certain purchased callable debt securities held at a premium. Prior to the issuance of this guidance, premiums were amortized as an adjustment of yield over the contractual life of instrument. ASU 2017-08 premiums on purchased callable debt securities that have an explicit, non-contingent call features that are callable at fixed prices to be amortized to the earliest call date. There are no accounting changes for securities held at a discount. This ASU is effective for annual periods and interim periods within those annual periods beginning after December 15, 2018 and early adoption is permitted. The adoption of ASU 2017-08 is not expected to have a material impact on the Company s Consolidated Financial Statements.

In January 2017, the FASB issued ASU 2017-01, Business Combinations (Topic 805): Clarifying the Definition of a Business, (ASU 2017-01) to improve such definition and, as a result, assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or as business combinations. The definition of a business impacts many areas of accounting including acquisitions, disposals, goodwill and consolidation. ASU 2017-01 was effective for the Company on January 1, 2018 and is to be applied under a prospective approach. The Company expects the adoption of this new guidance to impact the determination of whether future acquisitions are considered business combinations.

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ASU 2017-09 *Compensation Stock Compensation (Topic 718)* clarifies when changes to the terms or conditions of a share-based payment must be accounted for as modifications. Under AUS 2017-09, an entity should account for changes to the terms or conditions of a share-based payment unless all of the following are met:

The fair value of the modified award is the same as the fair value of the original award immediately before modification,

The vesting conditions of the modified award is the same as the vesting conditions value of the original award immediately before modification, and

The classification of the modified award as an equity instrument or a liability instrument is the same as the classification of the original award immediately before modification.

ASU 2017-09 was effective for the Company on January 1, 2018 and did not have a material impact on our consolidated financial statements.

ASU 2017-12 *Derivatives and Hedging (Topic 815)* amends the hedge accounting recognition and presentation requirements in ASC 815 to improve the transparency and understandability of information convey to financial statement users about an entity s risk management activities to better align the entity s financial reporting for hedging relationships with those risk management activities and to reduce the complexity of and simplify the application of hedge accounting. ASU 2017-12 will be effective for the Company on January 1, 2019 and is not expected to have a significant impact on the Company s Consolidated Financial Statements.

ASU 2018-02, Income Statement-Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. Issued in February 2018, ASU 2018-02 seeks to help entities reclassify certain stranded income tax effects in accumulated other comprehensive income resulting from the Tax Cuts and Jobs Act of 2017 (Tax Reform Act), enacted on December 22, 2017. ASU 2018-02 was issued in response to concerns regarding current guidance in GAAP that requires deferred tax liabilities and assets to be adjusted for the effect of a change in tax laws or rates with the effect included in income from continuing operations in the reporting period that includes the enactment date, even in situations in which the related income tax effects of items in accumulated other comprehensive income were originally recognized in other comprehensive income, rather than net income, and as a result the stranded tax effects would not reflect the appropriate tax rate. The amendments of ASU 2018-02 allow an entity to make a reclassification from accumulated other comprehensive income to retained earnings for the stranded tax effects, which is the difference between the historical corporate income tax rate of 35.0% and the newly enacted corporate income tax rate of 21.0%. ASU 2018-02 is effective for fiscal years, and interim periods within those years, beginning after December 31, 2018; however, public business entities are allowed to early adopt the amendments of ASU 2018-02 in any interim period for which the financial statements have not yet been issued. The amendments of ASU 2018-02 may be applied either at the beginning of the period (annual or interim) of adoption or retrospectively to each of the period(s) in which the effect of the change in the U.S. federal corporate tax rate in the Tax Reform Act is recognized. The Company is currently reviewing the impact of the adoption of ASU 2018-02 on its Consolidated Financial Statements.

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies are not expected to have a material impact on the Company s financial position, results of operations or cash flows.

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(8) INCOME TAXES

The Company files consolidated federal income tax returns and Tennessee excise tax returns. The Company files consolidated Kentucky income tax returns. The Bank is exempt from Kentucky corporate income tax. The Company has no unrecognized tax benefits and has accrued any interest or penalties for uncertain tax positions. The Company s effective tax rate changed from 34% to 21% effective January 1, 2018 as a result of the Tax Cut and Jobs Act of 2017. The effective tax rate differs from the statutory federal rate of 21% and Tennessee excise rate of 6.5% due to investments in qualified municipal securities, bank owned life insurance, income apportioned to Kentucky and certain non-deductible expenses. The Company s effective federal income tax rate varies significantly from our federal statutory tax rate for a variety of factors, including:

The Company s investment in Fort Webb LP, LLC generates tax credits and depreciation expense that the Company can use to offset taxable income. At June 30, 2018, the Company s balance sheet did not include any equity investment in Fort Webb. The Company has other investments that produce both tax credits and depreciation expense that may be used to offset net income.

At June 30, 2018, the Company has $10.5 million in Bank owned life insurance policies. The income generated from these policies increase the cash flow of the policies on a tax free basis. Life insurance proceeds are paid upon the death of a covered party. These proceeds, netted against the current cash value of the policy, result in tax free income to the Company. At June 30, 2018, the Company s investment portfolio includes $24.6 million of tax free municipal securities. Interest income on this portfolio, after netting out a disallowance for interest expense attributable to this portfolio, is tax exempt.

(9) ESOP

Substantially all of the Company s employees who are at least 21 years old and have one year of employment with the Company participate in the 2015 HopFed Bancorp, Inc. Employee Stock Ownership Plan (ESOP). The ESOP purchased 600,000 shares of the Company s common stock from the Company on March 2, 2015 at $13.14 per share. The ESOP borrowed $7.9 million from an open-end line of credit from the Company for the purchase of the stock, using the 600,000 shares of common stock as collateral. The Company makes discretionary contributions to the ESOP. The ESOP utilizes these contributions along with the dividends on unearned shares held by the ESOP to repay the loan from the Company. When loan payments are made, ESOP shares are released based on reductions in the principal balance of the loan. The shares are allocated to participants based on relative compensation.

Employees who are not employed on December 31st of each year are not eligible for participation in the ESOP. The Company anticipates that loan payments will be made at the end of each year. Participants receive shares at the end of employment. The Company has the option to repurchase the shares or provide the shares directly to the employee. At June 30, 2018, a total of 2,033 shares have been withdrawn from the plan as a result of former employees making direct common share withdrawals from the plan.

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The Company made its third ESOP loan payment in December 2017. At June 30, 2018 and December 31, 2017, shares held by the ESOP were as follows:

	June 30, 2018	December 31, 2017
Accrued for allocation to participants	22,457	
Earned ESOP shares	165,686	165,686
Shares withdrawn by former participants	(2,033)	
Unearned ESOP shares	412,091	434,548
Total ESOP shares	598,201	600,234
Fair value of unearned shares	$ 6,832,469	$ 6,127,127

(10) COMMITMENTS AND CONTINGENCIES
At June 30, 2018, the Bank had $32.5 million in outstanding commitments on revolving home equity lines of credit, $17.2 million in outstanding commitments on revolving personal lines of credit and $42.3 million in commitments to originate loans and undisbursed commitments on commercial lines of credit of $69.1 million. At June 30, 2018, the Company had $381,000 in standby letters of credit outstanding.

At June 30, 2018, the Company has $36.4 million in times deposits greater than $100,000 but less than $250,000 that are schedule to mature in one year and $60.4 million in time deposits with balances equal to or greater than $250,000 that are scheduled to mature in one year or less. Management believes that a significant percentage of such deposits will remain with the Bank.

The Bank s FHLB borrowings are secured by a blanket security agreement pledging the Bank s 1-4 family first mortgage loans and non-residential real estate loans. At June 30, 2018 and December 31, 2017, the Bank has pledged all eligible 1-4 family first mortgages. At June 30, 2018 and December 31, 2017, the Bank has outstanding borrowings of $38.0 million and $23.0 million from the FHLB. A schedule of FHLB borrowings at June 30, 2018 is provided below:

Balance	Rate	Maturity
$15,000,000	2.02%	Overnight
6,000,000	1.18%	7/6/2018
7,000,000	1.55%	1/10/2019
5,000,000	1.73%	1/10/2020
5,000,000	1.92%	10/6/2020
$38,000,000	1.75%	

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A schedule of FHLB borrowings at December 31, 2017 is provided below:

Balance	Rate	Maturity
$6,000,000	1.18%	7/6/2018
7,000,000	1.55%	1/10/2019
5,000,000	1.73%	1/10/2020
5,000,000	1.92%	10/6/2020
$23,000,000	1.57%	

The Federal Home Loan Bank of Cincinnati has issued letters of credit in the Bank s name totaling $46.9 million secured by the Bank s loan portfolio to secure additional municipal deposits. At June 30, 2018, securities with a book value of $39.3 million and a fair market value of $38.1 million were sold under agreements to repurchase from various customers.

The Company is a party to certain ordinary course litigation, and the Company intends to vigorously defend itself in all such matters. In the opinion of the Company, based on review and consultation with legal counsel, the outcome of such ordinary course litigation should not have a material adverse effect on the Company s consolidated financial statements or results of operations.

(11) REGULATORY MATTERS

The new minimum capital level requirements applicable to Bank holding companies and Banks subject to the rules are: (i) a new common equity Tier 1 capital ratio of 4.5%; (ii) a Tier 1 risk-based capital ratio of 6% (increased from 4%); (iii) a total risk-based capital ratio of 8% (unchanged from current rules); (iv) a Tier 1 leverage ratio of 4% for all institutions. The rules also establish a capital conservation buffer of 2.5% (to be phased in over three years) above the new regulatory minimum risk-based capital ratios, and result in the following minimum ratios once the capital conservation buffer is fully phased in: (i) a common equity Tier 1 risk-based capital ratio of 7%, (ii) a Tier 1 risk-based capital ratio of 8.5%, and (iii) a total risk-based capital ratio of 10.5%.

The capital conservation buffer requirement was phased in beginning in January 2016 at 0.625% of risk-weighted assets and will increase each year until fully implemented in January 2019. For 2018, the capital conservation buffer is 1.875%. An institution is subject to limitations on paying dividends, engaging in share repurchases and paying discretionary bonuses if capital levels fall below minimum plus the buffer amounts. These limitations establish a maximum percentage of eligible retained income that could be utilized for such actions.

Under these new rules, Tier 1 capital generally consists of common stock (plus related surplus) and retained earnings, limited amounts of minority interest in the form of additional Tier 1 capital instruments, and non-cumulative preferred stock and related surplus, subject to certain eligibility standards, less goodwill and other specified intangible assets and other regulatory deductions.

Cumulative preferred stock and trust preferred securities issued after May 19, 2010 no longer qualify as Tier 1 capital, but such securities issued prior to May 19, 2010, including in the case of bank

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holding companies with less than $15.0 billion in total assets, trust preferred securities issued prior to that date, continue to count as Tier 1 capital subject to certain limitations. The definition of Tier 2 capital is generally unchanged for most banking organizations, subject to certain new eligibility criteria.

The final rules allow banks and their holding companies with less than $250 billion in assets a one-time opportunity to opt-out of a requirement to include unrealized gains and losses in accumulated other comprehensive income in their capital calculation. The Company has made the decision to opt-out of this requirement. Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of tangible and core capital (as defined in the regulations) to adjusted total assets (as defined), and of total capital (as defined) and Tier 1 to risk weighted assets (as defined). The minimum required capital amounts presented include the minimum required capital levels as of June 30, 2018 and December 31, 2017 to which it is subject. Management believes, as of June 30, 2018 and December 31, 2017, that the Bank meets all capital adequacy requirements to which it is subject, including the phase in requirements of Basel III. The Company s consolidated capital ratios and the Bank s actual capital amounts and ratios as of June 30, 2018 and December 31, 2017 are presented below:

	Actual		Minimum Capital Required		To be Well Capitalized for Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollars in Thousands, Except Percentages)					
As of June 30, 2018						
Tier 1 leverage capital to adjusted total assets						
Company	$ 97,574	10.7%	$ 36,294	4.0%	$ 45,368	5.0%
Bank	$ 95,616	10.5%	$ 36,297	4.0%	$ 45,371	5.0%
Total capital to risk weighted assets						
Company	$ 102,211	15.6%	$ 52,513	8.0%	$ 65,641	10.0%
Bank	$ 100,254	15.3%	$ 51,946	8.0%	$ 64,933	10.0%
Tier 1 capital to risk weighted assets						
Company	$ 97,574	14.9%	$ 39,384	6.0%	$ 52.513	8.0%
Bank	$ 95,616	14.6%	$ 38,960	6.0%	$ 51,946	8.0%
Common equity tier 1 capital to risk weighted assets						
Company	$ 97,574	14.9%	$ 29,538	4.5%	n/a	n/a
Bank	$ 95,616	14.6%	$ 29,220	4.5%	$ 42,207	6.5%
As of December 31, 2017						
Tier 1 leverage capital to adjusted total assets						
Company	$ 95,709	10.6%	$ 36,137	4.0%	$ 45,171	5.0%
Bank	$ 95,123	10.5%	$ 36,090	4.0%	$ 45,112	5.0%
Total capital to risk weighted assets						
Company	$ 100,535	16.0%	$ 50,352	8.0%	$ 62,940	10.0%

Bank	$ 99,949	15.9%	$ 50,314	8.0%	$ 62,892	10.0%
Tier 1 capital to risk weighted assets						
Company	$ 95,709	15.2%	$ 37,764	6.0%	$ 50,352	8.0%
Bank	$ 95,123	15.1%	$ 37,735	6.0%	$ 50,314	8.0%
Common equity tier 1 capital to risk weighted assets						
Company	$ 95,709	15.2%	$ 28,323	4.5%	n/a	n/a
Bank	$ 95,123	15.1%	$ 28,301	4.5%	$ 40,880	6.5%

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

Critical Accounting Policies

The preparation of the Company s consolidated financial statements requires management to make subjective judgments associated with estimates. These estimates are necessary to comply with U.S. GAAP and general banking practices. These estimates include accounting for the allowance for loan losses, foreclosed assets, valuation of deferred tax assets and fair value measurements. A description of these estimates, which significantly affect the Company s determination of our consolidated financial position, results of operations and cash flows, is set forth in Note 1, Summary of Significant Accounting Policies of the Notes to the Company s consolidated financial statements in the Company s Annual Report on Form 10-K as of and for the year ended December 31, 2017.

The emphasis of this discussion is a comparison of assets, liabilities and stockholders equity as of June 30, 2018 to December 31, 2017, while comparing income and expenses for the three and six month periods ended June 30, 2018 and June 30, 2017. All information should be read in conjunction with the Company s unaudited interim consolidated condensed financial statements and related notes appearing elsewhere in this report and Management s Discussion and Analysis of Financial Condition and Results of Operations appearing in the Company s Annual Report on Form 10-K as of and for the year ended December 31, 2017.

Comparison of Financial Condition at June 30, 2018, and December 31, 2018

At June 30, 2018, total assets were $912.7 million compared to $917.6 million at December 31, 2017. For the six month period ended June 30, 2018, the Company s net loan portfolio has increased $35.2 million to $672.3 million. To fund the Company s loan growth, the Company reduced cash and cash equivalent balances by $25.7 million and securities available for sale by $15.8 million in the six month period ended June 30, 2018.

At June 30, 2018, total deposits declined by $20.8 million to $733.2 million. At June 30, 2018, interest-bearing checking accounts totaled $198.7 million, a decline of $9.8 million compared to December 31, 2017. At June 30, 2018, non-interest bearing checking accounts totaled $136.0 million, 18.5% of total deposits. Historically, the Company s total deposits are lower at June 30 than at any other time of the year due to our level of municipal deposits and agri-business interest. In the current year, the pricing of deposits has become more challenging, forcing the Company to increase its interest expense to maintain adequate funding levels.

The Company continues to place an emphasis on core funding while attempting to slow the growth of our deposit cost. However, increased competition and the Company s continued strong loan demand will force management to increase deposit rates to ensure adequate funding levels to meet liquidity needs. Management anticipates that future loan growth will be funded largely by the recruitment of time deposits. The Company s investment portfolio may provide additional liquidity. However, a significant portion of the investment portfolio is pledged to municipalities to secure deposits, limiting the Company s ability to significantly increase our loan to deposit ratio above current levels.

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Comparison of Operating Results for the Six Month Periods Ended June 30, 2018 and June 30, 2017.

The Company s net income was $2.8 million for the six month period ended June 30, 2018 compared to net income of $2.1 million for the six month period ended June 30, 2017. The improved level of net income for the six month period ended June 30, 2018 compared to the six month period ended June 30, 2017 was the result of a $35.9 million increase in the average balance of loans, a $492,000 increase in gains on the sale of investments a $220,000 decline in the Company s provision for loan loss expense and a reduction in the Company s federal tax rate from 34% to 21%.

The Company s total interest income for the six month period ended June 30, 2018 was $17.9 million, compared to $16.6 million for the six month period ended June 30, 2017. The increase in net interest income for the three month period ended June 30, 2018 compared to June 30, 2017 was largely due to the increase in the average balance of loans.

For the six month period ended June 30, 2018, the average balance of total interest bearing liabilities declined by $2.8 million compared to the six month period ended June 30, 2017. Despite the decline in interest bearing liabilities, the Company s total interest expense for the six month period ended June 30, 2018 increased by $587,000, to $3.4 million compared to the six month period ended June 30, 2017. For the six month period ended June 30, 2018, the cost of average total deposits was 0.71% compared to 0.63% for the six month period ended June 30, 2017. In addition to increases in our cost of deposits, the interest expense on the Company s floating rate subordinated debt has increased to $260,000 for the six month period ended June 30, 2018 from $212,000 for the six month period ended June 30, 2017 due to increases in the three month Libor rate. For the six month periods ended June 30, 2018 and June 30, 2017, the Company s cost of interest bearing liabilities was 1.00% and 0.83%, respectively. The increase in interest expense is the result of increases in short term interest rates spurred by the decision of the Open Market Committee of the Federal Reserve Board of Governors to increase its stated overnight Federal Funds (Fed Funds) rate.

For the six month period ended June 30, 2018, the Company s tax equivalent yield on loans was 4.66% compared to 4.44% for the six month period ended June 30, 2017. For the six month period ended June 30, 2018, the Company s tax equivalent yield on tax free municipal investments was 4.01% compared to 5.04% for the six month period ended June 30, 2017. The reduction in Company s stated tax rate from 34% to 21% significantly reduced our tax equivalent yield on tax free investments. For the six month periods ended June 30, 2018 and June 30, 2017, the Company s net interest margin was 3.45% and 3.35%. The increase in net interest margin occurred as result of loan growth and increases in loan yields due to increases in the Prime Rate. At June 30, 2018, the interest rate yield between the two year treasury and ten year treasury was 0.33%, very narrow by historical terms. The continued flattening of the yield curve is likely to reduce the Company s net interest margins in the future.

Average Balances, Yields and Interest Expenses. The table on the next page summarizes the overall effect of changes in both interest rates and the average balances of interest earning assets and liabilities for the six month periods ended June 30, 2018 and June 30, 2017. Yields on assets and cost of liabilities are derived by dividing income or expense by the average daily balances of interest earning assets and liabilities for the appropriate six month periods. Average balances for loans include loans classified as non-accrual, net of the allowance for loan losses. On January 1, 2018, the Company s stated tax rate decreased from 34.0% to 21.0%, reducing the tax equivalent yield on tax free loans and tax free municipal investments.

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The table adjusts tax-free investment income by $105,000 for the six month period ended June 30, 2018 and $279,000 for the six month period ended June 30, 2017, for a tax equivalent rate using a cost of funds rate of 1.00% for the six month period ended June 30, 2018 and 0.83% for the six month period ended June 30, 2017. The table adjusts tax-free loan income by $9,000 for the six month period ended June 30, 2018 and $21,000 for the six month period ended June 30, 2017, for a tax equivalent rate using the same cost of funds rate.

	Average Balance 6/30/2018	Income and Expense 6/30/2018	Average Rates 6/30/2018	Average Balance 6/30/2017	Income and Expense 6/30/2017	Average Rates 6/30/2017
	(Table Amounts in Thousands, Except Percentages)					
Loans receivable, net	$ 657,973	15,344	4.66%	618,430	13,720	4.44%
Taxable securities, AFS	157,134	2,112	2.69%	177,044	2,273	2.57%
Non-taxable securities, AFS	26,254	526	4.01%	33,391	842	5.04%
Other interest bearing deposits	4,041	45	2.23%	7,565	44	1.16%
Total interest earning assets	845,402	18,027	4.26%	836,430	16,879	4.04%
Other assets	65,555			73,072		
Total assets	$ 910,957			$ 909,502		
Retail time deposits	238,456	1,397	1.17%	258,518	1,342	1.04%
Brokered deposits	56,206	447	1.59%	47,461	280	1.18%
Interest bearing checking	215,319	704	0.65%	221,580	660	0.60%
Saving / MMDA	100,175	88	0.18%	99,294	82	0.17%
FHLB borrowings	27,856	226	1.62%	12,298	62	1.01%
Repurchase agreements	38,837	325	1.67%	40,482	222	1.10%
Subordinated debentures	10,310	260	5.04%	10,310	212	4.11%
Total interest bearing liabilities	687,159	3,447	1.00%	689,943	2,860	0.83%
Non-interest bearing deposits	133,244			127,447		
Other liabilities	4,059			3,987		
Stockholders equity	86,495			88,125		
Total liabilities and stockholders equity	$ 910,957			909,502		
Net interest income		14,580			14,019	
Net interest spread			3.26%			3.21%
Net interest margin			3.45%			3.35%

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Provision for Loan Losses. The allowance for loan losses is established through a provision for loan losses based on management s evaluation of the risk inherent in its loan portfolio and the general economy. Such evaluation considers numerous factors including general economic conditions, loan portfolio composition and prior loss experience, the estimated fair value of the underlying collateral and other factors that warrant recognition in providing for an adequate loan loss allowance. At June 30, 2018, the Company s reduced level of non-accrual and substandard loans reduced the amount of funding necessary for the allowance for loan loss account. The Company determined that an additional $130,000 in provision for loan loss was required for the six month period ended June 30, 2018 compared to a $350,000 provision for loan loss expense for the six month period ended June 30, 2017.

Non-Interest Expenses. For the six month period ended June 30, 2018, non-interest expenses were $15.1 million compared to $14.9 million for the six month period ended June 30, 2017. For the six month period ended June 30, 2018, data processing expenses increased $239,000 compared to the six month period ended June 30, 2017 due to the Company s receipt of a $225,000 one-time reimbursement of expenses from a vendor in June of 2017. For the six month period ended June 30, 2018, professional services expenses were $965,000, representing an increase of $153,000 compared to the six month period ended June 30, 2017. The increase in professional services is largely the result of legal expenses incurred in early 2018.

Income Taxes. The effective tax rate for the six month periods ending June 30, 2018 was 15.6% as a result of the Tax Cuts and Jobs Act of 2017. For the six month period ended June 30, 2017, the Company s effective tax rate was 19.5%.

Comparison of Operating Results for the Three Month Periods Ended June 30, 2018 and June 30, 2017.

The Company s net income was $1.7 million for the three month period ended June 30, 2018, compared to net income of $1.1 million for the three month period ended June 30, 2017. The improved level of net income for the three month period ended June 30, 2018 compared to the three month period ended June 30, 2017 was largely the result of loan portfolio growth, a $467,000 increase in the gain on sale of investments and a reduction in the federal tax rate.

The Company s total interest income for the three month period ended June 30, 2018 was $9.1 million, compared to $8.4 million for the three month period ended June 30, 2017. The increase in net interest income for the three month period ended June 30, 2018 compared to June 30, 2017 was largely due to the $43.7 million increase in the average balance of loans outstanding.

For the three month period ended June 30, 2018, total interest expense was $1.8 million compared to $1.5 million for the three month period ended June 30, 2017. For the three month period ended June 30, 2018, total interest bearing liabilities were $689.2 million, representing an increase of $30,000 compared to the three month period ended June 30, 2017. The increase in interest expense is the result of increases in short term interest rates spurred by the decision of the Open Market Committee of the Federal Reserve Board of Governors to increase its stated overnight Fed Funds rate. For the three month period ended June 30, 2018, the cost of average total deposits was 0.75% compared to 0.63% for the three month period ended June 30, 2017. Based on current fed funds future projections, Management anticipates that the Company s total cost of deposits will continue to increase into the foreseeable future.

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For the three month periods ended June 30, 2018 and June 30, 2017, the Company s cost of interest bearing liabilities was 1.06% and 0.84%. In addition to increases in our cost of deposits, the interest expense on the Company s floating rate subordinated debt has increased from $122,000 for the three month period ended June 30, 2018 from $102,000 for the three month period ended June 30, 2017 due to increases in the three month Libor rate.

For the three month period ended June 30, 2018, the Company s tax equivalent yield on loans was 4.72% compared to 4.38% for the three month period ended June 30, 2017. For the three month period ended June 30, 2018, the Company s tax equivalent yield on tax free municipal investments was 4.04% compared to 5.00% for the three month period ended June 30, 2017. For the three month periods ended June 30, 2018 and June 30, 2017, the Company s net interest margin was 3.45% and 3.39%. The increase in net interest margin occurred as result of loan growth and increases in the average balance of loans.

Average Balances, Yields and Interest Expenses. The table on the next page summarizes the overall effect of changes in both interest rates and the average balances of interest earning assets and liabilities for the three month periods ended June 30, 2018 and June 30, 2017. Yields on assets and cost of liabilities are derived by dividing income or expense by the average daily balances of interest earning assets and liabilities for the appropriate three month periods. Average balances for loans include loans classified as non-accrual, net of the allowance for loan losses. On January 1, 2018, the Company s stated tax rate decreased from 34.0% to 21.0%, reducing the tax equivalent yield on tax free loans and tax free municipal investments.

The table adjusts tax-free investment income by $51,000 for the three month period ended June 30, 2018 and $139,000 for the three month period ended June 30, 2017, for a tax equivalent rate using a cost of funds rate of 1.06% for the three month period ended June 30, 2018 and 0.84% for the three month period ended June 30, 2017. The table adjusts tax-free loan income by $4,000 for the three month period ended June 30, 2018 and $12,000 for the three month period ended June 30, 2017, for a tax equivalent rate using the same cost of funds rate.

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	Average Balance 6/30/2018	Income and Expense 6/30/2018	Average Rates 6/30/2018	Average Balance 6/30/2017	Income and Expense 6/30/2017	Average Rates 6/30/2017
	(Table Amounts in Thousands, Except Percentages)					
Loans receivable, net	$ 666,301	7,862	4.72%	622,606	6,975	4.48%
Taxable securities, AFS	153,723	1,033	2.69%	177,260	1,155	2.61%
Non-taxable securities, AFS	25,670	259	4.04%	32,919	419	5.09%
Other interest bearing deposits	3,735	16	1.71%	5,888	21	1.43%
Total interest earning assets	849,429	9,170	4.32%	838,673	8,570	4.09%
Other assets	63,565			70,359		
Total assets	$ 912,994			$ 909,032		
Retail time deposits	236,333	723	1.22%	257,956	678	1.05%
Brokered deposits	58,476	259	1.77%	48,866	145	1.19%
Interest bearing checking	215,286	363	0.67%	223,444	334	0.60%
Saving / MMDA	98,217	47	0.19%	98,317	40	0.16%
FHLB borrowings	32,011	134	1.67%	11,176	30	1.07%
Repurchase agreements	38,604	171	1.77%	39,138	119	1.22%
Subordinated debentures	10,310	138	5.35%	10,310	108	4.19%
Total interest bearing liabilities	689,237	1,835	1.06%	689,207	1,454	0.84%
Non-interest bearing deposits	133,075			128,078		
Other liabilities	4,099			3,915		
Stockholders equity	86,583			87,832		
Total liabilities and stockholders equity	$ 912,994			909,032		
Net interest income		7,335			7,116	
Net interest spread			3.26%			3.25%
Net interest margin			3.45%			3.39%

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Provision for Loan Losses. The allowance for loan losses is established through a provision for loan losses based on management s evaluation of the risk inherent in its loan portfolio and the general economy. Such evaluation considers numerous factors including general economic conditions, loan portfolio composition and prior loss experience, the estimated fair value of the underlying collateral and other factors that warrant recognition in providing for an adequate loan loss allowance. The Company determined that an additional $62,000 in provision for loan loss was required for the three month period ended June 30, 2018 compared to a $59,000 provision for loan loss expense for the three month period ended June 30, 2017.

Non-Interest Expenses. For the three month period ended June 30, 2018, non-interest expenses were $7.6 million compared to $7.2 million for the three month period ended June 30, 2017. For the three month period ended June 30, 2018, total salaries and benefits expense was $4.1 million compared to $4.0 million for the three month period ended June 30, 2017. In June of 2017, the Company s one-time receipt of a $225,000 reimbursement of data processing expenses resulting in the most significant change in total non-interest expenses.

Income Taxes. The effective tax rate for the three month periods ending June 30, 2018 was 16.1% due to the reduction in the Company s effective tax rate as a result of the Tax Cuts and Jobs Act of 2017. For the three month period ended June 30, 2017, the Company s effective tax rate was 24.4%.

Liquidity and Capital Resources. The Company has no business other than that of the Bank. Management believes that dividends that may be paid by the Bank to the Company will provide sufficient funds for its current needs. However, no assurance can be given that the Company will not have a need for additional funds in the future. The Bank is subject to certain regulatory limitations with respect to the payment of dividends to the Company.

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The Bank uses brokered deposits to supplement its asset liability need for longer term deposits reasonable prices. In addition to the coupon rate listed below, brokered deposits carry an additional fee of approximately 0.25% that includes the cost of selling and servicing the deposits. The Company includes this cost as interest expense on its income statement. At June 30, 2018, the Bank s brokered deposits consisted of the following:

Issue Date	Coupon Rate	Balance	Date of Maturity
2/15/2018	1.50%	3,130,000	7/16/2018
8/15/2017	1.45%	5,854,000	8/15/2018
1/12/2017	1.25%	5,074,000	9/12/2018
7/10/2017	1.40%	1,079,000	10/10/2018
7/19/2017	1.50%	2,060,000	11/19/2018
2/15/2017	1.30%	4,278,000	12/15/2018
10/11/2017	1.55%	5,000,000	1/11/2019
8/16/2016	1.00%	1,008,000	2/16/2019
6/19/2018	2.10%	2,931,000	3/19/2019
4/12/2018	2.00%	6,036,000	4/12/2019
7/22/2016	1.00%	2,138,000	5/22/2019
5/10/2018	2.20%	4,931,000	7/10/2019
7/29/2016	1.05%	2,964,000	7/29/2019
8/16/2016	1.10%	1,978,000	8/16/2019
6/19/2018	2.40%	2,822,000	9/19/2019
2/15/2018	2.20%	3,417,000	2/15/2020
4/12/2018	2.50%	4,190,000	1/12/2021
5/10/2018	2.70%	5,680,000	3/10/2021
6/19/2018	3.00%	3,153,000	6/19/2021
Total	1.84%	67,723,000	

Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements. Additional written or oral forward-looking statements may be made by the Company from time to time in filings with the Securities and Exchange Commission or otherwise. The words believe, expect, seek, and intend and similar expressions identify forward-looking stateme which speak only as of the date the statement is made. Such forward-looking statements are within the meaning of that term in Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Such statements may include, but are not limited to, projections of income or loss, expenditures, acquisitions, plans for future operations, financing needs or plans relating to services of the Company, as well as assumptions relating to the foregoing.

Forward-looking statements are inherently subject to risks and uncertainties, some of which cannot be predicted or quantified. Future events and actual results could differ materially from those set forth in, contemplated by or underlying the forward-looking statements. The Company does not undertake, and specifically disclaims, any obligation to publicly release the results of revisions, which may be made to forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

The actual results of the Company s asset liability management analysis are highly dependent on the prepayment speed of mortgage backed securities and collateralized mortgage obligations. The United States Treasury s policy of purchasing longer dated Treasury bonds has the result of lowering mortgage loan rates, allowing more consumers to refinance their mortgages and pay-off their current mortgage, resulting in higher prepayment speeds on mortgage investment products.

The effects of rising interest rates are discussed throughout Item 2, Management s Discussion and Analysis of Financial Condition and Results of Operations. Actual results for the year ending December 31, 2018 will differ from simulations due to timing, magnitude, and the frequency or interest rate changes, market conditions, management strategies, and the timing of the Company s cash receipts and disbursements.

The Company s analysis at June 30, 2018 indicates that changes in interest rates are less likely to result in significant changes in the Company s annual net interest income. A summary of the Company s analysis at June 30, 2018 for the twelve month period ending June 30, 2019 is as follows:

	Down 1.00%	No change	Up 1.00%	Up 2.00%	Up 3.00%
		(Dollars in Thousands)			
Net interest income	$ 29,706	$ 31,069	$ 31,863	$ 32,598	$ 33,341

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures.

In accordance with Rule 13a-15(b) under the Securities Exchange Act of 1934 (the Exchange Act), an evaluation was carried out with the participation of the Company s management, including the Company s Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company s disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the quarter ended June 30, 2018.

Based upon their evaluation of these disclosure controls and procedures, the Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures were effective as of the end of the six month period ended June 30, 2018 to ensure that material information relating to the Company, including its consolidated subsidiaries, was made known to them by others within those entities, particularly during the period in which this quarterly report on Form 10-Q was being prepared.

Any control system, no matter how well conceived and operated, can provide only reasonable assurance that its objectives are achieved. The design of a control system inherently has limitations, including the controls cost relative to their benefits. Additionally, controls can be circumvented. No cost-effective control system can provide absolute assurance that all control issues and instances of fraud will be detected.

The Company is subject to Section 404 of The Sarbanes-Oxley Act of 2002. Section 404 requires management to assess and report on the effectiveness of the Company s internal controls over financial reporting.

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Changes in Internal Control over Financial Reporting

There were no changes in the Company s internal control over financial reporting during the Company s fiscal quarter ended June 30, 2018 that have materially affected, or are reasonable likely to materially affect, the Company s internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, the Company is a party to certain ordinary course litigation. The Company will vigorously defend itself in all such matters when the Company determines that it has meritorious defenses. In the opinion of the Company, based on review and consultation with legal counsel, the outcome of such ordinary course litigation should not have a material adverse effect on the Company s consolidated financial statements or results of operations. The Company and its subsidiaries have adopted policies and procedures intended to minimize the impact of adverse litigation and regulatory actions, and has endeavored to secure reasonable insurance coverage.

Item 1A. Risk Factors

There have been no material changes to our risk factors as previously disclosed in Part 1, Item 1A of our annual report on Form 10-K for the fiscal year ended December 31, 2017.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

(a) Unregistered Sales of Equity Securities.

None

(b) Use of Proceeds.

Not applicable

(c) Repurchase of Equity Securities

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total number of shares Purchased as part of Publically Announced Programs	Maximum Number of Shares that Yet may be Purchased Under the Program at the end of the period
April 1, 2018 to April 30, 2018			1,940,394	297,966
May 1, 2018 to May 31, 2018	1,586	$ 14.00	1,941,980	296,380
June 1, 2018 to June 30, 2018			1,941,980	296,380
Total	1,586	$ 14.00	1,941,980	296,380

Item 3. Defaults Upon Senior Securities

None

Item 4. Mine Safety Disclosures

Not Applicable

Item 5. Other Information

None

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Item 6. Exhibits

31.1 Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 for John E. Peck, Chief Executive Officer.

31.2 Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 for Billy C. Duvall, Chief Financial Officer.

32.1 Certification Pursuant to Section 18 U.S.C. Section 1350 for John E. Peck, Chief Executive Officer.

32.2 Certification Pursuant to Section 18 U.S.C. Section 1350 for Billy C. Duvall, Chief Financial Officer.

101 The following materials from the Company s quarterly report on Form 10-Q for the three and six month periods ended June 30, 2018 formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Condensed Statements of Financial Condition as of June 30, 2018 (unaudited) and December 31, 2017, (ii) Consolidated Condensed Statements of Income for the three and six months periods ended June 30, 2018 and June 30, 2017 (unaudited), (iii) Consolidated Condensed Statements of Comprehensive Income (Loss) for the three and six month periods ended June 30, 2018 and June 30, 2017 (unaudited), (iv) Consolidated Condensed Statements of Stockholders Equity for the six month period ended June 30, 2018 (unaudited); and (v) Consolidated Condensed Statements of Cash Flows for the six month periods ended June 30, 2018 and June 30, 2017 (unaudited), and (iv) Notes to Consolidated Condensed Financial Statements (unaudited), tagged as blocks of text.

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SIGNATURES

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

	HOPFED BANCORP, INC.
Date: August 8, 2018	/s/ John E. Peck John E. Peck President and Chief Executive Officer
Date: August 8, 2018	/s/ Billy C. Duvall Billy C. Duvall Senior Vice President, Chief Financial Officer and Treasurer