MITEK SYSTEMS INC
Form 10-Q
August 10, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2015

£ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to .

Commission File Number 001-35231

MITEK SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Delaware	87-0418827
(State or Other Jurisdiction of	(I.R.S. Employer
Incorporation or Organization)	Identification No.)
8911 Balboa Avenue	
San Diego, California	92123
(Address of Principal Executive Offices)	(Zip Code)

(858) 309-1700

(Registrant’s Telephone Number, Including Area Code)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer ¨	Accelerated Filer x
Non-Accelerated Filer ¨ (Do not check if a smaller reporting company)	Smaller Reporting Company ¨

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

There were 30,989,451 shares of the registrant's common stock outstanding as of July 31, 2015.

MITEK SYSTEMS, INC.

FORM 10-Q

For The Quarterly Period Ended June 30, 2015

INDEX

PART I

FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

MITEK SYSTEMS, INC.

CONSOLIDATED BALANCE SHEETS

	June 30, 2015 (Unaudited)	September 30, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	$2,730,826	$7,766,590
Short-term investments	21,222,669	16,269,170
Accounts receivable, net	3,807,947	2,955,350
Other current assets	832,341	704,409
Total current assets	28,593,783	27,695,519
Long-term investments	763,005	2,072,018
Property and equipment, net	1,065,633	1,293,270
Intangible assets, net	3,546,343	-
Goodwill	2,882,959	-
Other non-current assets	92,049	42,049
Total assets	$36,943,772	$31,102,856
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$2,341,468	$1,792,267
Accrued payroll and related taxes	1,460,841	1,434,913
Deferred revenue, current portion	3,674,946	2,826,670
Other current liabilities	295,375	157,649
Total current liabilities	7,772,630	6,211,499
Deferred revenue, non-current portion	255,750	311,225
Other non-current liabilities	751,955	638,099
Total liabilities	8,780,335	7,160,823
Stockholders' equity:		
Preferred stock, $0.001 par value, 1,000,000 shares authorized, none issued and outstanding	-	-
Common stock, $0.001 par value, 60,000,000 shares authorized, 30,855,511 and	30,856	30,521

30,521,080 issued and outstanding, respectively		
Additional paid-in capital	62,603,445	59,946,288
Accumulated other comprehensive gain (loss)	(14,689)	(7,810)
Accumulated deficit	(34,456,175)	(36,026,966)
Total stockholders' equity	28,163,437	23,942,033
Total liabilities and stockholders' equity	$36,943,772	$31,102,856

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

1

MITEK SYSTEMS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS AND OTHER COMPREHENSIVE INCOME (LOSS)

(Unaudited)

	Three Months Ended		Nine Months Ended	
	June 30, 2015	2014	June 30, 2015	2014
Revenue				
Software	$4,675,096	$3,176,686	$12,414,627	$9,468,663
Services	1,764,899	1,483,038	5,087,017	4,137,723
Total revenue	6,439,995	4,659,724	17,501,644	13,606,386
Operating costs and expenses				
Cost of revenue-software	265,511	293,877	704,667	787,544
Cost of revenue-services	325,819	313,709	941,718	839,953
Selling and marketing	1,645,770	1,810,084	4,512,479	5,607,559
Research and development	1,353,285	1,589,521	3,896,255	4,745,723
General and administrative	1,804,025	2,302,973	5,700,453	6,968,419
Acquisition-related costs and expenses	736,172	-	816,291	-
Total operating costs and expenses	6,130,582	6,310,164	16,571,863	18,949,198
Operating income (loss)	309,413	(1,650,440)	929,781	(5,342,812)
Other income (expense), net				
Interest and other expense	(342)	(1,545)	(2,511)	(4,821)
Interest and other income	30,101	19,479	68,629	55,940
Total other income (expense), net	29,759	17,934	66,118	51,119
Income (loss) before income taxes	339,172	(1,632,506)	995,899	(5,291,693)
Income tax benefit (provision)	577,789	(95)	574,892	(2,226)
Net income (loss)	$916,961	$(1,632,601)	$1,570,791	$(5,293,919)
Net income (loss) per share – basic	$0.03	$(0.05)	$0.05	$(0.17)
Net income (loss) per share – diluted	$0.03	$(0.05)	$0.05	$(0.17)
Shares used in calculating net income (loss) per share – basic	30,764,694	30,481,168	30,704,250	30,451,058
Shares used in calculating net income (loss) per share – diluted	31,645,696	30,481,168	31,389,569	30,451,058
Other comprehensive income (loss):				
Net income (loss)	916,961	(1,632,601)	1,570,791	(5,293,919)
Foreign currency translation adjustment	(608)	-	(608)	-
Unrealized gain (loss) on investments	(416)	(4,948)	(6,271)	897
Other comprehensive income (loss)	915,937	(1,637,549)	1,563,912	(5,293,022)

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

2

MITEK SYSTEMS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Nine Months Ended June 30,	
	2015	2014
Operating activities:		
Net income (loss)	$1,570,791	$(5,293,919)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Stock-based compensation expense	2,545,324	2,667,969
Amortization of intangible assets	23,657	-
Depreciation and amortization	322,147	355,320
Accretion and amortization on debt securities	314,425	300,724
Provision (recoveries) for bad debt	8,500	(3,200)
Changes in assets and liabilities:		
Accounts receivable	(432,899)	(1,021,778)
Other assets	(444,422)	(169,498)
Accounts payable	351,897	(281,531)
Accrued payroll and related taxes	(118,740)	131,238
Deferred revenue	670,729	1,116,999
Deferred taxes	(634,930)	-
Other liabilities	13,922	(110,206)
Net cash provided by (used in) operating activities	4,190,401	(2,307,882)
Investing activities:		
Purchases of investments	(21,804,733)	(20,691,725)
Sales and maturities of investments	17,956,088	8,933,624
Acquisition, net of cash acquired	(5,433,235)	-
Purchases of property and equipment	(52,318)	(132,199)
Net cash used in investing activities	(9,334,198)	(11,890,300)
Financing activities:		
Proceeds from exercise of stock options	124,626	58,834
Principal payments on capital lease obligations	(15,612)	(13,982)
Net cash provided by financing activities	109,014	44,852
Foreign currency effect on cash and cash equivalents	(981)	-
Net decrease in cash and cash equivalents	(5,035,764)	(14,153,330)
Cash and cash equivalents at beginning of period	7,766,590	23,294,456
Cash and cash equivalents at end of period	$2,730,826	$9,141,126
Supplemental disclosures of cash flow information:		
Cash paid for interest	$3,144	$4,773
Cash paid for income taxes	$2,897	$2,226
Supplemental disclosures of non-cash investing and financing activities:		

Settlement of note receivable as consideration for business acquisition	$250,000	$-
Unrealized holding (loss) gain on available-for-sale investments	$(6,271)	$897
Cashless settlement of restricted stock units	$-	$15
Cashless exercise of stock options	$-	$3

The accompanying notes form an integral part of these consolidated financial statements

MITEK SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

.

1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

Mitek Systems, Inc. (the “Company”) is engaged in the development, sale and service of its proprietary software solutions related to mobile capture and identity authentication.

The Company applies its patented technology in image capture, correction and intelligent data extraction in the mobile financial and business services markets. The Company’s technology allows users to remotely deposit checks, pay bills, transfer credit card balances, open accounts and get insurance quotes by taking pictures of various documents with their camera-equipped smartphones and tablets instead of using the device keyboard. The Company’s products use advanced algorithms to correct image distortion, extract relevant data, route images to their desired location and process transactions through users’ financial institutions. As of June 30, 2015, the Company has been granted 21 patents and has an additional 21 patent applications pending.

The Company’s products enable deposits, confirm identity and accelerate payments for mobile transactions. Each product utilizes the Company’s proprietary MiSnap™ technology which improves user experience and reduces errors by automatically activating the camera shutter when held over a document.

Deposit

The Company’s Mobile Deposit® and Commercial Mobile Deposit Capture™ products are software that allow consumers and businesses to remotely deposit checks using their camera-equipped smartphone or tablet. As of June 30, 2015, the Company and its channel partners have signed 4,105 agreements with financial institutions to deploy Mobile Deposit® and 3,587 of these financial institutions have deployed Mobile Deposit® to their consumers, including all of the top ten, and nearly all of the top 50 U.S. retail banks, as ranked by SNL Financial for the first quarter of calendar year 2015. Commercial Mobile Deposit Capture™ utilizes the same technology as Mobile Deposit®, but has additional capabilities, such as invoice capture, specifically designed to meet the needs of business users.

Identity

The Company’s identity offerings are designed to optimize the mobile channel for customer acquisition safely and securely. Photo Fill™ allows a consumer to take a photo of his or her driver’s license or other identity document to pre-fill mobile application forms on a mobile device. Photo Verify™ instantly finds and decodes an encrypted security feature hidden on a driver’s license. The Company added additional global document verification technologies as a result of the acquisition of IDchecker NL B.V. (“IDC NL”) and ID Checker, Inc. (“IDC, Inc.” and together with IDC NL, “IDchecker”).

Payment

The Company's mobile photo payment solutions enable mobile bill payment for financial institutions and organizations that bill consumers directly.

Mobile Photo Bill Pay® is for financial institutions and Mobile Photo Payments™ is for organizations that bill consumers directly. Both allow a consumer to take a photo of a bill to extract data which is then used to pre-fill the fields required to accomplish certain tasks such as making a mobile payment, adding a new payee or paying monthly bills on a smartphone or tablet.

Mobile Photo Balance Transfer™ allows a consumer to take a photo of a credit card statement to extract data which is then used to pre-fill the fields of a credit card balance transfer application. The consumer is then presented with a competitive credit card offer and can transfer the existing credit card balance to the new credit card. The Company's mobile photo payment software solutions are available for iOS and Android operating systems.

Developer Program

The Mitek Developers program extends use of the Company's mobile capture SDK and Mobile Imaging Platform™ to developers interested in creating new mobile applications that use camera-equipped smartphones and tablets to capture data from documents.

Distribution Model

The Company delivers its mobile capture software solutions on-premise as well as in the cloud and markets and sells these solutions through channel partners or directly to enterprise customers. The Company's mobile capture software solutions are often embedded in mobile banking or enterprise applications developed by banks, insurance companies or their partners, and marketed under their own proprietary brands.

Basis of Presentation

The accompanying unaudited consolidated financial statements of the Company as of June 30, 2015 have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X and, accordingly, they do not include all information and footnote disclosures required by accounting principles generally accepted in the U.S. ("GAAP"). The results of IDchecker's operations from June 17, 2015 through June 30, 2015 are included in the Company's consolidated financial statements. The Company believes the footnotes and other disclosures made in the financial statements are adequate for a fair presentation of the results of the interim periods presented. The financial statements include all adjustments (solely of a normal recurring nature) which are, in the opinion of management, necessary to make the information presented not misleading. You should read these financial statements and the accompanying notes in conjunction with the financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2014, filed with the U.S. Securities and Exchange Commission (the "SEC") on December 5, 2014 (the "Form 10-K").

Results for the three and nine months ended June 30, 2015 are not necessarily indicative of results for any other interim period or for a full year.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

Foreign Currency

The Company has foreign subsidiaries that operate and sell its products and services in various countries and jurisdictions around the world. As a result, the Company is exposed to foreign currency exchange risks. For those subsidiaries whose functional currency is not the U.S. dollar, assets and liabilities are translated into U.S. dollars equivalents at the exchange rate in effect on the balance sheet date and revenues and expenses are translated into U.S. dollars using the average exchange rate over the period. Resulting currency translation adjustments are recorded in accumulated other comprehensive income in the consolidated balance sheet. The Company recorded net losses resulting from foreign exchange translation of $608 for the three months and nine months ended June 30, 2015. There were no foreign exchange translation gains or losses recorded in fiscal 2014.

Reclassifications

Certain prior period amounts have been reclassified to conform to the current period presentation. These reclassifications do not impact the reported net loss for such periods and do not have a material impact on the presentation of the overall financial statements.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses and the related disclosure of contingent assets and liabilities. On an ongoing basis, management reviews its estimates based upon currently available information. Actual future results could differ materially from those estimates. These estimates include, but are not limited to, assessing the collectability of accounts receivable, estimation of the value of stock-based compensation awards, fair value of assets and liabilities acquired, impairment of goodwill, useful lives of intangible assets and income taxes.

Goodwill and Intangible Assets

The Company evaluates and tests the recoverability of its goodwill for impairment at least annually during the fourth quarter or more often if and when circumstances indicate that goodwill may not be recoverable.

Intangible assets are amortized over their useful lives. Each period, the Company evaluates the estimated remaining useful life of its intangible assets and whether events or changes in circumstances warrant a revision to the remaining period of amortization. The carrying amounts of these assets are periodically reviewed for impairment whenever events or changes in circumstances indicate that the carrying value of these assets may not be recoverable. Recoverability of these assets is measured by comparing the carrying amount of each asset to the future undiscounted cash flows the asset is expected to generate. The carrying amount of such assets is reduced to fair value if the undiscounted cash flows used in the test for recoverability are less than the carrying amount of these assets.

Net Income (Loss) Per Share

The Company calculates net income (loss) per share in accordance with Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) Topic 260, Earnings Per Share. Basic and diluted net income (loss) per share are based on the weighted-average number of common shares outstanding during the period, without giving effect to potentially dilutive securities. In a period with a net loss position, potentially dilutive securities, such as options, warrants and restricted stock units (“RSUs”), are not included in the calculation of diluted net loss because to do so would be antidilutive, and the number of shares used to calculate basic and diluted net loss is the same.

For the three and nine months ended June 30, 2015 and 2014, the following potentially dilutive common shares were excluded from the calculation of net income (loss) per share, as they would have been antidilutive:

	Three Months Ended		Nine Months Ended	
	June 30,		June 30,	
	2015	2014	2015	2014
Stock options	2,288,077	2,616,121	2,316,232	2,616,121
Restricted stock units	330,684	1,212,292	408,869	1,212,292
Warrants	-	6,667	-	6,667
Total potentially dilutive common shares outstanding	2,618,761	3,835,080	2,725,101	3,835,080

The calculation of basic and diluted net income (loss) per share is as follows:

	Three Months Ended		Nine Months Ended	
	June 30,		June 30,	
	2015	2014	2015	2014
Net income (loss)	$916,961	$(1,632,601)	$1,570,791	$(5,293,919)
Weighted-average common shares outstanding:				
Basic	30,764,694	30,481,168	30,704,250	30,451,058
Diluted	31,645,696	30,481,168	31,389,569	30,451,058
Net income (loss) per share:				
Basic	0.03	(0.05)	0.05	(0.17)
Diluted	0.03	(0.05)	0.05	(0.17)

Revenue Recognition

Revenue from sales of software licenses sold through direct and indirect channels is recognized upon shipment of the related product if the requirements of FASB ASC Topic 985-605, Software Revenue Recognition (“ASC 985-605”) are met, including evidence of an arrangement, delivery, fixed or determinable fee, collectability and vendor specific objective evidence (“VSOE”) of the fair value of the undelivered element. If the requirements of ASC 985-605 are not met at the date of shipment, revenue is not recognized until such elements are known or resolved. Revenue from customer support services, or maintenance revenue, includes post-contract support and the rights to unspecified upgrades and enhancements. VSOE of fair value for customer support services is determined by reference to the price the customer pays for such element when sold separately; that is, the renewal rate offered to customers. Revenue derived from professional services primarily includes consulting, implementation, and training. Revenue from fixed fee service engagements is recognized after the services are performed using the completed performance method. Revenue from time and materials service engagements is generally recognized as the services are performed.

In those instances when objective and reliable evidence of fair value exists for the undelivered items but not for the delivered items, the residual method is used to allocate the arrangement consideration. Under the residual method, the amount of arrangement consideration allocated to the delivered items equals the total arrangement consideration less the aggregate fair value of the undelivered items. Revenue from post-contract customer support is recognized ratably over the term of the contract. Certain customers have agreements that provide for usage fees above fixed minimums. Fixed minimum transaction fees are recognized as revenue ratably over the term of the arrangement. Usage fees above fixed minimums are recognized as revenue when such amounts are reasonably estimable and billable. Revenue from professional services is recognized when such services are delivered. When a software sales arrangement requires professional services related to significant production, modification or customization of software, or when a customer considers professional services essential to the functionality of the software product, revenue is recognized based on predetermined milestone objectives required to complete the project, as those milestone objectives are deemed to be substantive in relation to the work performed. Any expected losses on contracts in progress are recorded in the period in which the losses become probable and reasonably estimable.

Accounts Receivable and Allowance for Doubtful Accounts

Trade accounts receivable are recorded at the net invoice value and are not interest bearing. The Company considers receivables past due based on the contractual payment terms. Allowances for doubtful accounts are established based on various factors, including credit profiles of the Company’s customers, contractual terms and conditions, historical payments, and current economic trends. The Company reviews its allowances by assessing individual accounts receivable over a specific aging and amount. Accounts receivable are written off on a case-by-case basis, net of any amounts that may be collected. The Company maintained an allowance for doubtful accounts of $14,600 and $6,100 as of June 30, 2015 and September 30, 2014, respectively.

Capitalized Software Development Costs

Costs incurred for the development of software that will be sold, leased or otherwise marketed are capitalized when technological feasibility has been established. Software development costs consist primarily of compensation of development personnel and related overhead incurred to develop new products and upgrade and enhance the Company’s current products, as well as fees paid to outside consultants. Capitalization of software development costs ceases and amortization of capitalized software development costs commences when the products are available for general release. For the three and nine months ended June 30, 2015 and 2014, no software development costs were capitalized because the time period and costs incurred between technological feasibility and general release for all software product releases were not material or were not realizable.

Guarantees

In the ordinary course of business, the Company is not subject to potential obligations under guarantees that fall within the scope of FASB ASC Topic 460, Guarantees (“ASC 460”), except for standard indemnification and warranty provisions that are contained within many of the Company’s customer license and service agreements and certain supplier agreements, and give rise only to the disclosure requirements prescribed by ASC 460. Indemnification and warranty provisions contained within the Company’s customer license and service agreements and certain supplier agreements are generally consistent with those prevalent in the Company’s industry. The Company has not previously incurred significant costs to settle claims or pay awards under these indemnification or warranty obligations. The Company accounts for these obligations in accordance with FASB ASC Topic 450, Contingencies, and records a liability for these obligations when a loss is probable and reasonably estimable. The Company has not recorded any liabilities for these obligations as of June 30, 2015 or 2014.

Fair Value of Equity Instruments

The fair value of equity instruments involves significant estimates based on underlying assumptions made by management. The fair value for purchase rights under the Company's equity plans is measured at the grant date using a Black-Scholes valuation model, which involves estimates of stock volatility, expected life of the instruments and other assumptions, and using the closing price of the Company's common stock on the grant date for RSUs. The fair value of stock-based awards is recognized as an expense over the respective terms of the awards.

Deferred Income Taxes

Deferred income taxes reflect the net tax effect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the tax basis of such assets and liabilities. The Company maintains a valuation allowance against its deferred tax assets due to the uncertainty regarding the future realization of such assets, which is based on historical taxable income, projected future taxable income and the expected timing of the reversals of existing temporary differences. Until such time as the Company can demonstrate that it will no longer incur losses, or if the Company is unable to generate sufficient future taxable income, it could be required to maintain the valuation allowance against its deferred tax assets.

Comprehensive Income (Loss)

Comprehensive income (loss) consists of net income (loss), unrealized gains and losses on available-for-sale securities and foreign currency translation adjustments. Included on the balance sheet at June 30, 2015 is an accumulated other comprehensive loss of $14,689, compared to an accumulated other comprehensive loss of $7,810 at September 30, 2014, related to the Company's available-for-sale securities and foreign currency translation adjustments.

Recent Accounting Pronouncements

In May 2014, the FASB issued guidance codified in ASC 606, Revenue Recognition – Revenue from Contracts with Customers ("ASC 606") which amends the guidance in former ASC 605, Revenue Recognition. This accounting standard update will be effective for the Company beginning in the first quarter of fiscal 2019. The Company is currently evaluating the impact of the provisions of ASC 606.

2. BUSINESS COMBINATION

On June 17, 2015, the Company completed the acquisition (the "Acquisition") of IDC NL, a company incorporated under the laws of the Netherlands, and IDC, Inc., a California corporation and wholly owned subsidiary of IDC NL, pursuant to a Share Purchase Agreement (the "Share Purchase Agreement") by and among the Company, IDC NL, ID Checker Holding B.V. ("Parent"), Stichting Administratiekantoor OPID (together with Parent, the "Sellers"), and the other individuals specified therein. IDchecker is a provider of cloud-based identification document verification services. As a result of the Acquisition, IDC NL and IDC, Inc. each became wholly owned subsidiaries of the Company and the transaction has been accounted for as an acquisition of a business.

Pursuant to the terms of the Share Purchase Agreement, the Company acquired all of the issued and outstanding shares of IDC NL and IDC Inc. At the closing of the Acquisition, the Company paid a purchase price of $5,855,000, which consists of (i) a cash payment to the Sellers of $5,600,000, subject to adjustments for transaction expenses, indebtedness, and working capital adjustments (the "Cash Payment") and (ii) the forgiveness of the outstanding balance of approximately $255,000 on a promissory note issued by the Company to Parent. In addition, approximately $2,745,000 in shares of the Company's common stock (the "Closing Shares"), par value $0.001 per share ("Common Stock"), or 712,790 shares, were issued to the Sellers, and subject to the achievement of certain revenue and net income targets by IDchecker for the nine-month period ending on September 30, 2015, and the twelve-month period ending on September 30, 2016 (each, an "Earnout Period"), the Company will issue to the Sellers up to an aggregate of $2,000,000 in shares of Common Stock (the "Earnout Shares"). If the revenue or net income achieved by IDchecker during an Earnout Period is less than the applicable target but equal to or greater than 80% of such target, the Sellers will receive a prorated amount of Earnout Shares. Vesting of both the Closing Shares and Earnout Shares (if any) is subject to the continued employment of the founders of IDchecker and such shares are being accounted for as compensation for future services in accordance with ASC 718 Compensation – Stock Compensation. For additional information regarding the Closing Shares and Earnout Shares, see Note 5 to these consolidated financial statements.

Upon the closing of the Acquisition, the Company deposited $1,820,000 of the Cash Payment and 20% of the Closing Shares into an escrow fund to serve as collateral and partial security for working capital adjustments and certain indemnification rights. To the extent any Earnout Shares are issued to the Sellers, 20% of such Earnout Shares will be placed in the escrow fund. The escrow fund will be maintained for up to 24 months following the last issuance of Earnout Shares or until such earlier time as the escrow fund is exhausted.

The purchase price is subject to a post-closing adjustment in net working capital as provided in the Stock Purchase Agreement.

The results of IDchecker's operations from June 17, 2015 through June 30, 2015 are included in the Company's consolidated financial statements. For the period from June 17, 2015 to June 30, 2015, IDchecker contributed revenue and earnings of $120,765 and $35,093, respectively. The Company recorded $736,172 and $816,291 of transaction-related costs and expenses in operating expenses in the consolidated statements of operations for the three and nine months ended June 30, 2015, respectively.

The following unaudited pro forma financial information is presented as if the Acquisition had taken place at the beginning of each of the periods presented and should not be taken as representative of the Company's future consolidated results of operations. The following unaudited pro forma information includes adjustments for stock based compensation expense related to the Closing Shares and Earnout Shares and amortization expense for identified intangibles. Acquisition-related costs and expenses of $736,172 and $816,291 have been excluded from the unaudited pro forma financial information for the three and nine months ended June 30, 2015. Acquisition-related costs and expenses consist primarily of legal expenses and fees paid to outside consultants in connection with the Acquisition.

The following table shows the Company's unaudited pro forma financial information for the three and nine month periods ended June 30, 2015 and June 30, 2014:

	Three Months Ended		Nine Months Ended	
	June 30,		June 30,	
	2015	2014	2015	2014
Revenue	$7,052,954	$5,359,969	$19,367,883	$15,320,520
Net income (loss)	1,017,398	(2,381,279)	433,371	(8,057,729)
Income (loss) per common share				
Basic	$0.03	$0.08	$0.01	$(0.26)
Diluted	$0.03	$0.08	$0.01	$(0.26)

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed on the date the Acquisition was completed. The Company is in the process of finalizing certain customary post-closing adjustments which could have an effect on the third-party valuations of certain tangible assets; thus the provisional measurements of net assets are subject to change.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed as part of the Acquisition as of June 17, 2015:

	June 17, 2015
Current assets	$604,019
Property, plant and equipment	42,173
Intangible assets	3,570,000
Assets acquired	$4,216,192
Current liabilities	$(475,752)
Other liabilities	(804,106)
Liabilities assumed	$(1,279,858)
Fair value of net assets acquired	$2,936,334
Total consideration paid	5,819,293
Goodwill	$2,882,959

The Company estimated the fair value of identifiable acquisition-related intangible assets primarily based on discounted cash flow projections that will arise from these assets. The Company exercised significant judgment with regard to assumptions used in the determination of fair value such as discount rates and the determination of the estimated useful lives of the intangible assets, see Note 4. The excess of the purchase price over the fair value of the assets acquired and liabilities assumed was allocated to goodwill. Goodwill in the amount of $2,882,959 was recorded. The goodwill recognized is due to expected synergies and other factors.

3. INVESTMENTS

The following table summarizes investments by type of security as of June 30, 2015:

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Market Value
Available-for-sale securities:				
Corporate debt securities, short-term	$21,236,636	$ 1,095	$ (15,062)	$21,222,669
Corporate debt securities, long-term	763,119	—	(114)	763,005
Total	$21,999,755	$ 1,095	$ (15,176)	$21,985,674

The following table summarizes investments by type of security as of September 30, 2014:

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Market Value
Available-for-sale securities:				

Corporate debt securities, short-term

ans-serif; COLOR: #000000; LINE-HEIGHT: 10.25pt">774

275

319

1,368

409,832

411,200

-

Consumer loans

369

68

220

657

44,857

45,514

51

Commercial loans

422

-

25

447

189,806

190,253

-

Total loans

$
3,442

$
823

$
2,170

$
6,435

$
1,086,095

$
1,092,530

$
79

	June 30, 2015						
(dollars in thousands)	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans Receivable	Total Loans > 90 Days & Accruing
Real Estate Loans:							
Residential	$1,143	$1,645	$ 439	$3,227	$374,238	$377,465	$ -
Construction	113	-	132	245	44,271	44,516	-
Commercial	350	246	34	630	404,090	404,720	-
Consumer loans	260	11	48	319	46,451	46,770	34
Commercial loans	375	127	30	532	191,354	191,886	11
Total loans	$2,241	$2,029	$ 683	$4,953	$1,060,404	$1,065,357	$ 45

At December 31, 2015, there were two purchased credit impaired loan totaling $1.4 million that were greater than 90 days past due, and none at June 30, 2015.

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

The tables below present impaired loans (excluding loans in process and deferred loan fees) as of December 31 and June 30, 2015. These tables include purchased credit impaired loans. Purchased credit impaired loans are those for which it was deemed probable, at acquisition, that the Company would be unable to collect all contractually required payments receivable. In an instance where, subsequent to the acquisition, the Company determines it is probable, for a specific loan, that cash flows received will exceed the amount previously expected, the Company will recalculate the amount of accretable yield in order to recognize the improved cash flow expectation as additional interest income over the remaining life of the loan. These loans, however, will continue to be reported as impaired loans. In an instance where, subsequent to the acquisition, the Company determines it is probable, for a specific loan, that cash flows received will be less than the amount previously expected, the Company will allocate a specific allowance under the terms of ASC 310-10-35.

	December 31, 2015		
(dollars in thousands)	Recorded Balance	Unpaid Principal Balance	Specific Allowance
Loans without a specific valuation allowance:			
Residential real estate	$3,408	$ 3,669	$ -
Construction real estate	1,426	1,820	-
Commercial real estate	11,927	13,665	-
Consumer loans	32	32	-
Commercial loans	1,302	1,387	-
Loans with a specific valuation allowance:			
Residential real estate	$-	$ -	$ -
Construction real estate	-	-	-
Commercial real estate	-	-	-

Consumer loans	-	-	-
Commercial loans	625	625	144
Total:			
Residential real estate	$ 3,408	$ 3,669	$ -
Construction real estate	$ 1,426	$ 1,820	$ -
Commercial real estate	$ 11,927	$ 13,665	$ -
Consumer loans	$ 32	$ 32	$ -
Commercial loans	$ 1,927	$ 2,012	$ 144

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

The above amounts include purchased credit impaired loans. At December 31, 2015, purchased credit impaired loans comprised $16.1 million of impaired loans without a specific valuation allowance; none with a specific valuation allowance; and $16.1 million of total impaired loans. At June 30, 2015, purchased credit impaired loans comprised $17.1 million of impaired loans without a specific valuation allowance; none with a specific valuation allowance; and $17.1 million of total impaired loans.

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

(dollars in thousands)	For the three-month period ended December 31, 2015 Average Investment in Impaired Loans	Interest Income Recognized
Residential Real Estate	$3,115	$ 16
Construction Real Estate	1,629	25
Commercial Real Estate	10,575	390
Consumer Loans	-	-
Commercial Loans	1,064	20
Total Loans	$16,383	$ 451

For the three-month period ended December 31, 2014

(dollars in thousands)	Average Investment in Impaired Loans	Interest Income Recognized
Residential Real Estate	$4,096	$ 68
Construction Real Estate	2,585	49
Commercial Real Estate	12,248	181
Consumer Loans	196	3
Commercial Loans	1,113	14
Total Loans	$20,238	$ 315

(dollars in thousands)	For the six months ended December 31, 2015 Average Investment in Impaired Loans	Interest Income Recognized
Residential Real Estate	$3,170	$ 44
Construction Real Estate	1,706	62
Commercial Real Estate	10,614	574
Consumer Loans	70	2
Commercial Loans	1,071	39
Total Loans	$16,631	$ 721

(dollars in thousands)	For the six months ended December 31, 2014 Average Investment in Impaired Loans	Interest Income Recognized
Residential Real Estate	$3,327	$ 137
Construction Real Estate	1,723	99
Commercial Real Estate	8,588	370
Consumer Loans	130	6
Commercial Loans	780	28
Total Loans	$14,548	$ 640

Interest income on impaired loans recognized on a cash basis in the three- and six-month periods ended December 31, 2015 and 2014, was immaterial.

For the three- and six-month periods ended December 31, 2015, the amount of interest income recorded for impaired loans that represented a change in the present value of cash flows attributable to the passage of time was approximately $48,000 and $97,000, respectively, as compared to $56,000 and $85,000, respectively, for the three-and six-month periods ended December 31, 2014.

The following table presents the Company's nonaccrual loans at December 31 and June 30, 2015. The table excludes performing troubled debt restructurings.

(dollars in thousands)	December 31, 2015	June 30, 2015
Residential real estate	$ 1,921	$2,202
Construction real estate	-	133
Commercial real estate	1,602	1,271
Consumer loans	242	88
Commercial loans	38	63

Total loans	$ 3,803	$3,757

The above amounts include purchased credit impaired loans. At December 31 and June 30, 2015, these loans comprised $2.7 million and $2.4 million of nonaccrual loans, respectively.

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

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

During the three- and six-month periods ended December 31, 2015 and 2014, certain loans were classified as TDRs. They are shown, segregated by class, in the tables below:

	For the three months ended			
	December 31, 2015		December 31, 2014	
(dollars in thousands)	Number of modifications	Recorded Investment	Number of modifications	Recorded Investment
Residential real estate	-	$ -	-	$ -
Construction real estate	-	-	-	-
Commercial real estate	-	-	1	41
Consumer loans	-	-	-	-
Commercial loans	-	-	1	250
Total	-	$ -	2	$ 291

	For the six months ended			
	December 31, 2015		December 31, 2014	
	Number of modifications	Recorded Investment	Number of modifications	Recorded Investment
Residential real estate	2	$ 49	-	$ -
Construction real estate	-	-	-	-
Commercial real estate	-	-	1	41
Consumer loans	-	-	-	-
Commercial loans	-	-	1	250
Total	2	$ 49	2	$ 291

Performing loans classified as TDRs outstanding at December 31 and June 30, 2015, segregated by class, are shown in the table below. Nonperforming TDRs are shown as nonaccrual loans.

	December 31, 2015		June 30, 2015	
(dollars in thousands)	Number of modifications	Recorded Investment	Number of modifications	Recorded Investment
Residential real estate	7	$ 487	7	$ 602
Construction real estate	-	-	-	-
Commercial real estate	11	3,808	14	4,666
Consumer loans	-	-	-	-
Commercial loans	3	1,253	3	1,280
Total	21	$ 5,548	24	$ 6,548

Note 5: Accounting for Certain Loans Acquired in a Transfer

The Company acquired loans in transfers during the fiscal year ended June 30, 2011 and during the six months ended December 31, 2014. At acquisition, certain transferred loans evidenced deterioration of credit quality since origination and it was probable, at acquisition, that all contractually required payments would not be collected.

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

The carrying amount of these loans is included in the balance sheet amounts of loans receivable at December 31 and June 30, 2015. The amount of these loans is shown below:

(dollars in thousands)	December 31, 2015	June 30, 2015
Residential real estate	$ 3,352	$ 3,542
Construction real estate	1,820	2,806
Commercial real estate	12,269	12,523
Consumer loans	-	207
Commercial loans	1,142	1,180
Outstanding balance	$ 18,583	$ 20,258
Carrying amount, net of fair value adjustment of $2,477 and $3,132 at December 31, 2015 and June 30, 2015, respectively	$ 16,106	$ 17,126

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

	For the three months ending	
(dollars in thousands)	December 31, 2015	December 31, 2014
Balance at beginning of period	$ 582	$ 317
Additions	-	-
Accretion	(255)	(86)
Reclassification from nonaccretable difference	339	304
Disposals	-	-
Balance at end of period	$ 666	$ 535

	For the six months ending	
(dollars in thousands)	December 31, 2015	December 31, 2014
Balance at beginning of period	$ 547	$ 380
Additions	-	(4)
Accretion	(304)	(145)
Reclassification from nonaccretable difference	423	304
Disposals	-	-
Balance at end of period	$ 666	$ 535

During the three- and six-month periods ended December 31, 2015 and 2014, the Company did not increase the allowance for loan losses related to these purchased credit impaired loans. During the same periods, the Company did not reverse the allowance for loan losses related to these loans.

Note 6: Deposits

Deposits are summarized as follows:

(dollars in thousands)	December 31, 2015	June 30, 2015

Non-interest bearing accounts	$127,487	$117,471
NOW accounts	392,353	336,097
Money market deposit accounts	76,906	67,752
Savings accounts	116,889	131,884
Certificates	403,586	402,038
Total Deposit Accounts	$1,117,221	$1,055,242

Note 7: Earnings Per Share

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

	Three months ended December 31,		Six months ended December 31,	
	2015	2014	2015	2014
(dollars in thousands except per share data)				
Net income	$4,209	$3,437	$7,844	$6,733
Dividend on preferred stock	35	50	85	100
Net income available to common shareholders	$4,174	$3,387	$7,759	$6,633
Average Common shares – outstanding basic	7,425,351	7,404,354	7,423,853	7,259,114
Stock options under treasury stock method	34,833	188,568	32,804	186,542
Average Common shares – outstanding diluted	7,460,184	7,592,922	7,456,657	7,445,656
Basic earnings per common share	$0.56	$0.46	$1.05	$0.91
Diluted earnings per common share	$0.56	$0.45	$1.04	$0.89

At December 31, 2015 and 2014, no options outstanding had an exercise price exceeding the market price.

Note 8: Income Taxes

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

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

(dollars in thousands)	For the three months ended December 31, 2015	December 31, 2014	For the six months ended December 31, 2015	December 31, 2014
Income taxes				
Current	$1,921	$ 2,101	$4,125	$ 3,465
Deferred	(101)	(641)	(640)	(624)
Total income tax provision	$1,820	$ 1,460	$3,485	$ 2,841

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

(dollars in thousands)	December 31, 2015	June 30, 2015
Deferred tax assets:		
Provision for losses on loans	$ 4,449	$5,037
Accrued compensation and benefits	782	538

Other-than-temporary impairment on available for sale securities	142	137
NOL carry forwards acquired	910	768
Minimum Tax Credit	130	130
Unrealized loss on other real estate	107	6
Other	637	319
Total deferred tax assets	7,157	6,935
Deferred tax liabilities:		
Purchase accounting adjustments	1,041	1,985
Depreciation	1,202	992
FHLB stock dividends	194	39
Prepaid expenses	243	81
Unrealized gain on available for sale securities	516	502
Total deferred tax liabilities	3,196	3,599
Net deferred tax asset	$ 3,961	$3,336

As of December 31 and June 30, 2015, the Company had approximately $1.8 and $3.9 million in federal and state net operating loss carryforwards, which were acquired in the July 2009 acquisition of Southern Bank of Commerce, the

February 2014 acquisition of Citizens State Bankshares of Bald Knob, Inc. and the August 2014 acquisition of Peoples Service Company. The amount reported is net of the IRC Sec. 382 limitation, or state equivalent, related to utilization of net operating loss carryforwards of acquired corporations. Unless otherwise utilized, the net operating losses will begin to expire in 2027.

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

(dollars in thousands)	For the three months ended December 31, 2015	December 31, 2014	For the six months ended December 31, 2015	December 31, 2014
Tax at statutory rate	$2,109	$ 1,665	$3,965	$ 3,256
Increase (reduction) in taxes resulting from:				
Nontaxable municipal income	(145)	(134)	(279)	(265)
State tax, net of Federal benefit	163	127	317	247
Cash surrender value of Bank-owned life insurance	(163)	(49)	(208)	(98)
Tax credit benefits	(63)	(91)	(125)	(181)
Other, net	(82)	(59)	(185)	(118)
Actual provision	$1,820	$ 1,460	$3,485	$ 2,841

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

Note 9: 401(k) Retirement Plan

The Southern Bank 401(k) Retirement Plan (the Plan) covers substantially all Southern Bank employees who are at least 21 years of age and who have completed one year of service. The Company made a safe harbor matching contribution to the Plan of up to 4% of eligible compensation, and also made additional, discretionary profit-sharing contributions for fiscal 2015; for fiscal 2016, the Company has maintained the safe harbor matching contribution of 4%, and expects to continue to make additional, discretionary profit-sharing contributions. During the three and six-month periods ended December 31, 2015, retirement plan expenses recognized for the Plan were approximately $207,000, and $421,000, respectively, as compared to $166,000 and $329,000, respectively, for the same periods of the prior fiscal year.

Note 10: Corporate Obligated Floating Rate Trust Preferred Securities

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

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

In connection with its October 2013 acquisition of Ozarks Legacy Community Financial, Inc. (OLCF), the Company assumed $3.1 million in floating rate junior subordinated debt securities. The debt securities had been issued in June 2005 by OLCF in connection with the sale of trust preferred securities, bear interest at a floating rate based on LIBOR, are now redeemable at par, and mature in 2035. The carrying value of the debt securities was approximately $2.5 million at December 31, and June 30, 2015.

In connection with its August 2014 acquisition of Peoples Service Company, Inc. (PSC), the Company assumed $6.5 million in floating rate junior subordinated debt securities. The debt securities had been issued in 2005 by PSC's subsidiary bank holding company, Peoples Banking Company, in connection with the sale of trust preferred securities, bear interest at a floating rate based on LIBOR, are now redeemable at par, and mature in 2035. The carrying value of the debt securities was approximately $4.9 million at December 31, and June 30, 2015.

Note 11: Small Business Lending Fund

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

The SBLF Preferred Stock qualifies as Tier 1 capital. The SBLF Preferred Stock is entitled to receive non-cumulative dividends, payable quarterly, on each January 1, April 1, July 1 and October 1, beginning October 1, 2011. The dividend rate, as a percentage of the liquidation amount, can fluctuate on a quarterly basis during the first 10 quarters during which the SBLF Preferred Stock is outstanding, based upon changes in the Bank's level of Qualified Small Business Lending (QBSL), as defined in the Purchase Agreement. Based upon the increase in the Bank's level of QBSL over the baseline level calculated under the terms of the Purchase Agreement, the dividend rate for the initial dividend period was set at 2.8155%. For the second through ninth calendar quarters, the dividend rate was adjusted to between one percent (1%) and five percent (5%) per annum, to reflect the amount of change in the Bank's level of QBSL. For the tenth calendar quarter through four and one half years after issuance, the dividend rate was fixed at between one percent (1%) and seven percent (7%) based upon the increase in QBSL as compared to the baseline. The dividend rate for the quarter ended December 31, 2015, was 1%. After four and one half years from issuance, the dividend rate would increase to 9% (including a quarterly lending incentive fee of 0.5%).

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

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

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

The Company noted in a Current Report on Form 8-k filed October 16, 2015, that it redeemed all 20,000 shares of the Company's Senior Preferred Non-Cumulative Perpetual Preferred Stock, Series A (the "Preferred Stock"), which were issued to the U.S. Department of the Treasury in July 2011 pursuant to Treasury's Small Business Lending Fund (SBLF) program. The shares of Preferred Stock were redeemed at their liquidation amount of $1,000 per share plus accrued but unpaid dividends to the redemption date.

Note 12: Fair Value Measurements

ASC Topic 820, Fair Value Measurements, defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Topic 820 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1 Quoted prices in active markets for identical assets or liabilities

Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in active markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities

Level 3 Unobservable inputs supported by little or no market activity that are significant to the fair value of the assets or liabilities

Recurring Measurements. The following table presents the fair value measurements of assets recognized in the accompanying balance sheets measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall at December 31, and June 30, 2015:

(dollars in thousands)	Fair Value Measurements at December 31, 2015, Using:			
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U.S. government sponsored enterprises (GSEs)	$13,882	$ -	$ 13,882	$ -
State and political subdivisions	45,381	-	45,381	-
Other securities	3,620	-	3,620	-
Mortgage-backed GSE residential	66,202	-	66,202	-

(dollars in thousands)	Fair Value Measurements at June 30, 2015, Using:			
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U.S. government sponsored enterprises (GSEs)	$14,814	$ -	$ 14,814	$ -
State and political subdivisions	42,021	-	42,021	-
Other securities	2,704	-	2,478	226
Mortgage-backed GSE residential	70,054	-	70,054	-

Following is a description of the valuation methodologies and inputs used for assets measured at fair value on a recurring basis and recognized in the accompanying consolidated balance sheets, as well as the general classification of such assets pursuant to the valuation hierarchy. There have been no significant changes in the valuation techniques during the period ended December 31, 2015.

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

The following table presents a reconciliation of activity for available for sale securities measured at fair value based on significant unobservable (Level 3) information for the three- and six-month periods ended December 31, 2015 and 2014:

	Three months ended	
(dollars in thousands)	December 31, 2015	December 31, 2014
Available-for-sale securities, beginning of period	$ -	$ 162
Total unrealized gain (loss) included in comprehensive income	-	10
Transferred from Level 3 to Level 2	-	-
Available-for-sale securities, end of period	$ -	$ 172

(dollars in thousands)	Six months ended December 31, 2015	December 31, 2014
Available-for-sale securities, beginning of period	$226	$ 133
Total unrealized gain (loss) included in comprehensive income	26	39
Transfer from Level 3 to Level 2	(252)	-
Available-for-sale securities, end of period	$-	$ 172

Nonrecurring Measurements. The following tables present the fair value measurement of assets measured at fair value on a nonrecurring basis and the level within the ASC 820 fair value hierarchy in which the fair value measurements fell at December 31 and June 30, 2015:

	Fair Value Measurements at December 31, 2015, Using:			
(dollars in thousands)	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans (collateral dependent)	$481	$ -	$ -	$ 481
Foreclosed and repossessed assets held for sale	3,735	-	-	3,735

	Fair Value Measurements at June 30, 2015, Using:			
(dollars in thousands)	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans (collateral dependent)	$515	$ -	$ -	$ 515
Foreclosed and repossessed assets held for sale	4,504	-	-	4,504

The following table presents gains and (losses) recognized on assets measured on a non-recurring basis for the six-month periods ended December 31, 2015 and 2014:

(dollars in thousands)	For the six months ended December 31, 2015	December 31, 2014
Impaired loans (collateral dependent)	$-	$ -
Foreclosed and repossessed assets held for sale	(176)	(7)
Total (losses) gains on assets measured on a non-recurring basis	$(176)	$ (7)

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

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

On a quarterly basis, loans classified as special mention, substandard, doubtful, or loss are evaluated including the loan officer's review of the collateral and its current condition, the Company's knowledge of the current economic environment in the market where the collateral is located, and the Company's recent experience with real estate in the area. The date of the appraisal is also considered in conjunction with the economic environment and any decline in the real estate market since the appraisal was obtained. For all loan types, updated appraisals are obtained if considered necessary. Of the Company's $16.1 million (carrying value) in impaired loans (collateral-dependent and purchased credit-impaired) at December 31, 2015, excluding TDR's, the Company utilized a real estate appraisal more than 12 months old to serve as the primary basis of our valuation for impaired loans with a carrying value of approximately $15.1. The remaining $1.0 million was secured by machinery, equipment and accounts receivable. In instances where the economic environment has worsened and/or the real estate market declined since the last appraisal, a higher distressed sale discount would be applied to the appraised value.

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

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

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

(dollars in thousands)	Fair value at December 31, 2015		Valuation technique	Unobservable inputs	Range of inputs applied	Weighted-average inputs applied
Nonrecurring Measurements						
Impaired loans (collateral dependent)	$	481	Internal evaluation of closely held stock	Discount to reflect realizable value	n/a	33.4%
Foreclosed and repossessed assets		3,735	Third party appraisal	Marketability discount	0.0% - 76.0%	36.9%

(dollars in thousands)	Fair value at June 30, 2015		Valuation technique	Unobservable inputs	Range of inputs applied	Weighted-average inputs applied
Recurring Measurements						
Available-for-sale securities (pooled trust preferred security)	$	226	Discounted cash flow	Discount rate	n/a	11.3%
				Annual prepayment rate	n/a	1.0%
					n/a	32.1%
				Projected defaults and deferrals (% of pool balance)	n/a	6.1%
				Anticipated recoveries		

					(% of pool balance)	
Nonrecurring Measurements						
Impaired loans (collateral dependent)	$	515	Internal evaluation of closely held stock	Discount to reflect realizable value	n/a	28.7%
Foreclosed and repossessed assets		4,504	Third party appraisal	Marketability discount	0.0% - 76.0%	33.0%

31

Fair Value of Financial Instruments. The following table presents estimated fair values of the Company's financial instruments and the level within the fair value hierarchy in which the fair value measurements fell at December 31 and June 30, 2015.

	December 31, 2015			
(dollars in thousands)	Carrying Amount	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial assets				
Cash and cash equivalents	$24,573	$24,573	$ -	$ -
Interest-bearing time deposits	1,221	-	1,221	-
Stock in FHLB	3,898	-	3,898	-
Stock in Federal Reserve Bank of St. Louis	2,340	-	2,340	-
Loans receivable, net	1,079,427	-	-	1,082,082
Accrued interest receivable	5,646	-	5,646	-
Financial liabilities				
Deposits	1,117,221	714,258	-	403,361
Securities sold under agreements to repurchase	23,066	-	23,066	-
Advances from FHLB	58,929	18,300	41,671	-
Accrued interest payable	700	-	700	-
Subordinated debt	14,705	-	-	11,624
Unrecognized financial instruments (net of contract amount)				
Commitments to originate loans	-	-	-	-
Letters of credit	-	-	-	-
Lines of credit	-	-	-	-

	June 30, 2015			
(dollars in thousands)	Carrying Amount	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial assets				
Cash and cash equivalents	$16,775	$16,775	$ -	$ -
Interest-bearing time deposits	1,944	-	1,944	-
Stock in FHLB	4,127	-	4,127	-
Stock in Federal Reserve Bank of St. Louis	2,340	-	2,340	-
Loans receivable, net	1,053,146	-	-	1,057,677

Accrued interest receivable	5,168	-	5,168	-
Financial liabilities				
Deposits	1,055,242	653,294	-	401,820
Securities sold under agreements to repurchase	27,332	-	27,332	-
Advances from FHLB	64,794	23,500	42,870	-
Accrued interest payable	777	-	777	-
Subordinated debt	14,658	-	-	12,290
Unrecognized financial instruments (net of contract amount)				
Commitments to originate loans	-	-	-	-
Letters of credit	-	-	-	-
Lines of credit	-	-	-	-

The following methods and assumptions were used in estimating the fair values of financial instruments:

Cash and cash equivalents and interest-bearing time deposits are valued at their carrying amounts, which approximates book value. Stock in FHLB and the Federal Reserve Bank of St. Louis is valued at cost, which approximates fair value. Fair value of loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities.

Loans with similar characteristics are aggregated for purposes of the calculations. The carrying amounts of accrued interest approximate their fair values.

The fair value of fixed-maturity time deposits is estimated using a discounted cash flow calculation that applies the rates currently offered for deposits of similar remaining maturities. Non-maturity deposits and securities sold under agreements are valued at their carrying value, which approximates fair value. Fair value of advances from the FHLB is estimated by discounting maturities using an estimate of the current market for similar instruments. The fair value of subordinated debt is estimated using rates currently available to the Company for debt with similar terms and maturities. The fair value of commitments to originate loans is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and committed rates. The fair value of letters of credit and lines of credit are based on fees currently charged for similar agreements or on the estimated cost to terminate or otherwise settle the obligations with the counterparties at the reporting date.

Note 13: Acquisitions

On August 5, 2014, the Company completed its acquisition of Peoples Service Company and its subsidiary, the Peoples Bank of the Ozarks, Nixa, Missouri (herein collectively, "Peoples Bank"). Peoples was merged into the Company's bank subsidiary, Southern Bank, in early December, 2014, in connection with the conversion of Peoples' data system. Included in noninterest expense for the three- and six-month periods ended December, 2014, was $381,000 and $508,000, respectively, in third-party acquisition related costs, with no comparable expenses in the current periods.

The following unaudited pro forma condensed financial information presents the results of operations of the Company, including the effects of the purchase accounting adjustments and acquisition expenses, had the acquisition taken place at the beginning of each period:

	For the three months ended December 31,		For the six months ended December 31,	
	2015	2014	2015	2014
(dollars in thousands except per share data)				
Interest income	14,235	14,357	28,207	28,765
Interest expense	2,335	2,195	4,602	4,385
Net interest income	11,900	12,162	23,605	24,380
Provision for loan losses	496	862	1,114	1,689
Noninterest income	2,791	2,187	4,992	4,164
Noninterest expense	8,166	8,590	16,154	17,978
Income before income taxes	6,029	4,897	11,329	8,877
Income taxes	1,820	1,460	3,485	2,767
Net income	4,209	3,437	7,844	6,110
Dividends on preferred shares	35	50	85	100
Net income available to common stockholders	4,174	3,387	7,759	6,010
Earnings per share				
Basic	$0.56	$0.46	$1.05	$0.81
Diluted	$0.56	$0.45	$1.04	$0.79

Basic weighted average shares outstanding - split adjusted	7,425,351	7,404,354	7,423,853	7,390,704
Diluted weighted average shares outstanding - split adjusted	7,460,184	7,592,922	7,456,657	7,577,246

The unaudited pro forma condensed combined financial statements do not reflect any anticipated cost savings and revenue enhancements. Accordingly, the pro forma results of operations of the Company as of and after the business combination may not be indicative of the results that actually would have occurred if the combination had been in effect during the periods presented or of the results that may be attained in the future.

PART I: Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations

SOUTHERN MISSOURI BANCORP, INC.

General

Southern Missouri Bancorp, Inc. (Southern Missouri or Company) is a Missouri corporation and owns all of the outstanding stock of Southern Bank (the Bank). The Company's earnings are primarily dependent on the operations of the Bank. As a result, the following discussion relates primarily to the operations of the Bank. The Bank's deposit accounts are generally insured up to a maximum of $250,000 by the Deposit Insurance Fund (DIF), which is administered by the Federal Deposit Insurance Corporation (FDIC). At December 31, 2015, the Bank operated from its headquarters, 31 full-service branch offices, and three limited-service branch offices. The Bank owns the office building and related land in which its headquarters are located, and 29 of its other branch offices. The remaining five branches are either leased or partially owned.

The significant accounting policies followed by Southern Missouri and its wholly owned subsidiaries for interim financial reporting are consistent with the accounting policies followed for annual financial reporting. All adjustments, which are of a normal recurring nature and are in the opinion of management necessary for a fair statement of the results for the periods reported, have been included in the accompanying consolidated condensed financial statements.

The consolidated balance sheet of the Company as of June 30, 2015, has been derived from the audited consolidated balance sheet of the Company as of that date. Certain information and note disclosures normally included in the Company's annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. These consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Form 10-K annual report filed with the Securities and Exchange Commission.

Management's discussion and analysis of financial condition and results of operations is intended to assist in understanding the financial condition and results of operations of the Company. The information contained in this section should be read in conjunction with the unaudited consolidated financial statements and accompanying notes. The following discussion reviews the Company's condensed consolidated financial condition at December 31, 2015, and results of operations for the three- and six-month periods ended December 31, 2015 and 2014.

Forward Looking Statements

This document contains statements about the Company and its subsidiaries which we believe are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements may include, without limitation, statements with respect to anticipated future operating and financial performance, growth opportunities, interest rates, cost savings and funding advantages expected or anticipated to be realized by management. Words such as "may," "could," "should," "would," "believe," "anticipate," "estimate," "expect," "intend," "plan" and similar expressions are intended to identify these forward looking statements. Forward-looking statements by the Company and its management are based on beliefs, plans, objectives, goals, expectations, anticipations, estimates and intentions of management and are not guarantees of future performance. The important factors we discuss below, as well as other factors discussed under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations" and identified in this filing and in our other filings with the SEC and those presented elsewhere by our management from time to time, could cause actual results to differ materially from those indicated by the forward-looking statements made in this document:

.

- the strength of the United States economy in general and the strength of the local economies in which we conduct operations;
- fluctuations in interest rates and in real estate values;
- monetary and fiscal policies of the Board of Governors of the Federal Reserve System (the "Federal Reserve Board") and the U.S. Government and other governmental initiatives affecting the financial services industry;
- the risks of lending and investing activities, including changes in the level and direction of loan delinquencies and write-offs and changes in estimates of the adequacy of the allowance for loan losses;
- our ability to access cost-effective funding;

- the timely development of and acceptance of our new products and services and the perceived overall value of these products and services by users, including the features, pricing and quality compared to competitors' products and services;
- expected cost savings, synergies and other benefits from our merger and acquisition activities, including our acquisition of Peoples Service Company and our other recently completed acquisitions, might not be realized within the anticipated time frames or at all, and costs or difficulties relating to integration matters, including but not limited to customer and employee retention, might be greater than expected;
- fluctuations in real estate values and both residential and commercial real estate market conditions;
- demand for loans and deposits in our market area;
- legislative or regulatory changes that adversely affect our business;
- results of examinations of us by our regulators, including the possibility that our regulators may, among other things, require us to increase our reserve for loan losses or to write-down assets;
- the impact of technological changes; and
- our success at managing the risks involved in the foregoing.

The Company disclaims any obligation to update or revise any forward-looking statements based on the occurrence of future events, the receipt of new information, or otherwise.

Non-GAAP Disclosures

The following financial measures contain information determined by methods other than in accordance with accounting principles generally accepted in the United States (commonly referred to as GAAP):

- net income available to common shareholders excluding the accretion of fair value discount on acquired loans and amortization of fair value premium on assumed time deposits;
- return on average assets excluding the accretion of fair value discount on acquired loans and amortization of fair value premium on assumed time deposits;
- return on average common equity excluding the accretion of fair value discount on acquired loans and amortization of fair value premium on assumed time deposits;
- net interest margin excluding the accretion of fair value discount on acquired loans and amortization of fair value premium on assumed time deposits;

These measures indicate what net income available to common shareholders, return on average assets, return on average common equity, and net interest margin would have been without the impact of the accretion of fair value discount on acquired loans and amortization of fair value premium on assumed time deposits resulting from the August 2014 acquisition of Peoples Service Company and its subsidiary, Peoples Bank of the Ozarks (the Peoples Acquisition). Management believes that showing these measures excluding these items provides useful information by which to evaluate the Company's operating performance on an ongoing basis from period to period. Other acquisitions, with smaller acquired loan balances remaining, result in less variation between GAAP and what management believes to be core operating results, and are therefore not reflected in this disclosure, although they may have been included in prior presentations.

These non-GAAP financial measures are supplemental and are not a substitute for an analysis based on GAAP measures. Because not all companies use identical calculations, these non-GAAP financial measures might not be comparable to other similarly-titled measures as determined and disclosed by other companies. Reconciliations to GAAP of these non-GAAP financial measures presented are set forth below.

The following table presents reconciliation to GAAP of net income available to common stockholders excluding accretion of fair value discount on acquired loans and amortization of fair value premium on assumed time deposits related to the Peoples Acquisition:

35

(dollars in thousands)	For the three months ended December 31, 2015	December 31, 2014	For the six months ended December 31, 2015	December 31, 2014
Net income available to common stockholders	$4,174	$ 3,387	$7,759	$ 6,633
Less: impact of excluding accretion of fair value discount on acquired loans and amortization of fair value premium on acquired time deposits related to the Peoples Acquisition, net of tax	348	451	606	695
Net income available to common shareholders - excluding accretion of fair value discount on acquired loans and amortization of fair value premium on acquired time deposits related to the Peoples Acquisition, net of tax	$3,826	$ 2,936	$7,153	$ 5,938

The following table presents reconciliation to GAAP of return on average assets excluding accretion of fair value discount on acquired loans and amortization of fair value premium on assumed time deposits related to the Peoples Acquisition:

	For the three months ended December 31, 2015	December 31, 2014	For the six months ended December 31, 2015	December 31, 2014
Return on average assets	1.27%	1.06 %	1.20%	1.07 %
Less: impact of excluding accretion of fair value discount on acquired loans and amortization of fair value premium on acquired time deposits related to the Peoples Acquisition, net of tax	0.10%	0.14 %	0.10%	0.11 %
Return on average assets - excluding accretion of fair value discount on acquired loans and amortization of fair value premium on acquired time deposits related to the Peoples Acquisition, net of tax	1.17%	0.92 %	1.10%	0.96 %

The following table presents reconciliation to GAAP of return on average common equity excluding accretion of fair value discount on acquired loans and amortization of fair value premium on assumed time deposits related to the Peoples Acquisition:

	For the three months ended December 31, 2015	December 31, 2014	For the six months ended December 31, 2015	December 31, 2014
Return on average common equity	13.98%	12.51 %	13.28%	12.82 %
Less: impact of excluding accretion of fair value discount on acquired loans and amortization of fair value premium on acquired time deposits related to the Peoples Acquisition, net of tax	1.16 %	1.67 %	1.03 %	1.34 %
Return on average common equity - excluding accretion of fair value discount on acquired loans and amortization of fair value premium on acquired time deposits related to the Peoples Acquisition, net of tax	12.82%	10.84 %	12.25%	11.48 %

The following table presents reconciliation to GAAP of net interest margin excluding accretion of fair value discount on acquired loans and amortization of fair value premium on assumed time deposits related to the Peoples Acquisition:

36

	For the three months ended December 31, 2015		For the three months ended December 31, 2014		For the six months ended December 31, 2015		For the six months ended December 31, 2014	
Net interest margin	3.88	%	4.03	%	3.88	%	3.98	%
Less: impact of excluding accretion of fair value discount on acquired loans and amortization of fair value premium on acquired time deposits related to the Peoples Acquisition	0.18	%	0.24	%	0.16	%	0.19	%
Net interest margin - excluding accretion of fair value discount on acquired loans and amortization of fair value premium on acquired time deposits related to the Peoples Acquisition	3.70	%	3.79	%	3.72	%	3.79	%

Critical Accounting Policies

Accounting principles generally accepted in the United States of America are complex and require management to apply significant judgments to various accounting, reporting and disclosure matters. Management of the Company must use assumptions and estimates to apply these principles where actual measurement is not possible or practical. For a complete discussion of the Company's significant accounting policies, see "Notes to the Consolidated Financial Statements" in the Company's 2015 Annual Report. Certain policies are considered critical because they are highly dependent upon subjective or complex judgments, assumptions and estimates. Changes in such estimates may have a significant impact on the financial statements. Management has reviewed the application of these policies with the Audit Committee of the Company's Board of Directors. For a discussion of applying critical accounting policies, see "Critical Accounting Policies" beginning on page 57 in the Company's 2015 Annual Report.

Executive Summary

Our results of operations depend primarily on our net interest margin, which is directly impacted by the interest rate environment. The net interest margin represents interest income earned on interest-earning assets (primarily real estate loans, commercial and agricultural loans, and the investment portfolio), less interest expense paid on interest-bearing liabilities (primarily certificates of deposit, interest-bearing transaction accounts, savings and money market deposit accounts, repurchase agreements, and borrowed funds), as a percentage of average interest-earning assets. Net interest margin is directly impacted by the spread between long-term interest rates and short-term interest rates, as our interest-earning assets, particularly those with initial terms to maturity or repricing greater than one year, generally price off longer term rates while our interest-bearing liabilities generally price off shorter term interest rates. This difference in longer term and shorter term interest rates is often referred to as the steepness of the yield curve. A steep yield curve – in which the difference in interest rates between short term and long term periods is relatively large – could be beneficial to our net interest income, as the interest rate spread between our interest-earning assets and interest-bearing liabilities would be larger. Conversely, a flat or flattening yield curve, in which the difference in rates between short term and long term periods is relatively small or shrinking, or an inverted yield curve, in which short term rates exceed long term rates, could have an adverse impact on our net interest income, as our interest rate spread could decrease.

Our results of operations may also be affected significantly by general and local economic and competitive conditions, particularly those with respect to changes in market interest rates, government policies and actions of regulatory authorities.

During the first six months of fiscal 2016, we grew our balance sheet by $37.6 million. Balance sheet growth was primarily attributable to loan growth. Loans, net of the allowance for loan losses, increased $26.3 million. Cash equivalents and time deposits increased a combined $7.1 million, fixed assets increased $5.8 million, and available-for-sale investments decreased $508,000. Deposits increased $62.0 million, due in part to seasonal inflows of public unit deposits; securities sold under agreements to repurchase decreased $4.3 million; and advances from the Federal Home Loan Bank (FHLB) decreased $5.9 million, with the decrease resulting from lower overnight borrowings. Equity decreased $13.4 million, due to the Company's redemption in October 2015 of $20.0 million in Senior Non-Cumulative Perpetual Preferred Stock, Series A (SBLF Preferred Stock) which had been issued in July 2011 under the U.S. Treasury's Small Business Lending Fund (SBLF), partially offset by retention of net income.

Net income for the first six months of fiscal 2016 was $7.8 million, an increase of $1.1 million, or 16.5% as compared to the same period of the prior fiscal year. After accounting for dividends on preferred stock of $85,000 in the current period, net earnings available to common shareholders were $7.8 million in the six-month period ended December

31, 2015, an increase of 17.0% as compared to the same period of the prior fiscal year. Compared to the year-ago period, the Company's increase in net income was the result of an increase in noninterest income, a decrease in provision for loan losses, an increase in net interest income, and a decrease in non-interest expense, partially offset by an increase in provision for income taxes. Diluted net income available to common shareholders was $1.04 per share for the first six months of fiscal 2016, as compared to $0.89 per share for the same period of the prior fiscal year, adjusted for the two-for-one common stock split in the form of a 100% common stock dividend paid in January 2015. For the first six months of fiscal 2016, noninterest income increased $826,000, or 19.8%; provision for loan losses decreased $575,000, or 34.0%; net interest income increased $316,000, or 1.4%; noninterest expense decreased $38,000, or 0.2%; and provision for income taxes increased $644,000, or 22.7%, as compared to the same period of the prior fiscal year. For more information see "Results of Operations."

Interest rates were volatile during the first six months of fiscal 2016, moving lower in late July and August, stabilizing in September and October, then moving back higher in November as the market came to the conclusion that a rate increase by the Federal Reserve's Federal Open Market Committee (FOMC) was likely. The FOMC did increase the federal funds rate target in December, and short term rates most affected by FOMC policy moved higher as a result, flattening the yield curve. A flat or flattening yield curve is generally detrimental to the Company. Market sentiment regarding the likelihood the FOMC's ability to execute multiple additional rate increases which they have projected for 2016 has recently become less certain. Our average yield on earning assets decreased, as reinvestment at relatively low market rates was partially offset by a shift in the earning asset mix towards higher-yielding investment types (see "Results of Operations: Comparison of the three- and six-month periods ended December 31, 2015 and 2014 – Net Interest Income"). Meanwhile, our cost of funds increased slightly.

Our net interest margin decreased by ten basis points when comparing the first six months of fiscal 2016 to the same period of the prior fiscal year. The deterioration was attributable primarily to lower loan yields, partially offset by holding an increased percentage of our earning assets in loans, versus securities and cash equivalents. Purchase accounting adjustments related to the Peoples Acquisition, in which the Company acquired loans at a material discount, were reduced, as a result of the lower average balance of those acquired loans during the current period, partially offset by a benefit resulting from the resolution of a purchased credit-impaired loan with a carrying value less than the payoff realized, and the holding of those discounted assets for a full six months in the current period, as compared to holding them for a five-month period beginning on the August 5, 2014, closing of the acquisition through the December 31, 2014, end of the comparable period. Net interest income resulting from the accretion of this discount (and a smaller premium on acquired time deposits) in the first six months of fiscal 2016 decreased to $969,000, as compared to $1.2 million in the first six months of fiscal 2015. This component of net interest income contributed 16 basis points to the net interest margin in the current six-month period, as compared to 20 basis points in the year-ago period. The Company expects that as the acquired loan portfolio pays down, the positive impact on net interest income of discount accretion resulting from the acquisition will be reduced. Our core net interest margin, excluding this income, decreased to 3.72% in the current six-month period, as compared to 3.78% in the prior year's six-month period.

The Company's net income is also affected by the level of its noninterest income and noninterest expenses. Non-interest income generally consists primarily of deposit account service charges, bank card interchange income, loan-related fees, increases in the cash value of bank-owned life insurance, gains on sales of loans, and other general operating income. Noninterest expenses consist primarily of compensation and employee benefits, occupancy-related expenses, deposit insurance assessments, professional fees, advertising, postage and office expenses, insurance, bank card network expenses, the amortization of intangible assets, and other general operating expenses. During the six-month period ended December 31, 2015, noninterest income increased $826,000, or 19.8%, as compared to the same period of the prior fiscal year, attributable to nonrecurring items related to bank-owned life insurance and the Company's ownership of stock in Ozark Trust and Investment Corporation, the acquisition of which by Simmons First National corporation closed during the quarter ended December 31, 2015. For the six-month period, aside from the nonrecurring items noted, noninterest income was up, as increased deposit account service charges, bank card interchange income, and loan fees were partially offset by lower gains realized on sales of residential loans into the secondary market. Noninterest expense for the six-month period ended December 31, 2015, decreased $38,000, or 0.2%, as compared to the same period of the prior fiscal year. The decrease was primarily attributable to inclusion in the prior period's results of charges totaling $487,000 related to merger activity, with no comparable expenses in the current period, partially offset by higher occupancy and advertising expenses in the current period.

We expect, over time, to continue to grow our assets through the origination and occasional purchase of loans, and purchases of investment securities. The primary funding for this asset growth is expected to come from retail deposits, brokered funding, and short- and long-term FHLB borrowings. We have grown and intend to continue to grow deposits by offering desirable deposit products for our current customers and by attracting new depository relationships. We will also continue to explore strategic expansion opportunities in market areas that we believe will be attractive to our business model.

Comparison of Financial Condition at December 31 and June 30, 2015

The Company experienced balance sheet growth in the first six months of fiscal 2016, with total assets of $1.3 billion at December 31, 2015, reflecting an increase of $37.6 million, or 2.9%, as compared to June 30, 2015. Balance sheet growth was funded primarily through deposit growth.

Available-for-sale (AFS) securities were $129.1 million at December 31, 2015, a decrease of $508,000, or 0.4%, as compared to June 30, 2015. The decrease was attributable to principal payments received on mortgage-backed securities and U.S. government agency obligations, partially offset by purchases of municipal securities. Cash equivalents and time deposits were $25.8 million, an increase of $7.1 million, or 37.8%, as compared to June 30, 2015.

Loans, net of the allowance for loan losses, were $1.1 billion at December 31, 2015, an increase of $26.3 million, or 2.5%, as compared to June 30, 2015. The increase was primarily attributable to growth in residential real estate loan, construction loan, and commercial real estate loan balances, partially offset by lower consumer and commercial loan balances.

Premises and equipment, net of accumulated depreciation, were $45.5 million at December 31, 2015, an increase of $5.8 million, or 14.5%, as compared to June 30, 2015. The increase was primarily attributable to ongoing construction of a new corporate headquarters office in Poplar Bluff, Missouri, and the finishing of leased office space in Springfield, Missouri, partially offset by an increase in accumulated depreciation.

Deposits were $1.1 billion at December 31, 2015, an increase of $62.0 million, or 5.9%, as compared to June 30, 2015. The increase was primarily attributable to growth in interest-bearing and noninterest-bearing transaction accounts, money market deposit accounts, and certificates of deposit, partially offset by decreases in statement and passbook savings accounts. The decline in savings account balances was attributed to larger public unit depositors shifting balances between deposit account types. The increase in deposits during the quarter ended December 31, 2015, was due in part to seasonal inflows of public unit deposits, which were up $26.5 million from September 30, 2015, and which generally reverse somewhat in the following quarter. The average loan-to-deposit ratio for the first quarter of fiscal 2016 was 99.2%, as compared to 98.9% for the same period of the prior fiscal year.

FHLB advances were $58.9 million at December 31, 2015, a decrease of $5.9 million, or 9.1%, as compared to June 30, 2015. The decrease was attributable to the Company's reduction in overnight borrowings due to strong deposit growth during the six months ended December 31, 2015. Securities sold under agreements to repurchase totaled $23.1 million at December 31, 2015, a decrease of $4.3 million, or 15.6%, as compared to June 30, 2015. At both dates, the full balance of repurchase agreements was due to local small business and government counterparties.

The Company's stockholders' equity was $119.2 million at December 31, 2015, a decrease of $13.4 million, or 10.1%, as compared to June 30, 2015. The decrease was attributable to the redemption of the Company's redemption in October 2015 of $20.0 million in SBLF preferred stock, combined with the payment of dividends on common and preferred stock, partially offset by retention of net income and an increase in accumulated other comprehensive income.

Average Balance Sheet, Interest, and Average Yields and Rates for the Three- and Six-Month Periods Ended December 31, 2015 and 2014

The tables below present certain information regarding our financial condition and net interest income for the three- and six-month periods ended December 31, 2015 and 2014. The tables present the annualized average yield on interest-earning assets and the annualized average cost of interest-bearing liabilities. We derived the yields and costs by dividing annualized income or expense by the average balance of interest-earning assets and interest-bearing liabilities, respectively, for the periods shown. Yields on tax-exempt obligations were not computed on a tax equivalent basis.

(dollars in thousands)	Three months ended December 31, 2015 Average Balance	Interest and Dividends	Yield/ Cost (%)	Three months ended December 31, 2014 Average Balance	Interest and Dividends	Yield/ Cost (%)
Interest earning assets:						
Mortgage loans (1)	$856,442	$ 10,566	4.93	$817,935	$ 10,530	5.15
Other loans (1)	224,084	2,796	4.99	212,886	2,831	5.32
Total net loans	1,080,526	13,362	4.95	1,030,821	13,361	5.18
Mortgage-backed securities	66,030	368	2.23	82,584	448	2.17
Investment securities (2)	69,014	496	2.87	72,921	499	2.74
Other interest earning assets	10,352	9	0.35	20,542	49	0.95
Total interest earning assets (1)	1,225,922	14,235	4.64	1,206,868	14,357	4.76
Other noninterest earning assets (3)	96,411	-		90,683	-	
Total assets	$1,322,333	$ 14,235		$1,297,551	$ 14,357	
Interest bearing liabilities:						
Savings accounts	$122,427	98	0.32	$109,137	100	0.37
NOW accounts	362,918	669	0.74	294,350	576	0.78
Money market deposit accounts	77,224	56	0.29	96,213	56	0.23
Certificates of deposit	400,940	1,024	1.02	420,866	971	0.92
Total interest bearing deposits	963,509	1,847	0.77	920,566	1,703	0.74
Borrowings:						
Securities sold under agreements to repurchase	24,861	29	0.47	23,475	27	0.46
FHLB advances	70,108	320	1.83	88,642	333	1.50
Subordinated debt	14,694	139	3.78	14,606	132	3.61
Total interest bearing liabilities	1,073,172	2,335	0.87	1,045,289	2,195	0.84
Noninterest bearing demand deposits	125,759	-		121,280	-	
Other noninterest bearing liabilities	755	-		658	-	
Total liabilities	1,199,686	2,335		1,167,227	2,195	
Stockholders' equity	122,647	-		128,324	-	
Total liabilities and stockholders' equity	$1,322,333	$ 2,335		$1,297,551	$ 2,195	
Net interest income		$ 11,900			$ 12,162	
Interest rate spread (4)			3.77 %			3.92 %
Net interest margin (5)			3.88 %			4.03 %
Ratio of average interest-earning assets to average interest-bearing liabilities	114.23 %			115.46 %		

(1) Calculated net of deferred loan fees, loan discounts and loans-in-process. Non-accrual loans are included in average loans.
(2) Includes FHLB and Federal Reserve Bank of St. Louis membership stock and related cash dividends.
(3) Includes average balances for fixed assets and BOLI of $41.8 million and $19.7 million, respectively, for the three-month period ended December 31, 2015, as compared to $32.7 million and $19.3 million, respectively, for

the same period of the prior fiscal year.

(4) Interest rate spread represents the difference between the average rate on interest-earning assets and the average cost of interest-bearing liabilities.

(5) Net interest margin represents net interest income divided by average interest-earning assets.

(dollars in thousands)	Six months ended December 31, 2015 Average Balance	Interest and Dividends	Yield/ Cost (%)	Six months ended December 31, 2014 Average Balance	Interest and Dividends	Yield/ Cost (%)
Interest earning assets:						
Mortgage loans (1)	$845,110	$ 20,773	4.92	$785,550	$ 20,112	5.12
Other loans (1)	227,078	5,687	5.01	204,890	5,474	5.34
Total net loans	1,072,188	26,460	4.94	990,440	25,586	5.17
Mortgage-backed securities	66,939	738	2.20	79,779	863	2.16
Investment securities (2)	68,436	992	2.90	76,059	1,045	2.75
Other interest earning assets	9,920	17	0.34	23,934	82	0.69
Total interest earning assets (1)	1,217,483	28,207	4.63	1,170,212	27,576	4.71
Other noninterest earning assets (3)	93,924	-		83,771	-	
Total assets	$1,311,407	$ 28,207		$1,253,983	$ 27,576	
Interest bearing liabilities:						
Savings accounts	$126,409	203	0.32	$114,344	199	0.35
NOW accounts	351,699	1,319	0.75	284,843	1,131	0.79
Money market deposit accounts	72,823	101	0.28	79,683	101	0.25
Certificates of deposit	398,369	2,010	1.01	398,151	1,874	0.94
Total interest bearing deposits	949,300	3,633	0.77	877,021	3,305	0.75
Borrowings:						
Securities sold under agreements to repurchase	25,373	58	0.46	24,037	55	0.45
FHLB advances	69,475	637	1.83	103,842	673	1.30
Subordinated debt	14,682	274	3.73	13,587	254	3.74
Total interest bearing liabilities	1,058,830	4,602	0.87	1,018,487	4,287	0.84
Noninterest bearing demand deposits	123,021	-		110,579	-	
Other noninterest bearing liabilities	1,106	-		1,373	-	
Total liabilities	1,182,957	4,602		1,130,439	4,287	
Stockholders' equity	128,450	-		123,544	-	
Total liabilities and stockholders' equity	$1,311,407	$ 4,602		$1,253,983	$ 4,287	
Net interest income		$ 23,605			$ 23,289	
Interest rate spread (4)			3.76 %			3.87 %
Net interest margin (5)			3.88 %			3.98 %
Ratio of average interest-earning assets to average interest-bearing liabilities	114.98 %			114.90 %		

(1) Calculated net of deferred loan fees, loan discounts and loans-in-process. Non-accrual loans are included in average loans.
(2) Includes FHLB and Federal Reserve Bank of St. Louis membership stock and related cash dividends.
(3) Includes average balances for fixed assets and BOLI of $40.2 million and $19.7 million, respectively, for the six-month period ended December 31, 2015, as compared to $30.3 million and $19.2 million, respectively, for the

same period of the prior fiscal year.

(4) Interest rate spread represents the difference between the average rate on interest-earning assets and the average cost of interest-bearing liabilities.

(5) Net interest margin represents net interest income divided by average interest-earning assets.

Rate/Volume Analysis

The following tables set forth the effects of changing rates and volumes on the Company's net interest income for the three- and six-month periods ended December 31, 2015. Information is provided with respect to (i) effects on interest income and expense attributable to changes in volume (changes in volume multiplied by the prior rate), (ii) effects on interest income and expense attributable to change in rate (changes in rate multiplied by prior volume), and (iii) changes in rate/volume (change in rate multiplied by change in volume).

	Three months ended December 31, 2015 Compared to three months ended December 31, 2014 Increase (Decrease) Due to			
(dollars in thousands)	Rate	Volume	Rate/ Volume	Net
Interest-earnings assets:				
Loans receivable (1)	$(614)	$ 644	$ (29)	$1
Mortgage-backed securities	12	(90)	(2)	(80)
Investment securities (2)	25	(27)	(1)	(3)
Other interest-earning deposits	(30)	(24)	14	(40)
Total net change in income on interest-earning assets	(607)	503	(18)	(122)
Interest-bearing liabilities:				
Deposits	71	89	(16)	144
Securities sold under agreements to repurchase	-	2	-	2
Subordinated debt	5	1	1	7
FHLB advances	71	(70)	(14)	(13)
Total net change in expense on interest-bearing liabilities	147	22	(29)	140
Net change in net interest income	$(754)	$ 481	$ 11	$(262)

	Six months ended December 31, 2015 Compared to six months ended December 31, 2014 Increase (Decrease) Due to			
(dollars in thousands)	Rate	Volume	Rate/ Volume	Net
Interest-earnings assets:				
Loans receivable (1)	$(1,143)	$2,112	$ (95)	$874
Mortgage-backed securities	16	(139)	(2)	(125)
Investment securities (2)	56	(105)	(4)	(53)
Other interest-earning deposits	(42)	(48)	25	(65)
Total net change in income on interest-earning assets	(1,113)	1,820	(76)	631

Interest-bearing liabilities:				
Deposits	(7)	295	40	328
Securities sold under agreements to repurchase	1	3	(1)	3
Subordinated debt	(1)	20	1	20
FHLB advances	279	(223)	(92)	(36)
Total net change in expense on interest-bearing liabilities	272	95	(52)	315
Net change in net interest income	$(1,385)	$ 1,725	$ (24)	$316

(1) Does not include interest on loans placed on nonaccrual status.
(2) Does not include dividends earned on equity securities.

Results of Operations – Comparison of the three- and six-month periods ended December 31, 2015 and 2014

General. Net income for the three- and six-month periods ended December 31, 2015, was $4.2 million and $7.8 million, respectively, increases of $772,000, or 22.4%, and $1.1 million, or 16.5%, as compared to the same periods of the prior fiscal year. After preferred dividends of $35,000 and $85,000, respectively, paid in the three- and six-month periods ended December 31, 2015, net income available to common shareholders was $4.2 million and $7.8 million, respectively, increases of $787,000, or 23.2%, and $1.1 million, or 17.0%, respectively, as compared to the same periods of the prior fiscal year, when preferred dividends of $50,000 and $100,000, respectively, were paid.

For the three-month period ended December 31, 2015, both basic and fully-diluted net income per share available to common shareholders was $0.56, an increase of $0.10, or 21.7%, and $.0.11, or 24.4%, respectively, as compared to basic and fully-diluted net income per share available to common shareholders in the same period of the prior fiscal year. Our annualized return on average assets for the three-month period ended December 31, 2015, was 1.27%, as compared to 1.06% for the same period of the prior fiscal year. Excluding accretion of fair value discount on acquired loans and amortization of fair value premium on assumed time deposits related to the Peoples Acquisition, return on average assets for the three-month period ended December 31, 2015, was 1.17%, as compared to 0.92% for the same period of the prior fiscal year. Our return on average common stockholders' equity for the three-month period ended December 31, 2015, was 14.0%, as compared to 12.5% in the same period of the prior fiscal year.

For the six-month period ended December 31, 2014, basic and fully-diluted net income per share available to common shareholders was $1.05 and $1.04, respectively, increases of $0.14, or 15.4%, and $0.15, or 16.9% respectively, as compared to the same period of the prior fiscal year. Our annualized return on average assets for the six-month period ended December 31, 2015, was 1.20%, as compared to 1.07% for the same period of the prior fiscal year. Excluding accretion of fair value discount on acquired loans and amortization of fair value premium on assumed time deposits related to the Peoples Acquisition, return on average assets for the six-month period ended December 31, 2015, was 1.10%, as compared to 0.96% for the same period of the prior fiscal year. Our return on average common stockholders' equity for the six-month period ended December 31, 2015, was 13.3%, as compared to 12.8% in the same period of the prior fiscal year.

Net Interest Income. Net interest income for the three-month period ended December 31, 2015, was $11.9 million, a decrease of $262,000, or 2.1%, as compared to the same period of the prior fiscal year. Net interest income attributable to the accretion of fair value discount on acquired loans and amortization of fair value premium on assumed time deposits related to the Peoples Acquisition was $557,000, in the current three-month period, as compared to $722,000 in the same period of the prior fiscal year.

Net interest income for the six-month period ended December 31, 2015, was $23.6 million, an increase of $316,000, or 1.4%, as compared to the same period of the prior fiscal year. Net interest income attributable to the accretion of fair value discount on acquired loans and amortization of fair value premium on assumed time deposits related to the Peoples Acquisition was $1.0 million in the current six-month period, as compared to $1.1 million in the same period of the prior fiscal year.

Our net interest margin for the three- and six-month periods ended December 31, 2015, determined by dividing annualized net interest income by total average interest-earning assets, was 3.88%, as compared to 4.03% and 3.98% in the same periods of the prior fiscal year. Our net interest margin excluding accretion of fair value discount on acquired loans and amortization of fair value premium on assumed time deposits related to the Peoples Acquisition was 3.70% and 3.72%, respectively, for the three-and six-month periods ended December 31, 2015, as compared to 3.79% for the same periods of the prior fiscal year. Our average net interest rate spread for the three- and six-month periods ended December 31, 2015, was 3.77% and 3.76%, respectively, as compared to 3.92% and 3.87%, respectively, for the same periods of the prior fiscal year.

For the three-month period ended December 31, 2015, our average net interest rate spread was 3.77%, as compared to 3.92% in the same period of the prior fiscal year, resulting from a 12 basis point decrease in the average yield on interest-earning assets, combined with a three basis point increase in the average cost of interest-bearing liabilities. The average balance of our interest-earning assets increased $19.1 million, or 1.6%, when comparing the three-month period ended December 31, 2015, with the same period of the prior fiscal year.

For the six-month period ended December 31, 2015, our average net interest rate spread was 3.76%, as compared to 3.87% in the same period of the prior fiscal year, resulting from an eight basis point decrease in the average yield on interest earning assets, combined with a three basis point increase in the average cost of interest-bearing liabilities.

The average balance of our interest-earning assets increased $47.3 million, or 4.0%, when comparing the six-month period ended December 31, 2015, with the same period of the prior fiscal year, due in part to the August 2014 completion of the Peoples Acquisition.

Interest Income. Total interest income for the three-month period ended December 31, 2015, was $14.2 million, a decrease of $122,000, or 0.9%, as compared to the same period of the prior fiscal year. The decrease was attributed to a twelve basis point decline in the average yield earned on interest-earning assets in the current period compared to the year ago period, partially offset by a 1.6% increase in the average balance of interest-earning assets for the current period as compared to the year ago period. The decline in yields earned was due to the continued generally low rate environment and reinvestment in interest earning assets at current market rates, along with a reduction in the accretion of fair value discount on loans acquired in the Peoples Acquisition which closed in early August 2014, while the increase in average balances was the result of higher average loan balances, partially offset by lower average balances for other interest-earning assets, including cash equivalents and available for sale investments.

Total interest income for the six-month period ended December 31, 2015, was $28.2 million, an increase of $631,000, or 2.3%, as compared to the same period of the prior fiscal year. The increase was attributed to a 4.6% increase in the average balance of interest-earning assets for the current period as compared to the year ago period, partially offset by an eight basis point decline in the average yield earned on interest-earning assets in the current period compared to the year ago period. The increase in average balances was due to higher average loan balances, partially offset by lower average balances for other interest-earning assets, including cash equivalents and available for sale investments, while the decline in yields earned was the result of the continued generally low rate environment and reinvestment in interest earning assets at current market rates, along with a reduction in the accretion of fair value discount on loans acquired in the Peoples Acquisition which closed in early August 2014.

Interest Expense. Total interest expense for the three- and six-month periods ended December 31, 2015 was $2.3 million and $4.6 million, increases of $140,000, or 6.3%, and $315,000, or 7.4%, respectively, as compared to the same periods of the prior fiscal year. The increases for the three- and six-month periods ended December 31, 2015, as compared to the same periods of the prior fiscal year were attributed to increases of three basis points in the average cost of interest-bearing liabilities, combined with increases of $25.9 million, or 2.5%, and $40.3 million, or 4.0%, respectively, in the average balance of interest-bearing liabilities. The increase in the average cost of interest-bearing liabilities was due to a reduced percentage of funding provided by relatively low-cost overnight funding (due to an increase in deposit growth) and an increasing cost of funds at recently-acquired facilities as those depositors shift to legacy Southern Bank products which, on average, have paid higher rates than those previously offered by acquired institutions. The increase in average balances was the result higher average interest-bearing deposit balances, partially offset by lower average balances of FHLB advances.

Provision for Loan Losses. The provision for loan losses for the three- and six-month periods ended December 31, 2015, was $496,000 and $1.1 million, respectively, as compared to $862,000 and $1.7 million, respectively, in the same periods of the prior fiscal year. As a percentage of average loans outstanding, provision for loan losses in the current three- and six-month periods represented an annualized charge of 0.18% and 0.21%, respectively, while the Company incurred net charge offs of 0.05% and 0.04%, respectively. During the same periods of the prior fiscal year, provision for loan losses as a percentage of average loans outstanding represented an annualized charge of 0.33% and 0.34%, respectively, while the Company incurred net charge offs in the three-month period of 0.01% (annualized), and recognized net recoveries in the six-month period of less than one basis point (annualized). The decrease was primarily attributable to slower loan growth during the current fiscal year and generally stable credit quality. (See "Critical Accounting Policies", "Allowance for Loan Loss Activity" and "Nonperforming Assets").

Noninterest Income. The Company's noninterest income for the three- and six-month periods ended December 31, 2015, was $2.8 million and $5.0 million, respectively, increases of $604,000, or 27.6%, and $826,000, or 19.8%, respectively, as compared to the same periods of the prior fiscal year. The increases included nonrecurring items recognized in the current three- and six-month periods of $323,000 related to the bank-owned life insurance and $301,000 related to the Company's ownership of stock in Ozarks Trust and Investment Corporation, the acquisition of which by Simmons First National Corporation closed during the quarter ended December 31, 2015. The bank-owned life insurance benefit is not subject to income tax. Aside from these nonrecurring items, other noninterest income categories were down slightly in total for the current three-month period, as compared to the same period of the prior fiscal year, as decreases in deposit account charges and gains realized on sales of residential loans into the secondary market were partially offset by increases in bank card interchange income and loan fees. For the six-month period, aside from the nonrecurring items noted, noninterest income was up, as increased deposit account service charges, bank card interchange income, and loan fees were partially offset by lower gains realized on sales of residential loans into the secondary market.

Noninterest Expense. Noninterest expense for the three- and six-month periods ended December 31, 2015, was $8.2 million and $16.2 million, respectively, decreases of $424,000, or 4.9%, and $38,000, or 0.2%, as compared to the same periods of the prior fiscal year. The decreases were attributed to lower legal and professional fees, compensation, amortization of intangibles, and deposit insurance premiums, partially offset by higher occupancy expenses. Included in noninterest expense for the three- and six-month periods ended December 31, 2014, was $359,000 and $487,000, respectively, in merger-related charges, with no comparable expenses in the same periods of the current fiscal year. The efficiency ratio, excluding securities gains or losses, for the three- and six-month periods ended December 31, 2015, was 55.6% and 56.5%, respectively, as compared to 59.9% and 59.0%, respectively, for the same periods of the prior fiscal year. The improvement in the efficiency ratio for the current periods is the result of a decrease in merger-related charges, compared to the year-ago period, as well as the increase in our noninterest income, and, for the current six-month period only, an increase in our net interest income.

Income Taxes. Provision for income taxes for the three- and six-month periods ended December 31, 2015, was $1.8 million and $3.5 million, respectively, increases of $360,000, or 24.7%, and $644,000, or 22.7%, as compared to the same periods of the prior fiscal year. The increases were attributed to higher pre-tax income, as well as an increase in the effective tax rate, to 30.2% and 30.8%, respectively, in the current three- and six-month periods, as compared to 29.8% and 29.7%, respectively, in the same periods of the prior fiscal year. The increase in the rate was attributed to the increase in pre-tax income, which outpaced new tax-advantaged investments by the Company.

Allowance for Loan Loss Activity

The Company regularly reviews its allowance for loan losses and makes adjustments to its balance based on management's analysis of the loan portfolio, the amount of non-performing and classified loans, as well as general economic conditions. Although the Company maintains its allowance for loan losses at a level that it considers sufficient to provide for losses, there can be no assurance that future losses will not exceed internal estimates. In addition, the amount of the allowance for loan losses is subject to review by regulatory agencies, which can order the establishment of additional loss provision. The following table summarizes changes in the allowance for loan losses over the three-month periods ended December 31, 2015 and 2014:

(dollars in thousands)	For the three months ended December 31, 2015	2014	For the six months ended December 31, 2015	2014
Balance, beginning of period	$12,812	$10,110	$12,298	$9,259
Loans charged off:				
Residential real estate	(26)	-	(90)	(11)
Construction	-	-	-	-
Commercial business	(88)	(18)	(100)	(19)
Commercial real estate	(56)	-	(77)	-
Consumer	(25)	(20)	(35)	(38)
Gross charged off loans	(195)	(38)	(302)	(68)
Recoveries of loans previously charged off:				
Residential real estate	2	1	3	9
Construction	-	-	-	-
Commercial business	9	-	10	3

Commercial real estate	46	22	46	40
Consumer	2	1	3	26
Gross recoveries of charged off loans	59	24	62	78
Net (charge offs) recoveries	(136)	(14)	(240)	10
Provision charged to expense	496	862	1,114	1,689
Balance, end of period	$13,172	$10,958	$13,172	$10,958

The allowance for loan losses has been calculated based upon an evaluation of pertinent factors underlying the various types and quality of the Company's loans. Management considers such factors as the repayment status of a loan, the estimated net fair value of the underlying collateral, the borrower's intent and ability to repay the loan, local economic conditions, and the Company's historical loss ratios. We maintain the allowance for loan losses through the provision for loan losses that we charge to income. We charge losses on loans against the allowance for loan losses when we believe the collection of loan principal is unlikely. The allowance for loan losses increased $874,000 to $13.2 million at December 31, 2015, from $12.3 million at June 30, 2015. The increase was deemed appropriate in order to bring the allowance for loan losses to a level that reflects management's estimate of the incurred loss in the Company's loan portfolio at December 31, 2015.

At December 31, 2015, the Company had loans of $12.6 million, or 1.15% of total loans, adversely classified ($12.6 million classified "substandard"; none classified "doubtful" or "loss"), as compared to loans of $14.8 million, or 1.39% of total loans, adversely classified ($14.8 million classified "substandard"; none classified "doubtful" or "loss") at June 30, 2015, and $13.2 million, or 1.29% of total loans, adversely classified ($13.2 million classified "substandard"; none classified "doubtful" or "loss") at December 31, 2014. Classified loans were generally comprised of loans secured by commercial and residential real estate loans, while a smaller amount of commercial operating loans and consumer loans were also classified. All loans were classified due to concerns as to the borrowers' ability to continue to generate sufficient cash flows to service the debt. Of our classified loans, the Company had ceased recognition of interest on loans with a carrying value of $3.7 million at December 31, 2015. As noted in Note 4 to the condensed consolidated financial statements, the Company's total past due loans increased from $5.0 million at June 30, 2015, to $6.4 million at December 31, 2015. The increase was primarily attributable to a single purchased credit impaired loan relationship secured by multi-family residential real estate.

In its quarterly evaluation of the adequacy of its allowance for loan losses, the Company employs historical data including past due percentages, charge offs, and recoveries for the previous five years for each loan category. The Company's allowance methodology considers the most recent twelve-month period's average net charge offs and uses this information as one of the primary factors for evaluation of allowance adequacy. Average net charge offs are calculated as net charge offs by portfolio type for the period as a percentage of the average balance of respective portfolio type over the same period.

The following table sets forth the Company's historical net charge offs as of December 31 and June 30, 2015:

Portfolio segment	December 31, 2015 Net charge offs – 12-month historical	June 30, 2015 Net charge offs – 12-month historical
Real estate loans:		
Residential	0.03 %	0.02 %
Construction	0.00 %	0.00 %
Commercial	0.01 %	(0.01 %)
Consumer loans	0.35 %	0.35 %
Commercial loans	0.07 %	0.03 %

Additionally, in its quarterly evaluation of the adequacy of the allowance for loan losses, the Company evaluates changes in the financial condition of individual borrowers; changes in local, regional, and national economic conditions; the Company's historical loss experience; and changes in market conditions for property pledged to the Company as collateral. The Company has identified specific qualitative factors that address these issues and subjectively assigns a percentage to each factor. Qualitative factors are reviewed quarterly and may be adjusted as necessary to reflect improving or declining trends. At December 31, 2015, these qualitative factors included:

· Changes in lending policies
· National, regional, and local economic conditions

· Changes in mix and volume of portfolio
· Experience, ability, and depth of lending management and staff
· Entry to new markets
· Levels and trends of delinquent, nonaccrual, special mention and classified loans
· Concentrations of credit
· Changes in collateral values
· Agricultural economic conditions
· Regulatory risk

The qualitative factors are applied to the allowance for loan losses based upon the following percentages by loan type:

Portfolio segment	Qualitative factor applied at interim period ended December 31, 2015		Qualitative factor applied at fiscal year ended June 30, 2015	
Real estate loans:				
Residential	0.77	%	0.76	%
Construction	1.90	%	1.90	%
Commercial	1.33	%	1.33	%
Consumer loans	1.28	%	1.42	%
Commercial loans	1.37	%	1.38	%

At December 31, 2015, the amount of our allowance for loan losses attributable to these qualitative factors was approximately $11.8 million, as compared to $10.8 million at June 30, 2015. The relative stability in qualitative factors was attributed to stable credit quality, classifications, and delinquencies within the legacy portfolio.

While management believes that our asset quality remains strong, it recognizes that, due to the continued growth in the loan portfolio and potential changes in market conditions, our level of nonperforming assets and resulting charge offs may fluctuate. Higher levels of net charge offs requiring additional provision for loan losses could result. Although management uses the best information available, the level of the allowance for loan losses remains an estimate that is subject to significant judgment and short-term change.

Nonperforming Assets

The ratio of nonperforming assets to total assets and nonperforming loans to net loans receivable is another measure of asset quality. Nonperforming assets of the Company include nonaccruing loans, accruing loans delinquent/past maturity 90 days or more, and assets which have been acquired as a result of foreclosure or deed-in-lieu of foreclosure. The table below summarizes changes in the Company's level of nonperforming assets over selected time periods:

(dollars in thousands)	December 31, 2015	June 30, 2015	December 31, 2014
Nonaccruing loans:			
Residential real estate	$ 1,921	$2,202	$ 2,554
Construction	-	133	196
Commercial real estate	1,602	1,271	1,688
Consumer	242	88	109
Commercial business	38	63	117
Total	3,803	3,757	4,664
Loans 90 days past due accruing interest:			
Residential real estate	28		