

**VERSAILLES FINANCIAL CORPORATION**  
Versailles, Ohio

**CONSOLIDATED FINANCIAL STATEMENTS**  
June 30, 2018 and 2017



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June 30, 2018 and 2017

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## INDEPENDENT AUDITOR'S REPORT

Board of Directors  
Versailles Financial Corporation  
Versailles, Ohio

### Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Versailles Financial Corporation, which comprise the consolidated balance sheets as of June 30, 2018 and 2017, and the related consolidated statements of operations, comprehensive income, changes in shareholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

### *Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### *Auditor's Responsibility*

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### *Opinion*

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Versailles Financial Corporation as of June 30, 2018 and 2017, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.



Crowe LLP

Cleveland, Ohio  
September 26, 2018

VERSAILLES FINANCIAL CORPORATION  
CONSOLIDATED BALANCE SHEETS  
June 30, 2018 and 2017

	<u>2018</u>	<u>2017</u>
<b>ASSETS</b>		
Cash and due from financial institutions	\$ 2,982,584	\$ 4,162,152
Overnight deposits and federal funds sold	<u>8,473,000</u>	<u>5,000,000</u>
Total cash and cash equivalents	11,455,584	9,162,152
Interest-bearing time deposits in other financial institutions	-	247,000
Securities held to maturity (fair value of \$117,581 at June 30, 2018 and \$165,910 at June 30, 2017)	112,747	159,573
Loans, net of allowance of \$255,432 at June 30, 2018 and 2017	41,695,783	41,943,637
Federal Home Loan Bank stock	397,500	397,500
Premises and equipment, net	1,183,521	1,231,897
Accrued interest receivable	127,748	113,703
Other assets	<u>301,751</u>	<u>467,932</u>
Total assets	<u>\$ 55,274,634</u>	<u>\$ 53,723,394</u>
<b>LIABILITIES</b>		
Savings and checking accounts	\$ 26,524,729	\$ 23,557,720
Certificates of deposit	<u>13,275,843</u>	<u>15,049,746</u>
Total deposits	39,800,572	38,607,466
Federal Home Loan Bank advances	3,000,000	3,000,000
Other liabilities	<u>943,525</u>	<u>856,425</u>
Total liabilities	43,744,097	42,463,891
<b>SHAREHOLDERS' EQUITY</b>		
Preferred stock, \$.01 par value, 1,000,000 shares authorized, none issued and outstanding	-	-
Common stock, \$.01 par value, 10,000,000 shares authorized; 387,367 and 387,867 shares issued	3,854	3,840
Additional paid-in capital	3,039,304	3,016,581
Retained earnings	9,038,629	8,807,432
Treasury stock, 35,460 shares, at cost	(354,600)	(354,600)
Unearned employee stock ownership plan shares	<u>(196,650)</u>	<u>(213,750)</u>
Total shareholders' equity	<u>11,530,537</u>	<u>11,259,503</u>
Total liabilities and shareholders' equity	<u>\$ 55,274,634</u>	<u>\$ 53,723,394</u>

See accompanying notes.

VERSAILLES FINANCIAL CORPORATION  
CONSOLIDATED STATEMENTS OF OPERATIONS  
Years ended June 30, 2018 and 2017

	<u>2018</u>	<u>2017</u>
Interest and dividend income		
Loans, including fees	\$ 1,916,735	\$ 1,857,108
Securities held to maturity	4,344	5,586
FHLB dividends	22,110	17,102
Deposits with banks	<u>115,400</u>	<u>40,788</u>
Total interest and dividend income	2,058,589	1,920,584
Interest expense		
Deposits	138,863	137,968
Federal Home Loan Bank advances	<u>67,100</u>	<u>112,904</u>
Total interest expense	<u>205,963</u>	<u>250,872</u>
Net interest income	1,852,626	1,669,712
Provision for loan losses	<u>-</u>	<u>-</u>
Net interest income after provision for loan losses	1,852,626	1,669,712
Noninterest income		
Gain (loss) on sale of land	-	(58,622)
Other income	<u>16,477</u>	<u>14,810</u>
Total noninterest income	16,477	(43,812)
Noninterest expense		
Salaries and employee benefits	680,593	1,140,422
Occupancy and equipment	78,779	90,328
Directors' fees	76,925	78,500
Data processing	134,682	119,950
Franchise taxes	90,665	91,804
Legal, accounting and exam fees	125,247	121,534
Federal deposit insurance	15,250	16,502
Other	<u>136,602</u>	<u>120,409</u>
Total noninterest expense	<u>1,338,743</u>	<u>1,779,449</u>
Income (loss) before income taxes	530,360	(153,549)
Income tax expense (benefit)	<u>299,163</u>	<u>(46,800)</u>
Net income (loss)	<u>\$ 231,197</u>	<u>\$ (106,749)</u>
Basic and diluted earnings (loss) per common share	<u>\$ 0.63</u>	<u>\$ (0.28)</u>

See accompanying notes.

VERSAILLES FINANCIAL CORPORATION  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
Years ended June 30, 2018 and 2017

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	<u>2018</u>	<u>2017</u>
Net income (loss)	\$ 231,197	\$ (106,749)
Other comprehensive income:		
Unrealized gains (losses) on defined benefit pension plan	-	-
Amortization of unrecognized net loss for defined benefit pension plan <sup>1</sup>	-	<u>543,665</u>
Net unrealized gains on defined benefit pension plan	-	543,665
Tax effect	-	<u>(184,846)</u>
Other comprehensive income	-	<u>358,819</u>
Comprehensive income	<u>\$ 231,197</u>	<u>\$ 252,070</u>

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<sup>1</sup> Amount is included in salaries and employee benefits on the consolidated statements of income. \$184,846 reduction of income tax expense was recognized in the consolidated statements of income related to this reclassification for the year ending June 30, 2017.

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VERSAILLES FINANCIAL CORPORATION  
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY  
Years ended June 30, 2018 and 2017

	Common Stock	Additional Paid-In Capital	Retained Earnings	Treasury Stock	Unearned ESOP Shares	Accumulated Other Comprehensive Income (Loss)	Total
Balance, July 1, 2016	\$ 4,146	\$ 3,646,365	\$ 8,914,181	\$ (354,600)	\$ (230,850)	\$ (358,819)	\$ 11,620,423
Net loss	-	-	(106,749)	-	-	-	(106,749)
Other comprehensive income	-	-	-	-	-	358,819	358,819
Commitment to release 1,710 ESOP common shares, at fair value	-	18,385	-	-	17,100	-	35,485
Repurchase of 33,800 shares held in reserve as unissued	(338)	(674,580)	-	-	-	-	(674,918)
Vesting of 3,252 shares under restricted stock award plan and related tax benefit	32	5,773	-	-	-	-	5,805
Stock-based compensation expense	-	20,638	-	-	-	-	20,638
Balance, June 30, 2017	3,840	3,016,581	8,807,432	(354,600)	(213,750)	-	11,259,503
Net income	-	-	231,197	-	-	-	231,197
Commitment to release 1,710 ESOP common shares, at fair value	-	23,577	-	-	17,100	-	40,677
Repurchase of 500 shares held in reserve as unissued	(5)	(9,995)	-	-	-	-	(10,000)
Vesting of 1,920 shares under restricted stock award plan	19	(19)	-	-	-	-	-
Stock-based compensation expense	-	9,160	-	-	-	-	9,160
Balance, June 30, 2018	<u>\$ 3,854</u>	<u>\$ 3,039,304</u>	<u>\$ 9,038,629</u>	<u>\$ (354,600)</u>	<u>\$ (196,650)</u>	<u>\$ -</u>	<u>\$ 11,530,537</u>

See accompanying notes.



VERSAILLES FINANCIAL CORPORATION  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
Years ended June 30, 2018 and 2017

	<u>2018</u>	<u>2017</u>
Cash flows from operating activities		
Net income (loss)	\$ 231,197	\$ (106,749)
Adjustments to reconcile net income to net cash provided from operating activities		
Provision for loan losses	-	-
Depreciation on premises and equipment	48,376	62,122
Loss on sale of land	-	58,622
Compensation expense related to share based plans	49,837	56,123
Deferred taxes	136,485	(212,397)
Change in:		
Deferred loan costs	(1,700)	(8,342)
Accrued interest receivable	(14,045)	2,529
Other assets	29,696	297,364
Other liabilities	<u>87,100</u>	<u>82,597</u>
Net cash from operating activities	566,946	231,869
Cash flow from investing activities		
Maturities of interest bearing time deposits	247,000	735,000
Maturities, repayments and calls of securities held to maturity	46,826	56,480
Loan originations and payments, net	249,554	(407,209)
Proceeds from sale of land	-	10,000
Property and equipment purchases	<u>-</u>	<u>(751)</u>
Net cash used in investing activities	543,380	393,520
Cash flow from financing activities		
Net change in deposits	1,193,106	3,255,401
Repayments of FHLB advances	-	(3,000,000)
Repurchase of shares held in reserve	(10,000)	(674,918)
Tax benefit from restricted stock award vesting	<u>-</u>	<u>5,805</u>
Net cash from financing activities	<u>1,183,106</u>	<u>(413,712)</u>
Net change in cash and cash equivalents	2,293,432	211,677
Cash and cash equivalents, beginning of period	<u>9,162,152</u>	<u>8,950,475</u>
Cash and cash equivalents at end of period	<u>\$ 11,455,584</u>	<u>\$ 9,162,152</u>
Cash paid during the year for		
Interest	\$ 207,627	\$ 252,862
Income taxes paid (refunded)	140,000	(126,364)

See accompanying notes.

VERSAILLES FINANCIAL CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
June 30, 2018 and 2017

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**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Basis of Presentation: The accompanying consolidated financial statements include the accounts of Versailles Financial Corporation (“Versailles”) and its wholly owned subsidiary, Versailles Savings and Loan Company (“Association”). Versailles and its subsidiary are collectively referred to as the (“Company”). All material intercompany transactions have been eliminated.

Nature of Operations: Versailles is a thrift holding company incorporated under the laws of the state of Maryland that owns all the outstanding shares of common stock of the Association. The Association is an Ohio chartered savings and loan company engaged primarily in the business of making residential mortgage loans and accepting checking account, passbook savings, statement savings and time deposits. Its operations are conducted through its only office located in Versailles, Ohio. Accordingly, all of its operations are reported in one segment, banking. The Company primarily grants one- to four-family residential loans to customers located in Darke and the western half of Shelby counties. This area is strongly influenced by agriculture, but there is also a substantial manufacturing base. Substantially all loans are secured by specific items of collateral including business assets, consumer assets and commercial and residential real estate. There are no significant concentrations of loans to any one industry or customer. However, the customers’ ability to repay their loans is dependent on the real estate and general economic conditions in the area.

Subsequent Events: The Company has evaluated subsequent events for recognition and disclosure through September 26, 2018, which is the date the financial statements were available to be issued.

Use of Estimates: To prepare financial statements in conformity with generally accepted accounting principles in the United States of America, management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and the disclosures provided, and actual results could differ.

Cash Flows: Cash and cash equivalents include cash and due from financial institutions, federal funds sold and overnight deposits. Net cash flows are reported for customer loan and deposit transactions and advances from the Federal Home Loan Bank with original maturities of 90 days or less.

Interest-bearing Time Deposits in Other Financial Institutions: Interest-bearing time deposits in other financial institutions have original maturities of greater than 90 days and are carried at cost.

Securities: Debt securities are classified as held to maturity and carried at amortized cost when management has the positive intent and ability to hold them to maturity. Debt securities are classified as available for sale when they might be sold before maturity. Equity securities with readily determinable fair values are classified as available for sale. Securities available for sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income, net of tax.

Interest income includes amortization of purchase premiums and discounts. Premiums and discounts on securities are amortized on the level-yield method without anticipating prepayments, except for mortgage backed securities where prepayments are anticipated. Gains and losses on sales are recorded on the trade date and determined using the specific identification method.

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Management evaluates securities for other-than-temporary impairment (“OTTI”) on at least a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. For securities in an unrealized loss position, management considers the extent and duration of the unrealized loss, and the financial condition and near-term prospects of the issuer. Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: 1) OTTI related to credit loss, which must be recognized in the income statement and 2) OTTI related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis.

Federal Home Loan Bank (FHLB) Stock: The Association is a member of the FHLB system. Members are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. FHLB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment based on ultimate recovery of par value. Both cash and stock dividends are reported as income.

Loans: Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding, net of deferred loan fees and costs, and an allowance for loan losses. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized in interest income using the level-yield method without anticipation of prepayments.

Interest income on loans is discontinued at the time the loan is 90 days delinquent unless the credit is well-secured and in process of collection. Past due status is based on the contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful. Nonaccrual loans and loans past due 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

All interest accrued but not received for loans placed on nonaccrual are reversed against interest income. Interest received on such loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Under the cost-recovery method, interest income is not recognized until the loan balance is reduced to zero. Under the cash-basis method, interest income is recorded when the payment is received in cash. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Allowance for Loan Losses: The allowance for loan losses is a valuation allowance for probable incurred credit losses. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management’s judgment, should be charged-off.

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired. A loan is impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Loans, for which the terms have been modified in a manner representing a concession, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired.

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

Commercial and commercial real estate loans are individually evaluated for impairment. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's effective rate or at the fair value of collateral if repayment is expected solely from the collateral.

Troubled debt restructurings are separately identified for impairment disclosures and are measured at the present value of estimated future cash flows using the loan's effective rate at inception. If a troubled debt restructuring is considered to be a collateral dependent loan, the loan is reported, net, at the fair value of the collateral. For troubled debt restructurings that subsequently default, the Company determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses on loans individually identified as impaired.

The general component covers non-impaired loans and loans collectively evaluated for impairment. Large groups of smaller balance homogeneous loans, such as consumer and residential real estate loans, are collectively evaluated for impairment, and accordingly, they are not separately identified for impairment disclosures. The general component is based on historical loss experience adjusted for current factors. The historical loss experience is determined by portfolio segment and is based on the actual loss history experienced by the Company over the most recent thirty-six months. This actual loss experience is supplemented with other economic factors based on the risks present for each portfolio segment. These economic factors include consideration of the following: levels of and trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedures, and practices; experience, ability, and depth of lending management and other relevant staff; national and local economic trends and conditions; industry conditions; and effects of changes in credit concentrations. The following portfolio segments have been identified: 1-4 family real estate, commercial real estate, commercial and consumer.

*1-4 Family real estate:* 1-4 family mortgage loans represent loans to consumers for the purchase, refinance or improvement of a residence. Real estate market values at the time of origination directly affect the amount of credit extended and, in the event of default, subsequent changes in these values may impact the severity of losses. Factors considered by management include unemployment levels, credit history and real estate values in the Company's market area.

*Commercial real estate:* Non-residential and multi-family loans are subject to underwriting standards and processes similar to commercial loans. These loans are viewed as cash flow loans and the repayment of these loans is largely dependent on the successful operation of the farm, business or property. Loan performance may be adversely affected by factors impacting the general economy or conditions specific to the real estate market such as geographic location and property types. Management specifically considers real estate values, credit history, unemployment levels, crop prices and yields.

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

*Commercial:* Commercial credit is extended to commercial customers for use in normal business operations to finance working capital needs, equipment purchases, or other projects. The majority of these borrowers are customer's doing business in the Company's primary market area. These loans are generally underwritten individually and secured with the assets of the company and the personal guarantee of the business owners. Commercial business loans are made based primarily on the borrower's ability to make repayment from the historical and projected cash flow of the borrower's business and the underlying collateral provided by the borrower. Management specifically considers unemployment, credit history and the nature of the business.

*Consumer:* Consumer loans are primarily comprised of secured loans including automobile loans, loans on deposit accounts, home improvement loans and to a lesser extent, unsecured personal loans. These loans are underwritten based on several factors including debt-to-income, type of collateral and loan to value, credit history and relationship with the borrower. Unemployment rates are specifically considered by management.

Premises and Equipment: Land is carried at cost. Premises and equipment are reported at cost less accumulated depreciation. Depreciation is computed on both the straight-line and accelerated methods over the estimated useful lives of the assets. Building and improvements have useful lives ranging from five to forty years. Furniture and equipment have useful lives ranging from five to ten years.

Foreclosed Assets: Assets acquired through or instead of loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. Physical possession of residential real estate property collateralizing a consumer mortgage loan occurs when legal title is obtained upon completion of foreclosure or when the borrower conveys all interest in the property to satisfy the loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. If fair value declines subsequent to foreclosure, a valuation allowance is recorded through expense. Operating costs after acquisition are expensed.

Earnings (Loss) Per Common Share: Basic earnings (loss) per common share is net income (loss) divided by the weighted average number of common shares outstanding during the period. Employee Stock Ownership Plan shares are considered outstanding for this calculation unless unearned. All outstanding unvested share-based payment awards that contain rights to nonforfeitable dividends are considered participating securities for this calculation.

The Company established a Rabbi Trust and participants in the Association's deferred compensation and supplemental retirement plans could elect to use all or some of the amounts in their accounts to purchase shares in the Company's mutual to stock conversion. These shares are held in the trust and the obligation under the deferred compensation and supplemental retirement plans will be settled with these shares. As such, the shares are carried as treasury stock in the consolidated balance sheets and the shares are considered outstanding for the purpose of calculating earnings per share.

Employee Stock Ownership Plan: The cost of shares issued to the Employee Stock Ownership Plan ("ESOP"), but not yet allocated to participants, is shown as a reduction of shareholders' equity. Compensation expense is based on the market price of shares as they are committed to be released to participant accounts. Dividends on allocated ESOP shares reduce retained earnings. Dividends on unearned ESOP shares reduce debt and accrued interest.

Retirement Plans: Pension expense is the net of service and interest cost, return on plan assets and amortization of gains and losses not immediately recognized. Employee 401(k) and profit sharing plan expense is the amount of matching contributions. Deferred compensation and supplemental retirement plan expense allocates the benefits over years of service.

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Stock-Based Compensation: Compensation cost is recognized for restricted stock awards issued to directors and officers based on the fair value of these awards at the date of grant, which is the market price of the Company's common stock at the date of grant.

Compensation cost is recognized over the required service period, generally defined as the vesting period. For awards with graded vesting, compensation cost is recognized on a straight-line basis over each requisite service period.

Income Taxes: Income tax expense is the total of the current year income due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between the carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized.

A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded.

The Company recognizes interest and/or penalties related to income tax matters in income tax expense.

Loan Commitments and Related Financial Instruments: Financial instruments include off-balance sheet credit instruments, such as commitments to make loans, issued to meet customer financing needs. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded.

Comprehensive Income (Loss): Comprehensive income (loss) consists of net income (loss) and other comprehensive income (loss). Other comprehensive income (loss) includes the net of tax impact of changes in the funded status of the defined benefit pension plan.

Loss Contingencies: Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Management does not believe there now are such matters that will have a material effect on the financial statements.

Fair Value of Financial Instruments: Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in a separate note. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates.

Reclassifications: Some items in prior financial statements have been reclassified to conform to the current presentation. Reclassifications had no effect on prior year net income or shareholders' equity.

VERSAILLES FINANCIAL CORPORATION  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 June 30, 2018 and 2017

**NOTE 2 – SECURITIES**

The carrying amount, unrecognized gains and losses, and fair value of securities held to maturity were as follows.

	2018			
	Carrying Amount	Gross Unrecognized Gains	Gross Unrecognized Losses	Fair Value
Government sponsored entities residential mortgage-backed:				
FHLMC	\$ 65,230	\$ 3,501	\$ -	\$ 68,731
GNMA	34,439	1,210	-	35,649
FNMA	13,078	123	-	13,201
	\$ 112,747	\$ 4,834	\$ -	\$ 117,581
	2017			
	Carrying Amount	Gross Unrecognized Gains	Gross Unrecognized Losses	Fair Value
Government sponsored entities residential mortgage-backed:				
FHLMC	\$ 93,245	\$ 4,182	\$ -	\$ 97,427
GNMA	41,777	1,477	-	43,254
FNMA	24,551	678	-	25,229
	\$ 159,573	\$ 6,337	\$ -	\$ 165,910

Securities of the Company are not due at a single maturity date, thus they are not presented by contractual maturity.

At June 30, 2018 and June 30, 2017, there were no holdings of securities of any one issuer in an amount greater than 10% of shareholders' equity.

**NOTE 3 – LOANS**

Loans at year-end were as follows:

	2018	2017
1-4 family real estate	\$ 29,418,405	\$ 29,251,050
Commercial real estate:		
Business	2,152,514	1,765,503
Agricultural	5,713,239	5,734,645
Multi-family	-	73,351
Commercial	3,036,008	3,559,833
Consumer:		
Auto	643,990	703,907
Other secured	917,120	818,154
Unsecured	72,357	293,344
Total loans	41,953,633	42,199,787
Deferred loan costs	(2,418)	(718)
Allowance for loan losses	(255,432)	(255,432)
	\$ 41,695,783	\$ 41,943,637

(Continued)

VERSAILLES FINANCIAL CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
June 30, 2018 and 2017

**NOTE 3 – LOANS** (Continued)

Loans to principal officers, directors, and their affiliates during fiscal 2018 and 2017 were as follows.

	<u>2018</u>	<u>2017</u>
Beginning balance	\$ 348,416	\$ 375,558
Additions	181,800	300,000
Repayments	(32,373)	(327,142)
Other changes	<u>(227,200)</u>	<u>-</u>
Ending balance	<u>\$ 270,643</u>	<u>\$ 348,416</u>

The following table presents the activity in the allowance for loan losses by portfolio segment for the years ended June 30, 2018 and 2017:

	Allowance at June 30, <u>2017</u>	Provision for Loan Losses	Loans Charged-off	Recoveries	Allowance at June 30, <u>2018</u>
1-4 family real estate	\$ 131,446	\$ 71,117	\$ -	\$ -	\$ 202,563
Commercial real estate	76,152	(40,444)	-	-	35,708
Commercial	39,729	(27,099)	-	-	12,630
Consumer	<u>8,105</u>	<u>(3,574)</u>	<u>-</u>	<u>-</u>	<u>4,531</u>
Total	<u>\$ 255,432</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 255,432</u>
	Allowance at June 30, <u>2016</u>	Provision for Loan Losses	Loans Charged-off	Recoveries	Allowance at June 30, <u>2017</u>
1-4 family real estate	\$ 185,954	\$ (54,508)	\$ -	\$ -	\$ 131,446
Commercial real estate	34,631	41,521	-	-	76,152
Commercial	21,997	17,732	-	-	39,729
Consumer	<u>12,850</u>	<u>(4,745)</u>	<u>-</u>	<u>-</u>	<u>8,105</u>
Total	<u>\$ 255,432</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 255,432</u>

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

	<u>Allowance for Loan Losses</u>			<u>Recorded Investment in Loans</u>		
	<u>Individually Evaluated</u>	<u>Collectively Evaluated</u>	<u>Total Allowance</u>	<u>Individually Evaluated</u>	<u>Collectively Evaluated</u>	<u>Total Loans</u>
<u>June 30, 2018</u>						
1-4 family real estate	\$ -	\$ 202,563	\$ 202,563	\$ -	\$ 29,524,887	\$ 29,524,887
Commercial real estate	-	35,708	35,708	-	7,872,148	7,872,148
Commercial	-	12,630	12,630	-	3,038,476	3,038,476
Consumer	<u>-</u>	<u>4,531</u>	<u>4,531</u>	<u>-</u>	<u>1,634,795</u>	<u>1,634,795</u>
Total	<u>\$ -</u>	<u>\$ 255,432</u>	<u>\$ 255,432</u>	<u>\$ -</u>	<u>\$ 42,070,306</u>	<u>\$ 42,070,306</u>

(Continued)



VERSAILLES FINANCIAL CORPORATION  
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**NOTE 3 – LOANS (Continued)**

	Allowance for Loan Losses			Recorded Investment in Loans		
	Individually Evaluated	Collectively Evaluated	Total Allowance	Individually Evaluated	Collectively Evaluated	Total Loans
<u>June 30, 2017</u>						
1-4 family real estate	\$ -	\$ 131,446	\$ 131,446	\$ -	\$ 29,346,277	\$ 29,346,277
Commercial real estate	-	76,152	76,152	-	7,579,996	7,579,996
Commercial	-	39,729	39,729	-	3,562,886	3,562,886
Consumer	-	8,105	8,105	-	1,816,962	1,816,962
Total	\$ -	\$ 255,432	\$ 255,432	\$ -	\$ 42,306,121	\$ 42,306,121

Included in recorded investment in 2018 is \$2,418 of net deferred loan fees and \$119,091 of accrued loan interest. Included in recorded investment in 2017 is \$718 of net deferred loan fees and \$107,052 of accrued loan interest.

There were no loans individually evaluated for impairment at June 30, 2018 or 2017 or during the years ending June 30, 2018 and 2017.

Loan Performance and Credit Quality Indicators: The Company considers the performance of the loan portfolio and its impact on the allowance for loan losses. For all loan classes, the Company primarily evaluates credit quality based on the aging status of the loan and by payment activity.

There were no nonaccrual loans or loans past due over 90 days still on accrual as of June 30, 2018 and 2017.

The following table presents the recorded investment of loans past due as of June 30, 2018 and 2017:

	2018		Total
	31-60 Days Past Due	61-90 Days Past Due	
1-4 family real estate	\$ 95,528	\$ -	\$ 95,528
Commercial real estate:			
Business	35,971	7,456	43,427
Agricultural	374,593	-	374,593
Commercial	-	6,676	6,676
Total delinquent loans	\$ 506,092	\$ 14,132	\$ 520,224
	2017		
	31-60 Days Past Due		
Commercial real estate: business	\$ 13,483		
Commercial	5,208		
Total delinquent loans	\$ 18,691		

**Troubled Debt Restructurings:**

The Company had no loans classified as troubled debt restructures (TDRs) at June 30, 2018 and 2017, and there were no loans modified as troubled debt restructurings that occurred during the year ending June 30, 2018 and 2017.

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**NOTE 4 – PREMISES AND EQUIPMENT**

Year-end premises and equipment were as follows.

	<u>2018</u>	<u>2017</u>
Land	\$ 81,807	\$ 81,807
Building and improvements	1,250,206	1,250,206
Furniture and equipment	<u>261,380</u>	<u>281,912</u>
Total	1,593,393	1,613,925
Accumulated depreciation	<u>(409,872)</u>	<u>(382,028)</u>
	<u>\$ 1,183,521</u>	<u>\$ 1,231,897</u>

**NOTE 5 – DEPOSITS**

Deposits from principal officers, directors, and their affiliates at June 30, 2018 and 2017 were \$1,889,147 and \$2,618,731. The aggregate amount of certificates of deposit accounts with balances greater than \$250,000 at year-end 2018 and 2017 was \$1,595,992 and \$2,063,135.

Scheduled maturities of certificates of deposit were as follows.

Year ended June 30, 2019	\$ 6,798,770
2020	4,835,912
2021	1,015,938
2022	<u>625,223</u>
	<u>\$ 13,275,843</u>

**NOTE 6 – FEDERAL HOME LOAN BANK ADVANCES**

Year-end advances from the Federal Home Loan Bank were as follows.

	<u>Rate</u>	<u>2018</u>	<u>2017</u>
Fixed rate advance, due October 2019	1.91%	\$ 1,000,000	\$ 1,000,000
Fixed rate advance, due February 2025	2.40%	<u>2,000,000</u>	<u>2,000,000</u>
		<u>\$ 3,000,000</u>	<u>\$ 3,000,000</u>

Fixed rate advances are payable at maturity and subject to prepayment penalties if paid off prior to maturity.

Required payments over the next five years and thereafter are as follows:

Year ended June 30, 2019	\$ -
2020	1,000,000
2021	-
2022	-
2023	-
Thereafter	<u>2,000,000</u>
	<u>\$ 3,000,000</u>

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**NOTE 6 – FEDERAL HOME LOAN BANK ADVANCES (Continued)**

Advances under the borrowing agreements are collateralized by a blanket pledge of the Company's residential mortgage loan portfolio and FHLB stock. At June 30, 2018 and 2017, the Company had approximately \$28,277,000 and \$27,940,000 of qualifying first-mortgage loans, and \$0 and \$73,000 of multi-family mortgage loans pledged, in addition to FHLB stock, as collateral for FHLB advances. At June 30, 2018, based on the Association's current FHLB stock ownership, total assets and pledgable first-mortgage and multi-family mortgage loan portfolios, the Association had the ability to obtain borrowings up to an additional \$13,517,000.

**NOTE 7 – INCOME TAXES**

On December 22, 2017, H.R.1, commonly known as the Tax Cuts and Jobs Act (the "Act"), was signed into law. The Act includes many provisions that impact the Corporation's income tax expense, including reducing the federal tax rate from 34% to 21% effective January 1, 2018. As a result of the rate reduction, the Corporation was required to re-measure, through income tax expense in the period of enactment, its deferred tax assets and liabilities using the enacted rate at which they are expected to be recovered or settled. The re-measurement of the net deferred tax asset resulted in additional income tax expense of \$150,638 for the fiscal year ended June 30, 2018.

Income tax expense was as follows.

	<u>2018</u>	<u>2017</u>
Current	\$ 162,678	\$ 165,597
Deferred	(14,153)	(212,397)
Impact of federal tax reform	<u>150,638</u>	<u>-</u>
Total	<u>\$ 299,163</u>	<u>\$ (46,800)</u>

Effective tax rates differ from the federal statutory rate applied to income before income taxes due to the following (27.55% statutory rate for 2018 and 34% for 2017).

	<u>2018</u>	<u>2017</u>
Federal statutory rate times financial statement income	\$ 146,114	\$ (52,207)
Effect of:		
Tax exempt interest income, net of interest expense disallowance	(728)	(852)
Impact of federal tax reform	150,638	-
Other, net	<u>3,139</u>	<u>6,259</u>
Total	<u>\$ 299,163</u>	<u>\$ (46,800)</u>
Effective tax rate	56.41%	(30.48)%

(Continued)

VERSAILLES FINANCIAL CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
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**NOTE 7 – INCOME TAXES** (Continued)

Year-end deferred tax assets and liabilities were due to the following.

	<u>2018</u>	<u>2017</u>
Deferred tax assets:		
Allowance for loan losses	\$ 53,641	\$ 86,847
Accrued compensation	244,850	367,338
Restricted stock expense	5,477	15,220
Capital loss carryforward	13,755	22,270
Deferred loan fees and costs	<u>508</u>	<u>244</u>
Total deferred tax asset	318,231	491,919
Deferred tax liabilities:		
FHLB stock	(46,367)	(75,070)
Accrual to cash	(25,397)	(26,700)
Accumulated depreciation	<u>(8,794)</u>	<u>(15,991)</u>
Total deferred tax liability	<u>(80,558)</u>	<u>(117,761)</u>
Net deferred tax asset	<u>\$ 237,673</u>	<u>\$ 374,158</u>

At June 30, 2018, the Company had \$65,500 of capital loss carry forwards which may be carried forward for up to five years. The capital loss carry forwards expire June 30, 2019 and may only be deducted to the extent the Company generates capital gains. No valuation allowance has been recorded against the capital loss carry forwards as the Company believes it is more likely than not that the benefit will be realized.

The Company has not recorded a deferred tax liability of approximately \$163,000 and \$265,000 at June 30, 2018 and 2017 related to approximately \$778,000 of cumulative special bad debt deductions arising prior to December 31, 1987, the end of the Company's base year for purposes of calculating the bad debt deduction. If the Company were liquidated or otherwise ceases to be a financial institution or if the tax laws were to change, this amount would be expensed.

At June 30, 2018 and 2017, the Company had no unrecognized tax benefits recorded. The Company does not expect the amount of unrecognized tax benefits to significantly change within the next twelve months ended June 30, 2018 and 2017 and no amounts accrued for penalties and interest as of June 30, 2018 or June 30, 2017.

The Company is subject to U.S. federal income tax. The Company is no longer subject to examination by the federal taxing authority for years prior to 2014. The tax years 2014-2017 remain open to examination by the U.S. taxing authority.

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**NOTE 8 – RETIREMENT PLANS**

The Company had a funded noncontributory defined benefit pension plan that covered substantially all of its employees. The plan provided defined benefits based on years of service and final average salary. The Company approved terminating the plan effective May 31, 2016 with intent to distribute benefits of the pension plan to participants. During the year-ending June 30, 2017, all benefits related to the pension plan were distributed.

Information about obligations and plan assets of defined benefit pension plan follows:

	<u>2017</u>
Benefit obligation	\$ -
Change in plan assets, at fair value:	
Beginning plan assets	1,384,275
Actual return	23,157
Employer contribution	509,997
Benefits and settlements paid	<u>(1,917,429)</u>
Ending plan assets	<u>-</u>
Funded status at end of year (benefit obligations less plan assets)	<u>\$ -</u>

Components of net periodic benefit cost and other amounts recognized in other comprehensive income:

	<u>2017</u>
Net periodic benefit cost	\$ 520,507
(Gain) loss recognized in other comprehensive income	<u>(543,665)</u>
Net (gain) loss recognized in net periodic benefit cost and other comprehensive income	<u>\$ (23,158)</u>

The Company contributed \$509,997 to its pension plan for the year ended June 30, 2017 to settle the plan.

**NOTE 8 – RETIREMENT PLANS (Continued)**

Employee 401(k) and Profit Sharing Plan: The Company maintains a 401(k) and profit sharing plan for all eligible employees. Employees are eligible one year from the date of hire and must have at least 1,000 hours of service. Eligible employees may contribute up to 15% of their compensation subject to a maximum statutory limitation. The Company provides a matching contribution on behalf of participants who make elective compensation deferrals, at the rate of 50% of the first 6% of the participant's discretionary contribution. Employee contributions are always 100% vested. Employer matching contributions vest on a graduated basis at the rate of 20% per year in years two through six so that the employee is 100% vested after six years of service. The 2018 and 2017 expense related to this plan was \$13,294 and \$12,851 respectively.

Deferred Compensation and Supplemental Retirement Plan: The Board of Directors adopted a deferred compensation and supplemental retirement plan for directors and an executive officers of the Company during fiscal 1999. Upon adoption, each nonemployee director was credited with \$1,494 for each year of service as a director and the employee director was credited with \$5,103 for each year of service prior to plan initiation. Beginning December 31, 1998, each nonemployee director receives a credit to their account equal to 24% of the cash compensation that a participant earned during that calendar year. Employees that are directors receive an annual credit of 8%. At the participant's election, the participant's account earns interest at the rate of the Company's return on average equity for that year or at the rate the Company is paying on a certificate of deposit having a term of one year or less at January 1 of that year. Total expense related to the Plan was \$26,367 and \$30,906 for the years ended June 30, 2018 and 2017. The accrued supplemental retirement liability included in other liabilities was \$279,805 at June 30, 2018 and \$253,438 at June 30, 2017. There were no distributions to participants or their beneficiary during the years ended June 30, 2018 and June 30, 2017.

Additionally, each participant may elect to defer up to 25% in base salary and up to 100% of director's fees, bonuses or other cash compensation. Amounts in participant's accounts are vested at all times. The accrued deferred compensation liability included in other liabilities was \$496,954 at June 30, 2018 and \$439,829 at June 30, 2017. Earnings on amounts deferred included in salaries and employee benefits totaled \$0 and \$7,361 for the years ended June 30, 2018 and 2017. There were no distributions to participants during the years ended June 30, 2018 and June 30, 2017. The Plan is unfunded and subject to the general claims of creditors.

In conjunction with the conversion to a stock company with concurrent formation of a holding company, the Company allowed participants in the supplemental retirement and deferred compensation plans to use all or a portion of their funds in an one time election to purchase shares of the holding company at conversion.

The shares are held in a Rabbi Trust and the obligation under the plans will be settled with these shares. Participant stock held by the Rabbi Trust is classified in equity in a manner similar to the manner in which treasury stock is accounted for. Subsequent changes in the fair value of the stock are not recognized. The deferred compensation obligation is classified as an equity instrument and changes in the fair value of the amount owed to the participant are not recognized. These shares are considered outstanding for the purpose of both basic and diluted EPS. The participants elected to use \$354,600 to purchase 35,460 shares of common stock.

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**NOTE 9 – EMPLOYEE STOCK OWNERSHIP PLAN**

As part of the conversion to a stock company, the Company formed a leveraged ESOP. The plan has a December 31 year-end and the first allocation was December 31, 2010. The ESOP borrowed from the Company, totaling \$342,000, to purchase 34,200 shares of stock at \$10 per share. The Company may make discretionary contributions to the ESOP, as well as paying dividends on unallocated shares to the ESOP, and the ESOP uses funds it receives to repay the loan. When loan payments are made, ESOP shares are allocated to participants based on relative compensation and expense is recorded. Dividends on allocated shares increase participant accounts. The shares in the plan are expected to be allocated over a twenty year period.

Participants receive the shares at the end of employment. A participant may require stock received to be repurchased unless the stock is traded on an established market.

Contributions to the ESOP during the years ended June 30, 2018 and 2017 were \$24,283 and \$23,905. ESOP expense was \$40,677 and \$35,485 for the year ended June 30, 2018 and 2017, respectively.

Shares held by the ESOP were as follows:

	<u>2018</u>	<u>2017</u>
Allocated	13,680	11,970
Committed to be released	855	855
Unearned	<u>19,665</u>	<u>21,375</u>
 Total ESOP shares	 <u>34,200</u>	 <u>34,200</u>
 Fair value of unearned shares	 <u>\$ 476,876</u>	 <u>\$ 472,388</u>
 Fair value of allocated shares subject to repurchase obligation	 <u>\$ 331,740</u>	 <u>\$ 264,537</u>

The Company expects to allocate 1,710 shares for the December 31, 2018 plan year.

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**NOTE 10 – COMMITMENTS, OFF-BALANCE-SHEET RISK AND CONTINGENCIES**

Some financial instruments, such as loan commitments, credit lines and letters of credit are issued to meet customer financing needs. These are agreements to provide credit or to support the credit of others, as long as conditions established in the contract are met, and usually have expiration dates. Commitments may expire without being used. Off-balance-sheet risk to credit loss exists up to the face amount of these instruments, although material losses are not anticipated. The same credit policies are used to make such commitments as are used for loans, including obtaining collateral at exercise of the commitment.

Commitments to make loans at current market rates at year-end were as follows.

	<u>2018</u>		<u>2017</u>	
	<u>Balance</u>	<u>Rate</u>	<u>Balance</u>	<u>Rate</u>
1-4 family real estate – fixed rate	\$ 1,530,000	3.50 - 5.74%	\$ 1,001,000	3.50-5.74%
1-4 family real estate – adjustable rate	-	-%	396,000	3.00%
Nonresidential real estate - fixed rate	32,000	6.50%	450,000	5.75%
Agricultural – fixed rate	680,000	5.24%	-	-%

Commitments to make loans are generally made for periods of 60 days or less. The loan commitments have maturities ranging up to 30 years.

At June 30, 2018 and 2017, the Company had \$30,000 and \$475,000 of unused lines of credit, respectively.

**NOTE 11 – FAIR VALUE**

There were no financial instruments measured at fair value on a recurring or non-recurring basis at June 30, 2018 or June 30, 2017. The carrying amounts and estimated fair values of other financial instruments, at June 30, 2018 and 2017 are as follows:

	<u>2018</u>		<u>2017</u>	
	<u>Carrying Value</u>	<u>Fair Value</u>	<u>Carrying Value</u>	<u>Fair Value</u>
<b>Financial assets</b>				
Cash and cash equivalents	\$ 11,455,584	\$ 11,455,584	\$ 9,162,152	\$ 9,162,152
Interest bearing time deposits in other financial institutions	-	-	247,000	247,228
Securities held-to-maturity	112,747	117,581	159,573	165,910
Net loans	41,695,783	41,338,000	41,943,637	41,570,000
FHLB stock	397,500	N/A	397,500	N/A
Accrued interest receivable	127,748	127,748	113,703	113,703
<b>Financial liabilities</b>				
Deposits	(39,800,572)	(39,663,000)	(38,607,466)	(38,558,000)
FHLB advances	(3,000,000)	(2,941,000)	(3,000,000)	(3,048,000)
Accrued interest payable	(19,630)	(19,630)	(21,295)	(21,295)

The methods and assumptions used to estimate fair values are described as follows:

Cash and Cash Equivalents: The carrying amount of cash and cash equivalents approximate fair value.

Interest Bearing Time Deposits in Other Financial Institutions: Fair value of interest-bearing time deposits in other financial institutions are estimated using a discounted cash flow calculation that applies interest rates currently being offered for instruments with maturities equal or similar to remaining maturities of the interest bearing time deposits.



**NOTE 11 – FAIR VALUE (Continued)**

Securities Held to Maturity: The fair values of securities held to maturity are determined by quoted prices for similar assets; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Loans: Fair values of loans are estimated as follows: For variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. Fair values for other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. The methods utilized to estimate the fair value of loans do not necessarily represent an exit price.

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

Deposits: The fair values disclosed for savings and checking accounts are equal to the amount payable at the reporting date (i.e. carrying amount). Fair values for fixed rate certificates of deposit are estimated using a discounted cash flows calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits.

FHLB Advances: The fair values of the Company's long-term borrowings are estimated using discounted cash flow analyses based on the current borrowing rates for similar types of borrowing arrangements.

Accrued Interest Receivable/Payable: The carrying amounts of accrued interest approximate fair value.

Off-balance Sheet Instruments: Fair values for off-balance sheet, credit-related financial instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. The fair value of commitments is not material.

**NOTE 12 – REGULATORY MATTERS**

The Association is subject to various regulatory capital requirements administered by the federal banking agencies. Capital adequacy guidelines and prompt corrective action regulations involve quantitative measures of assets, liabilities and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by the regulators. Failure to meet capital requirements can initiate regulatory action. Management believes as of June 30, 2018, the Association meets all capital adequacy requirements to which it is subject.

Prompt corrective action regulations provide five classifications: well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required. At June 30, 2018 and 2017, the most recent regulatory notifications categorized the Association as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the institution's category.

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**NOTE 12 – REGULATORY MATTERS (Continued)**

Basel III Capital Rules became effective for the Association on January 1, 2015 and certain provisions are subject to a phase-in period. The implementation of the capital conservation buffer began on January 1, 2016 at the 0.625% level and be phased in over a four-year period (increasing by that amount on each subsequent January 1, until it reaches 2.5% on January 1, 2019). The conservation buffer at June 30, 2018 is 1.875%. The Basel III Capital Rules also provide for a “countercyclical capital buffer” that is applicable to only certain covered institutions and does not have any current applicability to the Association. The aforementioned capital conservation buffer is designed to absorb losses during periods of economic stress. Banking institutions with a ratio of Common Equity Tier 1 capital to risk-weighted assets above the minimum but below the conservation buffer (or below the combined capital conservation buffer and countercyclical capital buffer, when the latter is applied) will face constraints on dividends, equity repurchases and compensation based on the amount of the shortfall.

At year-end, the Association’s actual capital levels and minimum required levels were as follows. The capital consolidation buffer is excluded from the adequately capitalized risk-based ratios.

	<u>Actual</u>		<u>For Capital Adequacy Purposes</u>		<u>To Be Well Capitalized Under Prompt Corrective Action Regulations</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
			(Dollars in thousands)			
<u>June 30, 2018</u>						
Total capital (to risk-weighted assets)	\$ 10,975	34.5%	\$ 2,542	8.0%	\$ 3,177	10.0%
Common equity Tier 1 capital (to risk-weighted assets)	10,720	33.7	1,430	4.5	2,065	6.5
Tier I (core) capital (to risk-weighted assets)	10,720	33.7	1,906	6.0	2,542	8.0
Tier I (core) capital (to adjusted total assets)	10,720	19.4	2,208	4.0	2,761	5.0
<u>June 30, 2017</u>						
Total capital (to risk-weighted assets)	\$ 10,668	33.4%	\$ 2,554	8.0%	\$ 3,193	10.0%
Common equity Tier 1 capital (to risk-weighted assets)	10,413	32.6	1,437	4.5	2,075	6.5
Tier I (core) capital (to risk-weighted assets)	10,413	32.6	1,916	6.0	2,554	8.0
Tier I (core) capital (to adjusted total assets)	10,413	19.0	2,190	4.0	2,737	5.0

The Qualified Thrift Lender test requires at least 65% of assets to be maintained in housing-related finance and other specified areas. If this test is not met, limits are placed on growth, branching, new investments and FHLB advances, or the Company must convert to a commercial bank charter. Management believes that this test is met.

The Association converted from a mutual to a stock institution, and a “liquidation account” was established at \$7,378,641, which was net worth reported in the conversion prospectus. The liquidation account represents a calculated amount for the purposes described below, and it does not represent actual funds included in the consolidated financial statements of the Company. Eligible depositors who have maintained their accounts, less annual reductions to the extent they have reduced their deposits, would receive a distribution from this account if the Company liquidated. Dividends may not reduce shareholders’ equity below the required liquidation account balance.

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**NOTE 13 – EARNINGS PER SHARE**

The two-class method is used in the calculation of basic earnings per share. Under the two-class method, earnings available to common shareholders for the period are allocated between common shareholders and participating securities according to dividends declared (or accumulated) and participation rights in undistributed earnings. The factors used in the earnings per share computation follow:

	<u>2018</u>	<u>2017</u>
Basic		
Net income available to common shareholders	\$ 231,197	\$ (106,749)
Less: (Income) loss allocated to participating securities	<u>(301)</u>	<u>403</u>
Net income (loss) allocated to common shareholders	<u>\$ 230,896</u>	<u>\$ (106,346)</u>
Weighted average common shares		
outstanding including participating securities	387,659	402,761
Less: Average unearned participating securities	(504)	(1,519)
Less: Average unallocated ESOP shares	<u>(20,520)</u>	<u>(22,230)</u>
Weighted average shares	<u>366,635</u>	<u>379,012</u>
Basic and diluted earnings (loss) per common share	<u>\$ 0.63</u>	<u>\$ (0.28)</u>

**NOTE 14 – STOCK-BASED COMPENSATION**

The Company's 2011 Equity Incentive Plan (the "Plan"), which was approved by shareholders on November 15, 2011, permits the grant of share options to its employees for up to an aggregate of 42,750 shares of common stock. Provisions of the plan indicate option awards are generally granted with an exercise price equal to the market price of the Company's common stock at the date of grant with vesting periods defined by the Board of Directors. The fair value of options awarded is estimated on the date of grant using a closed form option valuation (Black-Scholes) model. As of June 30, 2018 and 2017, no grants of stock options related to the Plan have occurred and thus no compensation expense has been recognized related to the Plan for the years ended June 30, 2018 and 2017.

The Plan also provides for the issuance of up to 17,100 restricted shares to directors and officers. During the year ended June 30, 2014, the Company awarded 13,600 restricted stock awards ("RSA"). Total compensation cost that has been charged against income for the RSAs was \$9,000 and \$21,000 for the years ended June 30, 2018 and 2017. The total income tax benefit was \$7,000 and \$7,000, respectively. The fair value of the stock was determined using the Company's over the counter bulletin board stock price at the grant date. RSA shares vest ratably over a three-year period for directors and a five-year-period for officers on the anniversary of the grant date. The shares have voting rights and participants receive nonforfeitable dividends on the unvested shares. These shares are considered to be participating securities in the earnings per share calculation.

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**NOTE 14 – STOCK-BASED COMPENSATION** (Continued)

A summary of changes in the Company's nonvested shares for the year follows:

<u>Nonvested Shares</u>	<u>Shares</u>	<u>Weighted-Average Grant-Date Fair Value</u>
Nonvested at July 1, 2017	3,840	\$ 15.00
Granted	-	-
Vested	(1,920)	15.00
Forfeited	<u>-</u>	<u>-</u>
Nonvested at June 30, 2018	<u>1,920</u>	<u>\$ 15.00</u>

The fair value of restricted stock awards which vested during the years ended June 30, 2018 and 2017 totaled \$46,000 and \$66,000. As of June 30, 2018, there was \$3,000 of total unrecognized compensation cost which will be recognized during the year ended June 30, 2019 related to nonvested shares granted under the Plan.