

Eagle Bancorp Montana, Inc.  
Form 10-Q  
November 14, 2018

Table of Contents

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

**FORM 10-Q**

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

For the quarterly period ended September 30, 2018

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 1-34682

Eagle Bancorp Montana, Inc.

---

(Exact name of small business issuer as specified in its charter)

Delaware 27-1449820  
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

1400 Prospect Avenue, Helena, MT 59601

---

Edgar Filing: Eagle Bancorp Montana, Inc. - Form 10-Q

(Address of principal executive offices)

(406) 442-3080

---

(Issuer's telephone number)

Website address: [www.opportunitybank.com](http://www.opportunitybank.com)

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  No

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

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

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

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

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

**APPLICABLE ONLY TO CORPORATE ISSUERS**

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

Common stock, par value \$0.01 per share 5,477,652 shares outstanding  
As of November 14, 2018

---

Table of Contents

EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

TABLE OF CONTENTS

<u>PART I.</u>	<u>Financial Information</u>	<u>PAGE</u>
Item 1.	<u>Financial Statements (Unaudited)</u>	
	<u>Consolidated Statements of Financial Condition as of September 30, 2018 and December 31, 2017</u>	1
	<u>Consolidated Statements of Income for the three and nine months ended September 30, 2018 and 2017</u>	3
	<u>Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2018 and 2017</u>	5
	<u>Consolidated Statements of Changes in Shareholders' Equity for the nine months ended September 30, 2018 and 2017</u>	6
	<u>Consolidated Statements of Cash Flows for the nine months ended September 30, 2018 and 2017</u>	7
	<u>Notes to the Unaudited Consolidated Financial Statements</u>	9
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	37
Item 3.	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	51
Item 4.	<u>Controls and Procedures</u>	52
<u>PART II.</u>	<u>OTHER INFORMATION</u>	
Item 1.	<u>Legal Proceedings</u>	53
Item 1A.	<u>Risk Factors</u>	53
Item 2.	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	53
Item 3.	<u>Defaults Upon Senior Securities</u>	54
Item 4.	<u>Mine Safety Disclosures</u>	54
Item 5.	<u>Other Information</u>	54
Item 6.	<u>Exhibits</u>	54
	<u>Signatures</u>	55

Table of Contents

EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

**Note Regarding Forward-Looking Statements**

This report includes “forward-looking statements” within the meaning and protections of Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. All statements other than statements of historical fact are statements that could be forward-looking statements. You can identify these forward-looking statements through our use of words such as “may,” “will,” “anticipate,” “assume,” “should,” “indicate,” “would,” “believe,” “contemplate,” “expect,” “estimate,” “continue,” “plan,” “intend,” “target” and other similar words and expressions of the future. These forward-looking statements include, but are not limited to:

- statements of our goals, intentions and expectations;
- statements regarding our business plans, prospects, growth and operating strategies;
- statements regarding the asset quality of our loan and investment portfolios; and
- estimates of our risks and future costs and benefits.

These forward-looking statements are based on current beliefs and expectations of management of Eagle Bancorp Montana, Inc. (“Eagle” or the “Company”) and Opportunity Bank of Montana (the “Bank”), Eagle’s wholly-owned subsidiary, and are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control. In addition, these forward-looking statements are subject to assumptions with respect to future business strategies and decisions that are subject to change.

The following factors, among others, could cause the Company’s actual results to differ materially from the anticipated results or other expectations expressed in the forward-looking statements:

- changes in laws or government regulations or policies affecting financial institutions, including changes in regulatory fees and capital requirements;
- general economic conditions, either nationally or in our market areas that are worse than expected;
- competition among depository and other financial institutions;
- changes in the prices, values and sales volume of residential and commercial real estate in Montana;
- inflation and changes in the interest rate environment that reduce our margins or reduce the fair value of financial instruments;
- changes or volatility in the securities markets;
- our ability to enter new markets successfully and capitalize on growth opportunities;

our ability to successfully perform due diligence and integrate acquired businesses including our proposed acquisition of Big Muddy Bancorp, Inc.;

changes in consumer spending, borrowing and savings habits;

our ability to continue to increase and manage our commercial and residential real estate, multi-family and commercial business loans;

possible impairments of securities held by us, including those issued by government entities and government sponsored enterprises;

the level of future deposit insurance premium assessments;

the costs or effects of mergers, acquisitions or dispositions we may make, including the pending merger of The State Bank of Townsend with and into Opportunity Bank of Montana, whether we are able to obtain any required governmental approvals in connection with any such mergers, acquisitions or dispositions, and/or our ability to realize the contemplated financial or business benefits, including any anticipated cost savings or synergies, associated with any such mergers, acquisitions or dispositions;

our ability to develop and maintain secure and reliable information technology systems, effectively defend ourselves against cyberattacks, or recover from breaches to our cybersecurity infrastructure;

the failure of assumptions underlying the establishment of allowance for possible loan losses and other estimates;

the possibility of goodwill impairment charges in the future;

changes in the financial performance, and/or condition of our borrowers and their ability to repay their loans when due; and

the effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Securities and Exchange Commission, the Public Company Accounting Oversight Board, the Financial Accounting Standards Board and other accounting standard setters.

Because of these and other uncertainties, our actual future results may be materially different from the results indicated by these forward-looking statements. For a further list and description of various risks, relevant factors and uncertainties that could cause future results or events to differ materially from those expressed or implied in our forward-looking statements, see the Item 1A, "Risk Factors" and Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" sections contained elsewhere in this report, as well as our Annual Report on Form 10-K for the year ended December 31, 2017, any subsequent Reports on Form 10-Q and Form 8-K, and other filings with the SEC. We do not undertake any obligation to publicly update or correct any forward-looking statements to reflect events or circumstances that subsequently occur, or of which we hereafter become aware.

---

Table of Contents

## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

(Dollars in Thousands, Except for Per Share Data)

(Unaudited)

	September 30, 2018	December 31, 2017
<b>ASSETS:</b>		
Cash and due from banks	\$ 7,889	\$ 5,517
Interest bearing deposits in banks	1,079	1,920
Total cash and cash equivalents	8,968	7,437
Securities available-for-sale	148,935	132,044
Federal Home Loan Bank stock	4,617	4,086
Federal Reserve Bank stock	2,033	1,465
Investment in Eagle Bancorp Statutory Trust I	155	155
Mortgage loans held-for-sale	8,747	8,949
Loans receivable, net of deferred loan fees of \$1,081 at September 30, 2018 and \$1,093 at December 31, 2017 and allowance for loan losses of \$6,350 at September 30, 2018 and \$5,750 at December 31, 2017	590,290	507,404
Accrued interest and dividends receivable	3,890	2,555
Mortgage servicing rights, net	6,947	6,578
Premises and equipment, net	28,600	21,958
Cash surrender value of life insurance	20,405	14,481
Real estate and other repossessed assets acquired in settlement of loans, net	457	525
Goodwill	12,124	7,034
Core deposit intangible, net	1,599	273
Deferred tax asset, net	2,100	1,360
Other assets	100	478
Total assets	\$ 839,967	\$ 716,782

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

Table of Contents

## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION (Continued)

(Dollars in Thousands, Except for Per Share Data)

(Unaudited)

	September 30, 2018	December 31, 2017
<b>LIABILITIES:</b>		
Deposit accounts:		
Noninterest bearing	\$ 142,351	\$ 99,799
Interest bearing	478,951	420,765
Total deposits	621,302	520,564
Accrued expenses and other liabilities	6,082	4,822
Federal Home Loan Bank advances and other borrowings	95,731	82,969
Other long-term debt:		
Principal amount	25,155	25,155
Unamortized debt issuance costs	(295 )	(344 )
Total other long-term debt less unamortized debt issuance costs	24,860	24,811
Total liabilities	747,975	633,166
<b>SHAREHOLDERS' EQUITY:</b>		
Preferred stock (par value \$0.01 per share; 1,000,000 shares authorized; no shares issued or outstanding)	-	-
Common stock (par value \$0.01 per share; 8,000,000 shares authorized; 5,718,942 and 5,272,168 shares issued; 5,460,452 and 5,013,678 shares outstanding at September 30, 2018 and December 31, 2017, respectively)	57	53
Additional paid-in capital	51,927	42,780
Unallocated common stock held by Employee Stock Ownership Plan	(518 )	(643 )
Treasury stock, at cost	(2,826 )	(2,826 )
Retained earnings	45,989	43,939
Net accumulated other comprehensive (loss) income	(2,637 )	313
Total shareholders' equity	91,992	83,616
Total liabilities and shareholders' equity	\$ 839,967	\$ 716,782

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





Table of Contents

## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF INCOME

(Dollars in Thousands, Except for Per Share Data)

(Unaudited)

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2018	
	2017	2018	2017	2018
<b>INTEREST AND DIVIDEND INCOME:</b>				
Interest and fees on loans	\$7,701	\$6,478	\$22,435	\$18,222
Securities available-for-sale	1,036	693	3,046	2,136
Federal Home Loan Bank and Federal Reserve Bank dividends	80	48	233	124
Interest on deposits in banks	5	2	40	3
Other interest income	3	3	4	4
Total interest and dividend income	8,825	7,224	25,758	20,489
<b>INTEREST EXPENSE:</b>				
Deposits	534	386	1,454	1,142
Federal Home Loan Bank advances and other borrowings	453	329	1,105	856
Other long-term debt	361	350	1,065	969
Total interest expense	1,348	1,065	3,624	2,967
<b>NET INTEREST INCOME</b>	7,477	6,159	22,134	17,522
Loan loss provision	194	331	720	934
<b>NET INTEREST INCOME AFTER LOAN LOSS PROVISION</b>	7,283	5,828	21,414	16,588
<b>NONINTEREST INCOME:</b>				
Service charges on deposit accounts	241	250	681	721
Net gain on sale of loans (includes \$402 and \$657 for the three months ended September 30, 2018 and 2017, respectively, and \$989 and \$1,556 for the nine months ended September 30, 2018 and 2017, respectively, related to accumulated other comprehensive earnings reclassification)	2,290	2,574	5,449	6,662
Mortgage loan servicing fees	575	525	1,698	1,581
Wealth management income	130	142	409	463
Interchange and ATM fees	270	214	766	648
Appreciation in cash surrender value of life insurance	166	125	436	375
	(23 )	-	(113 )	(14 )

Edgar Filing: Eagle Bancorp Montana, Inc. - Form 10-Q

Net loss on sale of available-for-sale securities (includes (\$23) and \$0 for the three months ended September 30, 2018 and 2017, respectively, and (\$113) and (\$14) for the nine months ended September 30, 2018 and 2017, respectively, related to accumulated other comprehensive earnings reclassification)

Net loss on sale of real estate owned and other repossessed property	-	-	(57 )	(25 )
Other noninterest income	112	158	255	355
Total noninterest income	3,761	3,988	9,524	10,766

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

-3-

---

Table of Contents

## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF INCOME (Continued)

(Dollars in Thousands, Except for Per Share Data)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
<b>NONINTEREST EXPENSE:</b>				
Salaries and employee benefits	\$5,123	\$4,331	\$15,493	\$13,350
Occupancy and equipment expense	880	680	2,543	2,069
Data processing	866	563	2,176	1,696
Advertising	295	255	871	713
Amortization of mortgage servicing rights	296	288	906	812
Amortization of core deposit intangible and tax credits	182	107	519	321
Loan costs	154	166	469	465
Federal insurance premiums	65	78	203	198
Postage	58	48	192	147
Legal, accounting and examination fees	121	107	447	392
Consulting fees	23	14	65	122
Acquisition costs	222	276	587	276
Write-down on real estate owned and other repossessed property	-	-	-	45
Other noninterest expense	767	644	2,149	2,010
Total noninterest expense	9,052	7,557	26,620	22,616
<b>INCOME BEFORE INCOME TAXES</b>	1,992	2,259	4,318	4,738
Income tax expense (includes (\$364) and (\$157) for the three months ended September 30, 2018 and 2017, respectively, and (\$1,064) and \$726 for the nine months ended September 30, 2018 and 2017, respectively related to income tax (benefit) expense from reclassification items)	360	538	780	1,188
<b>NET INCOME</b>	\$1,632	\$1,721	\$3,538	\$3,550
<b>BASIC EARNINGS PER SHARE</b>	\$0.30	\$0.45	\$0.65	\$0.93
<b>DILUTED EARNINGS PER SHARE</b>	\$0.30	\$0.45	\$0.65	\$0.92
	5,460,452	3,811,409	5,411,356	3,811,409

**WEIGHTED AVERAGE SHARES OUTSTANDING  
(BASIC EPS)**

**WEIGHTED AVERAGE SHARES OUTSTANDING  
(DILUTED EPS)**

5,524,912 3,863,656 5,475,816 3,869,695

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

Table of Contents

## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Dollars in Thousands)

(Unaudited)

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2018	
	2017	2018	2017	2018
<b>NET INCOME</b>	\$1,632	\$1,721	\$3,538	\$3,550
<b>OTHER ITEMS OF COMPREHENSIVE (LOSS) INCOME:</b>				
Change in fair value of investment securities available-for-sale, before income taxes	(1,237)	(91 )	(4,036)	1,963
Reclassification for net realized losses on investment securities included in income, before income tax	23	-	113	14
Change in fair value of derivatives designated as cash flow hedges, before income taxes	234	364	898	1,362
Reclassification for net realized gains on derivatives designated as cash flow hedges, before income taxes	(402 )	(657 )	(989 )	(1,556)
Total other items of comprehensive (loss) income	(1,382)	(384 )	(4,014)	1,783
Income tax benefit (expense) related to:				
Investment securities	320	38	1,040	(805 )
Derivatives designated as cash flow hedges	44	119	24	79
Total income tax benefit (expense)	364	157	1,064	(726 )
<b>COMPREHENSIVE INCOME</b>	\$614	\$1,494	\$588	\$4,607

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

Table of Contents

## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

For the Nine Months Ended September 30, 2018 and 2017

(Dollars in Thousands, Except for Per Share Data)

(Unaudited)

	PREFERRED STOCK	COMMON STOCK	UNALLOCATED ESOP CAPITAL	ESOP SHARES	TREASURY STOCK	RETAINED EARNINGS	ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)	TOTAL
<b>Balance at January 1, 2018</b>	\$ -	\$ 53	\$ 42,780	\$ (643 )	\$ (2,826 )	\$ 43,939	\$ 313	\$ 83,616
Net income						3,538		3,538
Other comprehensive loss							(2,950 )	(2,950 )
Dividends paid						(1,488 )		(1,488 )
Stock issued in connection with TwinCo acquisition		4	9,026					9,030
Employee Stock Ownership Plan shares allocated or committed to be released for allocation (12,462 shares)			121	125				246
<b>Balance at September 30, 2018</b>	\$ -	\$ 57	\$ 51,927	\$ (518 )	\$ (2,826 )	\$ 45,989	\$ (2,637 )	\$ 91,992
<b>Balance at January 1, 2017</b>	\$ -	\$ 41	\$ 22,366	\$ (809 )	\$ (2,971 )	\$ 41,240	\$ (411 )	\$ 59,456
Net income						3,550		3,550

Other comprehensive income							1,057	1,057
Dividends paid						(953 )		(953 )
Employee Stock Ownership Plan shares allocated or committed to be released for allocation (12,462 shares)		111	125					236
<b>Balance at September 30, 2017</b>	\$ -	\$ 41	\$ 22,477	\$ (684 )	\$ (2,971 )	\$ 43,837	\$ 646	\$ 63,346

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



Table of Contents

## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in Thousands)

(Unaudited)

	Nine Months Ended September 30,	
	2018	2017
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$3,538	\$3,550
Adjustments to reconcile net income to net cash provided by operating activities:		
Loan loss provision	720	934
Write-down on real estate owned and other repossessed assets	-	45
Depreciation	923	712
Net amortization of investment securities premium and discounts	950	1,208
Amortization of mortgage servicing rights	906	812
Amortization of core deposit intangible and tax credits	519	321
Deferred income tax provision (benefit)	516	(110 )
Net gain on sale of loans	(5,449 )	(6,662 )
Net loss on sale of available-for-sale securities	113	14
Net loss on sale of real estate owned and other repossessed assets	57	25
Net loss on sale/disposal of premises and equipment	(9 )	-
Net appreciation in cash surrender value of life insurance	(346 )	(290 )
Net change in:		
Accrued interest and dividends receivable	(630 )	(146 )
Loans held-for-sale	5,560	15,092
Other assets	258	558
Accrued expenses and other liabilities	1,487	1,371
Net cash provided by operating activities	9,113	17,434
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Activity in available-for-sale securities:		
Sales	46,058	2,749
Maturities, principal payments and calls	8,763	6,982
Purchases	(45,970)	(1,307 )
Federal Home Loan Bank stock purchased	(420 )	(109 )
Federal Reserve Bank stock purchased	(568 )	-
Cash paid for TwinCo Acquisition, net of cash received	(4,243 )	-
Loan origination and principal collection, net	(29,828)	(45,618)
Proceeds from Bank owned life insurance	205	-

Edgar Filing: Eagle Bancorp Montana, Inc. - Form 10-Q

Purchase of Bank owned life insurance	(5,600 )	-
Proceeds from sale of real estate and other repossessed assets acquired in settlement of loans	150	262
Proceeds from sale of premises and equipment	9	-
Additions to premises and equipment	(5,960 )	(2,179 )
Net cash used in investing activities	(37,404)	(39,220)

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

-7-

---

Table of Contents

## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)

(Dollars in Thousands)

(Unaudited)

	Nine Months Ended September 30,	
	2018	2017
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Net increase in deposits	\$18,548	\$12,372
Net short-term advances (payments) on Federal Home Loan Bank and other borrowings	39,417	(35,522)
Long-term advances from Federal Home Loan Bank and other borrowings	-	46,300
Payments on long-term Federal Home Loan Bank and other borrowings	(26,655)	(9,355 )
Proceeds from issuance of long-term debt	-	10,000
Payments for debt issuance costs	-	(219 )
Dividends paid	(1,488 )	(953 )
Net cash provided by financing activities	29,822	22,623
<b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>1,531</b>	<b>837</b>
<b>CASH AND CASH EQUIVALENTS, beginning of period</b>	<b>7,437</b>	<b>7,318</b>
<b>CASH AND CASH EQUIVALENTS, end of period</b>	<b>\$8,968</b>	<b>\$8,155</b>
<b>SUPPLEMENTAL CASH FLOW INFORMATION:</b>		
Cash paid during the period for interest	\$3,523	\$2,939
Cash paid during the period for income taxes	\$355	\$1,180
<b>NON-CASH INVESTING AND FINANCING ACTIVITIES:</b>		
(Decrease) increase in market value of securities available-for-sale	\$(3,923 )	\$1,977
Mortgage servicing rights recognized	\$1,275	\$1,357
Loans transferred to real estate and other assets acquired in foreclosure	\$4	\$34
Stock issued in connection with TwinCo acquisition	\$9,030	\$-
Employee Stock Ownership Plan shares released	\$246	\$236

See Note 12. Mergers and Acquisitions for additional information related to assets acquired and liabilities assumed in the TwinCo acquisition.

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

Table of Contents

EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**NOTE 1. BASIS OF PRESENTATION**

The accompanying unaudited consolidated financial statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for annual financial statements. However, such information reflects all adjustments (consisting of normal recurring adjustments) which are, in the opinion of management, necessary for a fair presentation of our financial position, results of operations, changes in comprehensive income and cash flows for the unaudited interim periods.

The results of operations for the nine-month period ended September 30, 2018 are not necessarily indicative of the results to be expected for the year ending December 31, 2018 or any other period. The unaudited consolidated financial statements and notes presented herein should be read in conjunction with the audited consolidated financial statements and related notes thereto included in Eagle Bancorp Montana, Inc.'s ("the Company" or "Eagle") Form 10-K for the year ended December 31, 2017.

Certain prior period amounts were reclassified to conform to the presentation for 2018. These reclassifications had no impact on net income or total shareholders' equity. Certain loan amounts were reclassified for prior periods to be consistent with loan category classification for September 30, 2018. During the quarter ended March 31, 2018, Eagle completed the acquisition of TwinCo, Inc. ("TwinCo"). See Note 12. Mergers and Acquisitions for more information. The acquisition included the addition of over \$55,000,000 in gross loans and added a considerable amount to Eagle's agricultural loans. There was no impact to Eagle's loan policies due to the acquisition. Loan costs were previously included in other noninterest expense on the Consolidated Statements of Income. These amounts were presented on their own lines for the three and nine months ended September 30, 2018 and prior year amounts were reclassified to be consistent with the current year presentation.

The Company evaluated subsequent events for potential recognition and/or disclosure through November 14, 2018, the date the unaudited consolidated financial statements were issued.

**NOTE 2. INVESTMENT SECURITIES**

Investment securities are summarized as follows:

	September 30, 2018			December 31, 2017				
	Amortized Cost (In Thousands)	Gross Unrealized Gains	(Losses) Fair Value	Amortized Cost	Gross Unrealized Gains	(Losses) Fair Value		
<b>Available-for-Sale:</b>								
U.S. government and agency obligations	\$10,452	\$-	\$(223 )	\$10,229	\$4,881	\$13	\$(37 )	\$4,857
Municipal obligations	74,853	100	(2,279 )	72,674	67,508	807	(429 )	67,886
Corporate obligations	11,419	24	(236 )	11,207	14,725	18	(99 )	14,644
Mortgage-backed securities	20,946	120	(446 )	20,620	24,770	364	(265 )	24,869
Collateralized mortgage obligations	24,668	-	(827 )	23,841	20,051	7	(270 )	19,788
Asset-backed securities	10,411	1	(48 )	10,364	-	-	-	-
Total	\$152,749	\$245	\$(4,059 )	\$148,935	\$131,935	\$1,209	\$(1,100 )	\$132,044

Table of Contents

## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**NOTE 2. INVESTMENT SECURITIES - continued**

Proceeds from sales of available-for-sale securities and the associated gross realized gains and losses were as follows:

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
	2018	2017	2018	2017
	(In Thousands)			
Proceeds from sale of available-for-sale securities	\$978	\$ -	\$46,058	\$2,749
Gross realized gain on sale of available-for-sale securities	\$-	\$ -	\$191	\$14
Gross realized loss on sale of available-for-sale securities	(23 )	-	(304 )	(28 )
Net realized loss on sale of available-for-sale securities	\$(23 )	-	\$(113 )	\$(14 )

The amortized cost and fair value of securities by contractual maturity are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	September 30, 2018	
	Amortized Fair	
	Cost	Value
	(In Thousands)	
Due in one year or less	\$1,255	\$1,254
Due from one to five years	18,245	17,920
Due from five to ten years	14,561	14,236
Due after ten years	73,074	71,064
	107,135	104,474
Mortgage-backed securities	20,946	20,620

Edgar Filing: Eagle Bancorp Montana, Inc. - Form 10-Q

Collateralized mortgage obligations	24,668	23,841
Total	\$152,749	\$148,935

Maturities of securities do not reflect repricing opportunities present in adjustable rate securities.

-10-

---



Table of Contents

## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**NOTE 2. INVESTMENT SECURITIES - continued**

The Company's investment securities that have been in a continuous unrealized loss position for less than twelve months and those that have been in a continuous unrealized loss position for twelve or more months were as follows:

	September 30, 2018			
	Less Than 12 Months		12 Months or Longer	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
	(In Thousands)			
U.S. government and agency	\$7,756	\$ (130 )	\$2,473	\$ (93 )
Municipal obligations	50,828	(1,274 )	17,332	(1,005 )
Corporate obligations	7,193	(227 )	991	(9 )
Mortgage-backed securities and collateralized mortgage obligations	17,702	(472 )	16,912	(801 )
Asset-backed securities	8,371	(48 )	-	-
Total	\$91,850	\$ (2,151 )	\$37,708	\$ (1,908 )
	December 31, 2017			
	Less Than 12 Months		12 Months or Longer	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
	(In Thousands)			
U.S. government and agency	\$2,943	\$ (14 )	\$1,363	\$ (23 )
Municipal obligations	15,404	(87 )	16,675	(342 )
Corporate obligations	7,643	(71 )	3,981	(28 )
Mortgage-backed securities and collateralized mortgage obligations	9,107	(81 )	21,653	(454 )
Asset-backed securities	-	-	-	-
Total	\$35,097	\$ (253 )	\$43,672	\$ (847 )

Management evaluates securities for other-than-temporary impairment at least quarterly, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. As of September 30, 2018 and December 31, 2017, there were, respectively, 139 and 87 securities in an unrealized loss position that were considered to be temporarily impaired and therefore an impairment charge has not been recorded.

As of September 30, 2018, 104 U.S. government and agency securities and municipal obligations had unrealized losses with aggregate depreciation of approximately 3.09% from the Company's amortized cost basis of these securities. At December 31, 2017, 52 U.S. government and agency securities and municipal obligations had unrealized losses with aggregate depreciation of approximately 1.28% from the Company's amortized cost basis of these securities. As of September 30, 2018, 9 corporate obligations had unrealized losses of approximately 2.80% from the Company's amortized cost basis of these securities. At December 31, 2017, 15 corporate obligations had unrealized losses with aggregate depreciation of approximately 0.84% from the Company's amortized cost basis of these securities. As management has the ability to hold debt securities until maturity, or for the foreseeable future, no declines are deemed to be other than temporary.

Table of Contents

## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**NOTE 2. INVESTMENT SECURITIES - continued**

As of September 30, 2018, 22 mortgage-backed securities (“MBSs”) and collateralized mortgage obligations (“CMOs”) had unrealized losses with aggregate depreciation of approximately 3.55% from the Company’s amortized cost basis of these securities. At December 31, 2017, 20 MBSs and CMOs had unrealized losses with aggregate depreciation of approximately 1.71% from the Company’s amortized cost basis. Management’s analysis as of September 30, 2018 revealed no expected credit losses on the securities and therefore, declines are not deemed to be other than temporary.

As of September 30, 2018, 4 asset-backed securities (“ABSs”) had unrealized losses with aggregate depreciation of approximately 0.57% from the Company’s amortized cost basis of these securities. The ABSs were purchased during the quarter ended March 31, 2018. Management’s analysis as of September 30, 2018 revealed no expected credit losses on the securities and therefore, declines are not deemed to be other than temporary.

**NOTE 3. LOANS RECEIVABLE**

Loans receivable consisted of the following:

	September 30, 2018	December 31, 2017
	(In Thousands)	
Real estate loans:		
Residential 1-4 family	\$ 144,972	\$ 135,217
Commercial real estate	303,660	244,783
Other loans:		
Home equity	53,342	52,672

Edgar Filing: Eagle Bancorp Montana, Inc. - Form 10-Q

Consumer	16,491	15,712
Commercial	79,256	65,863
Total	597,721	514,247
Deferred loan fees, net	(1,081 )	(1,093 )
Allowance for loan losses	(6,350 )	(5,750 )
Total loans, net	\$590,290	\$507,404

Within the commercial real estate loan category, \$12,637,000 and \$13,114,000 was guaranteed by the United States Department of Agriculture Rural Development, at September 30, 2018 and December 31, 2017, respectively. The commercial real estate category and the commercial category also include \$3,004,000 and \$1,480,000 of loans guaranteed by the United States Department of Agriculture Farm Service Agency at September 30, 2018, respectively. The United States Department of Agriculture Farm Service Agency guaranteed loans were acquired through the TwinCo acquisition. In addition, within the commercial loan category, \$229,000 and \$486,000 were in loans originated through a syndication program where the business resides outside of Montana, at September 30, 2018, and December 31, 2017, respectively.

Table of Contents

## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**NOTE 3. LOANS RECEIVABLE – continued**

The following table includes information regarding nonperforming assets.

	September 30, 2018	December 31, 2017		
	(Dollars in Thousands)			
Non-accrual loans	\$1,556	\$ 977		
Accruing loans delinquent 90 days or more	156	-		
Restructured loans, net	-	-		
Total nonperforming loans	1,712	977		
Real estate owned and other repossessed assets, net	457	525		
Total nonperforming assets	\$2,169	\$ 1,502		
Total nonperforming assets as a percentage of total assets	0.26 %	0.21 %		
Allowance for loan losses	\$6,350	\$ 5,750		
Percent of allowance for loan losses to nonperforming loans	370.91 %	588.54 %		
Percent of allowance for loan losses to nonperforming assets	292.76 %	382.82 %		

Table of Contents

## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**NOTE 3. LOANS RECEIVABLE - continued**

Allowance for loan losses activity was as follows:

	Residential 1-4 Family	Commercial Real Estate	Home Equity	Consumer	Commercial	Total
	(In Thousands)					
<i>Allowance for loan losses:</i>						
Beginning balance, July 1, 2018	\$1,301	\$ 3,230	\$427	\$ 185	\$ 1,007	\$6,150
Charge-offs	-	-	-	(14 )	-	(14 )
Recoveries	-	7	-	12	1	20
Provision	-	164	-	-	30	194
Ending balance, September 30, 2018	\$1,301	\$ 3,401	\$427	\$ 183	\$ 1,038	\$6,350
<i>Allowance for loan losses:</i>						
Beginning balance, January 1, 2018	\$1,301	\$ 2,778	\$506	\$ 225	\$ 940	\$5,750
Charge-offs	-	-	(80 )	(64 )	(24 )	(168 )
Recoveries	-	14	1	22	11	48
Provision	-	609	-	-	111	720
Ending balance, September 30, 2018	\$1,301	\$ 3,401	\$427	\$ 183	\$ 1,038	\$6,350
Ending balance, September 30, 2018 allocated to loans individually evaluated for impairment	\$-	\$ -	\$-	\$ -	\$ -	\$-
Ending balance, September 30, 2018 allocated to loans collectively evaluated for impairment	\$1,301	\$ 3,401	\$427	\$ 183	\$ 1,038	\$6,350
<i>Loans receivable:</i>						
Ending balance, September 30, 2018	\$144,972	\$ 303,660	\$53,342	\$ 16,491	\$ 79,256	\$597,721
	\$564	\$ 514	\$228	\$ 137	\$ 113	\$1,556

Ending balance, September 30, 2018 of loans  
individually evaluated for impairment

Ending balance, September 30, 2018 of loans collectively evaluated for impairment	\$ 144,408	\$ 303,146	\$ 53,114	\$ 16,354	\$ 79,143	\$ 596,165
--	------------	------------	-----------	-----------	-----------	------------

Table of Contents

## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**NOTE 3. LOANS RECEIVABLE - continued**

	Residential 1-4 Family (In Thousands)	Commercial Real Estate	Home Equity	Consumer	Commercial	Total
<i>Allowance for loan losses:</i>						
Beginning balance, July 1, 2017	\$ 1,251	\$ 2,378	\$ 505	\$ 225	\$ 866	\$ 5,225
Charge-offs	-	-	-	(41 )	(19 )	(60 )
Recoveries	-	-	-	3	1	4
Provision	50	200	-	31	50	331
Ending balance, September 30, 2017	\$ 1,301	\$ 2,578	\$ 505	\$ 218	\$ 898	\$ 5,500
<i>Allowance for loan losses:</i>						
Beginning balance, January 1, 2017	\$ 1,241	\$ 2,079	\$ 460	\$ 193	\$ 797	\$ 4,770
Charge-offs	-	-	-	(140 )	(118 )	(258 )
Recoveries	-	-	39	14	1	54
Provision	60	499	6	151	218	934
Ending balance, September 30, 2017	\$ 1,301	\$ 2,578	\$ 505	\$ 218	\$ 898	\$ 5,500
Ending balance, September 30, 2017 allocated to loans individually evaluated for impairment	\$-	\$-	\$-	\$ 32	\$-	\$ 32
Ending balance, September 30, 2017 allocated to loans collectively evaluated for impairment	\$ 1,301	\$ 2,578	\$ 505	\$ 186	\$ 898	\$ 5,468
<i>Loans receivable:</i>						
Ending balance, September 30, 2017	\$ 139,010	\$ 247,501	\$ 51,450	\$ 14,696	\$ 58,554	\$ 511,211
Ending balance, September 30, 2017 of loans individually evaluated for impairment	\$ 484	\$ 451	\$ 242	\$ 131	\$ 88	\$ 1,396
Ending balance, September 30, 2017 of loans collectively evaluated for impairment	\$ 138,526	\$ 247,050	\$ 51,208	\$ 14,565	\$ 58,466	\$ 509,815



The Company utilizes an 8-point internal loan rating system, largely based on regulatory classifications, as follows:

*Loans Rated Pass* – these are loans in categories 1 – 5 that are considered to be protected by the current net worth and paying capacity of the obligor, or by the value of the asset or the underlying collateral.

*Loans Rated Special Mention* – these loans in category 6 have potential weaknesses and are watched closely by management. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset at some future date.

*Loans Rated Substandard* – these loans in category 7 are inadequately protected by the current net worth and paying capacity of the obligor of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

*Loans Rated Doubtful* – these loans in category 8 have all the weaknesses inherent in those classified Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable.

*Loans Rated Loss* – these loans are considered uncollectible and are not part of the 8-point rating system. They are of such small value that their continuance as assets without establishment of a specific reserve is not warranted. This classification does not mean that an asset has absolutely no recovery or salvage value, but, rather, that it is not practical or desirable to defer writing off a basically worthless asset even though practical recovery may be affected in the future.

Table of Contents

## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**NOTE 3. LOANS RECEIVABLE - continued**

On an annual basis, or more often if needed, the Company formally reviews the ratings of all commercial real estate, construction, and commercial business loans that have a principal balance of \$750,000 or more. Quarterly, the Company reviews the rating of any consumer loan, broadly defined, that is delinquent 90 days or more. Likewise, quarterly, the Company reviews the rating of any commercial loan, broadly defined, that is delinquent 60 days or more. Annually, the Company engages an independent third-party to review a significant portion of loans within these segments. Management uses the results of these reviews as part of its annual review process.

Internal classification of the loan portfolio was as follows:

	September 30, 2018					
	Pass	Special Mention	Substandard	Doubtful	Loss	Total
	(In Thousands)					
Real estate loans:						
Residential 1-4 family	\$ 114,320	\$ -	\$ 897	\$ -	\$ -	\$ 115,217
Residential 1-4 family construction	29,418	-	337	-	-	29,755
Commercial real estate	232,721	1,758	2,421	-	-	236,900
Commercial construction and development	36,339	-	-	-	-	36,339
Farmland	30,421	-	-	-	-	30,421
Other loans:						
Home equity	53,114	-	228	-	-	53,342
Consumer	16,307	-	184	-	-	16,491
Commercial	59,403	870	134	-	-	60,407
Agricultural	18,451	-	398	-	-	18,849
Total	\$ 590,494	\$ 2,628	\$ 4,599	\$ -	\$ -	\$ 597,721

	December 31, 2017					
	Pass	Special Mention	Substandard	Doubtful	Loss	Total

Edgar Filing: Eagle Bancorp Montana, Inc. - Form 10-Q

(In Thousands)

Real estate loans:						
Residential 1-4 family	\$109,167	\$ -	\$ 744	\$ -	\$ -	\$109,911
Residential 1-4 family construction	24,850	-	456	-	-	25,306
Commercial real estate	194,502	-	303	-	-	194,805
Commercial construction and development	38,351	-	-	-	-	38,351
Farmland	11,627	-	-	-	-	11,627
Other loans:						
Home equity	52,430	-	242	-	-	52,672
Consumer	15,549	-	136	-	27	15,712
Commercial	63,165	-	113	-	22	63,300
Agricultural	2,563	-	-	-	-	2,563
Total	\$512,204	\$ -	\$ 1,994	\$ -	\$ 49	\$514,247

-16-

---

Table of Contents

## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**NOTE 3. LOANS RECEIVABLE – continued**

Credit risk profile based on payment activity of the loan portfolio was as follows:

	September 30, 2018			Total
	Performing Loans	Restructured	Nonperforming	
	(In Thousands)			
Real estate loans:				
Residential 1-4 family	\$ 114,860	\$ -	\$ 357	\$ 115,217
Residential 1-4 family construction	29,418	-	337	29,755
Commercial real estate	236,386	-	514	236,900
Commercial construction and development	36,313	-	26	36,339
Farmland	30,421	-	-	30,421
Other loans:				
Home equity	53,114	-	228	53,342
Consumer	16,354	-	137	16,491
Commercial	60,294	-	113	60,407
Agricultural	18,849	-	-	18,849
Total	\$ 596,009	\$ -	\$ 1,712	\$ 597,721

	December 31, 2017			Total
	Performing Loans	Restructured	Nonperforming	
	(In Thousands)			
Real estate loans:				
Residential 1-4 family	\$ 109,436	\$ -	\$ 475	\$ 109,911
Residential 1-4 family construction	25,306	-	-	25,306
Commercial real estate	194,805	-	-	194,805
Commercial construction and development	38,351	-	-	38,351
Farmland	11,627	-	-	11,627
Other loans:				
Home equity	52,430	-	242	52,672

Edgar Filing: Eagle Bancorp Montana, Inc. - Form 10-Q

Consumer	15,559	-	153	15,712	
Commercial	63,193	-	107	63,300	
Agricultural	2,563	-	-	2,563	
Total	\$513,270	\$	-	\$ 977	\$514,247

-17-

---

Table of Contents

## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**NOTE 3. LOANS RECEIVABLE – continued**

The following tables include information regarding delinquencies within the loan portfolio.

	September 30, 2018					
	Loans Past Due and Still					
	Accruing					
	90					
	Days					
	30-89	and	Total	Non-Accrual	Current	Total
	Days	Greater		Loans	Loans	Loans
	Past					
	Due					
	(In Thousands)					
Real estate loans:						
Residential 1-4 family	\$473	\$ 130	\$603	\$ 227	\$114,387	\$115,217
Residential 1-4 family construction	118	-	118	337	29,300	29,755
Commercial real estate	1,618	-	1,618	514	234,768	236,900
Commercial construction and development	10	26	36	-	36,303	36,339
Farmland		-	-	-	30,421	30,421
Other loans:						
Home equity	109	-	109	228	53,005	53,342
Consumer	80	-	80	137	16,274	16,491
Commercial	1,956		1,956	113	58,338	60,407
Agricultural	79	-	79	-	18,770	18,849
Total	\$4,443	\$ 156	\$4,599	\$ 1,556	\$591,566	\$597,721

December 31, 2017  
Loans Past Due and Still  
Accruing

90

Days

and

Non-Accrual Current Total

Edgar Filing: Eagle Bancorp Montana, Inc. - Form 10-Q

	30-89 Days Past Due (In Thousands)	Greater	Total	Loans	Loans	Loans
Real estate loans:						
Residential 1-4 family	\$898	\$ -	\$898	\$ 475	\$108,538	\$109,911
Residential 1-4 family construction	409	-	409	-	24,897	25,306
Commercial real estate	291	-	291	-	194,514	194,805
Commercial construction and development	-	-	-	-	38,351	38,351
Farmland	-	-	-	-	11,627	11,627
Other loans:						
Home equity	212	-	212	242	52,218	52,672
Consumer	111	-	111	153	15,448	15,712
Commercial	116	-	116	107	63,077	63,300
Agricultural	-	-	-	-	2,563	2,563
Total	\$2,037	\$ -	\$2,037	\$ 977	\$511,233	\$514,247

-18-

---

Table of Contents

## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**NOTE 3. LOANS RECEIVABLE - continued**

The following tables include information regarding impaired loans.

	September 30, 2018		
	Unpaid		
	Recorded	Principal	Related
	Investment	Balance	Allowance
	(In Thousands)		
With no related allowance:			
Real estate loans:			
Residential 1-4 family	\$227	\$ 248	\$ -
Residential 1-4 family construction	337	387	-
Commercial real estate	514	527	-
Commercial construction and development	-	-	-
Farmland	-	-	-
Other loans:			
Home equity	228	268	-
Consumer	137	190	-
Commercial	113	119	-
Agricultural	-	-	-
With a related allowance:			
Real estate loans:			
Residential 1-4 family	-	-	-
Residential 1-4 family construction	-	-	-
Commercial real estate	-	-	-
Commercial construction and development	-	-	-
Farmland	-	-	-
Other loans:			
Home equity	-	-	-
Consumer	-	-	-
Commercial	-	-	-
Agricultural	-	-	-



Total:

Real estate loans:

Residential 1-4 family	227	248	-
Residential 1-4 family construction	337	387	-
Commercial real estate	514	527	-
Commercial construction and development	-	-	-
Farmland	-	-	-
Other loans:			
Home equity	228	268	-
Consumer	137	190	-
Commercial	113	119	-
Agricultural	-	-	-
Total	\$1,556	\$ 1,739	\$ -

Table of Contents

## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**NOTE 3. LOANS RECEIVABLE - continued**

	December 31, 2017		
	Unpaid		
	Record	Principal	Related
	Investment	Balance	Allowance
	(In Thousands)		
With no related allowance:			
First mortgage loans:			
Residential 1-4 family	\$475	\$ 487	\$ -
Residential 1-4 family construction	-	-	-
Commercial real estate	-	-	-
Commercial construction and development	-	-	-
Farmland	-	-	-
Other loans:			
Home equity	242	263	-
Consumer	126	176	-
Commercial	85	87	-
Agricultural	-	-	-
With a related allowance:			
First mortgage loans:			
Residential 1-4 family	-	-	-
Residential 1-4 family construction	-	-	-
Commercial real estate	-	-	-
Commercial construction and development	-	-	-
Farmland	-	-	-
Other loans:			
Home equity	-	-	-
Consumer	27	27	27
Commercial	22	22	22
Agricultural	-	-	-
Total:			
First mortgage loans:			
Residential 1-4 family	475	487	-

Edgar Filing: Eagle Bancorp Montana, Inc. - Form 10-Q

Residential 1-4 family construction	-	-	-
Commercial real estate	-	-	-
Commercial construction and development	-	-	-
Farmland	-	-	-
Other loans:			
Home equity	242	263	-
Consumer	153	203	27
Commercial	107	109	22
Agricultural	-	-	-
Total	\$977	\$ 1,062	\$ 49

-20-

---

Table of Contents

## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**NOTE 3. LOANS RECEIVABLE – continued**

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2018	
	2017	2018	2017	2018
	Average Recorded Investment (In Thousands)			
Real estate loans:				
Residential 1-4 family	\$232	\$492	\$351	\$352
Residential 1-4 family construction	337	-	169	-
Commercial real estate	521	451	257	226
Commercial construction and development	-	-	-	-
Farmland	-	-	-	-
Other loans:				
Home equity	217	274	235	291
Consumer	119	137	145	114
Commercial	102	150	110	44
Agricultural	-	-	-	-
Total	\$1,528	\$1,504	\$1,267	\$1,027

Interest income recognized on impaired loans for the three and nine months ended September 30, 2018 and 2017 are considered insignificant.

**NOTE 4. TROUBLED DEBT RESTRUCTURINGS**

A troubled debt restructured (“TDR”) loan is a loan in which the Bank grants a concession to the borrower that it would not otherwise consider, for reasons related to a borrower's financial difficulties. The loan terms which have been modified or restructured due to a borrower's financial difficulty, include but are not limited to a reduction in the stated interest rate; an extension of the maturity at an interest rate below current market rates; a reduction in the face amount

of the debt; a reduction in the accrued interest; or re-aging, extensions, deferrals, renewals and rewrites or a combination of these modification methods. A TDR loan would generally be considered impaired in the year of modification and will be assessed periodically for continued impairment.

The Company offers a variety of modifications to borrowers. The modification categories offered can generally be described in the following categories:

*Rate Modification* – A modification in which the interest rate is changed.

*Term Modification* – A modification in which the maturity date, timing of payments, or frequency of payments is changed.

*Interest Only Modification* – A modification in which the loan is converted to interest only payments for a period of time.

*Payment Modification* – A modification in which the dollar amount of the payment is changed, other than an interest only modification described above.

*Combination Modification* – Any other type of modification, including the use of multiple categories above.

Table of Contents

EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**NOTE 4. TROUBLED DEBT RESTRUCTURINGS – continued**

The Company previously had one TDR loan with a recorded investment of \$43,000 and a \$34,000 charge-off at time of restructure. The loan was a home equity loan and was on accrual status. The remaining recorded investment of \$42,000 was paid-off during the quarter ended June 30, 2017 and the \$34,000 charge-off was recovered.

The Bank's policy is that loans placed on non-accrual will typically remain on non-accrual status until all principal and interest payments are brought current and the prospect for future payment in accordance with the loan agreement appears relatively certain. The Bank's policy generally refers to nine months of payment performance as sufficient to warrant a return to accrual status.

During the nine months ended September 30, 2018, there were no new restructured loans.

There were no loans modified as a troubled debt restructured loan within the previous nine months for which there was a payment default during the nine months ended September 30, 2018. A default for purposes of this disclosure is a troubled debt restructured loan in which the borrower is 90 days past due or results in the foreclosure and repossession of the applicable collateral.

As of September 30, 2018 and December 31, 2017, the Company had no commitments to lend additional funds to loan customers whose terms had been modified in trouble debt restructures.

**NOTE 5. DEPOSITS**

Deposits are summarized as follows:

	September 30, 2018	December 31, 2017
	(In Thousands)	
Noninterest checking	\$ 142,351	\$ 99,799
Interest bearing checking	103,372	99,255
Savings	108,878	88,603
Money market	104,794	89,558
Time certificates of deposit	161,907	143,349
Total	\$ 621,302	\$ 520,564

#### **NOTE 6. OTHER LONG-TERM DEBT**

Other long-term debt consisted of the following:

	September 30, 2018		December 31, 2017	
	Principal Amount (In Thousands)	Unamortized Debt Issuance Costs	Principal Amount	Unamortized Debt Issuance Costs
Senior notes fixed at 5.75%, due 2022	\$ 10,000	\$ (147 )	10,000	(180 )
Subordinated debentures fixed at 6.75%, due 2025	10,000	(148 )	10,000	(164 )
Subordinated debentures variable at 3-Month Libor plus 1.42%, due 2035	5,155	-	5,155	-
Total other long-term debt	\$ 25,155	\$ (295 )	\$ 25,155	\$ (344 )

Table of Contents

EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**NOTE 6. OTHER LONG-TERM DEBT - continued**

In February 2017, the Company completed the issuance, through a private placement, of \$10,000,000 aggregate principal amount of 5.75% fixed senior unsecured notes due in 2022. The interest will be paid semi-annually through maturity date. The notes are not subject to redemption at the option of the Company.

In June 2015, the Company completed the issuance of \$10,000,000 in aggregate principal amount of subordinated notes due in 2025 in a private placement transaction to an institutional accredited investor. The notes will bear interest at an annual fixed rate of 6.75% and interest will be paid quarterly through maturity date or earlier redemption.

In September 2005, the Company completed the private placement of \$5,155,000 in subordinated debentures to Eagle Bancorp Statutory Trust I (“the Trust”). The Trust funded the purchase of the subordinated debentures through the sale of trust preferred securities to First Tennessee Bank, N.A. with a liquidation value of \$5,155,000. Using interest payments made by the Company on the debentures, the Trust began paying quarterly dividends to preferred security holders in December 2005. The annual percentage rate of the interest payable on the subordinated debentures and distributions payable on the preferred securities was fixed at 6.02% until December 2010 then became variable at 3-Month LIBOR plus 1.42%, making the rate 3.818% and 3.114% as of September 30, 2018 and December 31, 2017, respectively. Dividends on the preferred securities are cumulative and the Trust may defer the payments for up to five years. The preferred securities mature in December 2035 unless the Company elects and obtains regulatory approval to accelerate the maturity date.

For the three months ended September 30, 2018 and 2017, interest expense on other long-term debt was \$361,000 and \$350,000, respectively. For the nine months ended September 30, 2018 and 2017, interest expense on other long-term debt was \$1,065,000 and \$969,000, respectively.



Table of Contents

EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**NOTE 7. EARNINGS PER SHARE**

Basic earnings per share for the three months ended September 30, 2018 was computed using 5,460,452 weighted average shares outstanding. Basic earnings per share for the three months ended September 30, 2017 was computed using 3,811,409 weighted average shares outstanding. Diluted earnings per share was computed using the treasury stock method by adjusting the number of shares outstanding by the shares purchased. The weighted average shares outstanding for the diluted earnings per share calculations was 5,524,912 for the three months ended September 30, 2018 and 3,863,656 for the three months ended September 30, 2017.

Basic earnings per share for the nine months ended September 30, 2018 was computed using 5,411,356 weighted average shares outstanding. Basic earnings per share for the nine months ended September 30, 2017 was computed using 3,811,409 weighted average shares outstanding. Diluted earnings per share was computed using the treasury stock method by adjusting the number of shares outstanding by the shares purchased. The weighted average shares outstanding for the diluted earnings per share calculations was 5,475,816 for the nine months ended September 30, 2018 and 3,869,695 for the nine months ended September 30, 2017.

**NOTE 8. DIVIDENDS AND STOCK REPURCHASE PROGRAM**

For the year ended December 31, 2017, Eagle paid dividends of \$0.08 per share for the quarters ended March 31 and June 30, 2017. Eagle paid dividends of \$0.09 per share for the quarters ended September 30 and December 31, 2017. A dividend of \$0.09 per share was declared on January 25, 2018 and paid March 1, 2018 to shareholders of record on February 9, 2018. A dividend of \$0.09 per share was declared on April 19, 2018 and paid June 1, 2018 to shareholders of record on May 11, 2018. A dividend of \$0.0925 per share was declared on July 19, 2018 and paid on September 7, 2018 to shareholders of record on August 17, 2018. A dividend of \$0.0925 per share was declared on October 18, 2018, payable on December 7, 2018 to shareholders of record on November 16, 2018.

On July 19, 2018, the Board authorized the repurchase of up to 100,000 shares of its common stock. Under the plan, shares may be purchased by the Company on the open market or in privately negotiated transactions. The extent to which the company repurchases its shares and the timing of such repurchase will depend upon market conditions and other corporate considerations. No shares were purchased under this plan during the three months ended September 30, 2018. The plan expires on July 19, 2019.

On July 20, 2017, the Board authorized the repurchase of up to 100,000 shares of its common stock. Under the plan, shares could be purchased by the Company on the open market or in privately negotiated transactions. No shares were purchased under this plan. The plan expired on July 20, 2018.

On July 21, 2016, the Board authorized the repurchase of up to 100,000 shares of its common stock. Under the plan, shares could be purchased by the Company on the open market or in privately negotiated transactions. No shares were purchased under this plan. The plan expired on July 21, 2017.

Table of Contents

## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**NOTE 9. ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)**

The following table includes information regarding the activity in accumulated other comprehensive income (loss).

	Unrealized Gains (Losses) on Derivatives Designated as Cash Flow Hedges	Unrealized Gains (Losses) on Investment Securities Available for Sale (In Thousands)	Total
Balance, January 1, 2018	\$ 234	\$ 79	\$313
Other comprehensive income (loss), before reclassifications and income taxes	664	(2,799 )	(2,135)
Amounts reclassified from accumulated other comprehensive income, before income taxes	(587 )	90	(497 )
Income tax (expense) benefit	(20 )	720	700
Total other comprehensive income (loss)	57	(1,989 )	(1,932)
Balance, June 30, 2018	291	(1,910 )	(1,619)
Other comprehensive income (loss), before reclassifications and income taxes	234	(1,237 )	(1,003)
Amounts reclassified from accumulated other comprehensive income (loss), before income taxes	(402 )	23	(379 )
Income tax benefit	44	320	364
Total other comprehensive loss	(124 )	(894 )	(1,018)
Balance, September 30, 2018	\$ 167	\$ (2,804 )	\$(2,637)
Balance, January 1, 2017	\$ 330	\$ (741 )	\$(411 )
Other comprehensive income, before reclassifications and income taxes	998	2,054	3,052
Amounts reclassified from accumulated other comprehensive income (loss), before income taxes	(899 )	14	(885 )

Edgar Filing: Eagle Bancorp Montana, Inc. - Form 10-Q

Income tax expense	(40 )	(843 )	(883 )
Total other comprehensive income	59	1,225	1,284
Balance, June 30, 2017	389	484	873
Other comprehensive income (loss), before reclassifications and income taxes	364	(91 )	273
Amounts reclassified from accumulated other comprehensive income, before income taxes	(657 )	-	(657 )
Income tax benefit	119	38	157
Total other comprehensive loss	(174 )	(53 )	(227 )
Balance, September 30, 2017	\$ 215	\$ 431	\$646

-25-

---

Table of Contents

EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**NOTE 10. DERIVATIVES AND HEDGING ACTIVITIES**

*Mortgage Loan Commitments*

Mortgage loan commitments are referred to as derivative loan commitments if the loan that will result from exercise of the commitment will be held-for-sale upon funding. The Company enters into commitments to fund residential mortgage loans at specified times in the future, with the intention that these loans will subsequently be sold in the secondary market. A mortgage loan commitment binds the Company to lend funds to a potential borrower at a specified interest rate and within a specified period of time, generally up to 60 days after inception of the rate lock.

*Interest Rate Lock Commitments*

Outstanding derivative loan commitments expose the Company to the risk that the price of the loans arising from exercise of the loan commitment might decline from inception of the rate lock to funding of the loan due to increases in mortgage interest rates. If interest rates increase, the value of these loan commitments decreases. Conversely, if interest rates decrease, the value of these loan commitments increases. The notional amount of interest rate lock commitments was \$31,583,000 and \$15,338,000 at September 30, 2018 and December 31, 2017, respectively. The fair value of such commitments was insignificant.

The Company has no other off-balance-sheet arrangements or transactions with unconsolidated, special purpose entities that would expose the Company to liability that is not reflected on the face of the financial statements.

**NOTE 11. FAIR VALUE DISCLOSURES**

FASB ASC 820 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. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall not be adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets and liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal market that are (i) independent, (ii) knowledgeable, (iii) able to transact and, (iv) willing to transact.

FASB ASC 820 requires the use of valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets and liabilities. The income approach uses valuation techniques to convert future amounts, such as cash flows or earnings, to a single present amount on a discounted basis. The cost approach is based on the amount that currently would be required to replace the service capacity of an asset (replacement costs). Valuation techniques should be consistently applied.

Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. In that regard, FASB ASC 820 establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs.

The fair value hierarchy is as follows:

*Level 1 Inputs* – Unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date, or convert to cash in the short term.

*Level 2 Inputs* – Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (for example, interest rates, volatilities, prepayment speeds, loss severities, credit risks and default rates) or inputs that are derived principally from or corroborated by observable market data by correlation or other means.

*Level 3 Inputs* – Significant unobservable inputs that reflect an entity’s own assumptions that market participants would use in pricing the assets or liabilities.

Table of Contents

EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**NOTE 11. FAIR VALUE DISCLOSURES – continued**

A description of the valuation methodologies used for assets and liabilities measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below.

In general, fair value is based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon internally developed models that primarily use, as inputs, observable market-based parameters. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. While management believes the Company's valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

*Available-for-Sale Securities* – Securities classified as available-for-sale are reported at fair value utilizing Level 1 and Level 2 inputs. For these securities, the 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 prepayments speeds, credit information and the bond's terms and conditions, among other things.

*Impaired Loans* – Impaired loans are reported at the fair value of the underlying collateral if repayment is expected solely from the collateral. Collateral values are estimated using Level 3 inputs based on internally customized discounting criteria.

*Loans Held-for-Sale* – These loans are reported at the lower of cost or fair value. Fair value is determined based on expected proceeds based on sales contracts and commitments and are considered Level 2 inputs.



*Repossessed Assets* – Fair values are valued at the time the loan is foreclosed upon and the asset is transferred from loans. The value is based upon primary third party appraisals, less costs to sell. The appraisals are generally discounted based on management’s historical knowledge, changes in market conditions from the time of valuation, and/or management’s expertise and knowledge of the client and client’s business. Such discounts are typically significant and result in Level 3 classification of the inputs for determining fair value. Repossessed assets are reviewed and evaluated on at least a quarterly basis for additional impairment and adjusted accordingly, based on same or similar factors above.

Table of Contents

## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**NOTE 11. FAIR VALUE DISCLOSURES – continued**

The following tables summarize financial assets and financial liabilities measured at fair value on a recurring basis, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value.

	September 30, 2018			
	Level 1	Level 2	Level 3	Total
	Inputs	Inputs	Inputs	Fair
	(In Thousands)			
Financial assets:				
Available-for-sale securities				
U.S. government and agency obligations	\$-	\$10,229	\$ -	\$10,229
Municipal obligations	-	72,674	-	72,674
Corporate obligations	-	11,207	-	11,207
Mortgage-backed securities	-	20,620	-	20,620
Collateralized mortgage obligations	-	23,841	-	23,841
Asset-backed securities	-	10,364	-	10,364
Loans held-for-sale	-	8,747	-	8,747

	December 31, 2017			
	Level 1	Level 2	Level 3	Total
	Inputs	Inputs	Inputs	Fair
	(In Thousands)			
Financial assets:				
Available-for-sale securities				
U.S. government and agency	\$-	\$4,857	\$ -	\$4,857
Municipal obligations	-	67,886	-	67,886
Corporate obligations	-	14,644	-	14,644
Mortgage-backed securities	-	24,869	-	24,869
Collateralized mortgage obligations	-	19,788	-	19,788
Asset-backed securities	-	-	-	-

Loans held-for-sale	-	8,949	-	8,949
---------------------	---	-------	---	-------

-28-

---

Table of Contents

## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**NOTE 11. FAIR VALUE DISCLOSURES - continued**

Certain financial assets and financial liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment).

The following table summarizes financial assets and financial liabilities measured at fair value on a nonrecurring basis, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

	September 30, 2018			
	Level 1	Level 2	Level 3	Total
	Inputs	Inputs	Inputs	Fair
	(In Thousands)			
Impaired loans	\$-	\$ -	\$1,556	\$1,556
Repossessed assets	-	-	457	457

	December 31, 2017			
	Level 1	Level 2	Level 3	Total
	Inputs	Inputs	Inputs	Fair
	(In Thousands)			
Impaired loans	\$-	\$ -	\$ 928	\$ 928
Repossessed assets	-	-	525	525

As of September 30, 2018, certain impaired loans were remeasured and reported at fair value through a specific valuation allowance allocation of the allowance for possible loan losses based upon the fair value of the underlying collateral. Impaired loans with a carrying value of \$1,556,000 were not reduced by specific valuation allowance allocations, resulting in a total reported fair value of \$1,556,000 based on collateral valuations utilizing Level 3 valuation inputs.

As of December 31, 2017, certain impaired loans were remeasured and reported at fair value through a specific valuation allowance allocation of the allowance for possible loan losses based upon the fair value of the underlying collateral. Impaired loans with a carrying value of \$977,000 were reduced by specific valuation allowance allocations totaling \$49,000 to a total reported fair value of \$928,000 based on collateral valuations utilizing Level 3 valuation inputs.

The following table represents the Bank's Level 3 financial assets and liabilities, the valuation techniques used to measure the fair value of those financial assets and liabilities, and the significant unobservable inputs and the ranges of values for those inputs.

Instrument (Dollars In Thousands)	Fair Value at		Principal Valuation Technique	Significant Unobservable Inputs	Range of Significant Input Values
	September 30, 2018	December 31, 2017			
Impaired loans	\$ 1,556	\$ 928	Appraisal of collateral <sup>(1)</sup>	Appraisal adjustments	10 - 30%
Repossessed assets	\$ 457	\$ 525	Appraisal of collateral <sup>(1)(3)</sup>	Liquidation expenses <sup>(2)</sup>	10 - 30%

(1) Fair value is generally determined through independent appraisals of the underlying collateral, which generally include various Level 3 inputs which are not identifiable, less associated allowance.

(2) Appraisals may be adjusted for qualitative factors such as economic conditions and estimated liquidation expenses.

(3) The range of liquidation expenses and other appraisal adjustments are presented as a percent of the appraisal.

(3) Includes qualitative adjustments by management and estimated liquidation expenses.

Table of Contents

## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**NOTE 11. FAIR VALUE DISCLOSURES - continued**

FASB ASC Topic 825 requires disclosure of the fair value of financial instruments, both assets and liabilities recognized and not recognized in the statement of financial position, for which it is practicable to estimate fair value. Below is a table that summarizes the fair market values of all financial instruments of the Company at September 30, 2018 and December 31, 2017, followed by methods and assumptions that were used by the Company in estimating the fair value of the classes of financial instruments.

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

	September 30, 2018			Total	
	Level 1	Level 2	Level 3	Estimated	Carrying
	Inputs	Inputs	Inputs	Fair	Amount
	(In Thousands)			Value	
Financial assets:					
Cash and cash equivalents	\$8,968	\$-	\$-	\$8,968	\$8,968
Federal Home Loan Bank stock	4,617	-	-	4,617	4,617
Federal Reserve Bank stock	2,033	-	-	2,033	2,033
Loans receivable, net	-	-	581,434	581,434	588,734
Accrued interest and dividends receivable	3,890	-	-	3,890	3,890
Mortgage servicing rights	-	-	8,411	8,411	6,947
Cash surrender value of life insurance	20,405	-	-	20,405	20,405
Financial liabilities:					
Non-maturing interest bearing deposits	-	317,044	-	317,044	317,044
Noninterest bearing deposits	142,351	-	-	142,351	142,351
Time certificates of deposit	-	-	159,867	159,867	161,907

Edgar Filing: Eagle Bancorp Montana, Inc. - Form 10-Q

Accrued expenses and other liabilities	6,082	-	-	6,082	6,082
Federal Home Loan Bank advances and other borrowings	-	-	95,137	95,137	95,731
Other long-term debt	-	-	23,641	23,641	25,155
Off-balance-sheet instruments	-	-	-	-	-
Forward delivery commitments	-	-	-	-	-
Commitments to extend credit	-	-	-	-	-
Rate lock commitments	-	-	-	-	-

-30-

---

Table of Contents

## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**NOTE 11. FAIR VALUE DISCLOSURES – continued**

	December 31, 2017			Total Estimated Fair Value	Carrying Amount
	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs		
	(In Thousands)				
Financial assets:					
Cash and cash equivalents	\$7,437	\$-	\$-	\$7,437	\$7,437
Federal Home Loan Bank stock	4,086	-	-	4,086	4,086
Federal Reserve Bank stock	1,465	-	-	1,465	1,465
Loans receivable, net	-	-	505,615	505,615	506,476
Accrued interest and dividends receivable	2,555	-	-	2,555	2,555
Mortgage servicing rights	-	-	7,312	7,312	6,578
Cash surrender value of life insurance	14,481	-	-	14,481	14,481
Financial liabilities:					
Non-maturing interest bearing deposits	-	277,416	-	277,416	277,416
Noninterest bearing deposits	99,799	-	-	99,799	99,799
Time certificates of deposit	-	-	142,202	142,202	143,349
Accrued expenses and other liabilities	4,822	-	-	4,822	4,822
Federal Home Loan Bank advances and other borrowings	-	-	82,579	82,579	82,969
Other long-term debt	-	-	24,209	24,209	25,155
Off-balance-sheet instruments					
Forward delivery commitments	-	-	-	-	-
Commitments to extend credit	-	-	-	-	-
Rate lock commitments	-	-	-	-	-

The following methods and assumptions were used by the Company in estimating the fair value of the following classes of financial instruments. However, the Form 10-K for the year ended December 31, 2017 provides additional description of valuation methodologies used in estimating fair value of these financial instruments.



*Cash, Interest Bearing Accounts, Accrued Interest and Dividend Receivable and Accrued Expenses and Other Liabilities* – The carrying amounts approximate fair value due to the relatively short period of time between the origination of these instruments and their expected realization.

*Stock in the Federal Home Loan Bank of Des Moines (“FHLB”) and Federal Reserve Bank (“FRB”)* – The fair value of stock approximates redemption value.

*Loans Receivable* – Fair values are estimated by stratifying the loan portfolio into groups of loans with similar financial characteristics. Loans are segregated by type such as real estate, commercial, and consumer, with each category further segmented into fixed and adjustable rate interest terms. For mortgage loans, the Company uses the secondary market rates in effect for loans that have similar characteristics. The fair value of other fixed rate loans is calculated by discounting scheduled cash flows through the anticipated maturities adjusted for prepayment estimates. Adjustable interest rate loans are assumed to approximate fair value because they generally reprice within the short term.

Fair values are adjusted for credit risk based on assessment of risk identified with specific loans, and risk adjustments on the remaining portfolio based on credit loss experience.

Assumptions regarding credit risk are judgmentally determined using specific borrower information, internal credit quality analysis, and historical information on segmented loan categories for non-specific borrowers.

*Mortgage Servicing Rights* – the fair value of servicing rights was determined at loan level using a discount rate of 12.50% for all investor types and prepayment speeds ranging from approximately 80.00% to 230.00% PSA, depending on stratification of the specific loan. The weighted average prepayment speed was 114.00% PSA. The fair value was also adjusted for the effect of potential past dues and foreclosures. Individual mortgage servicing rights values were capped at a maximum of 1.25% for all investor types.

Table of Contents

EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**NOTE 11. FAIR VALUE DISCLOSURES - continued**

*Cash Surrender Value of Life Insurance* – The carrying amount for cash surrender value of life insurance approximates fair value as policies are recorded at redemption value.

*Deposits and Time Certificates of Deposit* – The fair value of deposits with no stated maturity, such as checking, passbook, and money market, is equal to the amount payable on demand. The fair value of time certificates of deposit is based on the discounted value of contractual cash flows. The discount rate is estimated using the rates currently offered for deposits of similar maturities.

*Advances from the FHLB/Other Borrowings and Other Long-Term Debt* – The fair value of the Company's advances and debentures are estimated using discounted cash flow analysis based on the interest rate that would be effective September 30, 2018 and December 31, 2017, respectively if the borrowings repriced according to their stated terms.

*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 values of these financial instruments are considered insignificant. Additionally, those financial instruments have no carrying value.

**NOTE 12. MERGERS AND ACQUISITIONS**

On September 5, 2017, the Company entered into an Agreement and Plan of Merger with TwinCo, a Montana corporation, and TwinCo's wholly-owned subsidiary, Ruby Valley Bank, a Montana chartered commercial bank to acquire 100% of TwinCo's equity voting interests. The merger agreement provided that Ruby Valley Bank would merge with and into Opportunity Bank of Montana and that TwinCo would merge with and into the Company. Ruby

Valley Bank operated 2 branches in Madison County, Montana. The transaction provided an opportunity to expand market presence and lending activities, particularly in agricultural lending. The acquisition closed January 31, 2018, after receipt of approvals from regulatory authorities, approval of TwinCo shareholders and the satisfaction of other closing conditions. The total consideration paid was \$18,930,000 and included cash consideration of \$9,900,000 and common stock issued of \$9,030,000.

The transaction was accounted for under the acquisition method of accounting in accordance with FASB ASC 805, Business Combinations. In business combination transactions in which the consideration given is not in the form of cash (that is, in the form of non-cash assets, liabilities incurred, or equity interests issued), measurement of the acquisition consideration is based on the fair value of the consideration given or the fair value of the asset (or net assets) acquired, whichever is more clearly evident and, thus, a more reliable measure.

Under FASB ASC 805, all of the assets acquired and liabilities assumed in a business combination are recognized at acquisition at their acquisition-date fair value, while transaction costs and restructuring costs associated with the business combination are expensed as incurred. The excess of the acquisition consideration over the fair value of assets acquired and liabilities assumed, if any, is allocated to goodwill. Goodwill recorded in the acquisition was accounted for in accordance with the authoritative business combination guidance. Accordingly, goodwill will not be amortized, but will be tested for impairment annually. The goodwill recorded is not deductible for federal income tax purposes.

Table of Contents

## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**NOTE 12. MERGERS AND ACQUISITIONS – continued**

Assets acquired and liabilities assumed were recorded on the consolidated statement of financial condition at estimated fair value on acquisition date. The following table summarizes fair values of assets acquired and liabilities assumed, consideration paid and resulting goodwill.

	January 31, 2018 (In Thousands,  Except Share Data)
Assets acquired:	
Cash and cash equivalents	\$ 5,657
Investment securities	30,728
Loans	55,057
Premises and equipment	1,605
Other real estate owned	135
Core deposit intangible	1,609
Other assets	1,258
Total assets acquired	\$ 96,049
Liabilities assumed:	
Deposits	\$ 82,190
Accrued expenses and other liabilities	19
Total liabilities assumed	\$ 82,209
Net assets acquired	\$ 13,840
Consideration paid:	
Cash	\$ 9,900
Common stock issued (446,774 shares)	9,030
Total consideration paid	\$ 18,930

Goodwill resulting from acquisition \$ 5,090

The fair value analysis of the loan portfolio resulted in a valuation adjustment for each loan based on an amortization schedule of expected cash flow. Individual amortization schedules were used for each loan over a certain amount and those with specifically identified loss exposure. The remainder of the loans were grouped by type and risk rating into loan pools (based on loans type, fixed or variable interest rate, revolving or term payments and risk rating). Yield inputs for the amortization schedules included contractual interest rates, estimated prepayment speeds, liquidity adjustments and market yields. Credit inputs for the amortization schedules included probability of payment default, loss given default rates and individually identified loss exposure.

Information regarding loans acquired as of acquisition date is as follows:

	January 31, 2018 (In Thousands)
Contractually required principal and interest at acquisition	\$ 56,891
Contractual cash flows not expected to be collected (nonaccretable discount)	(1,346 )
Expected cash flows at acquisition	55,545
Interest component of expected cash flows (accretable discount)	(488 )
Fair value of acquired loans	\$ 55,057

Table of Contents

EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**NOTE 12. MERGERS AND ACQUISITIONS – continued**

Core deposit intangible assets of \$1,609,000 are being amortized using an accelerated method over the estimated useful lives of the related deposits of 10 years.

The core deposit intangible value is a function of the difference between the cost of the acquired core deposits and the alternative cost of funds. This cash flow stream was discounted to present value. The fair value of other deposit accounts acquired were valued by estimating future cash flows to be received or paid from individual or homogenous groups of assets and liabilities and then discounting those cash flows to a present value using rates of return that were available in financial markets for similar financial instruments on or near January 31, 2018.

Direct costs related to the acquisition were expensed as incurred. The Company recorded acquisition costs related to the TwinCo acquisition of \$131,000 during the quarter ended June 30, 2018, \$234,000 during the quarter ended March 31, 2018 and \$676,000 during the year ended December 31, 2017. Acquisition costs included legal and professional fees and data processing incurred related to the acquisition.

Operations of TwinCo have been included in the consolidated financial statements since February 1, 2018. The Company does not consider TwinCo a separate reporting segment and does not track the amount of revenues and net income attributable to TwinCo since acquisition. As such, it is impracticable to determine such amounts for the period from February 1, 2018 through September 30, 2018.

The accompanying consolidated statements of income include the results of operations of the acquired entity since the January 31, 2018 acquisition date. The following table presents unaudited pro forma results of operations for the three and nine months ended September 30, 2018 and 2017 as if the acquisition had occurred on January 1, 2017. This pro forma information gives effect to certain adjustments, including purchase accounting fair value adjustments and amortization of the core deposit intangible asset. The pro forma information does not necessarily reflect the results of operations that would have occurred had the Company purchased and assumed the assets and liabilities of TwinCo on January 1, 2017.

Edgar Filing: Eagle Bancorp Montana, Inc. - Form 10-Q

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
	(Dollars in Thousands, Except Per Share Data)			
Pro forma net income <sup>(1)</sup>				
Net interest income after loan loss provision	\$7,283	\$6,756	\$21,697	\$19,371
Noninterest income	3,761	4,069	9,559	11,009
Noninterest expense	9,052	8,230	26,771	24,634
Income before income taxes	1,992	2,595	4,485	5,746
Income tax expense	360	727	826	1,609
Net income	\$1,632	\$1,868	\$3,659	\$4,137
Pro forma earnings per share <sup>(1)</sup>				
Basic earnings per share	\$0.30	\$0.49	\$0.68	\$1.09
Diluted earnings per share	\$0.30	\$0.48	\$0.67	\$1.07
Weighted average shares outstanding, basic	5,460,452	3,811,409	5,411,356	3,811,409
Weighted average shares outstanding, diluted	5,524,912	3,863,656	5,475,816	3,869,695

<sup>(1)</sup> Significant assumptions utilized include the acquisition cost noted above, accretion of interest rate fair value adjustments, amortization of the core deposit intangible asset and a 28.00% effective tax rate for 2017.

Table of Contents

EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**NOTE 12. MERGERS AND ACQUISITIONS – continued**

On August 21, 2018, the Company entered into an Agreement and Plan of Merger with Big Muddy Bancorp, Inc. (“Big Muddy Bancorp”), a Montana corporation, and Big Muddy Bancorp’s wholly-owned subsidiary, The State Bank of Townsend, a Montana chartered commercial bank. The merger agreement provides that, upon the terms and subject to the conditions set forth in the merger agreement, Big Muddy Bancorp will merge with and into Eagle, with Eagle continuing as the surviving corporation. The State Bank of Townsend operates four branches in Townsend, Dutton, Denton and Choteau, Montana. The transaction provides an opportunity to expand market presence. The acquisition is expected to close during the first quarter of 2019, after receipt of approvals from regulatory authorities, approval of Big Muddy Bancorp shareholders and the satisfaction of other closing conditions.

**NOTE 13. RECENT ACCOUNTING PRONOUNCEMENTS**

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606). This guidance is a comprehensive new revenue recognition standard that supersedes substantially all existing revenue recognition guidance. The new standard’s core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. In doing so, companies will need to use more judgment and make more estimates than under existing guidance. These may include identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. In July 2015, the FASB agreed to delay the effective date of the standard by one year. Therefore, the new standard was effective in the first quarter of 2018 and was adopted by the Company. Our revenue is comprised of net interest income on financial assets and financial liabilities, which is explicitly excluded from the scope of ASU 2014-09, and non-interest income. The largest percentage of our non-interest income is derived from the gain on sale of mortgage loans. The gains are recognized at the time of the sale of the loan, when proceeds are sent to us by the investor purchasing the loan. No change in the recognition of revenue on that portion of our noninterest income was recognized. We also evaluated the impact of this standard on our revenue from our wealth management division and it did not have a significant impact on our consolidated financial statements.



In January 2016, the FASB issued ASU No. 2016-01, Financial Instruments – Overall: Recognition and Measurement of Financial Assets and Financial Liabilities (Subtopic 825-10). The amendment has a number of provisions including the requirements that public business entities use the exit price notion when measuring the fair value of financial instruments for disclosure purposes, a separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (i.e. securities or loans receivables), and eliminating the requirement for public business entities to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost. The amendment is effective for annual and interim reporting periods beginning after December 15, 2017 and was adopted by the Company in the first quarter of 2018. Note 11. Fair Value Disclosures for September 30, 2018, reflects the provisions of this pronouncement.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842) intended to improve financial reporting regarding leasing transactions. The new standard affects all companies and organizations that lease assets. The standard will require organizations to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases if the lease terms are more than 12 months. The guidance also will require qualitative and quantitative disclosures providing additional information about the amounts recorded in the financial statements. The amendments in this update are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company is evaluating the potential impact of the amendment on the Company's consolidated financial statements. We currently lease six locations that serve as full-service branches, with the longest running lease expiring in 2027. We continue to explore options for using a third party vendor to assist with the implementation of this standard.

Table of Contents

EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**NOTE 13. RECENT ACCOUNTING PRONOUNCEMENTS - continued**

In September 2016, the FASB issued ASU No. 2016-13, Financial Instruments – Credit Losses (Topic 326) intended to improve financial reporting by requiring timelier recording of credit losses on loans and other financial instruments held by financial institutions and other organizations. The standard requires an organization to measure all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. The standard also requires enhanced disclosures to help investors and other financial statement users better understand significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization’s portfolio. These disclosures include qualitative and quantitative requirements that provide additional information about the amounts recorded in the financial statements. Additionally, the standard amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The amendments in this update are effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. All entities may adopt the amendments in this update earlier as of the fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. An entity will apply the amendments in this update through a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective (that is, a modified-retrospective approach). The Company believes the amendments in this update will have an impact on the Company’s consolidated financial statements and is working to evaluate the significance of that impact. In that regard, we have established a working group under the direction of our Chief Financial Officer and Chief Credit Officer. The group is composed of individuals from the finance and credit administration areas of the Company. We are currently developing an implementation plan, including assessment of processes, segmentation of the loan portfolio and identifying and adding data fields necessary for analysis. The adoption of this standard is likely to result in an increase in the allowance for loan and lease losses as a result of changing from an “incurred loss” model to an “expected loss” model. While we currently cannot reasonably estimate the impact of adopting this standard, we expect the impact will be influenced by the composition, characteristics and quality of our loan and securities portfolios, as well as the general economic conditions and forecasts as of the adoption date.

In January 2017, the FASB issued ASU No. 2017-04, Intangibles – Goodwill and Other (Topic 350) to amend and simplify current goodwill impairment testing to eliminate Step 2 from the current provisions. Under the new guidance, an entity should perform the goodwill impairment test by comparing the fair value of a reporting unit with its carrying value and recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit’s fair value. An entity still has the option to perform the quantitative assessment for a reporting unit to determine if a

quantitative impairment test is necessary. The guidance will be effective for the Company on January 1, 2020 and is not expected to have a significant impact on the Company's consolidated financial statements. We have improved our internal reporting systems as it relates to profitability by divisions and markets within the Company. We expect these systems to help in our evaluation of potential impairment.

In March 2017, the FASB issued ASU No. 2017-08, Receivables–Nonrefundable Fees and Other Costs (Subtopic 310-20) to shorten the amortization period for certain purchased callable debt securities held at a premium to the earliest call date. Currently, entities generally amortize the premium as a yield adjustment over the contractual life of the security. The guidance does not change the accounting for callable debt securities held at a discount. For public business entities, the guidance is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted, including in an interim period. We have currently been following this guidance based on our internal investment policy guidelines. There is little impact on our consolidated financial statements, as we typically do not invest in these types of securities.

Table of Contents

EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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

**Overview**

The Company's primary business activity is the ownership of its wholly owned subsidiary, Opportunity Bank of Montana (the "Bank"). The Bank is a Montana chartered commercial bank that focuses on both consumer and commercial lending. It engages in typical banking activities: acquiring deposits from local markets and originating loans and investing in securities. Its deposits are insured by the Federal Deposit Insurance Corporation. The Bank's primary component of earnings is its net interest margin (also called spread or margin), the difference between interest income and interest expense. The net interest margin is managed by management (through the pricing of its products and by the types of products offered and kept in portfolio), and is affected by changes in market interest rates. The Bank also generates noninterest income in the form of fee income and gain on sale of loans.

The Bank has a strong mortgage lending focus, with a large portion of its loan originations represented by single-family residential mortgages, which has enabled it to successfully market home equity loans, as well as a wide range of shorter term consumer loans for various personal needs (automobiles, recreational vehicles, etc.). In recent years, the Bank has focused on adding commercial loans to its portfolio, both real estate and non-real estate. We have made significant progress in this initiative. The purpose of this diversification is to mitigate the Bank's dependence on the residential mortgage market, as well as to improve its ability to manage its spread. The Bank's management recognizes that fee income will also enable it to be less dependent on specialized lending and it now maintains a significant loan serviced portfolio which provides a steady source of fee income. Fee income is also supplemented with fees generated from the Bank's deposit accounts. The Bank has a high percentage of non-maturity deposits, such as checking accounts and savings accounts, which allows management flexibility in managing its spread. Non-maturity deposits and certificates of deposits do not automatically reprice as interest rates rise. Gain on sale of loans also provides significant noninterest income in periods of high mortgage loan origination volumes. Such income will be adversely affected in periods of lower mortgage activity.

Management continues to focus on improving the Bank's core earnings. Core earnings can be described as income before taxes, with the exclusion of gain on sale of loans and adjustments to the market value of the Bank's loan servicing portfolio. Management believes that the Bank will need to continue to concentrate on increasing net interest margin, other areas of fee income and control of operating expenses to achieve earnings growth going forward. Management's strategy of growing the bank's loan portfolio and deposit base is expected to help achieve these goals as follows: loans typically earn higher rates of return than investments; a larger deposit base should yield higher fee income; increasing the asset base will reduce the relative impact of fixed operating costs. The biggest challenge to the strategy is funding the growth of the Bank's balance sheet in an efficient manner. Though deposit growth has been steady, it may become more difficult to maintain due to significant competition and possible reduced customer demand for deposits as customers may shift into other asset classes.

The level and movement of interest rates impacts the Bank's earnings as well. The Federal Open Market Committee changed the federal funds target rate from 0.75% to 1.50% during the year ended December 31, 2017. The rate increased from 1.50% to 2.25% during the nine months ended September 30, 2018.

On October 13, 2017, the Company successfully completed a public offering of its common stock, and issued 1,189,041 shares and received approximately \$20.16 million in net cash proceeds.

### **Acquisitions**

On August 21, 2018, the Company entered into an Agreement and Plan of Merger with Big Muddy Bancorp, Inc. ("Big Muddy Bancorp"), a Montana corporation, and Big Muddy Bancorp's wholly-owned subsidiary, The State Bank of Townsend, a Montana chartered commercial bank. The merger agreement provides that, upon the terms and subject to the conditions set forth in the merger agreement, Big Muddy Bancorp will merge with and into Eagle, with Eagle continuing as the surviving corporation. The State Bank of Townsend operates four branches in Townsend, Dutton, Denton and Choteau, Montana. The transaction provides an opportunity to expand market presence. The acquisition is expected to close during the first quarter of 2019, after receipt of approvals from regulatory authorities, approval of Big Muddy Bancorp shareholders and the satisfaction of other closing conditions.

Subject to the terms and conditions of the merger agreement upon completion of the merger, each outstanding share of Big Muddy Bancorp common stock will be converted into the right to receive 20.49 shares of Eagle common stock. Based on the number of shares of Big Muddy Bancorp common stock outstanding as of August 21, 2018, we expect to issue approximately 996,142 shares of our common stock to Big Muddy Bancorp shareholders in the aggregate upon completion of the merger.

On January 31, 2018, we acquired all of the outstanding common stock of TwinCo Inc. ("TwinCo"), the parent company of Ruby Valley Bank, a Montana chartered commercial bank with 2 branches in Madison County, Montana. The transaction provided an opportunity to expand market presence and lending activities, particularly in agricultural lending. The total consideration paid was \$18.93 million and included cash consideration of \$9.90 million and

common stock issued of \$9.03 million.

-37-

---

Table of Contents

EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

**Financial Condition**

Comparisons of financial condition in this section are between September 30, 2018 and December 31, 2017.

Total assets were \$839.97 million at September 30, 2018, an increase of \$123.19 million, or 17.2%, from \$716.78 million at December 31, 2017. The increase was largely due to the change in securities and loans receivable, net partly due to the acquisition of TwinCo. Securities available-for-sale increased \$16.90 million, or 12.8%, to \$148.94 million at September 30, 2018 from \$132.04 million at December 31, 2017. Loans receivable, net increased by \$82.89 million, or 16.3%, to \$590.29 million at September 30, 2018, from \$507.40 million at December 31, 2017. Total liabilities were \$747.98 million at September 30, 2018, an increase of \$114.81 million, or 18.1%, from \$633.17 million at December 31, 2017. The increase was largely due to an increase in deposits due in part to the TwinCo acquisition, as well as an increase in Federal Home Loan Bank (“FHLB”) advances and other borrowings. Total deposits increased by \$100.74 million to \$621.30 million at September 30, 2018 from \$520.56 million at December 31, 2017. FHLB advances and other borrowings increased \$12.76 million to \$95.73 million at September 30, 2018 from \$82.97 million at December 31, 2017.

**Balance Sheet Details**

***Investment Activities***

The following table summarizes investment activities:

September 30, 2018		December 31, 2017	
Fair Value	Percentage of Total	Fair Value	Percentage of Total

Edgar Filing: Eagle Bancorp Montana, Inc. - Form 10-Q

(Dollars in Thousands)

Securities available-for-sale:						
U.S. government and agency	\$ 10,229	6.53	%	\$ 4,857	3.48	%
Municipal obligations	72,674	46.38	%	67,886	48.66	%
Corporate obligations	11,207	7.15	%	14,644	10.50	%
Mortgage-backed securities	20,620	13.16	%	24,869	17.82	%
Collateralized mortgage obligations	23,841	15.22	%	19,788	14.18	%
Asset-backed securities	10,364	6.62	%	-	0.00	%
Total securities available-for-sale	148,935	95.06	%	132,044	94.64	%
Interest bearing deposits	1,079	0.69	%	1,920	1.38	%
FHLB capital stock, at cost	4,617	2.95	%	4,086	2.93	%
FRB capital stock, at cost	2,033	1.30	%	1,465	1.05	%
Total	\$ 156,664	100.00	%	\$ 139,515	100.00	%

Securities available-for-sale were \$148.94 million at September 30, 2018, an increase of \$16.90 million, or 12.8%, from \$132.04 million at December 31, 2017. The net increase was due in part to the acquisition of TwinCo. All categories of securities available-for sale increased during the period with the exception of corporate obligations and mortgage-backed securities. Corporate obligations decreased primarily due to maturities, and mortgage-backed securities decreased due to principal payments partially offset by net purchases.



Table of Contents

## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

**Financial Condition – continued***Lending Activities*

The following table includes the composition of the Bank's loan portfolio by loan category:

	September 30, 2018		December 31, 2017	
	Amount	Percent of Total	Amount	Percent of Total
	(Dollars in thousands)			
Real estate loans:				
Residential 1-4 family <sup>(1)</sup>	\$ 115,217	19.28 %	\$ 109,911	21.37 %
Residential 1-4 family construction	29,755	4.98 %	25,306	4.92 %
Commercial real estate	236,900	39.63 %	194,805	37.88 %
Commercial construction and development	36,339	6.08 %	38,351	7.46 %
Farmland	30,421	5.09 %	11,627	2.26 %
Total first mortgage loans	448,632	75.06 %	380,000	73.89 %
Other loans:				
Home equity	53,342	8.92 %	52,672	10.24 %
Consumer	16,491	2.76 %	15,712	3.06 %
Commercial	60,407	10.11 %	63,300	12.31 %
Agricultural	18,849	3.15 %	2,563	0.50 %
Total other loans	149,089	24.94 %	134,247	26.11 %
Total loans	597,721	100.00 %	514,247	100.00 %
Deferred loan fees	(1,081 )		(1,093 )	

Allowance for loan losses	(6,350 )	(5,750 )
Total loans, net	\$590,290	\$507,404

<sup>(1)</sup> Excludes loans held-for-sale.

Loans receivable, net increased \$82.89 million to \$590.29 million at September 30, 2018 due in part to the TwinCo acquisition. The TwinCo acquisition included \$55.07 million of acquired loans. Excluding acquired loans, loans receivable, net increased by \$27.82 million. Including acquired loans, commercial real estate loans increased \$42.10 million, farmland loans increased \$18.79 million, agricultural loans increased \$16.29 million, residential 1-4 family construction loans increased \$4.45 million, residential 1-4 family loans increased \$5.31 million, consumer loans increased \$779,000 and home equity loans increased \$670,000. These increases were slightly offset by a decrease in commercial construction and development loans of \$2.01 million and commercial loans of \$2.89 million. Total loan originations were \$364.67 million for the nine months ended September 30, 2018, with residential mortgage accounting for \$227.71 million of the total. Commercial real estate loan originations were \$43.47 million and commercial construction and development loan originations were \$12.69 million. Residential 1-4 family construction loan originations were \$20.25 million. Consumer loan originations were \$7.10 million and home equity originations were \$11.35 million. Farmland loan originations were \$8.99 million and agricultural loan originations were \$11.40 million. Commercial loans originations were \$21.71 million. Loans held-for-sale decreased slightly to \$8.75 million at September 30, 2018 from \$8.95 million at December 31, 2017.

*Nonperforming Assets.* Generally, our collection procedures provide that when a loan is 15 or more days delinquent, the borrower is sent a past due notice. If the loan becomes 30 days delinquent, the borrower is sent a written delinquency notice requiring payment. If the delinquency continues, subsequent efforts are made to contact the delinquent borrower, including face to face meetings and counseling to resolve the delinquency. All collection actions are undertaken with the objective of compliance with the Fair Debt Collection Act.

Table of Contents

## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

**Financial Condition – continued*****Lending Activities– continued***

For mortgage loans and home equity loans, if the borrower is unable to cure the delinquency or reach a payment agreement, we will institute foreclosure actions. If a foreclosure action is taken and the loan is not reinstated, paid in full or refinanced, the property is sold at judicial sale at which we may be the buyer if there are no adequate offers to satisfy the debt. Any property acquired as the result of foreclosure, or by deed in lieu of foreclosure, is classified as real estate owned until such time as it is sold or otherwise disposed of. When real estate owned is acquired, it is recorded at its fair market value less estimated selling costs. The initial recording of any loss is charged to the allowance for loan losses. Subsequent write-downs are recorded as a charge to operations. As of September 30, 2018, the Bank had \$457,000 of real estate owned.

The following table sets forth information regarding nonperforming assets:

	September 30, 2018	December 31, 2017
	(Dollars in Thousands)	
Non-accrual loans		
Real estate loans:		
Residential 1-4 family	\$227	\$ 475
Residential 1-4 family construction	337	-
Commercial real estate	514	-
Other loans:		
Home equity	228	242
Consumer	137	153
Commercial	113	107

Accruing loans delinquent 90 days or more

Real estate loans:

Residential 1-4 family	130	-
------------------------	-----	---

Other loans:

Commercial construction and development	26	-
---	----	---

Restructured loans	-	-
--------------------	---	---

Total nonperforming loans	1,712	977
---------------------------	-------	-----

Real estate owned and other repossessed property, net	457	525
---	-----	-----

Total nonperforming assets	\$2,169	\$ 1,502
----------------------------	---------	----------

Total nonperforming loans to total loans	0.29	%	0.19	%
--	------	---	------	---

Total nonperforming loans to total assets	0.20	%	0.14	%
---	------	---	------	---

Total allowance for loan loss to nonperforming loans	370.91	%	588.54	%
--	--------	---	--------	---

Total nonperforming assets to total assets	0.26	%	0.21	%
--	------	---	------	---

The commercial real estate non-accrual loans at September 30, 2018 relate to the TwinCo acquisition.

Table of Contents

## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

**Financial Condition – continued***Deposits and Other Sources of Funds*

The following table includes deposit accounts by category:

	September 30, 2018		December 31, 2017	
	Amount	Percent of Total	Amount	Percent of Total
	(Dollars in Thousands)			
Noninterest checking	\$142,351	22.91 %	\$99,799	19.17 %
Interest bearing checking	103,372	16.64 %	99,255	19.07 %
Savings	108,878	17.52 %	88,603	17.02 %
Money market accounts	104,794	16.87 %	89,558	17.20 %
Total	459,395	73.94 %	377,215	72.46 %
Certificates of deposit accounts:				
IRA certificates	30,134	4.85 %	28,189	5.42 %
Brokered certificates	1,266	0.20 %	4,601	0.88 %
Other certificates	130,507	21.01 %	110,559	21.24 %
Total certificates of deposit	161,907	26.06 %	143,349	27.54 %
Total deposits	\$621,302	100.00 %	\$520,564	100.00 %

Deposits increased by \$100.74 million, or 19.4%, to \$621.30 million at September 30, 2018 from \$520.56 million at December 31, 2017. The increase was due in part to the TwinCo acquisition. Noninterest checking increased by \$42.55 million. Savings and interest bearing checking increased by \$20.27 million and \$4.12 million, respectively. Money market accounts increased by \$15.24 million. Certificates of deposit increased by \$18.56 million.

The following table summarizes borrowing activity:

	September 30, 2018		December 31, 2017	
	Net Amount	Percent of Total	Net Amount	Percent of Total
	(Dollars in Thousands)			
FHLB advances and other borrowings	\$95,731	79.39 %	\$82,969	76.98 %
Other long-term debt:				
Senior notes fixed at 5.75%, due 2022	9,853	8.17 %	9,820	9.11 %
Subordinated debentures fixed at 6.75%, due 2025	9,852	8.17 %	9,836	9.13 %
Subordinated debentures variable, due 2035	5,155	4.27 %	5,155	4.78 %
Total other long-term debt	24,860	20.61 %	24,811	23.02 %
Total borrowings	120,591	100.00 %	107,780	100.00 %

FHLB advances and other borrowings increased by \$12.76 million, or 15.4%, to \$95.73 million at September 30, 2018 from \$82.97 million at December 31, 2017. The borrowings were used to help fund the continued loan growth.

### *Shareholders' Equity*

Total shareholders' equity increased \$8.37 million, or 10.0%, to \$91.99 million at September 30, 2018 from \$83.62 million at December 31, 2017. This was primarily the result of stock issued in connection with the TwinCo acquisition of \$9.03 million and net income of \$3.54 million. These increases were partially offset by other comprehensive loss of \$2.95 million and dividends paid of \$1.49 million.

Table of Contents

## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Analysis of Net Interest Income

The Bank's earnings have historically depended primarily upon net interest income, which is the difference between interest income earned on loans and investments and interest paid on deposits and any borrowed funds. It is the single largest component of Eagle's operating income. Net interest income is affected by (i) the difference between rates of interest earned on loans and investments and rates paid on interest bearing deposits and borrowings (the "interest rate spread") and (ii) the relative amounts of loans and investments and interest bearing deposits and borrowings.

The following tables include average balances for balance sheet items, as well as, interest and dividends and average yields related to the average balances. All average balances are daily average balances. Non-accrual loans were included in the computation of average balances, but have been reflected in the table as loans carrying a zero yield. The yields include the effect of deferred fees and discounts and premiums that are amortized or accreted to interest income or expense.

	For the Three Months Ended September 30,							
	2018			2017				
	Average Daily Balance	Interest and Dividends	Yield/ Cost <sup>(4)</sup>	Average Daily Balance	Interest and Dividends	Yield/ Cost <sup>(4)(5)</sup>		
	(Dollars in Thousands)							
Assets:								
Interest earning assets:								
Investment securities	\$151,750	\$ 1,036	2.71 %	\$121,971	\$ 693	2.25 %		
FHLB and FRB stock	6,473	80	4.90 %	5,308	48	3.57 %		
Loans receivable <sup>(1)</sup>	591,441	7,701	5.17 %	520,603	6,478	4.94 %		
Other earning assets	1,020	8	3.11 %	503	5	3.94 %		
Total interest earning assets	750,684	8,825	4.66 %	648,385	7,224	4.42 %		
Noninterest earning assets	80,191			55,951				
Total assets	\$830,875			\$704,336				
Liabilities and equity:								

Edgar Filing: Eagle Bancorp Montana, Inc. - Form 10-Q

Interest bearing liabilities:

Deposit accounts:

Checking	\$ 105,060	\$ 8	0.03	%	\$ 96,788	\$ 8	0.03	%
Savings	104,884	14	0.05	%	85,596	11	0.05	%
Money market	104,421	51	0.19	%	87,699	36	0.16	%
Certificates of deposit	162,877	461	1.12	%	150,322	331	0.87	%
Advances from FHLB and other borrowings including long-term debt	114,438	814	2.82	%	118,240	679	2.28	%
Total interest bearing liabilities	591,680	1,348	0.90	%	538,645	1,065	0.78	%
Noninterest checking	138,302				97,255			
Other noninterest bearing liabilities	8,215				5,121			
Total liabilities	738,197				641,021			
Total equity	92,678				63,315			
Total liabilities and equity	\$ 830,875				\$ 704,336			
Net interest income/interest rate spread <sup>(2)</sup>		\$ 7,477	3.76	%		\$ 6,159	3.64	%
Net interest margin <sup>(3)</sup>			3.95	%			3.77	%
Total interest earning assets to interest bearing liabilities			126.87	%			120.37	%

(1) Includes loans held-for-sale.

(2) Interest rate spread represents the difference between the average yield on interest-earning assets and the average rate on interest-bearing liabilities.

(3) Net interest margin represents income before the provision for loan losses divided by average interest-earning assets.

(4) For purposes of this table, tax exempt income is not calculated on a tax equivalent basis.

(5) Calculated based on actual days. Previously calculated on a 360-day basis.



Table of Contents

## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

**Analysis of Net Interest Income – continued**

	For the Nine Months Ended September 30,							
	2018			2017				
	Average Daily Balance	Interest and Dividends	Yield/ Cost <sup>(4)</sup>	Average Daily Balance	Interest and Dividends	Yield/ Cost <sup>(4)(5)</sup>		
	(Dollars in Thousands)							
Assets:								
Interest earning assets:								
Investment securities	\$ 152,580	\$ 3,046	2.67 %	\$ 125,642	\$ 2,136	2.27 %		
FHLB and FRB stock	6,166	233	5.05 %	4,942	124	3.35 %		
Loans receivable, net <sup>(1)</sup>	583,274	22,435	5.14 %	502,563	18,222	4.85 %		
Other earning assets	3,450	44	1.70 %	1,218	7	0.77 %		
Total interest earning assets	745,470	25,758	4.62 %	634,365	20,489	4.32 %		
Noninterest earning assets	78,356			55,747				
Total assets	\$823,826			\$690,112				
Liabilities and equity:								
Interest bearing liabilities:								
Deposit accounts:								
Money market	\$ 107,280	\$ 156	0.19 %	\$ 91,056	\$ 94	0.14 %		
Savings	103,325	40	0.05 %	84,687	31	0.05 %		
Checking	107,412	27	0.03 %	95,246	23	0.03 %		
Certificates of deposit	164,010	1,231	1.00 %	154,752	994	0.86 %		
Advances from FHLB and other borrowings including long-term debt	108,484	2,170	2.67 %	108,290	1,825	2.25 %		
Total interest bearing liabilities	590,511	3,624	0.82 %	534,031	2,967	0.74 %		
Noninterest checking	132,773			90,453				
Other noninterest bearing liabilities	9,603			4,532				
Total liabilities	732,887			629,016				
Total equity	90,939			61,096				
Total liabilities and equity	\$823,826			\$690,112				
Net interest income/interest rate spread <sup>(2)</sup>		\$ 22,134	3.80 %		\$ 17,522	3.58 %		

Net interest margin <sup>(3)</sup>	3.97 %	3.69 %
Total interest earning assets to interest bearing liabilities	126.24%	118.79 %

(1) Includes loans held-for-sale.

(2) Interest rate spread represents the difference between the average yield on interest-earning assets and the average rate on interest-bearing liabilities.

(3) Net interest margin represents income before the provision for loan losses divided by average interest-earning assets.

(4) For purposes of this table, tax exempt income is not calculated on a tax equivalent basis.

(5) Calculated based on actual days. Previously calculated on a 360-day basis.

Table of Contents

## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Rate/Volume Analysis

The following tables present the dollar amount of changes in interest income and interest expense for major components of interest earning assets and interest bearing liabilities. For each category of interest earning assets and interest bearing liabilities, information is provided on changes attributable to: (1) changes in volume multiplied by the old rate; (2) changes in rate, which are changes in rate multiplied by the old volume; and (3) changes not solely attributable to rate or volume, which have been allocated proportionately to the change due to volume and the change due to rate.

	For the Three Months Ended September 30,					
	2018			2017		
	Due		Net	Due		Net
	to			to		
	Volume	Rate	Net	Volume	Rate	Net
	(In Thousands)					
<b>Interest earning assets:</b>						
Investment securities	\$ 169	\$ 174	\$ 343	\$ (66 )	\$ 50	\$ (16 )
FHLB and FRB stock	10	22	32	4	7	11
Loans receivable <sup>(1)</sup>	881	342	1,223	570	447	1,017
Other earning assets	5	(2 )	3	1	3	4
Total interest earning assets	1,065	536	1,601	509	507	1,016
<b>Interest bearing liabilities:</b>						
Savings, money market and checking accounts	11	7	18	2	12	14
Certificates of deposit	28	102	130	(21 )	10	(11 )
Advances from FHLB and other borrowings including long-term debt	(22 )	157	135	77	198	275
Total interest bearing liabilities	17	266	283	58	220	278
Change in net interest income	\$ 1,048	\$ 270	\$ 1,318	\$ 451	\$ 287	\$ 738

<sup>(1)</sup> Includes loans held for sale.



Table of Contents

## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

**Rate/Volume Analysis – continued**

	For the Nine Months Ended September 30,					
	2018			2017		
	Due to			Due to		
	Volume	Rate	Net	Volume	Rate	Net
	(In Thousands)					
Interest earning assets:						
Investment securities	\$458	\$452	\$910	\$(240 )	\$180	\$(60 )
FHLB and FRB stock	31	78	109	5	16	21
Loans receivable <sup>(1)</sup>	2,926	1,287	4,213	1,806	1,163	2,969
Other earning assets	13	24	37	(1 )	3	2
Total interest earning assets	3,428	1,841	5,269	1,570	1,362	2,932
Interest bearing liabilities:						
Savings, money market and checking accounts	27	48	75	5	22	27
Certificates of deposit	59	178	237	(2 )	(2 )	(4 )
Advances from FHLB and other borrowings including long-term debt	3	342	345	181	438	619
Total interest bearing liabilities	89	568	657	184	458	642
Change in net interest income	\$3,339	\$1,273	\$4,612	\$1,386	\$904	\$2,290

<sup>(1)</sup> Includes loans held for sale.

**Results of Operations for the Three Months Ended September 30, 2018 and 2017**

*Net Income.* Eagle's net income for the three months ended September 30, 2018 was \$1.63 million compared to \$1.72 million for the three months ended September 30, 2017. The slight decrease of \$89,000, or 5.2%, was due to an increase in noninterest expense of \$1.49 million, a decrease in noninterest income of \$227,000, largely offset by an

increase in net interest income after loan loss provision of \$1.45 million and a decrease in income tax expense of \$178,000. Basic and diluted earnings per share were both \$0.30 for the current period. Basic and diluted earnings per share were both \$0.45 for the prior year comparable period.

*Net Interest Income.* Net interest income increased to \$7.48 million for the three months ended September 30, 2018, from \$6.16 million for the same quarter in the prior year. This increase of \$1.32 million, or 21.4%, was the result of an increase in interest and dividend income of \$1.61 million, partially offset by an increase in interest expense of \$283,000.

*Interest and Dividend Income.* Interest and dividend income was \$8.83 million for the three months ended September 30, 2018, compared to \$7.22 million for the three months ended September 30, 2017, an increase of \$1.61 million, or 22.3%. Interest and fees on loans increased to \$7.70 million for the three months ended September 30, 2018 from \$6.48 million for the three months ended September 30, 2017. This increase of \$1.22 million, or 18.8%, was due to an increase in the average balance of loans, as well as, an increase in the average yield of loans for the quarter ended September 30, 2018. Average balances for loans receivable, including loans held-for-sale, for the three months ended September 30, 2018 were \$591.44 million, compared to \$520.60 million for the prior year period. This represents an increase of \$70.84 million, or 13.6% and was due in part to the TwinCo acquisition. The average interest rate earned on loans receivable increased by 23 basis points, from 4.94% to 5.17%. Interest and dividends on investment securities available-for-sale increased by \$343,000, or 49.5% period over period. Average interest rates earned on investments increased to 2.71% for the three months ended September 30, 2018 from 2.25% for the three months ended September 30, 2017. Average balances for investments increased to \$151.75 million for the three months ended September 30, 2018, from \$121.97 million for the three months ended September 30, 2017. This increase was largely due to the TwinCo acquisition.

Table of Contents

EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

**Results of Operations for the Three Months Ended September 30, 2018 and 2017 – continued**

*Interest Expense.* Total interest expense was \$1.35 million for the three months ended September 30, 2018 compared to \$1.07 million for the three months ended September 30, 2017. The increase of \$283,000 or 26.6% was due to an increase in interest expense on deposits, as well as interest expense on borrowings. The average balance for total deposits was \$615.54 million for the three months ended September 30, 2018 compared to \$517.66 million for the three months ended September 30, 2017. This increase was due in part to the TwinCo acquisition. The overall average rate on total deposits was 0.34% for the three months ended September 30, 2018 compared to 0.30% for the three months ended September 30, 2017. The average borrowing balance decreased from \$118.24 million for the three months ended September 30, 2017 to \$114.44 million for the three months ended September 30, 2018. However, the average rate paid on total borrowings increased from 2.28% for the three months ended September 30, 2017, to 2.82% for the three months ended September 30, 2018.

*Loan Loss Provision.* Loan loss provisions are charged to earnings to maintain total allowance for loan losses at a level considered adequate by management of the Bank, to provide for probable loan losses based on prior loss experience, volume and type of lending conducted by the Bank and past due loans in the portfolio. The Bank's policies require review of assets on a quarterly basis. The Bank classifies loans as well as other assets if warranted. While management believes it uses the best information available to make a determination with respect to the allowance for loan losses, it recognizes that future adjustments may be necessary. The Bank recorded \$194,000 in provision for loan losses for the three months ended September 30, 2018 and \$331,000 for the three months ended September 30, 2017.

*Noninterest Income.* Total noninterest income was \$3.76 million for the three months ended September 30, 2018, compared to \$3.99 million for the three months ended September 30, 2017, a decrease of \$227,000 or 5.7%. The decrease is primarily due to a decrease in net gain on sale of loans which decreased to \$2.29 million for the three months ended September 30, 2018 from \$2.57 million for the three months ended September 30, 2017. The decrease is primarily due to a decrease in gross margin on sale of mortgage loans for the three months ended September 30, 2018 compared to the three months ended September 30, 2017. The decrease in gross margin on sale of mortgage loans is due to interest rate movements in the mortgage market and strategic defensive posture due to competitive pressure.

*Noninterest Expense.* Noninterest expense was \$9.05 million for the three months ended September 30, 2018 compared to \$7.56 million for the three months ended September 30, 2017. The increase of \$1.49 million or 19.7% is largely due to increases in salaries and employee benefits expense of \$792,000. The increase is due in part to higher commission-based compensation related to the continued loan growth in both commercial and mortgage lending activities as well as the TwinCo acquisition. Data processing increased \$303,000, primarily due to one-time costs to improve network infrastructure and to support growth. Occupancy and equipment expense increased \$200,000 as a result of facility improvements and bringing in acquired branches.

*Income Tax Expense.* Income tax expense was \$360,000 for the three months ended September 30, 2018, compared to \$538,000 for the three months ended September 30, 2017. The effective tax rate for the three months ended September 30, 2018 was 18.1%.

### **Results of Operations for the Nine Months Ended September 30, 2018 and 2017**

*Net Income.* Eagle's net income for the nine months ended September 30, 2018 was \$3.54 million compared to \$3.55 million of net income for the nine months ended September 30, 2017. The slight decrease of \$12,000, or 0.3%, was primarily due to an increase in noninterest expense of \$4.00 million and a decrease in noninterest income of \$1.25 million, largely offset by an increase in net interest income after loan loss provision of \$4.82 million and a decrease in income tax expense of \$408,000. Basic and diluted earnings per share were both \$0.65 for the current period. Basic and diluted earnings per share were \$0.93 and \$0.92, respectively, for the prior year comparable period.

*Net Interest Income.* Net interest income increased to \$22.13 million for the nine months ended September 30, 2018, from \$17.52 million for the previous year's nine-month period. This increase of \$4.61 million, or 26.3%, was the result of an increase in interest and dividend income of \$5.27 million, partially offset by an increase in interest expense of \$657,000.

*Interest and Dividend Income.* Interest and dividend income was \$25.76 million for the nine months ended September 30, 2018, compared to \$20.49 million for the nine months ended September 30, 2017, an increase of \$5.27 million, or 25.7%. Interest and fees on loans increased to \$22.44 million for the nine months ended September 30, 2018 from \$18.22 million for the same period ended September 30, 2017. This increase of \$4.22 million, or 23.2%, was due to an increase in the average balance of loans, as well as, an increase in the average yield on loans. Average balances for loans receivable, including loans held-for-sale, for the nine months ended September 30, 2018 were \$583.27 million, compared to \$502.56 million for the prior year period. This represents an increase of \$80.71 million, or 16.1% and was due in part to the TwinCo acquisition. The average interest rate earned on loans receivable increased by 29 basis points, from 4.85% to 5.14%. Interest and dividends on investment securities available-for-sale loans increased to \$3.05 million for the nine months ended September 30, 2018 from \$2.14 million for the same period ended September 30, 2017. Average balances for investments increased to \$152.58 million for the nine months ended September 30, 2018, from \$125.64 million for the nine months ended September 30, 2017. This increase was largely due to the TwinCo acquisition. Average interest rates earned on investments increased to 2.67% for the nine months ended September 30, 2018 from 2.27% for the nine months ended September 30, 2017.





Table of Contents

EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

**Results of Operations for the Nine Months Ended September 30, 2018 and 2017 – continued**

*Interest Expense.* Total interest expense for the nine months ended September 30, 2018 was \$3.62 million compared to \$2.97 million for the nine months ended September 30, 2017. The increase of \$657,000, or 22.1%, was due to an increase in interest expense on borrowings, as well as an increase in interest expense on deposits. Interest expense on FHLB advances and other borrowings and other long term debt increased \$345,000 for the nine months ended September 30, 2018 compared to the same period in the prior year. The average borrowing balance increased slightly from \$108.29 million for the nine months ended September 30, 2017 to \$108.48 million for the nine months ended September 30, 2018. However, the average rate paid on borrowings increased from 2.25% for the nine months ended September 30, 2017, to 2.67% for the nine months ended September 30, 2018. Interest expense on deposits increased \$312,000 for the nine months ended September 30, 2018 compared to the same period in the prior year. The increase is due to higher overall average balances for total deposits which increased from \$516.19 million for the nine months ended September 30, 2017 to \$614.80 million for the nine months ended September 30, 2018. This increase was due in part to the TwinCo acquisition. The overall average rate on total deposits increased from 0.30% for the nine months ended September 30, 2017 to 0.32% for the nine months ended September 30, 2018.

*Loan Loss Provision.* Loan loss provisions are charged to earnings to maintain the total allowance for loan losses at a level considered adequate by management of the Bank, to provide for probable loan losses based on prior loss experience, volume and type of lending conducted by the Bank and past due loans in the portfolio. The Bank's policies require a review of assets on a quarterly basis. The Bank classifies loans as well as other assets if warranted. While management believes it uses the best information available to make a determination with respect to the allowance for loan losses, it recognizes that future adjustments may be necessary. The Bank recorded \$720,000 in loan loss provisions for the nine months ended September 30, 2018 and \$934,000 in the nine months ended September 30, 2017. Management believes the level of total allowances is adequate. As of September 30, 2018, the Bank had \$457,000 in foreclosed real estate property and other repossessed property.

*Noninterest Income.* Total noninterest income decreased to \$9.52 million for the nine months ended September 30, 2018, from \$10.77 million for the nine months ended September 30, 2017, a decrease of \$1.25 million or 11.6%. The decrease is largely due to a decrease in net gain on sale of loans which decreased to \$5.45 million for the nine months ended September 30, 2018 from \$6.66 million for the nine months ended September 30, 2017. During the nine months ended September 30, 2018, \$205.06 million mortgage loans were sold compared to \$215.20 million in the same period

in the prior year. In addition, gross margin on sale of mortgage loans for the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017 declined. The decrease in gross margin on sale of mortgage loans is due to interest rate movements in the mortgage market and strategic defensive posture due to competitive pressure.

*Noninterest Expense.* Noninterest expense was \$26.62 million for the nine months ended September 30, 2018 compared to \$22.62 million for the nine months ended September 30, 2017. The increase of \$4.00 million, or 17.7%, is largely due to increased salaries and employee benefits expense of \$2.14 million. The increase in salaries expense is due in part to higher commission-based compensation related to the continued loan growth in both commercial and mortgage lending activities as well as the TwinCo acquisition. Data processing increased \$480,000, primarily due to one-time costs to improve network infrastructure and to support growth. Occupancy and equipment expense increased \$474,000 as a result of facility improvements and bringing in acquired branches. In addition, the Company incurred acquisition costs totaling \$587,000 for the nine months ended September 30, 2018 compared to \$276,000 for the nine months ended September 30, 2017.

*Income Tax Expense.* Income tax expense was \$780,000 for the nine months ended September 30, 2018, compared to \$1.19 million for the nine months ended September 30, 2017. The effective tax rate for the nine months ended September 30, 2018 was 18.1%. The tax was lower due to lower income before income taxes for the nine months ended September 30, 2018 compared to the same period in the prior year, as well as the impact of the Tax Cuts and Job Act enacted in December 2017.

Table of Contents

EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

**Liquidity and Capital Resources**

*Liquidity*

The Bank is required to maintain minimum levels of liquid assets as defined in the regulations of the Montana Division of Banking and Financial Institutions and Federal Reserve Bank ("FRB") regulations. The liquidity requirement is retained for safety and soundness purposes, and appropriate levels of liquidity will depend upon the types of activities in which the company engages. For internal reporting purposes, the Bank uses policy minimums of 1.0%, and 8.0% for "basic surplus" and "basic surplus with FHLB" as internally defined. In general, the "basic surplus" is a calculation of the ratio of unencumbered short-term assets reduced by estimated percentages of CD maturities and other deposits that may leave the Bank in the next 90 days divided by total assets. "Basic surplus with FHLB" adds to "basic surplus" the additional borrowing capacity the Bank has with FHLB. The Bank exceeded those minimum ratios as of both September 30, 2018 and December 31, 2017.

The Bank's primary sources of funds are deposits, repayment of loans and mortgage-backed and collateralized mortgage obligation securities, maturities of investments, funds provided from operations and advances from FHLB and other borrowings. Scheduled repayments of loans and mortgage-backed and collateralized mortgage obligation securities and maturities of investment securities are generally predictable. However, other sources of funds, such as deposit flows and loan prepayments, can be greatly influenced by the general level of interest rates, economic conditions and competition. The Bank uses liquidity resources principally to fund existing and future loan commitments. It also uses them to fund maturing certificates of deposit, demand deposit withdrawals and to invest in other loans and investments, maintain liquidity and meet operating expenses.

Liquidity may be adversely affected by unexpected deposit outflows, higher interest rates paid by competitors and similar matters. Management monitors projected liquidity needs and determines the level desirable, based in part on commitments to make loans and management's assessment of the Bank's ability to generate funds.

***Capital Resources***

As of September 30, 2018, the Bank's internally determined measurement of sensitivity to interest rate movements as measured by a 200 basis point rise in interest rates scenario, increased the economic value of equity ("EVE") by 2.0% compared to an increase of 2.7% at December 31, 2017. The Bank is within the guidelines set forth by the Board of Directors for interest rate risk sensitivity in rising interest rate scenarios.

Beginning January 1, 2015, community banking organizations became subject to a new regulatory rule recently adopted by federal banking agencies (commonly referred to as Basel III). The new rule establishes a new regulatory capital framework that incorporates revisions to the Basel capital framework, strengthens the definition of regulatory capital, increases risk-based capital requirements, and amends the methodologies for determining risk-weighted assets. These changes are expected to increase the amount of capital required by community banking organizations. Basel III includes a multiyear transition period from January 1, 2015 through December 31, 2019.

The Bank's Tier I leverage ratio, as measured under State of Montana and FRB rules, increased from 10.39% as of December 31, 2017 to 11.434% as of September 30, 2018. The Bank's capital position helps to mitigate its interest rate risk exposure.

As of September 30, 2018, the Bank's regulatory capital was in excess of all applicable regulatory requirements. As of September 30, 2018, the Bank's total capital, Tier 1 capital, common equity Tier 1 capital and Tier 1 leverage ratios were 15.779%, 14.759%, 14.759% and 11.434%, respectively, compared to regulatory requirements of 9.875%, 7.875%, 6.375% and 4.00%, respectively. All of these ratios with the exception of the Tier 1 leverage ratio include the capital conservation buffer of 1.875% phased in beginning January 1, 2018.

Table of Contents

## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

**Liquidity and Capital Resources – continued**

	September 30, 2018 (Unaudited)	
	Dollar Amount	% of Assets
	(Dollars in Thousands)	
Total risk-based capital to risk weighted assets:		
Actual capital level	\$98,203	15.779%
Minimum required for capital adequacy Basel III phase-in schedule	61,457	9.875
Excess capital	\$36,746	5.904 %
Tier I capital to risk weighted assets:		
Actual capital level	\$91,853	14.759%
Minimum required for capital adequacy Basel III phase-in schedule	49,010	7.875
Excess capital	\$42,843	6.884 %
Common equity tier I capital to risk weighted assets:		
Actual capital level	\$91,853	14.759%
Minimum required for capital adequacy Basel III phase-in schedule	39,675	6.375
Excess capital	\$52,178	8.384 %
Tier I capital to adjusted total average assets:		
Actual capital level	\$91,853	11.434%
Minimum required for capital adequacy Basel III phase-in schedule	32,133	4.000
Excess capital	\$59,720	7.434 %

**Interest Rate Risk**

Interest rate risk is the potential for loss of future earnings resulting from adverse changes in the level of interest rates. Interest rate risk results from several factors and could have a significant impact on the Company's net interest income, which is the Company primary source of income. Net interest income is affected by changes in interest rates, the relationship between rates on interest bearing assets and liabilities, the impact of interest fluctuations on asset prepayments and the mix of interest bearing assets and liabilities.

Although interest rate risk is inherent in the banking industry, banks are expected to have sound risk management practices in place to measure, monitor and control interest rate exposures. The objective of interest rate risk management is to contain the risks associated with interest rate fluctuations. The process involves identification and management of the sensitivity of net interest income to changing interest rates.

The ongoing monitoring and management of this risk is an important component of the Company's asset/liability committee, which is governed by policies established by the Company's Board that are reviewed and approved annually. The Board delegates responsibility for carrying out the asset/liability management policies to the Bank's asset/liability committee. In this capacity, the asset/liability committee develops guidelines and strategies impacting the Company's asset/liability management related activities based upon estimated market risk sensitivity, policy limits and overall market interest rate levels and trends. The Company's goal of its asset and liability management practices is to maintain or increase the level of net interest income within an acceptable level of interest rate risk. Our asset and liability policy and strategies are expected to continue as described so long as competitive and regulatory conditions in the financial institution industry and market interest rates continue as they have in recent years.

Table of Contents

## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

**Interest Rate Risk – continued**

The Bank has established acceptable levels of interest rate risk as follows: Projected net interest income over the next twelve months will not be reduced by more than 15.0% given a change in interest rates of up to 200 basis points (+ or -).

The following table includes the Bank's net interest income sensitivity analysis.

Changes in Market Interest Rates (Basis Points)	Rate Sensitivity As of September 30, 2018 Policy Year 1 Year 2 Limits		
	+200	0.61%	1.62%
-200	-2.47%	-9.07%	-15.00%

**Impact of Inflation and Changing Prices**

Our financial statements and the accompanying notes have been prepared in accordance with generally accepted accounting principles, which require the measurement of financial position and operating results in terms of historical dollars without considering the change in the relative purchasing power of money over time and due to inflation. The impact of inflation is reflected in the increased cost of our operations. Interest rates have a greater impact on our performance than do the general levels of inflation. Interest rates do not necessarily move in the same direction or to the same extent as the prices of goods and services.





Table of Contents

EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

This item has been omitted based on Eagle's status as a smaller reporting company.

-51-

---

Table of Contents

EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

CONTROLS AND PROCEDURES

**Item 4. Controls and Procedures**

As of the end of the period covered by this report, we conducted an evaluation under the supervision and with the participation of our management including our Chief Executive Officer (“CEO”) and our Chief Financial Officer (“CFO”) of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, to ensure that information required to be disclosed by us in the reports filed or submitted by us under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission’s rules and forms, including to ensure that information required to be disclosed by us in the reports filed or submitted by us under the Exchange Act is accumulated and communicated to management to allow timely decisions regarding required disclosure. Based on that evaluation, our CEO and CFO concluded that as of September 30, 2018, our disclosure controls and procedures were effective. During the last quarter, there were no changes in the Company’s internal control over financial reporting that have materially affected, or were reasonably likely to materially affect, the Company’s internal control over financial reporting.

Table of Contents

EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

**Part II - OTHER INFORMATION**

**Item 1. Legal Proceedings.**

Neither the Company nor the Bank is involved in any pending legal proceeding other than non-material legal proceedings occurring in the ordinary course of business.

**Item 1A. Risk Factors.**

There have not been any material changes in the risk factors previously disclosed in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2017.

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

On July 19, 2018, the Board authorized the repurchase of up to 100,000 shares of its common stock. Under the plan, shares may be purchased by the Company on the open market or in privately negotiated transactions. The extent to which the company repurchases its shares and the timing of such repurchase will depend upon market conditions and other corporate considerations. No shares were purchased under this plan during the three months ended September 30, 2018. The plan expires on July 19, 2019.

On July 20, 2017, the Board authorized the repurchase of up to 100,000 shares of its common stock. Under the plan, shares could be purchased by the Company on the open market or in privately negotiated transactions. No shares were purchased under this plan. The plan expired on July 20, 2018.

On July 21, 2016, the Board authorized the repurchase of up to 100,000 shares of its common stock. Under the plan, shares could be purchased by the Company on the open market or in privately negotiated transactions. No shares were purchased under this plan. The plan expired on July 21, 2017.



Table of Contents

EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

**Part II - OTHER INFORMATION (CONTINUED)**

**Item 3. Defaults Upon Senior Securities.**

Not applicable.

**Item 4. Mine Safety Disclosures**

Not applicable

**Item 5. Other Information.**

None.

**Item 6. Exhibits.**

**Exhibit**

**Description**

**Number**

- |     |   |
|-----|---|
| 2.1 | <u>Agreement and Plan of Merger, dated as of August 21, 2018, by and among Eagle Bancorp Montana, Inc., Opportunity Bank of Montana, Big Muddy Bancorp, Inc. and The State Bank of Townsend (incorporated herein by reference to Exhibit 2.1 of our Current Report on Form 8-K filed on August 21, 2018).</u> |
| 3.1 | <u>Amended and Restated Certificate of Incorporation of Eagle Bancorp Montana, Inc. (incorporated herein by reference to Exhibit 3.1 of our Current Report on Form 8-K filed on February 23, 2010).</u>   |
| 3.2 | <u>Bylaws of Eagle Bancorp Montana, Inc., amended as of August 20, 2015 (incorporated herein by reference to Exhibit 3.1 of our Current Report on Form 8-K filed on August 25, 2015).</u>   |

- 10.1 Salary Continuation Agreement between Opportunity Bank of Montana and Patrick D. Rensmon (incorporated herein by reference to Exhibit 10.1 of our Current Report on Form 8-K filed on October 11, 2018).
- 10.2 Amendment to Salary Continuation Agreement between Opportunity Bank of Montana and Peter J. Johnson (incorporated herein by reference to Exhibit 10.2 of our Current Report on Form 8-K filed on October 11, 2018).
- 10.3 Amendment to Salary Continuation Agreement between Opportunity Bank of Montana and Laura F. Clark (incorporated herein by reference to Exhibit 10.3 of our Current Report on Form 8-K filed on October 11, 2018).
- 10.4 Salary Continuation Agreement between Opportunity Bank of Montana and Mark O'Neill (filed herewith).
- 10.5 Amendment to Salary Continuation Agreement between Opportunity Bank of Montana and Dale Field (filed herewith).
- 10.6 Amendment to Salary Continuation Agreement between Opportunity Bank of Montana and Chantelle Nash (filed herewith).
- 31.1 Certification by Peter J. Johnson, Chief Executive Officer, pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 (a) of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification by Laura F. Clark, Chief Financial Officer, pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 (a) of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification by Peter J. Johnson, Chief Executive Officer, and Laura F. Clark, Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101.INS XBRL Instance Document
- 101.SCHXBRL Taxonomy Extension Schema Document
- 101.CALXBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document
- 101.LABXBRL Taxonomy Extension Label Linkbase Document
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

Table of Contents

EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

SIGNATURES

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

EAGLE BANCORP MONTANA,  
INC.

Date: November 14, 2018 By: /s/ Peter J. Johnson

Peter J. Johnson  
President/CEO

Date: November 14, 2018 By: /s/ Laura F. Clark

Laura F. Clark  
Executive Vice President/CFO