

MALVERN BANCORP, INC.
Form 10-Q
February 12, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended: December 31, 2013

or
 Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from _____ to _____

Commission File Number: 000-54835

MALVERN BANCORP, INC.
(Exact name of Registrant as specified in its charter)

Pennsylvania
(State or Other Jurisdiction of
Incorporation or Organization)

45-5307782
(I.R.S. Employer
Identification Number)

42 E. Lancaster Avenue, Paoli, Pennsylvania
(Address of Principal Executive Offices)

19301
(Zip Code)

(610) 644-9400
(Registrant's Telephone
Number, Including
Area Code)

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). YES o NO x

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's class of common stock, as of the latest practicable date: As of February 11, 2014, 6,558,473 shares of the Registrant's common stock were issued and outstanding.

MALVERN BANCORP, INC.

TABLE OF CONTENTS

	Page
PART I—FINANCIAL INFORMATION	
Item 1.	Financial Statements
	2
	<u>Consolidated Statements of Financial Condition as of December 31, 2013 and September 30, 2013 (Unaudited)</u>
	2
	<u>Consolidated Statements of Operations for the Three Months Ended December 31, 2013 and 2012 (Unaudited)</u>
	3
	<u>Consolidated Statements of Comprehensive (Loss) Income for the Three Months Ended December 31, 2013 and 2012 (Unaudited)</u>
	4
	<u>Consolidated Statements of Changes in Shareholders' Equity for the Three Months Ended December 31, 2013 and 2012 (Unaudited)</u>
	5
	<u>Consolidated Statements of Cash Flows for the Three Months Ended December 31, 2013 and 2012 (Unaudited)</u>
	6
	<u>Notes to Consolidated Financial Statements (Unaudited)</u>
	7
<u>Item 2.</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>
	40
<u>Item 3.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>
	51
<u>Item 4.</u>	<u>Controls and Procedures</u>
	51
<u>PART II—OTHER INFORMATION</u>	
<u>Item 1.</u>	<u>Legal Proceedings</u>
	52
<u>Item 1A.</u>	<u>Risk Factors</u>
	52
<u>Item 2.</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>
	52
<u>Item 3.</u>	<u>Defaults Upon Senior Securities</u>
	52
<u>Item 4.</u>	<u>Mine Safety Disclosure</u>
	52

<u>Item 5.</u>	<u>Other Information</u>	52
<u>Item 6.</u>	<u>Exhibits</u>	52
<u>SIGNATURES</u>		53

Table of ContentsMalvern Bancorp, Inc. and Subsidiaries
Consolidated Statements of Financial Condition (Unaudited)

	December 31, 2013	September 30, 2013
	(Dollars in thousands, except per share data)	
Assets		
Cash and due from depository institutions	\$ 1,126	\$ 1,251
Interest bearing deposits in depository institutions	21,544	22,436
Cash and Cash Equivalents	22,670	23,687
Investment securities available for sale, at fair value	123,826	124,667
Restricted stock, at cost	3,236	3,038
Loans held for sale	-	10,367
Loans receivable, net of allowance for loan losses of \$4,845 and \$5,090, respectively	407,306	401,857
Other real estate owned	2,472	3,962
Accrued interest receivable	1,438	1,404
Property and equipment, net	7,140	7,259
Deferred income taxes, net	2,510	2,464
Bank-owned life insurance	21,486	21,341
Other assets	1,957	1,508
Total Assets	\$ 594,041	\$ 601,554
Liabilities and Shareholders' Equity		
Liabilities		
Deposits:		
Deposits-noninterest-bearing	\$ 24,638	\$ 24,761
Deposits-interest-bearing	446,363	459,835
Total Deposits	471,001	484,596
FHLB advances	43,000	38,000
Advances from borrowers for taxes and insurance	2,911	1,118
Accrued interest payable	133	139
Other liabilities	2,383	2,295
Total Liabilities	519,428	526,148
Commitments and Contingencies	-	-
Shareholders' Equity	-	-

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Preferred stock, \$0.01 par value, 10,000,000 shares authorized, none issued		
Common stock, \$0.01 par value, 40,000,000 shares authorized, issued and outstanding: 6,558,473	66	66
Additional paid-in capital	60,311	60,302
Retained earnings	19,857	19,793
Unearned Employee Stock Ownership Plan (ESOP) shares	(2,030)	(2,067)
Accumulated other comprehensive loss	(3,591)	(2,688)
Total Shareholders' Equity	74,613	75,406
Total Liabilities and Shareholders' Equity	\$ 594,041	\$ 601,554

See notes to unaudited consolidated financial statements.

Table of ContentsMalvern Bancorp, Inc. and Subsidiaries
Consolidated Statements of Operations (Unaudited)

	Three Months Ended December 31,	
	2013	2012
	(Dollars in thousands, except per share data)	
Interest and Dividend Income		
Loans, including fees	\$ 4,527	\$ 5,533
Investment securities, taxable	555	329
Investment securities, tax-exempt	54	52
Dividends, restricted stock	14	5
Interest-bearing cash accounts	15	31
Total Interest and Dividend Income	5,165	5,950
Interest Expense		
Deposits	1,067	1,517
Long-term borrowings	263	430
Total Interest Expense	1,330	1,947
Net Interest Income	3,835	4,003
Provision for Loan Losses	80	400
Net Interest Income after Provision for Loan Losses	3,755	3,603
Other Income		
Service charges and other fees	258	331
Rental income-other	64	63
Gain on sale of investments, net	14	27
Gain on sale of loans, net	27	164
Earnings on bank-owned life insurance	145	722
Total Other Income	508	1,307
Other Expense		
Salaries and employee benefits	2,067	1,848
Occupancy expense	516	482
Federal deposit insurance premium	191	217
Advertising	158	180
Data processing	330	319
Professional fees	485	364
Other real estate owned expense, net	13	425
Other operating expenses	436	458
Total Other Expenses	4,196	4,293
Income before income tax expense (benefit)	67	617
Income tax expense (benefit)	3	(54)
Net Income	\$ 64	\$ 671
Basic Earnings Per Share	\$ 0.01	\$ 0.11

See notes to unaudited consolidated financial statements.

3

Table of ContentsMalvern Bancorp, Inc. and Subsidiaries
Consolidated Statements of Comprehensive (Loss) Income (Unaudited)

	Three Months Ended December 31,	
	2013	2012
	(In thousands)	
Net Income	\$ 64	\$ 671
Other Comprehensive (Loss) Income:		
Changes in net unrealized gains and losses on securities available for sale	(1,354)	5
Gains realized in net income(1)	(14)	(27)
	(1,368)	(22)
Deferred income tax effect	465	8
Total other comprehensive loss	(903)	(14)
Total comprehensive (loss) income	\$ (839)	\$ 657

(1) Amounts are included in net gains on sales of securities on the Consolidated Statements of Operations in total other income.

Related income tax expense in the amount of \$4 and \$9, respectively, are included in income tax expense (benefit).

See notes to unaudited consolidated financial statements.

Table of Contents

Malvern Bancorp, Inc. and Subsidiaries

Consolidated Statements of Changes in Shareholders' Equity (Unaudited)

	Common Stock	Additional Paid-In Capital	Retained Earnings	Treasury Stock	Unearned ESOP Shares	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
(Dollars in thousands, except share and per share data)							
Balance, October 1, 2012	\$62	\$25,846	\$38,596	\$(477)	\$(2,032)	\$ 641	\$ 62,636
Net Income	-	-	671	-	-	-	671
Other comprehensive loss	-	-	-	-	-	(14)	(14)
Cancellation of common stock	(62)	62	-	-	-	-	-
Cancellation of treasury stock	-	(477)	-	477	-	-	-
Additional ESOP shares converted at exchange rate of 1.0748 (18,040 shares at \$10/share)	-	180	-	-	(180)	-	-
Dissolution of mutual holding company	-	100	-	-	-	-	100
Proceeds from issuance of common stock, net of offering expenses of \$1.6 million	66	34,567	-	-	-	-	34,633
Committed to be released ESOP shares (3,351 shares)	-	8	-	-	36	-	44
Balance, December 31, 2012	\$66	\$60,286	\$39,267	\$-	\$(2,176)	\$ 627	\$ 98,070

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Balance, October 1, 2013	\$66	\$60,302	\$19,793	\$-	\$(2,067)) \$ (2,688)) \$ 75,406
Net Income	-	-	64	-	-	-	64
Other comprehensive loss	-	-	-	-	-	(903)	(903)
Committed to be released ESOP shares (3,600 shares)	-	9	-	-	37	-	46
Balance, December 31, 2013	\$66	\$60,311	\$19,857	\$-	\$(2,030)) \$ (3,591)) \$ 74,613

See notes to unaudited consolidated financial statements.

Table of ContentsMalvern Bancorp, Inc. and Subsidiaries
Consolidated Statements of Cash Flows (Unaudited)

	Three Months Ended December 31,	
	2013	2012
	(In thousands)	
Cash Flows from Operating Activities		
Net income	\$ 64	\$ 671
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation expense	163	172
Provision for loan losses	80	400
Deferred income tax expense (benefit)	419	(100)
ESOP expense	46	44
Accretion of premiums and discounts on investment securities, net	(657)	(101)
Amortization of loan origination fees and costs	(87)	(569)
(Accretion) amortization of mortgage servicing rights	(2)	6
Net gain on sale of investment securities available for sale	(14)	(27)
Net gain on sale of loans	-	(164)
Net gain on sale of secondary market loans	(27)	-
Proceeds on sale of secondary market loans	2,007	-
Originations of secondary market loans	(1,980)	-
Gain on sale of other real estate owned	(6)	(96)
Write down of other real estate owned	11	505
(Increase) decrease in accrued interest receivable	(34)	81
Decrease in accrued interest payable	(6)	(28)
Increase (decrease) increase in other liabilities	88	(171)
Earnings on bank-owned life insurance	(145)	(722)
Increase in other assets	(434)	(292)
Decrease in prepaid FDIC assessment	-	208
Net Cash Used in Operating Activities	(514)	(183)
Cash Flows from Investing Activities		
Proceeds from maturities and principal collections:		
Investment securities available for sale	3,586	9,886
Proceeds from sales of investment securities available for sale	824	17
Purchases of investment securities available for sale	(4,266)	(14,496)
Proceeds from sale of loans	10,367	4,567
Loan buyback from sale of loans	(1,117)	-
Loan purchases	(6,747)	(4,371)
Loan originations and principal collections, net	2,411	10,865
Proceeds from sale of other real estate owned	1,496	399
Additions to mortgage servicing rights	(13)	(18)
Net (increase) decrease in restricted stock	(198)	493
Purchases of property and equipment	(44)	(68)

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Net Cash Provided by Investing Activities	6,299	7,274
Cash Flows from Financing Activities		
Net decrease in deposits	(13,595)	(5,912)
Proceeds for long-term borrowings	5,000	-
Repayment of long-term borrowings	-	(85)
Increase in advances from borrowers for taxes and insurance	1,793	3,657
Return of excess stock subscription funds	-	(20,841)
Cash from mutual holding company reorganization	-	100
Net Cash Used in Financing Activities	(6,802)	(23,081)
Net Decrease in Cash and Cash Equivalents	(1,017)	(15,990)
Cash and Cash Equivalents - Beginning	23,687	131,910
Cash and Cash Equivalents - Ending	\$22,670	\$115,920
Supplementary Cash Flows Information		
Interest paid	\$1,336	\$1,975
Income taxes paid	\$17	\$-
Non-cash transfer of loans to other real estate owned	\$11	\$2
Stock subscription funds transferred to shareholders' equity	\$-	\$34,633

See notes to unaudited consolidated financial statements.

Table of Contents

Notes to Consolidated Financial Statements (Unaudited)

Note 1 – Organizational Structure and Nature of Operations

Malvern Bancorp, Inc., a Pennsylvania company (the “Company” or “Malvern Bancorp”), is the holding company for the Malvern Federal Savings Bank (“Malvern Federal Savings” or the “Bank”) and owns all of the issued and outstanding shares of the common stock of Malvern Federal Savings Bank. In connection with the “second-step” conversion and reorganization which we completed in October 2012, 3,636,875 shares of common stock, par value \$0.01 per share, of the Malvern Bancorp were sold in a subscription offering to certain depositors of the Bank and other investors for \$10 per share, or \$36.4 million in the aggregate, and 2,921,598 shares of common stock were issued in exchange for the outstanding shares of common stock of the former federally chartered mid-tier holding company, Malvern Federal Bancorp, Inc. (the “Mid-Tier Holding Company”), held by the “public” shareholders of the Mid-Tier Holding Company (all shareholders except Malvern Federal Mutual Holding Company). Each share of common stock of the Mid-Tier Holding Company was converted into the right to receive 1.0748 shares of common stock of the new Malvern Bancorp, Inc. in the conversion and reorganization.

The Bank was originally organized in 1887 and is headquartered in Paoli, Pennsylvania. The Bank operates eight full service financial center offices in Chester and Delaware Counties, Pennsylvania. The Bank is primarily engaged in attracting deposits from the general public through its branch offices and using such deposits primarily to (i) originate various loan types including single-family residential mortgage loans, commercial real estate mortgage loans, construction and development loans, home equity loans and lines of credit and other consumer loans and (ii) invest in securities issued by the U.S. Government and agencies thereof, municipal and corporate debt securities and mortgage-backed securities. The Bank derives its income principally from interest earned on loans, mortgage-backed securities and investments and, to a lesser extent, from fees received in connection with the origination of loans and for other services. The Bank’s primary expenses are interest expense on deposits and borrowings and general operating expenses.

The Bank, as a federally chartered savings association, is subject to federal regulation and oversight by the Office of the Comptroller of the Currency (the “OCC”) extending to all aspects of its operations. The Bank is also subject to regulation and examination by the Federal Deposit Insurance Corporation (“FDIC”), which insures its deposits to the maximum extent permitted by law, and requirements established by the Federal Reserve Board. As a registered savings and loan holding company, the Company is subject to examination and supervision by the Board of Governors of the Federal Reserve System (the “Federal Reserve Board” or the “FRB”).

Note 2 – Summary of Significant Accounting Policies

Basis of Presentation and Consolidation - The consolidated financial statements include the accounts of the Company and its subsidiaries, Malvern Federal Holdings, Inc., a Delaware company, and the Bank and the Bank’s subsidiaries, Strategic Asset Management Group, Inc. (“SAMG”) and Malvern Federal Investments, Inc., a Delaware company. SAMG owns 50% of Malvern Insurance Associates, LLC. Malvern Insurance Associates, LLC offers a full line of business and personal lines of insurance products.

The accompanying unaudited consolidated financial statements were prepared in accordance with the instructions to Form 10-Q, and therefore, do not include all the information or footnotes necessary for a complete presentation of financial condition, operations, changes in shareholders’ equity, and cash flows in conformity with accounting

principles generally accepted in the United States of America (“GAAP”). However, all normal recurring adjustments that, in the opinion of management, are necessary for a fair presentation of the consolidated financial statements have been included. The results for the three months ended December 31, 2013 are not necessarily indicative of the results that may be expected for the fiscal year ending September 30, 2014, or any other period. All significant intercompany transactions and balances have been eliminated. The unaudited consolidated financial statements presented herein should be read in conjunction with the audited consolidated financial statements and related notes thereto included in the Company’s Annual Report on Form 10-K for the year ended September 30, 2013.

Use of Estimates - The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, other real estate owned, the valuation of deferred tax assets, the evaluation of other-than-temporary impairment of investment securities and fair value measurements.

Table of Contents

Notes to Consolidated Financial Statements (Unaudited)

Note 2 – Summary of Significant Accounting Policies (Continued)

Significant Group Concentrations of Credit Risk - Most of the Company's activities are with customers located within Chester and Delaware Counties, Pennsylvania. Note 5 discusses the types of investment securities that the Company invests in. Note 6 discusses the types of lending that the Company engages in. The Company does not have any significant concentrations to any one industry or customer. Although the Company has a diversified portfolio, its debtors ability to honor their contracts is influenced by, among other factors, the region's economy.

Cash and Cash Equivalents - For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from depository institutions and interest bearing deposits.

The Company maintains cash deposits in other depository institutions that occasionally exceed the amount of deposit insurance available. Management periodically assesses the financial condition of these institutions and believes that the risk of any possible credit loss is minimal.

Investment Securities - Debt securities held to maturity are securities that the Company has the positive intent and the ability to hold to maturity; these securities are reported at amortized cost and adjusted for unamortized premiums and discounts. Securities held for trading are securities that are bought and held principally for the purpose of selling in the near term; these securities are reported at fair value, with unrealized gains and losses reported in current earnings. At December 31, 2013 and September 30, 2013, the Company had no investment securities classified as trading or held to maturity. Debt securities that will be held for indefinite periods of time and equity securities, including securities that may be sold in response to changes in market interest or prepayment rates, needs for liquidity and changes in the availability of and the yield of alternative investments, are classified as available for sale. Realized gains and losses are recorded on the trade date and are determined using the specific identification method. Securities held as available for sale are reported at fair value, with unrealized gains and losses, net of tax, reported as a component of accumulated other comprehensive income ("AOCI"). Management determines the appropriate classification of investment securities at the time of purchase.

Securities are evaluated on a quarterly basis, and more frequently when market conditions warrant such an evaluation, to determine whether declines in their value are other-than-temporary. To determine whether a loss in value is other-than-temporary, management utilizes criteria such as the reasons underlying the decline, the magnitude and duration of the decline and whether or not management intends to sell or expects that it is more likely than not that it will be required to sell the security prior to an anticipated recovery of the fair value. The term "other-than-temporary" is not intended to indicate that the decline is permanent, but indicates that the prospects for a near-term recovery of value is not necessarily favorable, or that there is a lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. Once a decline in value for a debt security is determined to be other-than-temporary, the other-than-temporary impairment is separated into (a) the amount of the total other-than-temporary impairment related to a decrease in cash flows expected to be collected from the debt security (the credit loss) and (b) the amount of the total other-than-temporary impairment related to all other factors. The amount of the total other-than-temporary impairment related to the credit loss is recognized in earnings. The amount of the total other-than-temporary impairment related to all other factors is recognized in other comprehensive income.

Loans Receivable - The Company, through the Bank, grants mortgage, construction, commercial and consumer loans to customers. A substantial portion of the loan portfolio is represented by residential and commercial mortgage loans secured by properties located throughout Chester County, Pennsylvania and surrounding areas. The ability of the Company's debtors to honor their contracts is dependent upon, among other factors, the real estate and general economic conditions in this area.

Loans receivable that management has the intent and ability to hold until maturity or payoff are stated at their outstanding unpaid principal balances, net of an allowance for loan losses and any deferred fees and costs. Interest income is accrued on the unpaid principal balance. Loan origination fees and costs are deferred and recognized as an adjustment of the yield (interest income) of the related loans using the interest method. The Company is amortizing these amounts over the contractual lives of the loans.

Table of Contents

Notes to Consolidated Financial Statements (Unaudited)

Note 2 – Summary of Significant Accounting Policies (Continued)

The loans receivable portfolio is segmented into residential loans, construction and development loans, commercial loans and consumer loans. The residential loan segment has one class, one- to four-family first lien residential mortgage loans. The construction and development loan segment consists of the following classes: residential and commercial construction and development loans and land loans. Residential construction loans are made for the acquisition of and/or construction on a lot or lots on which a residential dwelling is to be built. Commercial construction loans are made for the purpose of acquiring, developing and constructing a commercial structure. The commercial loan segment consists of the following classes: commercial real estate loans, multi-family real estate loans, and other commercial loans, which are also generally known as commercial and industrial loans or commercial business loans. The consumer loan segment consists of the following classes: home equity lines of credit, second mortgage loans and other consumer loans, primarily unsecured consumer lines of credit.

For all classes of loans receivable, the accrual of interest is discontinued when the contractual payment of principal or interest has become 90 days past due or management has serious doubts about further collection of principal or interest, even though the loan is currently performing. A loan may remain on accrual status if it is in the process of collection and is either guaranteed or well secured. When a loan is placed on nonaccrual status, unpaid interest credited to income in the current year is reversed and unpaid interest accrued in prior years is charged against the allowance for loan losses. Interest received on nonaccrual loans, including impaired loans, generally is either applied against principal or reported as interest income, according to management's judgment as to the collectability of principal. Generally, loans are restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time (generally six months) and the ultimate collectability of the total contractual principal and interest is no longer in doubt. The past due status of all classes of loans receivable is determined based on contractual due dates for loan payments.

In addition to originating loans, the Company purchases consumer and residential mortgage loans from brokers in our market area. Such purchases are reviewed for compliance with our underwriting criteria before they are purchased, and are generally purchased without recourse to the seller. Premiums and discounts on purchased loans are amortized as adjustments to interest income using the effective yield method.

Loans Held-For-Sale - Loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated fair value on the consolidated balance sheet. Gains and losses on loan sales (sales proceeds minus carrying value) are recorded in noninterest income, and direct loan origination costs and fees are deferred at origination of the loan and are recognized in noninterest income upon sale of the loan. Servicing is retained at the Bank for loans sold in the secondary market and are placed as a mortgage servicing asset on the consolidated balance sheet (see "Loan Servicing" for more detail). There were no loans classified as held for sale as of December 31, 2013. As of September 30, 2013, there were \$10.4 million in loans classified as held for sale. The loans held for sale at September 30, 2013 were sold in a bulk transaction to one purchaser in October 2013, they were not sold in the secondary market for residential mortgage loans.

Allowance for Loan Losses - The allowance for credit losses consists of the allowance for loan losses and the reserve for unfunded lending commitments. The allowance for loan losses represents management's estimate of losses inherent in the loan portfolio as of the consolidated statement of financial condition date and is recorded as a reduction to

loans. Reserves for unfunded lending commitments represents management's estimate of losses inherent in its unfunded loan commitments and is recorded in other liabilities on the consolidated statement of financial condition. The allowance for loan losses ("ALLL") is increased by the provision for loan losses and decreased by charge-offs, net of recoveries. Loans deemed to be uncollectible are charged against the allowance for loan losses, and subsequent recoveries, if any, are credited to the allowance. All, or part, of the principal balance of loans receivable are charged off to the allowance as soon as it is determined that the repayment of all, or part, of the principal balance is highly unlikely. Non-residential consumer loans are generally charged off no later than when they become 120 days past due on a contractual basis or earlier in the event of the borrower's bankruptcy or if there is an amount deemed uncollectible. Because all identified losses are immediately charged off, no portion of the allowance for loan losses is restricted to any individual loan or groups of loans, and the entire allowance is available to absorb any and all loan losses.

The allowance for credit losses is maintained at a level considered adequate to provide for losses that can be reasonably estimated. Management performs a quarterly evaluation of the adequacy of the allowance. The allowance is based on the Company's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, the composition of the loan portfolio, current economic conditions and other relevant factors. This evaluation is inherently subjective as it requires material estimates that may be susceptible to significant revision as more information becomes available.

Table of Contents

Notes to Consolidated Financial Statements (Unaudited)

Note 2 – Summary of Significant Accounting Policies (Continued)

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as impaired. For loans that are classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers pools of loans by loan class that are not considered impaired. These pools of loans are evaluated for loss exposure based upon historical loss rates for each of these classes of loans, as adjusted for qualitative factors. These qualitative risk factors include:

1. Lending policies and procedures, including underwriting standards and collection, charge-off, and recovery practices.
2. National, regional, and local economic and business conditions as well as the condition of various market segments, including the value of underlying collateral for collateral dependent loans.
3. The nature and volume of the loan portfolio and terms of loans.
4. The experience, ability, and depth of lending management and staff.
5. The volume and severity of past due, classified and nonaccrual loans as well as and other loan modifications.
6. The quality of the Company's loan review system, and the degree of oversight by the Company's Board of Directors.
7. The existence and effect of any concentrations of credit and changes in the level of such concentrations.
8. The value of underlying collateral.

The qualitative factors are applied to the historical loss rates for each class of loan. In addition, while not reported as a separate factor, changes in the value of underlying collateral (for regional property values) for collateral dependent loans is considered and addressed within the economic trends factor. A quarterly calculation is made adjusting the reserve allocation for each factor within a risk weighted range as it relates to each particular loan type, collateral type and risk rating within each segment. Data is gathered and evaluated through internal, regulatory, and government sources quarterly for each factor.

An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

In addition, the allowance calculation methodology includes further segregation of loan classes into risk rating categories. The borrower's overall financial condition, repayment sources, guarantors and value of collateral, if appropriate, are evaluated annually for commercial loans or when credit deficiencies arise, such as delinquent loan payments, for commercial and consumer loans. Credit quality risk ratings include categories of "pass," "special mention," "substandard" and "doubtful." Assets classified as "Pass" are those protected by the current net worth and paying capacity of the obligor or by the value of the underlying collateral. Assets which do not currently expose the insured institution to sufficient risk to warrant classification as substandard or doubtful but possess certain identified weaknesses are required to be designated "special mention." If uncorrected, the potential weaknesses may result in deterioration of the repayment prospects. An asset is considered "substandard" if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. "Substandard" assets include those characterized by the "distinct possibility" that the insured institution will sustain "some loss" if the deficiencies are not corrected. Assets

classified as “doubtful” have all of the weaknesses inherent in those classified “substandard” with the added characteristic that the weaknesses present make “collection or liquidation in full,” on the basis of currently existing facts, conditions, and values, “highly questionable and improbable.”

Residential Lending. Residential mortgage originations are secured primarily by properties located in the Company’s primary market area and surrounding areas. We currently originate fixed-rate, fully amortizing mortgage loans with maturities of 15 to 30 years. We also offer adjustable rate mortgage (“ARM”) loans where the interest rate either adjusts on an annual basis or is fixed for the initial one, three, five or seven years and then adjusts annually.

We underwrite one- to four-family residential mortgage loans with loan-to-value ratios of up to 95%, provided that the borrower obtains private mortgage insurance on loans that exceed 80% of the appraised value or sales price, whichever is less, of the secured property. We also require that title insurance, hazard insurance and, if appropriate, flood insurance be maintained on all properties securing real estate loans. We require that a licensed appraiser from our list of approved appraisers perform and submit to us an appraisal on all properties secured by a first mortgage on one- to four-family first mortgage loans.

Table of Contents

Notes to Consolidated Financial Statements (Unaudited)

Note 2 – Summary of Significant Accounting Policies (Continued)

In underwriting one- to four-family residential mortgage loans, the Company evaluates both the borrower's ability to make monthly payments and the value of the property securing the loan. Most properties securing real estate loans made by the Company are appraised by independent fee appraisers approved by the Bank's Board of Directors. The Company generally requires borrowers to obtain an attorney's title opinion or title insurance, and fire and property insurance (including flood insurance, if necessary) in an amount not less than the amount of the loan. Real estate loans originated by the Company generally contain a "due on sale" clause allowing the Company to declare the unpaid principal balance due and payable upon the sale of the security property. The Company has not engaged in sub-prime residential mortgage loan originations. Our single-family residential mortgage loans generally are underwritten on terms and documentation conforming to guidelines issued by Freddie Mac and Fannie Mae.

Construction and Development Loans. We originate construction loans for residential and, to a lesser extent, commercial uses within our market area. We generally limit construction loans to builders and developers with whom we have an established relationship, or who are otherwise known to officers of the Bank. Our construction and development loans currently in the portfolio typically have variable rates of interest tied to the prime rate which improves the interest rate sensitivity of our loan portfolio.

Construction and development loans generally are considered to involve a higher level of risk than one-to four-family residential lending, due to the concentration of principal in a limited number of loans and borrowers and the effect of economic conditions on developers, builders and projects. Additional risk is also associated with construction lending because of the inherent difficulty in estimating both a property's value at completion and the estimated cost (including interest) to complete a project. The nature of these loans is such that they are more difficult to evaluate and monitor. In addition, speculative construction loans to a builder are not pre-sold and thus pose a greater potential risk than construction loans to individuals on their personal residences. In order to mitigate some of the risks inherent to construction lending, we inspect properties under construction, review construction progress prior to advancing funds, work with builders with whom we have established relationships, require annual updating of tax returns and other financial data of developers and obtain personal guarantees from the principals.

Commercial Lending. Commercial and multi-family real estate loans generally present a higher level of risk than loans secured by one- to four-family residences. This greater risk is due to several factors, including the concentration of principal in a limited number of loans and borrowers, the effect of general economic conditions on income producing properties and the increased difficulty of evaluating and monitoring these types of loans. Furthermore, the repayment of loans secured by commercial and multi-family real estate is typically dependent upon the successful operation of the related real estate project. If the cash flow from the project is reduced (for example, if leases are not obtained or renewed, or a bankruptcy court modifies a lease term, or a major tenant is unable to fulfill its lease obligations), the borrower's ability to repay the loan may be impaired.

Most of the Company's commercial business loans have been extended to finance local and regional businesses and include short-term loans to finance machinery and equipment purchases, inventory and accounts receivable. The commercial business loans which we originated may be either a revolving line of credit or for a fixed term of generally 10 years or less. Interest rates are adjustable, indexed to a published prime rate of interest, or fixed. Generally, equipment, machinery, real property or other corporate assets secure such loans. Personal guarantees from

the business principals are generally obtained as additional collateral.

Consumer Lending. The Company currently originates most of its consumer loans in its primary market area and surrounding areas. The Company originates consumer loans on both a direct and indirect basis. Consumer loans generally have higher interest rates and shorter terms than residential mortgage loans; however, they have additional credit risk due to the type of collateral securing the loan or in some case the absence of collateral. As a result of the declines in the market value of real estate and the deterioration in the overall economy, we are continuing to evaluate and monitor the credit conditions of our consumer loan borrowers and the real estate values of the properties securing our second mortgage loans as part of our on-going efforts to assess the overall credit quality of the portfolio in connection with our review of the allowance for loan losses.

Consumer loans may entail greater credit risk than do residential mortgage loans, particularly in the case of consumer loans which are unsecured or are secured by rapidly depreciable assets, such as automobiles or recreational equipment. In such cases, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment of the outstanding loan balance as a result of the greater likelihood of damage, loss or depreciation. In addition, consumer loan collections are dependent on the borrower's continuing financial stability, and thus are more likely to be affected by adverse personal circumstances. Furthermore, the application of various federal and state laws, including bankruptcy and insolvency laws, may limit the amount which can be recovered on such loans.

Table of Contents

Notes to Consolidated Financial Statements (Unaudited)

Note 2 – Summary of Significant Accounting Policies (Continued)

Once all factor adjustments are applied, general reserve allocations for each segment are calculated, summarized and reported on the ALLL summary. ALLL final schedules, calculations and the resulting evaluation process are reviewed quarterly by the Bank's Asset Classification Committee and the Bank's Board of Directors.

In addition, Federal bank regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses and may require the Company to recognize additions to the allowance based on their judgments about information available to them at the time of their examination. Based on management's comprehensive analysis of the loan portfolio, management believes the current level of the allowance for loan losses is adequate.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed.

An allowance for loan losses is established for an impaired loan if its carrying value exceeds its estimated fair value. The estimated fair values of substantially all of the Company's impaired loans are measured based on the estimated fair value of the loan's collateral.

For commercial loans secured by real estate, estimated fair values are determined primarily through third-party appraisals. When a real estate secured loan becomes impaired, a decision is made regarding whether an updated appraisal of the real estate is necessary. This decision is based on various considerations, including the age of the most recent appraisal, the loan-to-value ratio based on the original appraisal and the condition of the property. Appraised values are discounted to arrive at the estimated selling price of the collateral, which is considered to be the estimated fair value. The discounts also include estimated costs to sell the property.

For commercial and industrial loans secured by non-real estate collateral, such as accounts receivable, inventory and equipment, estimated fair values are determined based on the borrower's financial statements, inventory reports, accounts receivable aging or equipment appraisals or invoices. Indications of value from these sources are generally discounted based on the age of the financial information or the quality of the assets.

Troubled Debt Restructurings - Loans whose terms are modified are classified as troubled debt restructurings if the Company grants such borrowers concessions and it is deemed that those borrowers are experiencing financial difficulty. Concessions granted under a troubled debt restructuring may be modified by means of extending the maturity date of the loan, reducing the interest rate on the loan to a rate which is below market, a combination of rate adjustments and maturity extensions, or by other means including covenant modifications, forbearances or other concessions. However, the Company generally only restructures loans by modifying the payment structure to interest

only or by reducing the actual interest rate.

We do not accrue interest on loans that were non-accrual prior to the troubled debt restructuring until they have performed in accordance with their restructured terms for a period of at least six months. We continue to accrue interest on troubled debt restructurings which were performing in accordance with their terms prior to the restructure and continue to perform in accordance with their restructured terms. Management evaluates the ALLL with respect to TDRs under the same policy and guidelines as all other performing loans are evaluated with respect to the ALLL.

Loan Servicing - Servicing assets are recognized as separate assets when rights are acquired through purchase or through sale of financial assets. For sales of mortgage loans, a portion of the cost of originating the loan is allocated to the servicing right based on relative fair value. Fair value is based on market prices for comparable mortgage servicing contracts, when available, or alternatively is based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, the custodial earnings rate, an inflation rate, ancillary income, prepayment speeds and default rates and losses. Capitalized servicing rights are reported in other assets and are amortized into non-interest expense in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets.

Table of Contents

Notes to Consolidated Financial Statements (Unaudited)

Note 2 – Summary of Significant Accounting Policies (Continued)

Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to amortized cost. Impairment is determined by stratifying rights into tranches based on predominant risk characteristics, such as interest rate, loan type and investor type. Impairment is recognized through a valuation allowance for an individual tranche, to the extent that fair value is less than the capitalized amount for the tranche. If the Company later determines that all or a portion of the impairment no longer exists for a particular tranche, a reduction of the allowance may be recorded as an increase to income.

Other Real Estate Owned - Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of the previously established carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in other expenses from other real estate owned.

Restricted Stock - Restricted stock represents required investments in the common stock of a correspondent bank and is carried at cost. As of December 31, 2013 and September 30, 2013, restricted stock consisted solely of the common stock of the Federal Home Loan Bank of Pittsburgh (“FHLB”).

Management’s evaluation and determination of whether these investments are impaired is based on their assessment of the ultimate recoverability of their cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of an investment’s cost is influenced by criteria such as (1) the significance of the decline in net assets of the FHLB as compared to the capital stock amount for the FHLB and the length of time this situation has persisted, (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB, and (3) the impact of legislative and regulatory changes on institutions and, accordingly, on the customer base of the FHLB.

Property and Equipment - Property and equipment are carried at cost. Depreciation is computed using the straight-line and accelerated methods over estimated useful lives ranging from 3 to 39 years beginning when assets are placed in service. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts and any gain or loss is reflected in income for the period. The cost of maintenance and repairs is charged to income as incurred.

Transfers of Financial Assets - Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Bank-Owned Life Insurance - The Company invests in bank owned life insurance (“BOLI”) as a source of funding for employee benefit expenses. BOLI involves the purchasing of life insurance by the Bank on a chosen group of employees. The Bank is the owner and beneficiary of the policies. This life insurance investment is carried at the cash surrender value of the underlying policies. Earnings from the increase in cash surrender value of the policies are

included in other income on the statement of operations.

Advertising Costs - The Company follows the policy of charging the costs of advertising to expense as incurred.

Income Taxes - Deferred tax assets and liabilities are recognized for the future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. These calculations are based on many complex factors including estimates of the timing of reversals of temporary differences, the interpretation of federal income tax laws and a determination of the differences between the tax and the financial reporting basis of assets and liabilities. Actual results could differ significantly from the estimates and interpretations used in determining the current and deferred income tax assets and liabilities.

Table of Contents

Notes to Consolidated Financial Statements (Unaudited)

Note 2 – Summary of Significant Accounting Policies (Continued)

A valuation allowance is required to be recognized if it is “more likely than not” that a portion of the deferred tax assets will not be realized. The Company’s policy is to evaluate the deferred tax asset on a quarterly basis and record a valuation allowance for our deferred tax asset if we do not have sufficient positive evidence indicating that it is more likely than not that some or all of the deferred tax asset will be realized. The Company’s policy is to account for interest and penalties as components of income tax expense.

Commitments and Contingencies - In the ordinary course of business, the Company has entered into off-balance sheet financial instruments consisting of commitments to extend credit and standby letters of credit. Such financial instruments are recorded in the statement of financial condition when they are funded.

Segment Information - The Company has one reportable segment, “Community Banking.” All of the Company’s activities are interrelated, and each activity is dependent and assessed based on how each of the activities of the Company supports the others. For example, lending is dependent upon the ability of the Company to fund itself with deposits and other borrowings and manage interest rate and credit risk. Accordingly, all significant operating decisions are based upon analysis of the Company as one segment or unit.

Comprehensive Income - Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available for sale investment securities, are reported as a separate component of the shareholders’ equity section of the statement of financial condition, such items, along with net income, are components of comprehensive income.

Recent Accounting Pronouncements - In January 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2014-04, “Receivables - Troubled Debt Restructurings by Creditors (Subtopic 310-40) - Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure.” The amendments are intended to clarify when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan should be derecognized and the real estate recognized. These amendments clarify that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either: (a) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure; or (b) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additional disclosures are required. The amendments are effective for annual periods and interim periods within those annual periods beginning after December 15, 2014. We have not determined the effect that the adoption of this ASU will have on our financial position or results of operations.

Table of Contents

Notes to Consolidated Financial Statements (Unaudited)

Note 3 – Earnings Per Share

Basic earnings per common share is computed based on the weighted average number of shares outstanding reduced by unearned ESOP shares. Diluted earnings per share is computed based on the weighted average number of shares outstanding and common stock equivalents (“CSEs”) that would arise from the exercise of dilutive securities reduced by unearned ESOP shares. As of December 31, 2013 and for the three months ended December 31, 2013 and 2012 the Company had not issued and did not have any outstanding CSEs and, at the present time, the Company’s capital structure has no potential dilutive securities.

The following table sets forth the composition of the weighted average shares (denominator) used in the earnings per share computations.

	Three Months Ended December 31,	
	2013	2012
	(Dollars in thousands, except per share data)	
Net Income	\$ 64	\$ 671
Weighted average shares outstanding	6,558,473	6,503,954
Average unearned ESOP shares	(184,941)	(197,215)
Weighted average shares outstanding – basic	6,373,532	6,306,739
Earnings per share – basic	\$ 0.01	\$ 0.11

Note 4 – Employee Stock Ownership Plan

The Company established an employee stock ownership plan (“ESOP”) for substantially all of its full-time employees. Certain senior officers of the Bank have been designated as Trustees of the ESOP. Shares of the Company’s common stock purchased by the ESOP are held until released for allocation to participants. Shares released are allocated to each eligible participant based on the ratio of each such participant’s base compensation to the total base compensation of all eligible plan participants. As the unearned shares are committed to be released and allocated among participants, the Company recognizes compensation expense equal to the fair value of the ESOP shares during the periods in which they become committed to be released. To the extent that the fair value of the ESOP shares released differs from the cost of such shares, the difference is charged or credited to additional paid-in capital. During the period from May 20, 2008 to September 30, 2008, the ESOP purchased 241,178 shares of the common stock for approximately \$2.6 million, an average price of \$10.86 per share, which was funded by a loan from Malvern Federal Bancorp, Inc. The ESOP loan is being repaid principally from the Bank’s contributions to the ESOP. The loan, which bears an interest rate of 5%, is being repaid in quarterly installments through 2026. Shares are released to participants proportionately as the loan is repaid. During the three months ended December 31, 2013 and 2012, there were 3,600 and 3,351 shares, respectively, committed to be released. At December 31, 2013, there were 183,165 unallocated shares and 76,053 allocated shares held by the ESOP which had an aggregate fair value of approximately \$2.0 million.

Table of Contents

Notes to Consolidated Financial Statements (Unaudited)

Note 5 - Investment Securities

At December 31, 2013 and September 30, 2013, the Company's mortgage-backed securities consisted solely of securities backed by residential mortgage loans. The Company held no mortgage-backed securities backed by commercial mortgage loans at either date.

Investment securities available for sale at December 31, 2013 and September 30, 2013 consisted of the following:

	Amortized Cost	December 31, 2013		Fair Value
		Gross Unrealized Gains	Gross Unrealized Losses	
		(In thousands)		
U.S. government agencies	\$20,565	\$2	\$(918)) \$19,649
State and municipal obligations	11,568	3	(558)) 11,013
Single issuer trust preferred security	1,000	-	(185)) 815
Corporate debt securities	1,755	23	(3)) 1,775
	34,888	28	(1,664)) 33,252
Mortgage-backed securities:				
FNMA:				
Adjustable-rate	1,934	49	(2))