

UGI CORP /PA/  
Form 424B5  
March 19, 2004  
Table of Contents

Filed Pursuant to Rule 424(b)(5)

File Number 333-112132

PROSPECTUS SUPPLEMENT TO PROSPECTUS DATED MARCH 15, 2004

## 7,500,000 Shares

### Common Stock

---

We are selling 7,500,000 shares of our common stock.

Our common stock is listed on the New York Stock Exchange and the Philadelphia Stock Exchange under the symbol UGI. The last reported sale price of our common stock on the New York Stock Exchange on March 18, 2004 was \$32.10 per share.

The underwriters have an option to purchase a maximum of 1,125,000 additional shares to cover over-allotments of shares.

Investing in our common stock involves risk. See Risk Factors beginning on page S-9 of this prospectus supplement.

	Price to Public	Underwriting Discounts and Commissions	Proceeds to UGI Corporation
Per Share	\$ 32.10	\$ 1.4044	\$ 30.6956
Total	\$ 240,750,000	\$ 10,533,000	\$ 230,217,000

Delivery of the shares of common stock will be made on or about March 23, 2004.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus supplement is truthful or complete. Any representation to the contrary is a criminal offense.

**Credit Suisse First Boston**

**Citigroup**

**Wachovia Securities**

**Janney Montgomery Scott LLC**

The date of this Prospectus Supplement is March 18, 2004.

**Table of Contents****TABLE OF CONTENTS**

	<u>Page</u>
<u>PROSPECTUS SUMMARY</u>	S-1
<u>WHO WE ARE</u>	S-1
<u>RISK FACTORS</u>	S-9
<u>SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS</u>	S-15
<u>USE OF PROCEEDS</u>	S-16
<u>DIVIDEND POLICY</u>	S-16
<u>PRICE RANGE OF OUR COMMON STOCK</u>	S-17
<u>CAPITALIZATION</u>	S-18
	<u>Page</u>
<u>CERTAIN UNITED STATES FEDERAL TAX CONSEQUENCES TO NON-U.S. HOLDERS</u>	S-19
<u>UNDERWRITING</u>	S-21
<u>WHERE YOU CAN FIND MORE INFORMATION</u>	S-23
<u>INCORPORATION OF CERTAIN DOCUMENTS BY REFERENCE</u>	S-23
<u>LEGAL MATTERS</u>	S-23
<u>EXPERTS</u>	S-24
<u>INDEX TO FINANCIAL STATEMENTS</u>	S-25

You should rely only on the information contained in, or incorporated by reference into, this document or to which we have referred you. We have not authorized anyone to provide you with information that is different. This document may only be used where it is legal to sell these securities. The information in this document may only be accurate on the date of this document.

**Table of Contents**

**PROSPECTUS SUMMARY**

*You should read the following summary together with the more detailed information regarding our company, our common stock, the financial statements and notes to those statements incorporated herein by reference from our other filings with the Securities and Exchange Commission (the SEC) and the AGZ Holding financial statements and notes to those statements included herein. We urge you to read the entire prospectus supplement carefully, especially the risks of investing in our common stock, which are discussed under Risk Factors, before making an investment decision. All references to we, our or us in this prospectus supplement refer to UGI Corporation and, where appropriate, its consolidated subsidiaries, unless the context otherwise requires.*

**Who We Are**

UGI Corporation is a distributor and marketer of energy products and services serving nearly 2 million customers principally in North America and Europe through subsidiaries and joint venture affiliates, including:

AmeriGas Partners, L.P. ( AmeriGas Partners ) the largest retail propane marketer in the United States based on retail volume, distributing more than one billion retail gallons in its fiscal year ended September 30, 2003. As of September 30, 2003, AmeriGas Partners served approximately 1.3 million customers from approximately 650 locations in 46 states. On October 1, 2003, AmeriGas Partners acquired the assets of Horizon Propane LLC. Giving effect to the Horizon Propane acquisition, AmeriGas Partners has over 700 locations. The common units of AmeriGas Partners, representing limited partnership interests in the limited partnership, trade on the New York Stock Exchange under the symbol APU. We have an effective 48% ownership interest in AmeriGas Partners. The remaining interest is publicly held.

UGI Utilities, Inc. ( UGI Utilities ) a regulated gas and electric distribution utility serving over 300,000 customers in eastern Pennsylvania as of September 30, 2003. UGI Utilities is regulated by the Pennsylvania Public Utility Commission.

UGI Enterprises, Inc. ( UGI Enterprises ) a company that conducts domestic and international energy related-businesses through subsidiaries and joint ventures. UGI Enterprises principal operating business is UGI Energy Services, Inc. ( ESI ), which markets natural gas, oil and electricity in the eastern region of the United States under the trade name GASMARK® and served approximately 5,000 customers as of September 30, 2003. ESI also owns and operates liquefied natural gas and propane plants which are used to meet peak energy needs. UGI Development Company, a subsidiary of ESI, owns interests in and operates Pennsylvania-based electric generation assets. UGI HVAC Enterprises, Inc. operates a heating and cooling installation and service business in the Mid-Atlantic region.

UGI Enterprises conducts its international liquefied petroleum gases ( LPG ) distribution business through wholly-owned subsidiaries and joint ventures. It owns FLAGA GmbH, the largest retail LPG distributor in Austria and one of the largest suppliers in the Czech Republic and Slovakia, distributing approximately 33 million gallons of LPG during the fiscal year ended September 30, 2003. UGI Enterprises also participates in a propane distribution joint venture in China. As discussed more fully below, UGI Enterprises currently holds, through UGI France, Inc., an approximate 19.5% interest in AGZ Holding, a French corporation (*société anonyme*) and the parent holding company of Antargaz, one of the largest distributors of LPG in France. We expect to acquire the remaining approximate 80.5% interest in AGZ Holding in the transaction that is intended to be funded, in part, through this offering.

**Table of Contents**

The following chart depicts the current ownership structure of our principal subsidiaries:

S-2

**Table of Contents**

**Our Competitive Strengths**

We believe that our competitive strengths include the following:

Operational and managerial expertise in the U.S. and international propane markets and a proven ability to maintain propane margins in warm weather periods.

An experienced management team with a successful track record of growing the regulated gas utility operations within its service territory.

A disciplined pursuit of acquisition opportunities focused in the propane and retail energy market sectors.

A demonstrated ability to integrate acquisitions and achieve operating efficiencies.

**Our Business Strategy**

In the late 1990s, we undertook an evaluation of our businesses and their prospects. Following that evaluation, we decided to focus on being a distributor and marketer of energy products and services both nationally and internationally.

In pursuing our energy distribution and marketing strategy, we seek to leverage our asset base, our geographic reach and our intellectual capital. We employ our core competencies from our existing businesses, and use our national scope, international experience, extensive asset base, access to customers and operating expertise to accelerate growth in related and complementary businesses, both domestic and international. During fiscal year 2003, we completed a number of transactions in pursuit of this strategy.

We have identified the international LPG distribution business as one area for potential growth. This area is of particular interest to us because (1) through it, we can leverage our substantial intellectual capital and operating expertise in propane distribution, (2) international LPG markets include both mature markets, which meet our need for income, and developing markets, which are consistent with our desire for growth, and (3) we believe this strategy provides greater potential to achieve economies of scale over time.

Our wholly-owned subsidiary, UGI Enterprises, Inc., currently participates in the international LPG distribution business in Austria, the Czech Republic and Slovakia, and through joint ventures in France (through its holdings in AGZ Holding) and China. Our management philosophy in the international LPG distribution business consists of three elements:

Ensure that each business has strong in country expertise to ensure proper regard is given to local cultural and market differences. This in country expertise is gained through a strong local management team, board or partner.

## Edgar Filing: UGI CORP /PA/ - Form 424B5

Transfer the best practices of our U.S. propane distribution business to our international LPG distribution businesses.

Transfer the best practices of our international LPG distribution businesses to our U.S. propane distribution business.

We believe that our intended acquisition of the remaining interests in AGZ Holding is consistent with our focus on the international LPG distribution business and our commitment to remain a superior, balanced growth and income investment for our shareholders.

S-3

**Table of Contents**

**Planned Acquisition of Antargaz**

We hold, through our indirect, wholly-owned subsidiary, UGI France, Inc., approximately 19.5% of the issued and outstanding shares of the capital stock of AGZ Holding. AGZ Holding owns 99.99% of Antargaz, a French corporation (*société anonyme*), which, through its wholly- and partially-owned subsidiaries, is engaged in the business of marketing, selling and distributing LPG in mainland France and the French island of Corsica. We expect to acquire the ownership interests in AGZ Holding that we do not already own as of April 1, 2004.

Antargaz is one of the four leading distributors of LPG in France. During its fiscal year ended March 31, 2003, Antargaz sold approximately 350 million gallons of LPG and had an approximate 24% market share in France. The French LPG market is mature, with limited future growth expected. Antargaz serves over 220,000 customers using a logistical system that includes five primary storage facilities and 26 secondary storage facilities. Antargaz's customer base consists of residential, commercial, agricultural and motor fuel accounts that use LPG for space heating, cooking, water heating, process heat and transportation. As of September 30, 2003, Antargaz had approximately 1,350 employees.

We expect to realize a number of significant economic and strategic benefits as a result of our planned acquisition of Antargaz. We anticipate that the planned transaction will:

Contribute to our earnings growth strategy;

Provide significant financial resources to grow our earnings per share;

Provide a larger platform for growth in Europe;

Provide an experienced management team in Europe; and

Enhance the opportunities for a sharing of best practices.

On February 17, 2004 and February 20, 2004, we executed a share purchase agreement and a joinder agreement, respectively, to effect the acquisition of the ownership interests in AGZ Holding that we do not already own by purchasing, through UGI France, Inc., or another of our wholly-owned subsidiaries, (1) approximately 78.3% of the issued and outstanding capital stock of AGZ Holding, approximately 68.5% of which is currently owned by privately-held, French-based investment funds that are managed by PAI partners, a French corporation (*société par actions simplifiée*) ( PAI ), and approximately 9.8% of which is currently owned by Medit Mediterranea GPL S.r.L., a company organized under the laws of Italy ( Medit ), and (2) approximately 99.99% of the shares of the issued and outstanding capital stock of Financière AGZ, a French corporation (*société par actions simplifiée*) which owns approximately 2.2% of the issued and outstanding capital stock of AGZ Holding. Financière AGZ has nominal assets and conducts no business operations; its shareholders are currently comprised of AGZ Holding, PAI, Medit, UGI France and certain individuals, including officers and managers of AGZ Holding, Antargaz, Antargaz subsidiaries or their affiliates.

In the anticipated transaction, we have agreed to pay approximately 258.5 million (\$320.2 million based on an exchange rate of \$1.2387 per euro on March 18, 2004), based upon estimates of working capital and pre- and post-closing adjustments, for the ownership interests in AGZ Holding that we do not already own. We expect to fund the purchase price with approximately \$100 million of existing cash balances and the proceeds of this offering.



UGI Corporation has made an offer to acquire, upon completion of the transaction, the outstanding 10% Senior Notes due 2011 of AGZ Finance (the AGZ Notes ), a wholly-owned subsidiary of AGZ Holding, at the purchase price of 101% of the principal amount of the notes tendered plus accrued and unpaid interest thereon and specified additional amounts, if any, as provided for in the trust deed governing the AGZ Notes. Although, at this time, we do not expect significant amounts of AGZ Notes to be tendered in such offer, we have executed agreements with certain affiliates of Credit Suisse First Boston to enable us to finance the purchase of any AGZ Notes tendered pursuant to such offer.

S-4

## **Table of Contents**

Under AGZ Holding's senior facilities agreement, dated June 26, 2003, as amended, with Credit Lyonnais as mandated lead arranger, facility agent and security agent, our acquisition of Antargaz will constitute a change of control and result in an acceleration of all amounts borrowed and outstanding under such agreement, unless our subsidiary, UGI France, Inc., or any of its affiliates obtains, within six months of the consummation of the acquisition, a corporate rating from Standard & Poor's Ratings Group of at least BBB. AGZ Holding will not be able to make any restricted payments under the senior facilities agreement during such six-month period prior to obtaining such rating. As of December 31, 2003, there were term loans of \$211,000,000 outstanding under AGZ Holding's senior facilities agreement. We expect to seek an amendment of the senior facilities agreement to provide that our acquisition of AGZ Holding does not constitute a change of control under the agreement.

## **Additional Information**

We were incorporated in Pennsylvania in 1991. UGI Corporation is not subject to regulation by the Pennsylvania Public Utility Commission. We are also exempt from registration as a holding company and not otherwise subject to the Public Utility Holding Company Act of 1935, except for Section 9(a)(2), which regulates the acquisition of voting securities of an electric or gas utility company.

Our executive offices are located at 460 North Gulph Road, King of Prussia, Pennsylvania 19406, and our telephone number is (610) 337-1000. Our website is <http://www.ugicorp.com>. The information on our website is not incorporated into, and does not constitute a part of, this prospectus supplement.

## **Recent Events**

On January 27, 2004, we announced our intention to increase the annual dividend rate on our common stock to \$1.25 per share from \$1.14 per share effective with the regularly scheduled July dividend payment, assuming the completion of the anticipated acquisition of the shares in AGZ Holding that we do not already own.

**Table of Contents**

**The Offering**

*Unless otherwise indicated, all of the information in this prospectus supplement assumes no exercise of any underwriters' over-allotment option to purchase additional shares of common stock from us.*

Common stock offered by us	7,500,000 shares
Common stock to be outstanding after the offering	50,278,798 shares
Use of proceeds	To pay the purchase price for the ownership interests that we do not already own in AGZ Holding, the parent holding company of Antargaz. To the extent any proceeds remain after paying such purchase price or we do not complete such transaction, we will use the proceeds for general corporate purposes.
New York Stock Exchange Symbol	UGI
Philadelphia Stock Exchange Symbol	UGI

The number of shares of common stock to be outstanding after this offering is based on 42,778,798 shares outstanding as of December 31, 2003, and excludes:

2,950,288 shares of common stock underlying options as of March 1, 2004, at an average option exercise price of \$21.877 per share;

a maximum of 507,854 shares of common stock that may be issued pursuant to grants of phantom units as of March 1, 2004; and

2,712,096 shares available for future grants under all equity compensation plans as of March 1, 2004.

**Table of Contents****Summary Financial Data**

The following data (except pro forma data), insofar as they relate to each of the years in the three-year period ended September 30, 2003, have been derived from our audited annual financial statements, including the consolidated balance sheets at September 30, 2002 and 2003 and the related consolidated statements of operations and cash flows for the three years ended September 30, 2003 and the notes thereto, incorporated herein by reference. The unaudited pro forma income statement data give effect to the acquisition of the ownership interests in AGZ Holding that we do not already own as if the acquisition had been consummated on October 1, 2002. The unaudited pro forma balance sheet data give effect to the acquisition as if it had been consummated on December 31, 2003. The selected unaudited pro forma financial data are not necessarily indicative of operating results or financial position that would have been achieved had the acquisition of the ownership interests in AGZ Holding that we do not already own been consummated and should not be construed as representative of future operating results or financial position. The following data should be read in conjunction with our historical financial statements, and the related notes thereto, which are incorporated herein by reference, the Unaudited Pro Forma Condensed Combined Financial Statements beginning on page P-1, and the historical financial statements and the related notes of AGZ Holding beginning on page F-1.

	Year Ended September 30,				Three Months Ended December 31,		
	2003				2003		
	2001(a)	2002	2003	Pro Forma (b) (c)	2002	2003	Pro Forma(b)
(Millions of dollars, except per share amounts)							
<b>Income Statement Data:</b>							
Revenues	\$ 2,468.1	\$ 2,213.7	\$ 3,026.1	\$ 3,725.0	\$ 739.9	\$ 893.7	\$ 1,108.0
Income before accounting changes	\$ 52.0	\$ 75.5	\$ 98.9		\$ 36.7	\$ 38.8	
Cumulative effect of accounting changes (d)	4.5						
Net income (e)	\$ 56.5	\$ 75.5	\$ 98.9	\$ 119.4	\$ 36.7	\$ 38.8	\$ 57.5
<b>Earnings per common share - basic (c) (f)</b>							
Income before accounting changes	\$ 1.28	\$ 1.83	\$ 2.34		\$ 0.88	\$ 0.91	
Cumulative effect of accounting changes, net (d)	0.11						
Net income - basic	\$ 1.39	\$ 1.83	\$ 2.34	\$ 2.40	\$ 0.88	\$ 0.91	\$ 1.14
<b>Earnings per common share - diluted (c) (f)</b>							
Income before accounting changes	\$ 1.27	\$ 1.80	\$ 2.29		\$ 0.86	\$ 0.88	
Cumulative effect of accounting changes, net (d)	0.11						
Net income - diluted (e)	\$ 1.38	\$ 1.80	\$ 2.29	\$ 2.35	\$ 0.86	\$ 0.88	\$ 1.12
Cash dividends declared per common share	\$ 1.05	\$ 1.083	\$ 1.13	\$ 1.13	\$ 0.275	\$ 0.285	\$ 0.285

**Table of Contents**

	As of September 30,			As of December 31,		
	2001(a)	2002	2003	2002	2003	2003 Pro Forma (b)
(Millions of dollars)						
<b>Balance Sheet Data:</b>						
Total assets	\$ 2,550.2	\$ 2,610.9	\$ 2,781.3	\$ 2,870.6	\$ 3,027.0	\$ 4,432.7
<b>Capitalization:</b>						
<b>Debt:</b>						
Bank loans - AmeriGas Propane	\$ 10.0	\$ 10.0	\$ 37.0	\$ 36.0	\$ 36.0	\$ 36.0
Bank loans - UGI Utilities	57.8	37.2	40.7	78.3	72.2	72.2
Bank loans - other	10.0	8.6	15.9	11.2	18.1	18.1
<b>Long-term debt (including current maturities):</b>						
AmeriGas Propane	1,005.9	945.8	927.3	1,035.7	926.0	926.0
UGI Utilities	208.4	248.4	217.3	222.3	217.2	217.2
AGZ Holding (g)						510.6
Other	80.9	81.5	78.9	85.3	83.7	83.7
<b>Total debt</b>	<b>\$ 1,363.0</b>	<b>\$ 1,331.5</b>	<b>\$ 1,280.1</b>	<b>\$ 1,469.8</b>	<b>\$ 1,353.2</b>	<b>\$ 1,863.8</b>
Minority interests	246.2	276.0	134.6	122.9	149.8	164.9
UGI Utilities preferred shares subject to mandatory redemption	20.0	20.0	20.0	20.0	20.0	20.0
Common stockholders equity	255.6	313.8	569.4	503.3	608.6	838.8
<b>Total capitalization</b>	<b>\$ 1,884.8</b>	<b>\$ 1,941.3</b>	<b>\$ 2,004.1</b>	<b>\$ 2,116.0</b>	<b>\$ 2,131.6</b>	<b>\$ 2,887.5</b>
<b>Ratio of Capitalization:</b>						
Total debt	72.3%	68.6%	63.9%	69.5%	63.5%	64.5%
Minority interests	13.1%	14.2%	6.7%	5.8%	7.0%	5.7%
UGI Utilities preferred shares subject to mandatory redemption	1.1%	1.0%	1.0%	0.9%	0.9%	0.7%
Common stockholders equity	13.5%	16.2%	28.4%	23.8%	28.6%	29.1%

- (a) Arthur Andersen LLP audited our consolidated financial statements for 2001. You should refer to the final risk factor under Risk Factors Risks Related to our Common Stock on page S-14 of this prospectus supplement.
- (b) The pro forma income statement data assume that our acquisition of the ownership interests in AGZ Holding that we do not already own was completed on October 1, 2002 and are based on the average currency exchange rate of \$1.19 per euro and \$1.08 per euro for the three months ended December 31, 2003 and the fiscal year ended September 30, 2003, respectively. The pro forma balance sheet data assume that the acquisition was completed on December 31, 2003 and are based on a currency exchange rate of \$1.26 per euro as of December 31, 2003.
- (c) Pro forma net income and earnings per diluted share include (1) the write-down of goodwill related to AGZ Holding's investment in an equity investee of \$4.8 million and \$0.09, respectively, (2) the after-tax write-off of debt issuance costs of \$3.2 million and \$0.06, respectively, associated with AGZ Holding's issuance and subsequent refinancing of the AGZ Notes, and (3) the after-tax write-off of an interest rate swap of \$4.0 million and \$0.08, respectively, associated with AGZ Holding's senior debt redeemed in July 2003.
- (d) Includes the cumulative effect of accounting changes associated with (1) AmeriGas Partners' changes in accounting for tank fee revenues and tank installation costs and (2) our adoption of Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities. See Notes 1 and 15 to our Consolidated Financial Statements, incorporated herein by reference.
- (e) Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets, was adopted effective October 1, 2001. Net income and net income per diluted share adjusted to reflect the impact of SFAS No. 142 as if it had been adopted at the beginning of the 2001 fiscal year would have been \$70.5 million and \$1.72, respectively.
- (f) Earnings per share for all periods presented reflect the effects of our 3-for-2 common stock split distributed on April 1, 2003 to stockholders of record on February 28, 2003.
- (g) Includes 165 million aggregate principal amount of AGZ Notes, reflected at fair market value on December 31, 2003.

**Table of Contents**

**RISK FACTORS**

*Investing in our common stock involves a high degree of risk. You should carefully consider the following risk factors, in addition to the other information in this prospectus supplement, before making an investment decision. Each of these risk factors could adversely affect our business, operating results and financial condition, and the value of an investment in our common stock. Generally, each of the following risk factors that relates to our propane operations is also a risk factor that is applicable to Antargaz's LPG operations.*

**Risks Related to Our Business**

*Decreases in the demand for our energy products and services because of warmer weather adversely affect our results of operations.*

Because many of our customers rely on our energy products and services to heat their homes and businesses, our results of operations are adversely affected by warmer weather. Weather conditions have a significant impact on the demand for our energy products and services for both heating and agricultural purposes. Accordingly, the volume of our energy products sold is at its highest during the five-month peak heating season of November through March and is directly affected by the severity of the winter weather. For example, historically, approximately 55% to 60% of AmeriGas Partners' annual retail propane volume has been sold during these months and approximately 60% of our natural gas throughput (the total volume of gas sold to or transported for customers within our distribution system) occurs during these months. In certain prior years, warmer-than-normal weather in our service territories reduced demand for our energy products and services for heating purposes below normal levels, which had an adverse effect on our operating results. There can be no assurance that normal winter weather in our service territories will occur in the future.

*Our holding company structure could limit our ability to pay dividends or debt service.*

We are a holding company whose material assets are the stock of our subsidiaries and interests in joint ventures. Accordingly, we conduct all of our operations through our subsidiaries and joint venture affiliates. Our ability to pay dividends on our common stock and to pay principal and accrued interest on our debt, if any, depends on the payment of dividends or distributions to us by our principal operating subsidiaries, AmeriGas Partners, L.P., UGI Utilities, Inc. and UGI Enterprises, Inc. Payments to us by those subsidiaries, in turn, depends upon their results of operations and cash flows and, in the case of AmeriGas Partners, the provisions of its partnership agreement. The operations of those subsidiaries are affected by conditions beyond our control, including weather, competition in markets we serve, the costs and availability of propane, natural gas, electricity and other energy sources and changes in capital market conditions. The ability of our subsidiaries, including AGZ Holding after completion of the proposed acquisition, to make payments to us is also affected by the level of indebtedness of such subsidiaries, which is substantial, and the restrictions on payments to us imposed under the terms of such indebtedness.

*Our profitability is subject to propane pricing and inventory risk.*

The retail propane business is a margin-based business in which gross profits are dependent upon the excess of the sales price over the propane supply costs. Propane is a commodity, and, as such, its unit price is subject to volatile fluctuations in response to changes in supply or other market conditions. We have no control over these market conditions. Consequently, the unit price of the propane that our subsidiaries and other marketers purchase can change rapidly over a short period of time. Most of our propane product supply contracts permit suppliers to charge posted prices at the time of delivery or the current prices established at major U.S. storage points such as Mont Belvieu, Texas or Conway,

## Edgar Filing: UGI CORP /PA/ - Form 424B5

Kansas. Because our subsidiaries' profitability is sensitive to changes in wholesale propane supply costs, it will be adversely affected if we cannot pass on increases in the cost of propane to our customers. Due to competitive pricing in the propane industry, our subsidiaries may not be able to pass on product cost increases to our customers when product costs rise rapidly.

S-9

## **Table of Contents**

or when our competitors do not raise their product prices. In addition, high propane product prices may lead to customer conservation, resulting in reduced demand. Finally, market volatility may cause our subsidiaries to sell propane at less than the price at which they purchased it, which could adversely affect our operating results.

*Our operations may be adversely affected by competition from other energy sources.*

Our energy products and services face competition from other energy sources, some of which are less costly for equivalent energy value. In addition, we cannot predict the effect that the development of alternative energy sources might have on our operations.

Our propane business competes for customers against suppliers of electricity, fuel oil and natural gas. Electricity is a major competitor of propane, but propane generally enjoys a competitive price advantage over electricity for space heating, water heating and cooking. Fuel oil is also a major competitor of propane and is generally less expensive than propane. Furnaces and appliances that burn propane will not operate on fuel oil and vice versa, however, so a conversion from one fuel to the other requires the installation of new equipment. Our customers generally have an incentive to switch to fuel oil only if fuel oil becomes significantly less expensive than propane. Except for certain industrial and commercial applications, propane is generally not competitive with natural gas in areas where natural gas pipelines already exist because natural gas is generally a less expensive source of energy than propane. The gradual expansion of natural gas distribution systems in our service areas has resulted in the availability of natural gas in some areas that previously depended upon propane. As long as natural gas remains a less expensive energy source than propane, our propane business will lose customers in each region into which natural gas distribution systems are expanded. In France, the state-owned natural gas monopoly, Gaz de France, has in the past extended France's natural gas grid.

Our natural gas business competes primarily with electricity and fuel oil, and, to a lesser extent, with propane and coal. Competition among these fuels is primarily a function of their comparative price and the relative cost and efficiency of fuel utilization equipment. Electric utilities within the areas served by our natural gas business are seeking new customers, primarily in the new construction market. Fuel oil dealers compete with us for customers in all areas, including industrial customers. There can be no assurance that our natural gas revenues will not be adversely affected by this competition.

*Our ability to increase revenues is adversely affected by the maturity of the retail propane industry.*

The retail propane industry in the United States is mature, with only modest growth in total demand for the product foreseen. Given this limited growth, we expect that year-to-year industry volumes will be principally affected by weather patterns. Therefore, our ability to grow within the propane industry is dependent on our ability to acquire other retail distributors and to achieve internal growth, which includes expansion of the PPX<sup>®</sup> program (through which consumers can exchange an empty propane grill cylinder for a filled one) and the strategic accounts program (through which we encourage large, multi-location propane users to enter into a supply agreement with us rather than with many small suppliers), as well as the success of our sales and marketing programs designed to attract and retain customers. Any failure to retain and grow our customer base would have an adverse effect on our results.

*Our ability to grow our businesses will be adversely affected if we are not successful in making acquisitions or in integrating the acquisitions we have made.*



## Edgar Filing: UGI CORP /PA/ - Form 424B5

Given the mature nature of the U.S. propane market, one of our strategies is to grow through acquisitions in the United States and in international markets. We may choose to finance future acquisitions with debt, equity, cash or a combination of the three. There is significant competition for acquisitions in the U.S. propane industry, specifically among publicly-traded master limited partnerships. We believe that there are numerous potential acquisition candidates in the U.S. propane industry, some of which represent acquisition opportunities that would be material to us. We cannot assure you that we will find attractive acquisition candidates in the future, that we will be able to acquire such candidates on economically acceptable terms, that any acquisitions will not be dilutive to earnings or that any additional debt incurred to finance an acquisition will not affect our ability to pay dividends.

S-10

## **Table of Contents**

In addition, the restructuring of the energy markets in the United States and internationally, including the privatization of government-owned utilities and the sale of utility-owned assets, is creating opportunities for, and competition from, well-capitalized competitors, which may affect our ability to achieve our business strategy.

To the extent we are successful in making acquisitions, such acquisitions, including the anticipated acquisition of Antargaz, involve a number of risks, including, but not limited to, the assumption of material liabilities, the diversion of management's attention from the management of daily operations to the integration of operations, difficulties in the assimilation and retention of employees and difficulties in the assimilation of different cultures and practices, as well as in the assimilation of broad and geographically dispersed personnel and operations. The failure to successfully integrate acquisitions could have an adverse affect on our business, financial condition and results of operations.

### ***The U.S. propane retail distribution business is highly competitive.***

We compete in the U.S. propane retail distribution business with other large propane marketers, including other full-service marketers, and thousands of small independent operators. In recent years, some rural electric cooperatives and fuel oil distributors have expanded their businesses to include propane distribution, and we compete with them as well. The ability to compete effectively depends on providing satisfactory customer service, maintaining competitive retail prices and controlling operating expenses.

### ***We are dependent on our principal propane suppliers, which increases the risks from an interruption in supply and transportation.***

During the year ended September 30, 2003, AmeriGas Partners purchased approximately 79% of its propane needs in the United States from ten suppliers. If supplies from these sources were interrupted, the cost of procuring replacement supplies and transporting those supplies from alternative locations might be materially higher and, at least on a short-term basis, our earnings could be affected. Additionally, in certain market areas, some of AmeriGas Partners' suppliers provide 70% to 80% of its propane requirements. Disruptions in supply in these areas could also have an adverse impact on our earnings. Antargaz is similarly dependent upon its suppliers. Significant amounts of propane must be imported to meet demand in France. There is no assurance that Antargaz will be able to continue to acquire sufficient supplies of propane to meet demand at prices or within time periods that would allow it to remain competitive.

### ***The expansion of our international business means that we will face increased risks, which may negatively affect our business results.***

Our intended acquisition of Antargaz will significantly increase our international presence. As we continue to grow as a multi-national corporation, with subsidiaries around the world, we face risks in doing business abroad that we do not face domestically. Certain aspects inherent in transacting business internationally could negatively impact our operating results, including:

costs and difficulties in staffing and managing international operations;

regulatory requirements and changes in regulatory requirements, including French and EU competition laws that may adversely affect the terms of contracts with customers, and new environmental requirements that have led to stricter regulations of LPG storage sites in France;

tariffs and other trade barriers;

difficulties in enforcing contractual rights;

longer payment cycles;

local political and economic conditions;

potentially adverse tax consequences, including restrictions on repatriating earnings and the threat of double taxation ; and

fluctuations in currency exchange rates.

S-11

**Table of Contents**

*We are subject to operating and litigation risks that may not be covered by insurance.*

Our business operations and those of Antargaz are subject to all of the operating hazards and risks normally incidental to the handling, storage and delivery of combustible products, such as LPG and natural gas, and the generation of electricity. These risks could result in substantial losses due to personal injury and/or loss of life, severe damage to and destruction of property and equipment and pollution or other environmental damage. As a result, we are sometimes a defendant in legal proceedings and litigation arising in the ordinary course of business. We maintain insurance policies with insurers in such amounts and with such coverages and deductibles as we believe are reasonable and prudent. We cannot assure you, however, that such insurance will be adequate to protect us from all material expenses related to potential future claims for personal and property damage or that such levels of insurance will be available in the future at economical prices.

Moreover, our acquisition of the remaining interests in AGZ Holding will expose us to additional litigation risks at Antargaz. Specifically, in connection with its 2001 acquisition of its propane business, AGZ Holding entered into a guarantee agreement with Elf Antar France, now Total France, and Elf Aquitaine pursuant to which Total France and Elf Aquitaine agreed to indemnify AGZ Holding for all payments which would have been due from Antargaz in respect of certain matters, including a business tax related to AGZ Holding's propane tanks for the period from January 1, 1997 through December 31, 2000, and certain potential environmental/safety liabilities. If Total France and Elf Aquitaine were to reject their indemnity obligations or if such obligations were found to be unenforceable, AGZ Holding may not have recourse against any third party with respect to any such liabilities, which, in turn, could have an adverse effect on our ability to receive distributions of cash from AGZ Holding.

*If energy conservation and efficiency and technology trends continue to decrease demand for our energy products and services, our revenues will decrease.*

Retail customers primarily use our energy products and services for home heating, water heating and cooking purposes. Energy conservation and efficiency measures and advances in heating, conservation and other devices have begun to decrease demand for our energy products. Should that decrease continue, and not be offset by colder weather, our revenues will decrease. Additionally, new technologies and alternative sources of energy may be developed that could negatively affect the competitiveness of our operating subsidiaries and therefore, our revenues.

*We may be unable to respond effectively to competition, which may adversely affect our operating results.*

We may be unable to timely respond to changes within the energy and utility sectors that may result from regulatory initiatives to further increase competition within our industry. Such regulatory initiatives may create opportunities for additional competitors to enter our markets, and, as a result, we may be unable to maintain our revenues or continue to pursue our current business strategy.

*The loss of key personnel would have an adverse effect on our business, financial results and results of operations.*

Our continued success is dependent upon the efforts and abilities of our executive officers and other key employees and our ability to continue to attract, motivate and retain highly-qualified personnel. Our ability to effectively integrate acquired businesses, including Antargaz, will also depend on the efforts and abilities of the officers or key employees we retain in those acquisitions. The loss of key personnel or the failure to attract and motivate key personnel could have an adverse effect on our business, financial condition and results of operations.

*Our net income will decrease if we are required to incur additional costs to comply with existing and new governmental safety, health, transportation and environmental regulation.*

We are subject to extensive and changing international, federal, state and local safety, health, transportation and environmental laws and regulations governing the storage, distribution and transportation of our energy products.

S-12

---

**Table of Contents**

New regulations, or a change in the interpretation of existing regulations, could result in increased expenditures. For example, the explosion at Grande Parissos S.A.'s chemical factory in Toulouse, France in September 2001 gave rise to new regulations relating to the safety risks of operations such as Antargaz's, which involve the storage of large amounts of flammable substances. In addition, for many of our operations, we are required to obtain permits from regulatory authorities. Failure to comply with these permits or applicable laws could result in civil and criminal fines or the cessation of the operations in violation.

We are investigating and remediating contamination at a number of present and former operating sites in the United States, including former sites where we or our former subsidiaries operated manufactured gas plants. We have also received claims from third parties that allege that we are responsible for costs to clean up properties where we or our former subsidiaries operated a manufactured gas plant or conducted other operations. Costs we incur to remediate sites outside of Pennsylvania cannot be recovered in future utility rate proceedings, and insurance may not cover all or even part of these costs. Our actual costs to clean up these sites may exceed our current estimates due to factors beyond our control, such as:

the discovery of presently unknown conditions;

changes in environmental laws and regulations;

judicial rejection of our legal defenses to the third-party claims; or

the insolvency of other responsible parties at the sites at which we are involved.

In addition, if we discover additional contaminated sites, we could be required to incur material costs, which would reduce our net income.

***Under certain conditions, if the credit rating of UGI Utilities' long-term debt is downgraded, FLAGA's lenders may accelerate repayment of FLAGA's debt, which could adversely affect our ability to pay dividends on our common stock.***

FLAGA has a \$15 million working capital loan commitment from a European bank expiring in November 2004. As of December 31, 2003, borrowings under this working capital facility totaled \$14.4 million (\$18.1 million U.S. dollar equivalent). We guarantee the debt issued under this agreement, as well as \$78.0 million of acquisition and special purpose debt of FLAGA. In the event that the credit rating of UGI Utilities' long-term debt is downgraded from A3 to Baa2 by Moody's Investors Service and from BBB+ to BBB by Standard & Poor's, FLAGA's lenders may accelerate the repayment of this debt, which could require us to refinance FLAGA's debt immediately. On January 29, 2004, Standard & Poor's Ratings Services placed its BBB+ corporate credit and other ratings on UGI Utilities on CreditWatch with negative implications. If we were unable to refinance the debt, we could be unable to pay dividends on our common stock.

***Current economic and political conditions may harm our business.***

U.S. and international economic conditions and the effects of ongoing military actions against terrorists may cause significant disruptions to commerce throughout the world. To the extent that such conditions and disruptions result in delays or cancellations of customer orders, impair our ability to effectively market our energy products or services or acquire our sources of supply for our energy products, or cause or prolong an economic recession, we would have lower consolidated revenues, and, therefore, lower consolidated net income. In addition, our ability to raise capital for acquisitions, capital expenditures and ongoing operations is dependent upon ready access to capital markets. During times of adverse

## Edgar Filing: UGI CORP /PA/ - Form 424B5

economic and political conditions, investor confidence in and accessibility to capital markets could decrease. If capital markets are not available to us over an extended period of time, we could be unable to make acquisitions, refinance debt, invest in capital expenditures and fund operations.

S-13

**Table of Contents**

**Risks Related to Our Common Stock**

*The price of our securities may be affected by the general perception of the energy and utility sectors of the economy.*

Events, such as the blackout in parts of the United States on August 14, 2003, those involving Enron Corporation, political unrest in oil-producing countries and the energy crisis in California, could adversely affect investors' perceptions of the energy and utility sectors. A negative perception of our industry by investors could adversely affect the equity prices of companies within the energy and utility sectors. We cannot predict what news or events might affect the perceptions of investors in our industry or how such news or events might affect the market price of our common stock, but fluctuations in the market price of our common stock could be severe and any effects could be long-term.

*Your ability to seek potential recoveries from our former independent public accountants, Arthur Andersen LLP, is limited.*

Arthur Andersen LLP audited our financial statements and schedules as of and for the year ended September 30, 2001, which are incorporated by reference into this prospectus supplement. Arthur Andersen LLP has not reissued their report on our financial statements in this prospectus supplement, and we have relied on Rule 437a under the Securities Act in filing this registration statement without such a consent. On June 15, 2002, Arthur Andersen LLP was convicted of obstruction of justice by a federal jury in Houston, Texas in connection with Arthur Andersen LLP's work for Enron Corporation. On September 15, 2002, a federal judge upheld this conviction. Arthur Andersen LLP ceased its audit practice before the SEC on August 31, 2002. In May 2002, we terminated our engagement of Arthur Andersen LLP as our independent accountants and engaged PricewaterhouseCoopers LLP to serve as our independent accountants for the fiscal year ending September 30, 2002. Because Arthur Andersen has not consented to the incorporation by reference of their reports on our financial statements in this prospectus and because of the circumstances affecting Arthur Andersen LLP, as a practical matter, it may not be able to satisfy any claims arising from the provision of auditing services to us, including claims you may have that are available to securities holders under federal and state securities law.



**Table of Contents**

**SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS**

The information in this prospectus supplement, including the information incorporated by reference into this prospectus supplement, includes forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act), and Section 27A of the Securities Act as enacted by the Private Securities Litigation Reform Act of 1995. Such statements use forward-looking words such as believe, plan, anticipate, continue, estimate, expect, may, will, or other similar words. These statements discuss plans, events or developments that we expect or anticipate will or may occur in the future.

A forward-looking statement may include a statement of the assumptions or bases underlying the forward-looking statement. We believe that we have chosen these assumptions or bases in good faith and that they are reasonable. However, we caution you that actual results almost always vary from assumed facts or bases, and the differences between actual results and assumed facts or bases can be material, depending on the circumstances. When considering forward-looking statements, you should keep in mind the following important factors which could affect our future results and could cause those results to differ materially from those expressed in our forward-looking statements:

adverse weather conditions resulting in reduced demand;

price volatility and availability of propane, fuel oil, electricity and natural gas and the capacity to transport them to our market areas;

changes in laws and regulations, including safety, tax, competition, environmental and accounting matters;

competitive pressures from the same and alternative energy sources;

failure to acquire new customers, thereby reducing or limiting any increase in revenues;

liability for environmental claims;

customer conservation measures and improvements in energy efficiency and technology resulting in reduced demand;

adverse labor relations;

large customer, counterparty or supplier defaults;

liability for personal injury and property damage arising from explosions and other catastrophic events, including acts of terrorism, resulting from operating hazards and risks incidental to generating and distributing electricity and transporting, storing and distributing natural gas and propane, including liability in excess of insurance coverage;

political, regulatory and economic conditions in the United States and in foreign countries;

## Edgar Filing: UGI CORP /PA/ - Form 424B5

interest rate fluctuations and other capital market conditions, including foreign currency rate fluctuations;

reduced distributions or dividends from subsidiaries;

the timing of the completion of our proposed acquisition of the ownership interests that we do not already own in AGZ Holding; and

the timing and success of our efforts to develop new business opportunities.

These factors are not necessarily all of the important factors that could cause actual results to differ materially from those expressed in any of our forward-looking statements. Other unknown or unpredictable factors could also have material adverse effects on future results. We undertake no obligation to update publicly any forward-looking statement whether as a result of new information or future events except as required by federal securities laws.

S-15

**Table of Contents****USE OF PROCEEDS**

Our net proceeds from the sale of the 7,500,000 shares of common stock will be approximately \$229.1 million, or approximately \$263.6 million if the underwriters exercise their over-allotment option in full, based on a price to the public of \$32.10 per share and after deducting the underwriting discount and the estimated offering expenses payable by us.

We intend to use all of the net proceeds from this offering to acquire the ownership interests in AGZ Holding, the parent holding company of Antargaz, that we do not already own. You should refer to the section in this prospectus supplement entitled "Who We Are" Planned Acquisition of Antargaz, for a description of that transaction. To the extent any proceeds remain after paying the purchase price for the ownership interests in AGZ Holding that we do not already own or such transaction is not completed, we will use the proceeds for general corporate purposes.

**DIVIDEND POLICY**

We paid quarterly dividends on our common stock as set forth in the following table. On January 27, 2004, we announced our intention to increase the annual dividend rate on our common stock to \$1.25 per share from \$1.14 per share effective with the regularly scheduled July dividend payment, assuming the completion of the anticipated acquisition of the shares in AGZ Holding that we do not already own.

	<b>Amount*</b>
	<b>_____</b>
<b>2004 Fiscal Year</b>	
Second Quarter	\$ 0.285
First Quarter	0.285
<b>2003 Fiscal Year</b>	
Fourth Quarter	\$ 0.285
Third Quarter	0.285
Second Quarter	0.275
First Quarter	0.275
<b>2002 Fiscal Year</b>	
Fourth Quarter	\$ 0.275
Third Quarter	0.267
Second Quarter	0.267
First Quarter	0.267

\* On January 28, 2003, our Board of Directors approved a 3-for-2 split of our common stock, effective April 1, 2003. Dividends paid are reflected on a post-split basis.

**Table of Contents****PRICE RANGE OF OUR COMMON STOCK**

Our common stock is traded on the New York and Philadelphia stock exchanges under the symbol UGI. The following table sets forth, for the periods indicated, the high and low sales prices for our common stock on The New York Stock Exchange Composite Transactions tape as reported in The Wall Street Journal.

	<u>High*</u>	<u>Low*</u>
<b>2004 Fiscal Year</b>		
Second Quarter (through March 18, 2004)	\$ 34.35	\$ 31.40
First Quarter	34.20	28.85
<b>2003 Fiscal Year</b>		
Fourth Quarter	\$ 33.45	\$ 28.86
Third Quarter	35.05	29.00
Second Quarter	30.57	24.93
First Quarter	26.99	23.27
<b>2002 Fiscal Year</b>		
Fourth Quarter	\$ 24.51	\$ 17.11
Third Quarter	22.14	19.60
Second Quarter	20.99	18.06
First Quarter	21.02	17.79

\* On January 28, 2003, our Board of Directors approved a 3-for-2 split of our common stock, effective April 1, 2003. Sales prices for the periods presented are reflected on a post-split basis.

**Table of Contents****CAPITALIZATION**

The following table shows our capitalization as of December 31, 2003, (i) on an actual basis and (ii) on a pro forma and as adjusted basis giving effect to the consummation of the acquisition of the ownership interests in AGZ Holding that we do not already own and the sale of 7,500,000 shares of our common stock in this offering (assuming no exercise of the underwriters' over-allotment option). You should read this table in conjunction with our financial statements and the notes to those financial statements incorporated by reference into this prospectus supplement and the Unaudited Pro Forma Condensed Combined Financial Statements beginning on page P-1.

	December 31, 2003	
	Actual	Pro Forma and As Adjusted
	(in millions)	
Cash, cash equivalents and short-term investments (a)	\$ 193.5	\$ 157.0
Total debt	\$ 1,353.2	\$ 1,863.8(b)
Minority interests	\$ 149.8	\$ 164.9
UGI Utilities preferred shares subject to mandatory redemption, without par value	\$ 20.0	\$ 20.0
Total common stockholders' equity		
Common Stock, without par value; 150,000,000 shares authorized; 42,778,798 outstanding as of December 31, 2003; and 50,278,798 outstanding as adjusted	\$ 582.9	\$ 813.1
Retained earnings	117.5	117.5
Accumulated other comprehensive income	15.6	15.6
Notes receivable from employees	(0.4)	(0.4)
Less treasury stock, at cost	(107.0)	(107.0)
Total common stockholders' equity	608.6	838.8
Total capitalization	\$ 2,131.6	\$ 2,887.5

- (a) \$23.3 million of which is held by AmeriGas Partners, L.P., which currently makes distributions pursuant to the terms of its partnership agreement.
- (b) Includes 165 million aggregate principal amount of AGZ Notes, reflected at fair market value on December 31, 2003.

The number of shares of common stock to be outstanding after this offering is based on 42,778,798 shares outstanding as of December 31, 2003, and excludes:

2,950,288 shares of common stock underlying options as of March 1, 2004, at an average option exercise price of \$21.877 per share;

Edgar Filing: UGI CORP /PA/ - Form 424B5

a maximum of 507,854 shares of common stock that may be issued pursuant to grants of phantom units as of March 1, 2004; and

2,712,096 shares available for future grants under all equity compensation plans as of March 1, 2004.

S-18

---

**Table of Contents**

**CERTAIN UNITED STATES FEDERAL TAX CONSEQUENCES TO NON-U.S. HOLDERS**

This discussion describes the material United States federal income and estate tax consequences of the ownership and disposition of shares of our common stock by a non-U.S. holder. When we refer to a non-U.S. holder, we mean a beneficial owner of our common stock that, for U.S. federal income tax purposes, is other than:

a citizen or resident of the United States;

a corporation (including for this purpose any other entity treated as a corporation for U.S. federal income tax purposes) created or organized in or under the laws of the United States or any political subdivision thereof;

an estate the income of which is subject to U.S. federal income taxation regardless of its source; or

a trust that is subject to the primary supervision of a U.S. court and to the control of one or more U.S. persons, or that has a valid election in effect under applicable U.S. Treasury regulations to be treated as a U.S. person.

If a partnership (including for this purpose any other entity, either organized within or without the United States, treated as a partnership for U.S. federal income tax purposes) holds the shares, the tax treatment of a partner as a beneficial owner of the shares generally will depend upon the status of the partner and the activities of the partnership. Foreign partnerships also generally are subject to special U.S. tax documentation requirements.

*This discussion does not consider the specific facts and circumstances that may be relevant to a particular non-U.S. holder and does not address the treatment of a non-U.S. holder under the laws of any state, local or foreign taxing jurisdiction. This section is based on the tax laws of the United States, including the Internal Revenue Code of 1986, as amended, which we refer to as the Code, existing and proposed regulations, and administrative and judicial interpretations, all as currently in effect. These laws are subject to change, possibly on a retroactive basis. You should consult a tax advisor regarding the U.S. federal tax consequences of acquiring, holding and disposing of our common stock in your particular circumstances, as well as any tax consequences that may arise under the laws of any state, local or foreign taxing jurisdiction.*

**Dividends**

We pay dividends with respect to our common stock. Dividends paid to a non-U.S. holder, except as described below, are subject to withholding of U.S. federal income tax at a 30% rate or at a lower rate if the holder is eligible for the benefits of an income tax treaty that provides for a lower rate (and you have furnished to us a valid Internal Revenue Service Form W-8BEN or an acceptable substitute form).

If dividends paid to a non-U.S. holder are effectively connected with your conduct of a trade or business within the United States, and, if required by a tax treaty, the dividends are attributable to a permanent establishment that the non-U.S. holder maintains in the United States, we generally are not required to withhold tax from the dividends, provided that the non-U.S. holder has furnished to us a valid Internal Revenue Service Form W-8ECI or an acceptable substitute form. Instead, effectively connected dividends are taxed at rates applicable to United States persons. If a non-U.S. holder is a corporation, effectively connected dividends that it receives may, under certain circumstances, be subject to an additional branch profits tax at a 30% rate or at a lower rate if the holder is eligible for the benefits of an income tax treaty that provides for a

lower rate.

S-19



## **Table of Contents**

### **Gain on Disposition of Common Stock**

Non-U.S. holders generally will not be subject to United States federal income tax on gain that they recognize on a disposition of our common stock unless:

the holder is an individual who is present in the United States for 183 days or more in the taxable year of disposition and certain other conditions are met;

such gain is effectively connected with the holder's conduct of a trade or business within the United States and, if certain tax treaties apply, is attributable to a U.S. permanent establishment maintained by the holder;

the holder is subject to the Code provisions applicable to certain U.S. expatriates; or

we are or have been a U.S. real property holding corporation for U.S. federal income tax purposes and, assuming that our common stock is deemed to be regularly traded on an established securities market, the holder held, directly or indirectly at any time during the five-year period ending on the date of disposition or such shorter period that such shares were held, more than five percent of our common stock. We have not been, are not and do not anticipate becoming, a United States real property holding corporation for United States federal income tax purposes.

### **Federal Estate Taxes**

If our common stock is held by a non-U.S. holder at the time of death, such stock will be included in the holder's gross estate for U.S. federal estate tax purposes, unless an applicable estate tax treaty provides otherwise.

### **Backup Withholding and Information Reporting**

Backup withholding and information reporting requirements will not apply to dividends paid on our common stock to a non-U.S. holder, provided the non-U.S. holder provides a valid Internal Revenue Service Form W-8BEN (or satisfies certain documentary evidence requirements for establishing that such holder is a non-U.S. person) or otherwise establishes an exemption. Information reporting and backup withholding also generally will not apply to a payment of the proceeds of a sale of common stock effected outside the United States by a foreign office of a foreign broker.

However, a sale of our common stock will be subject to information reporting if it is effected at a foreign office of a broker that is:

a U.S. person;

## Edgar Filing: UGI CORP /PA/ - Form 424B5

a controlled foreign corporation for U.S. tax purposes;

a foreign person 50% or more of whose gross income is effectively connected with the conduct of a U.S. trade or business for a specified three-year period; or

a foreign partnership, if at any time during its tax year one or more of its partners are U.S. persons, as defined in U.S. Treasury regulations, who in the aggregate hold more than 50% of the income or capital interest in the partnership, or such foreign partnership is engaged in the conduct of a U.S. trade or business;

unless the documentation requirements described above are met or you otherwise establish an exemption and the broker does not have actual knowledge or reason to know that you are a United States person. Backup withholding will apply if the sale is subject to information reporting and the broker has actual knowledge that the holder is a U.S. person.

A non-U.S. holder generally may obtain a refund of any amounts withheld under the backup withholding rules that exceed its income tax liability by filing a refund claim with the Internal Revenue Service.

S-20

**Table of Contents**

**UNDERWRITING**

Under the terms and subject to the conditions contained in an underwriting agreement dated March 18, 2004, we have agreed to sell to the underwriters named below, for whom Credit Suisse First Boston (Europe) Limited is acting as representative, the following respective numbers of shares of common stock:

<u>Underwriter</u>	<u>Number of Shares</u>
Credit Suisse First Boston (Europe) Limited	4,500,000
Citigroup Global Markets Inc.	1,875,000
Wachovia Capital Markets, LLC	750,000
Janney Montgomery Scott LLC	375,000
<b>Total</b>	<b>7,500,000</b>

Credit Suisse First Boston (Europe) Limited will make offers and sales in the United States through Credit Suisse First Boston LLC, which is acting as selling agent for Credit Suisse First Boston (Europe) Limited.

The underwriting agreement provides that the underwriters are obligated to purchase all the shares of common stock in the offering if any are purchased, other than those shares covered by the over-allotment option described below. The underwriting agreement also provides that if an underwriter defaults, the purchase commitments of non-defaulting underwriters may be increased or the offering may be terminated.

We have granted to the underwriters a 30-day option to purchase on a pro rata basis up to 1,125,000 additional shares at the initial public offering price less the underwriting discounts and commissions. The option may be exercised only to cover any over-allotments of common stock.

The underwriters propose to offer the shares of common stock initially at the public offering price on the cover page of this prospectus and to selling group members at that price less a selling concession of \$0.8426 per share. The underwriters and selling group members may allow a discount of \$0.100 per share on sales to other broker/dealers. After the initial public offering the representatives may change the public offering price and concession and discount to broker/dealers.

The following table summarizes the compensation and estimated expenses we will pay:

<u>Per Share</u>		<u>Total</u>	
Without Over-allotment	With Over-allotment	Without Over-allotment	With Over-allotment

## Edgar Filing: UGI CORP /PA/ - Form 424B5

Underwriting discounts and commissions paid by us	\$ 1.4044	\$ 1.4044	\$ 10,533,000	\$ 12,112,950
Expenses payable by us	\$ 0.1467	\$ 0.1275	\$ 1,100,000	\$ 1,100,000

We have agreed that we will not offer, sell, contract to sell, pledge or otherwise dispose of, directly or indirectly, or file with the SEC a registration statement under the Securities Act relating to, any shares of our common stock or securities convertible into or exchangeable or exercisable for any shares of our common stock, or publicly disclose the intention to make any offer, sale, pledge, disposition or filing, without the prior written consent of Credit Suisse First Boston (Europe) Limited for a period of 90 days after the date of this prospectus supplement (other than shares of our common stock or options to acquire shares of our common stock issued pursuant to our equity compensation and savings plans, shares of our common stock issued pursuant to our dividend reinvestment plan, shares of our common stock issued in connection with options or warrants outstanding as of the date of this prospectus supplement or shares of our common stock issued as consideration for any acquisition).

Our executive officers have agreed that they will not offer, sell, contract to sell, pledge or otherwise dispose of, directly or indirectly, any shares of our common stock or securities convertible into or exchangeable or exercisable for any shares of our common stock, enter into a transaction that would have the same effect, or enter into any swap, hedge or other arrangement that transfers, in whole or in part, any of the economic consequences

## **Table of Contents**

of ownership of our common stock, whether any of these transactions are to be settled by delivery of our common stock or other securities, in cash or otherwise, or publicly disclose the intention to make any offer, sale, pledge or disposition, or to enter into any transaction, swap, hedge or other arrangement, without, in each case, the prior written consent of Credit Suisse First Boston (Europe) Limited for a period of 45 days after the date of this prospectus supplement.

We have agreed to indemnify the underwriters against liabilities under the Securities Act, or to contribute to payments which the underwriters may be required to make in that respect.

Our common stock is listed on the New York Stock Exchange and the Philadelphia Stock Exchange under the symbol UGI .

In connection with the offering, the underwriters may engage in stabilizing transactions, over-allotment transactions, syndicate covering transactions and penalty bids in accordance with Regulation M under the Securities Exchange Act of 1934.

Stabilizing transactions permit bids to purchase the underlying security so long as the stabilizing bids do not exceed a specified maximum.

Over-allotment involves sales by the underwriters of shares in excess of the number of shares the underwriters are obligated to purchase, which creates a syndicate short position. The short position may be either a covered short position or a naked short position. In a covered short position, the number of shares over-allotted by the underwriters is not greater than the number of shares that they may purchase in the over-allotment option. In a naked short position, the number of shares involved is greater than the number of shares in the over-allotment option. The underwriters may close out any short position by either exercising their over-allotment option and/or purchasing shares in the open market.

Syndicate covering transactions involve purchases of the common stock in the open market after the distribution has been completed in order to cover syndicate short positions. In determining the source of shares to close out the short position, the underwriters will consider, among other things, the price of shares available for purchase in the open market as compared to the price at which they may purchase shares through the over-allotment option. If the underwriters sell more shares than could be covered by the over-allotment option, a naked short position, the position can only be closed out by buying shares in the open market. A naked short position is more likely to be created if the underwriters are concerned that there could be downward pressure on the price of the shares in the open market after pricing that could adversely affect investors who purchase in the offering.

Penalty bids permit the representatives to reclaim a selling concession from a syndicate member when the common stock originally sold by the syndicate member is purchased in a stabilizing or syndicate covering transaction to cover syndicate short positions.

These stabilizing transactions, syndicate covering transactions and penalty bids may have the effect of raising or maintaining the market price of our common stock or preventing or retarding a decline in the market price of the common stock. As a result, the price of our common stock may be higher than the price that might otherwise exist in the open market. These transactions may be effected on the New York Stock Exchange or otherwise and, if commenced, may be discontinued at any time.

In the ordinary course of business, certain of the underwriters and their affiliates have provided and may in the future provide financial advisory, investment banking and general financing and banking services for us and our affiliates for customary fees.

A prospectus in electronic format may be made available on the websites maintained by one or more of the underwriters or selling group members, if any, participating in this offering. The representatives may agree to allocate a number of shares to underwriters and selling group members for sale to their online brokerage account holders. Internet distributions will be allocated by the underwriters and selling group members that will make internet distributions on the same basis as other allocations.

S-22

**Table of Contents**

**WHERE YOU CAN FIND MORE INFORMATION**

We file annual, quarterly and current reports, proxy statements and other information with the SEC. You may read and copy any document we file with the SEC at the SEC's public reference room at 450 Fifth Street, N.W., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the public reference room. The SEC maintains a website at <http://www.sec.gov> that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC. In addition, we maintain a website at <http://www.ugicorp.com> and make available free of charge on this website our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. The information on our website, other than the documents incorporated by reference into this prospectus supplement pursuant to the section entitled "Incorporation of Certain Documents By Reference" below, is not incorporated into, and does not constitute a part of, this prospectus supplement.

**INCORPORATION OF CERTAIN DOCUMENTS BY REFERENCE**

The SEC allows us to incorporate by reference the information we file with them, which means that we can disclose important information to you by referring you to those documents. Statements made in this prospectus supplement as to the contents of any contract, agreement or other documents are not necessarily complete, and, in each instance, we refer you to a copy of such document filed as an exhibit to the registration statement, of which this prospectus supplement is a part, or otherwise filed with the SEC. The information incorporated by reference is considered to be part of this prospectus supplement. When we file information with the SEC in the future, that information will automatically update and supersede this information. We incorporate by reference herein our documents listed below and any future filings we make with the SEC under Sections 13(a), 13(c), 14 or 15(d) of the Exchange Act until all of the shares of common stock that we have registered are sold (other than Current Reports on Form 8-K containing disclosure furnished under Item 9 or Item 12 of Form 8-K and exhibits relating to such disclosures, unless otherwise specifically stated in any such Current Report or Form 8-K):

our annual report on Form 10-K for the fiscal year ended September 30, 2003, filed on December 23, 2003, except to the extent superseded by the current report on Form 8-K filed on March 11, 2004;

our quarterly report on Form 10-Q for the fiscal quarter ended December 31, 2003, filed on February 13, 2004;

our current report on Form 8-K filed on March 11, 2004; and

the description of our common stock contained in our registration statement on Form 8-B, dated March 23, 1992, as amended by Amendment No. 1 to Form 8-B, dated April 10, 1992, and on Form 8-A, dated June 24, 1996, and any amendments or reports filed after the date hereof for the purpose of updating such description.

We will provide, upon written or oral request, to each person to whom a prospectus supplement is delivered, a copy of any or all of the information that has been incorporated by reference into the prospectus supplement but not delivered with the prospectus supplement. You may request a copy of these filings, at no cost, by writing us at UGI Corporation, 460 North Gulph Road, King of Prussia, Pennsylvania 19406, Attention: Vice President and Treasurer. Our telephone number is (610) 337-1000.

**LEGAL MATTERS**

Edgar Filing: UGI CORP /PA/ - Form 424B5

The validity of the shares of common stock offered hereby will be passed upon for us by Morgan, Lewis & Bockius LLP. The underwriters have been represented by Cravath, Swaine & Moore LLP, New York, N.Y.

S-23



**Table of Contents**

**EXPERTS**

The audited consolidated financial statements incorporated into this prospectus supplement by reference to the current report on Form 8-K dated March 11, 2004 have been so incorporated in reliance on the report of PricewaterhouseCoopers LLP, independent accountants, given on the authority of said firm as experts in auditing and accounting.

The consolidated financial statements of AGZ Holding at March 31, 2003 and for the year then ended, appearing in this prospectus supplement have been audited by PricewaterhouseCoopers Audit and Barbier Frinault & Autres, Ernst & Young, independent auditors, as set forth in their report thereon appearing elsewhere herein, and are included in reliance upon such report given on the authority of such firms as experts in accounting and auditing.

The audited consolidated financial statements and schedules for the period ended September 30, 2001, which are incorporated by reference in this prospectus supplement, were audited by Arthur Andersen LLP, our former independent accountants, as indicated in their reports with respect thereto. Copies of such reports are incorporated by reference herein, but Arthur Andersen LLP has not reissued such reports or consents to the incorporation of such reports into this prospectus supplement and has ceased operations.

**Table of Contents**

**INDEX TO FINANCIAL STATEMENTS**

UGI Corporation Unaudited Pro Forma Condensed Combined Financial Statements	P-1
AGZ Holding Consolidated Financial Statements as of and for the Fiscal Year Ended March 31, 2003	F-1
AGZ Holding Unaudited Consolidated Financial Statements as of December 31, 2003 and for the Nine Months Ended December 31, 2003 and 2002	F-29

S-25

---

**Table of Contents**

**UGI CORPORATION**

**INTRODUCTION TO UNAUDITED PRO FORMA CONDENSED COMBINED**

**FINANCIAL STATEMENTS**

The Unaudited Pro Forma Condensed Combined Financial Statements of UGI Corporation ( UGI ) give effect to the proposed acquisition of the outstanding shares not already owned by our indirect, wholly-owned subsidiary, UGI France, Inc., of AGZ Holding ( AGZ ), which owns 99.99% of Antargaz, a French corporation (*société anonyme*). Prior to the acquisition of the outstanding shares not already owned by UGI, AGZ is owned by PAI partners, a French corporation, Medit Mediterraenea, GPL S.r.L, an Italian company, certain officers and managers of AGZ, and UGI France, Inc. The pro forma adjustments are based upon available information and assumptions that management believes are reasonable. The Unaudited Pro Forma Condensed Combined Financial Statements do not purport to represent what the results of operations or financial position of UGI would have been if the purchase transaction had occurred on the dates indicated below, nor do they purport to project the results of operations or financial position of UGI for any future period or as of any future date. The Unaudited Pro Forma Condensed Combined Financial Statements reflect net cash proceeds to UGI, before deducting the estimated offering expenses payable by us, from the issuance of 7.5 million shares of common stock of \$230.2 million (assuming no exercise of the underwriters' over-allotment option).

The Unaudited Pro Forma Condensed Combined Balance Sheet as of December 31, 2003 was prepared by combining the unaudited condensed consolidated balance sheet of UGI and the unaudited consolidated balance sheet of AGZ as of December 31, 2003, giving effect to the acquisition of AGZ as though it had been completed on December 31, 2003. The Unaudited Pro Forma Condensed Combined Statement of Income for the three months ended December 31, 2003 was prepared by combining UGI's unaudited consolidated statement of income for the three months ended December 31, 2003 with AGZ's unaudited consolidated statement of income for the three months ended December 31, 2003 to give effect to the acquisition of AGZ as though it had occurred on October 1, 2002. The Unaudited Pro Forma Condensed Combined Statement of Income for the year ended September 30, 2003 was prepared by combining UGI's audited consolidated statement of income for the year ended September 30, 2003 with AGZ's unaudited consolidated statement of income for the twelve months ended September 30, 2003 to give effect to the acquisition of AGZ as though it had occurred on October 1, 2002. The historical AGZ unaudited consolidated financial statements are presented in accordance with accounting principles generally accepted in France ( French GAAP ). Euro balances were translated to U.S. dollars at the exchange rate of \$1.26 per euro at December 31, 2003 for the consolidated balance sheet amounts and at the average exchange rates of \$1.19 per euro for the consolidated statement of income for the three months ended December 31, 2003 and \$1.08 per euro for the consolidated statement of income for the twelve months ended September 30, 2003. Separate adjustments are reflected to (1) convert AGZ consolidated balance sheet and consolidated statement of income amounts from French GAAP to accounting principles generally accepted in the United States ( U.S. GAAP ), (2) reclassify certain amounts in the AGZ consolidated balance sheet and consolidated statement of income to conform to UGI financial statement presentation, and (3) record pro forma purchase accounting adjustments.

The revaluation of AGZ's identifiable assets acquired and liabilities assumed, representing the portion not already owned by UGI, is based on a preliminary valuation based upon currently available information and is subject to final adjustments. Accordingly, the actual adjustments to be recorded in connection with the final purchase price allocation may differ from the pro forma adjustments reflected in the Unaudited Pro Forma Condensed Combined Financial Statements, and any such differences may be material. The historical amounts of UGI as of and for the three months ended December 31, 2003 are derived from unaudited consolidated financial statements included in the Form 10-Q filed by UGI on February 13, 2004 with the SEC. The historical amounts of UGI for the fiscal year ended September 30, 2003 are derived from audited consolidated financial statements included in the Form 8-K filed by UGI on March 11, 2004 with the SEC. AGZ's historical unaudited consolidated balance sheet as of December 31, 2003 was derived from unaudited consolidated financial statements included elsewhere herein. The unaudited consolidated statement of income of AGZ for the three

**Table of Contents**

months ended December 31, 2003 was derived from unaudited consolidated financial statements. The unaudited consolidated statement of income of AGZ for the twelve months ended September 30, 2003 was derived by excluding the unaudited statement of income for the six months ended September 30, 2002 from the audited consolidated statement of income for the year ended March 31, 2003 and including the unaudited statement of income for the six months ended September 30, 2003. The statements of income, reported in euros, were translated to U.S. dollars using the average exchange rate of \$1.08 per euro.

You should read the Unaudited Pro Forma Condensed Combined Financial Statements along with UGI's consolidated financial statements and accompanying notes included in its prior SEC filings and the historical financial statements and the related notes of AGZ Holding included herein.

**Table of Contents****UGI CORPORATION AND SUBSIDIARIES****UNAUDITED PRO FORMA CONDENSED COMBINED BALANCE SHEET**

As of December 31, 2003

(Millions of dollars)

	Historical UGI Corporation (2)	Historical AGZ Holding (3)	French GAAP to U.S. GAAP Adjustments (4)	Pro Forma Adjustments (5)	Pro Forma Combined
<b>ASSETS</b>					
Current assets:					
Cash and cash equivalents	\$ 143.6	\$ 13.8	\$	\$ (102.1)(12)	\$ 55.3
Short-term investments (at cost, which approximates fair value)	49.9	51.8			101.7
Accounts receivable	361.1	162.6			523.7
Accrued utility revenues	30.6				30.6
Inventories	148.6	24.8			173.4
Deferred income taxes	18.8				18.8
Prepaid expenses and other current assets	39.8	32.1			71.9
<b>Total current assets</b>	<b>792.4</b>	<b>285.1</b>		<b>(102.1)</b>	<b>975.4</b>
Property, plant and equipment, net	1,360.3	231.1		317.4(13)	1,908.8
Goodwill and excess reorganization value	679.8	423.2	44.4(6) (22.6)(6)	92.8(14)	1,217.6
Intangible assets	36.3	61.7	(23.6)(7) 55.6(7)	19.0(15)	149.0
Utility regulatory assets	61.3				61.3
Other assets	96.9	53.7		(30.0)(16)	120.6
<b>Total assets</b>	<b>\$ 3,027.0</b>	<b>\$ 1,054.8</b>	<b>\$ 53.8</b>	<b>\$ 297.1</b>	<b>\$ 4,432.7</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>					
Current liabilities:					
Current maturities of long-term debt	\$ 65.3	\$	\$	\$	\$ 65.3
Current maturities of UGI Utilities preferred shares subject to mandatory redemption	1.0				1.0
AmeriGas Propane bank loans	36.0				36.0
UGI Utilities bank loans	72.2				72.2
Other bank loans	18.1				18.1
Accounts payable	327.2	157.5			484.7
Deferred income taxes		19.3			19.3
Other current liabilities	230.0		9.6(8) 1.7(9)		241.3
<b>Total current liabilities</b>	<b>749.8</b>	<b>176.8</b>	<b>11.3</b>		<b>937.9</b>
Long-term debt	1,161.6	496.8	(9.6)(8)	23.4(17)	1,672.2

Edgar Filing: UGI CORP /PA/ - Form 424B5

Deferred income taxes	230.9		33.0(10)	111.1(18)	375.0
UGI Utilities preferred shares subject to mandatory redemption	19.0				19.0
Other noncurrent liabilities	107.3	319.3	(1.7)(9)		424.9
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Total liabilities	2,268.6	992.9	33.0	134.5	3,429.0
Commitments and contingencies					
Minority interests	149.8	15.1			164.9
Common stockholders' equity:					
Common Stock, without par value	582.9	44.2		186.0(19)	813.1
Retained earnings	117.5	2.6	20.8(11)	(23.4)(20)	117.5
Accumulated other comprehensive income	15.6				15.6
Notes receivable from employees	(0.4)				(0.4)
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Treasury stock, at cost	715.6	46.8	20.8	162.6	945.8
	<u>(107.0)</u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>(107.0)</u>
Total common stockholders' equity	608.6	46.8	20.8	162.6	838.8
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Total liabilities and stockholders' equity	\$ 3,027.0	\$ 1,054.8	\$ 53.8	\$ 297.1	\$ 4,432.7
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>

See accompanying notes to unaudited pro forma condensed combined financial statements.

Table of Contents

## UGI CORPORATION AND SUBSIDIARIES

## UNAUDITED PRO FORMA CONDENSED COMBINED STATEMENT OF INCOME

Three Months Ended December 31, 2003

(Millions, except per share amounts)

	Historical UGI Corporation(2)	Historical AGZ Holding(3)	French GAAP to U.S. GAAP		Pro Forma Adjustments(5)	Pro Forma Combined
			Adjustments(4)	Reclassi- fications(4)		
Revenues	\$ 893.7	\$ 214.3	\$	\$	\$	\$ 1,108.0
Costs and expenses:						
Cost of sales	596.9	92.9				689.8
Operating and administrative expenses	163.3	65.3		2.1(24)		230.7
Utility taxes other than income taxes	3.1					3.1
Depreciation and amortization	27.5	17.4	2.0 (21)	(2.1)(24)	(6.8)(25)	38.0
Amortization of goodwill		5.8	(5.8)(22)			
Other (income) expense, net	(5.4)	0.5				(4.9)
	<u>785.4</u>	<u>181.9</u>	<u>(3.8)</u>	<u></u>	<u>(6.8)</u>	<u>956.7</u>
Operating income	108.3	32.4	3.8		6.8	151.3
Income (loss) from equity investees	4.2	(0.5)			(4.2)(26)	(0.5)
Interest (expense) income	(26.7)	(7.4)			0.1 (27)	(34.0)
Minority interests	(22.7)	1.0			(0.8)(28)	(22.5)
Income before income taxes	63.1	25.5	3.8		1.9	94.3
Income tax (expense) benefit	(24.3)	(11.3)	0.7 (23)		(1.9)(29)	(36.8)
Net income	<u>\$ 38.8</u>	<u>\$ 14.2</u>	<u>\$ 4.5</u>	<u>\$</u>	<u>\$</u>	<u>\$ 57.5</u>
Earnings per share:						
Basic	<u>\$ 0.91</u>					<u>\$ 1.14</u>
Diluted	<u>\$ 0.88</u>					<u>\$ 1.12</u>
Average common shares outstanding (millions):						
Basic	<u>42.839</u>				<u>7.500(30)</u>	<u>50.339</u>
Diluted	<u>43.947</u>				<u>7.500(30)</u>	<u>51.447</u>

See accompanying notes to unaudited pro forma condensed combined financial statements.

P-4



Table of Contents

## UGI CORPORATION AND SUBSIDIARIES

## UNAUDITED PRO FORMA CONDENSED COMBINED STATEMENT OF INCOME

Year Ended September 30, 2003

(Millions, except per share amounts)

	Historical	Historical AGZ Holding (3)	French GAAP to U.S. GAAP		Pro	Pro
	UGI Corporation (2)		Adjustments (4)	Reclassifications (4)	Forma Adjustments (5)	Forma Combined
Revenues	\$ 3,026.1	\$ 698.9	\$	\$	\$	\$ 3,725.0
Costs and expenses:						
Cost of sales	1,984.3	335.1				2,319.4
Operating and administrative expenses	643.3	228.9		7.4(24)		879.6
Utility taxes other than income taxes	13.0					13.0
Depreciation and amortization	103.0	71.8	7.4(21)	(14.3)(24)	(26.5)(25)	141.4
Amortization of goodwill		25.8	(21.0)(22)			4.8
Other income, net	(19.8)	(4.8)				(24.6)
	<u>2,723.8</u>	<u>656.8</u>	<u>(13.6)</u>	<u>(6.9)</u>	<u>(26.5)</u>	<u>3,333.6</u>
Operating income	302.3	42.1	13.6	6.9	26.5	391.4
Income (loss) from equity investees	5.3	(2.0)			(5.9)(26)	(2.6)
Loss on extinguishments of debt	(3.0)					(3.0)
Interest (expense) income	(109.2)	(37.9)		(6.9)(24)	0.5(27)	(153.5)
Minority interests	(34.6)	4.2			(3.2)(28)	(33.6)
Income before income taxes and subsidiary preferred stock dividends	160.8	6.4	13.6		17.9	198.7
Income tax (expense) benefit	(60.7)	(11.1)	2.6(23)		(8.9)(29)	(78.1)
Dividends on UGI Utilities preferred shares subject to mandatory redemption	(1.2)					(1.2)
Net income (loss)	\$ 98.9	\$ (4.7)	\$ 16.2	\$	\$ 9.0	\$ 119.4
Earnings per share:						
Basic	\$ 2.34					\$ 2.40
Diluted	\$ 2.29					\$ 2.35

Edgar Filing: UGI CORP /PA/ - Form 424B5

Average common shares  
outstanding (millions):

Basic	42.220	7.500(30)	49.720
Diluted	43.236	7.500(30)	50.736

See accompanying notes to unaudited pro forma condensed combined financial statements.

P-5

**Table of Contents****UGI CORPORATION****NOTES TO UNAUDITED PRO FORMA CONDENSED COMBINED****FINANCIAL STATEMENTS**

(Millions of dollars)

1. UGI and its wholly owned subsidiary UGI France, Inc. have executed a share purchase agreement and a joinder agreement to effect the acquisition of the outstanding shares of AGZ that UGI France, Inc. does not already own in a cash purchase transaction pursuant to the terms of said share purchase agreements. The purchase price for the outstanding shares owned by other parties is approximately 258.5 million based upon estimates of working capital and pre- and post-closing adjustments. Based upon the currency exchange rate of \$1.26 per euro at December 31, 2003, the purchase price would have translated to approximately \$325.7 million in cash.

The preliminary allocation of the purchase price (including estimated transaction fees and expenses) to the assets acquired and liabilities assumed, representing a revaluation of the portion not already owned by UGI, in the Unaudited Pro Forma Condensed Combined Balance Sheet at December 31, 2003, is as follows:

	<b>Book Value</b>		
	<b>of Assets</b>	<b>Preliminary</b>	
	<b>Acquired</b>	<b>Purchase</b>	<b>Preliminary</b>
	<b>(Liabilities</b>	<b>Price</b>	<b>Fair</b>
	<b>Assumed)*</b>	<b>Allocation</b>	<b>Value</b>
	<u>          </u>	<u>          </u>	<u>          </u>
Cash and cash equivalents	\$ 11.1	\$	\$ 11.1
Short-term investments	41.7		41.7
Accounts receivable	130.9		130.9
Inventories	20.0		20.0
Prepaid and other current assets	25.8		25.8
Property, plant and equipment	186.0	317.4	503.4
Goodwill	358.3	76.0	434.3
Intangible assets	75.5	19.0	94.5
Other assets	43.2		43.2
Accounts payable	(126.8)		(126.8)
Deferred income taxes	(15.5)		(15.5)
Other current liabilities	(7.7)		(7.7)
Long-term debt	(392.2)	(23.4)	(415.6)
Deferred income taxes	(26.6)	(111.1)	(137.7)
Noncurrent liabilities	(257.1)		(257.1)
Minority interest	(12.2)		(12.2)
	<u>          </u>	<u>          </u>	<u>          </u>
	<b>\$ 54.4</b>	<b>\$ 277.9</b>	<b>\$ 332.3</b>
	<u>          </u>	<u>          </u>	<u>          </u>

## Edgar Filing: UGI CORP /PA/ - Form 424B5

\* Represents 80.5% of the book value of AGZ as of December 31, 2003

The Unaudited Pro Forma Condensed Combined Financial Statements are not necessarily indicative of the operating results or financial position that would have occurred had the acquisition been completed as of the dates indicated, nor are they necessarily indicative of future operating results or financial position. The purchase accounting adjustments made in connection with the Unaudited Pro Forma Condensed Combined Financial Statements are based on a preliminary valuation that has been made solely for purposes of developing the pro forma financial information and is based upon currently available information. Such valuation is subject to final adjustments. Accordingly, the actual adjustments to be recorded in connection with the final purchase price allocation may differ from the pro forma adjustments reflected in the Unaudited Pro Forma Condensed Combined Financial Statements, and any such differences may be material.

2. These columns represent UGI's historical consolidated financial statements. The unaudited consolidated financial statements as of and for the three months ended December 31, 2003 are derived from the unaudited

**Table of Contents**

**UGI CORPORATION**

**NOTES TO UNAUDITED PRO FORMA CONDENSED COMBINED**

**FINANCIAL STATEMENTS (Continued)**

(Millions of dollars)

consolidated financial statements included in the Form 10-Q filed by UGI on February 13, 2004 with the SEC. The audited consolidated statement of income for the year ended September 30, 2003 is derived from audited consolidated financial statements included in the Form 8-K filed by UGI on March 11, 2004 with the SEC.

3. These columns represent AGZ's historical unaudited consolidated financial statements. The consolidated balance sheet as of December 31, 2003 was derived from unaudited consolidated financial statements. The balance sheet, reported in euros, was translated to U.S. dollars at the exchange rate of \$1.26 per euro at December 31, 2003. The unaudited consolidated statement of income of AGZ for the three months ended December 31, 2003 was derived from unaudited consolidated financial statements. The statement of income, reported in euros, was translated to U.S. dollars using the average exchange rate of \$1.19 per euro. The unaudited consolidated statement of income of AGZ for the twelve months ended September 30, 2003 was derived by excluding the unaudited statement of income for the six months ended September 30, 2002 from the audited consolidated statement of income for the year ended March 31, 2003 and including the unaudited statement of income for the six months ended September 30, 2003. The statements of income, reported in euros, were translated to U.S. dollars using the average exchange rate of \$1.08 per euro.
4. These columns reflect the adjustments and reclassifications necessary to convert AGZ's historical consolidated financial statements from French GAAP to U.S. GAAP for presentation in the Unaudited Pro Forma Condensed Combined Financial Statements.
5. These columns reflect (1) the purchase price allocation to the portion of AGZ's identifiable assets acquired and liabilities assumed representing the portion not already owned by UGI, (2) the issuance of UGI Common Stock, the proceeds of which, together with available cash on hand, will be used by UGI to acquire the outstanding shares of AGZ not already owned by UGI, (3) the payment of the cash purchase price, and (4) the pro forma income statement effects resulting from the purchase accounting adjustments.
6. These adjustments (1) eliminate goodwill amortization to reflect the application of Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets, effective April 1, 2002 and (2) adjust goodwill for amounts which would have been allocated to customer lists, trademarks and deferred income taxes under U.S. GAAP as a result of AGZ's acquisition of Antargaz on March 27, 2001.
7. These adjustments (1) record amortization of AGZ's customer list, which is not amortized under French GAAP (customer list amortization is calculated using an estimated useful life of eleven years) and (2) increase the value of customer lists and trademarks to what would have been recorded under U.S. GAAP as a result of AGZ's acquisition of Antargaz on March 27, 2001.
8. Reflects the reclassification of accrued interest on AGZ's high yield bonds included in long-term debt under French GAAP.
9. Reclassification of the current portion of prepaid cylinder and tank rental fees to other current liabilities.
10. This adjustment records the deferred tax liability associated with the customer lists that would have been recorded under U.S. GAAP as a result of AGZ's acquisition of Antargaz on March 27, 2001.

Edgar Filing: UGI CORP /PA/ - Form 424B5

11. Reflects the net impact of the adjustments to eliminate goodwill amortization and record customer list amortization on AGZ's retained earnings.

P-7

**Table of Contents****UGI CORPORATION****NOTES TO UNAUDITED PRO FORMA CONDENSED COMBINED****FINANCIAL STATEMENTS (Continued)**

(Millions of dollars)

12. Reflects pro forma adjustments to cash and cash equivalents as follows:

Net cash proceeds from issuance of UGI Common Stock	\$ 230.2
Cash payments pursuant to the share purchase agreement	(325.7)
Estimated transaction fees and expenses and offering expenses	(6.6)
	<u>          </u>
	<u>\$ (102.1)</u>

13. Reflects pro forma adjustment to record at fair value the portion of property, plant and equipment not already owned.
14. Reflects pro forma adjustment to record goodwill representing the excess of the purchase price over the fair value of the net assets acquired and to record goodwill on the initial investment in AGZ as follows:

Goodwill relating to the purchase of 80.5% interest in AGZ not already owned by UGI	\$ 76.0
Goodwill relating to 19.5% investment in AGZ	16.8
	<u>          </u>
	<u>\$ 92.8</u>

15. Reflects pro forma adjustment to record at fair value the intangible customer list acquired.
16. Reflects pro forma adjustment to eliminate UGI's carrying value of its approximate 19.5% ownership interest in AGZ which is accounted for under the equity method prior to the acquisition of the outstanding shares of AGZ that it did not already own.
17. Reflects pro forma adjustment to adjust fixed rate, long-term debt to fair value.
18. Reflects pro forma adjustment to record deferred income taxes on the increase in fair value of property, plant and equipment not already owned by UGI.
19. Reflects pro forma issuance of UGI Common Stock to fund a portion of the purchase price and to eliminate the historical equity of AGZ as follows:

## Edgar Filing: UGI CORP /PA/ - Form 424B5

Issuance of UGI Common Stock to fund a portion of the purchase price	\$ 230.2
Eliminate AGZ common stock	(44.2)
	<hr/>
	\$ 186.0
	<hr/>

20. Reflects pro forma adjustment to eliminate historical retained earnings of AGZ, net of French GAAP to U.S. GAAP adjustments.
21. Reflects pro forma adjustment to record amortization of AGZ's customer list, which is not amortized under French GAAP. Customer list amortization is calculated using an estimated useful life of eleven years.
22. Reflects pro forma adjustment to eliminate goodwill amortization to reflect the application of Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets.
23. Reflects pro forma adjustment to record income tax benefit on customer list amortization.



Table of Contents

## UGI CORPORATION

## NOTES TO UNAUDITED PRO FORMA CONDENSED COMBINED

## FINANCIAL STATEMENTS (Continued)

(Millions of dollars)

24. Reclassification adjustment of certain expenses to conform AGZ's presentation to U.S. GAAP. Under French GAAP, certain expenses included in depreciation and amortization are considered operating and administrative expenses under U.S. GAAP.
25. Reflects pro forma adjustment to record depreciation on the fair value of the property, plant and equipment acquired and to record depreciation and amortization on fixed assets and intangible assets using useful lives which are consistent with UGI's policies, and are generally longer than useful lives utilized by AGZ, as follows:

Three Months Ended December 31, 2003:

Depreciation expense	\$ 8.1
Amortization of customer list	2.0
Amortization of other intangible assets	0.4
Eliminate historical depreciation and amortization, net of reclassifications and U.S. GAAP adjustment	(17.3)
	<u>          </u>
	<u>\$ (6.8)</u>

Year Ended September 30, 2003:

Depreciation expense	\$ 29.6
Amortization of customer list	7.4
Amortization of other intangible assets	1.4
Eliminate historical depreciation and amortization, net of reclassifications and U.S. GAAP adjustment	(64.9)
	<u>          </u>
	<u>\$ (26.5)</u>

26. Reflects pro forma adjustment to eliminate UGI's 19.5% equity income from AGZ.

## Edgar Filing: UGI CORP /PA/ - Form 424B5

27. Reflects pro forma adjustment to reflect interest expense on the fair value of debt assumed.
28. Reflects pro forma adjustment to allocate a portion of depreciation on property, plant and equipment relating to a consolidated subsidiary of AGZ, which is not 100% owned.
29. Reflects pro forma income tax expense on pro forma adjustments at AGZ's incremental income tax rate of 35%.
30. Reflects pro forma issuance of UGI Common Stock in conjunction with the acquisition.

P-9

**Table of Contents**

**INDEX TO FINANCIAL STATEMENTS**

Report of Independent Auditors	F-2
Consolidated Balance Sheet at March 31, 2003	F-3
Consolidated Statement of Operations for the Year Ended March 31, 2003	F-5
Consolidated Statement of Cash Flows for the Year Ended March 31, 2003	F-6
Notes to the Consolidated Financial Statements	F-7

F-1

**Table of Contents**

**PricewaterhouseCoopers Audit**

**Barbier Frinault & Autres**

**Tour AIG**

**Ernst & Young**

**34, place des Corolles**

**41, rue Ybry**

**92908 Paris la Défense Cedex**

**92576 Neuilly-sur-Seine Cedex**

**To the Board of Directors and Shareholders of AGZ Holding SA**

**43, avenue de l Opéra**

**75 002 Paris**

**Report of Independent Auditors**

We have audited the accompanying consolidated balance sheet of AGZ Holding SA and its subsidiaries as of March 31, 2003 and the related consolidated statements of income and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in France and in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of AGZ Holding SA as of March 31, 2003, and the consolidated results of its operations and its cash flows for the year then ended, in conformity with accounting principles generally accepted in France.

Accounting principles generally accepted in France vary in certain significant respects from accounting principles generally accepted in the United States of America. Information relating to the nature and effect of such differences is presented in Note 30 to the consolidated financial statements.

Paris and Neuilly sur Seine, June 21, 2003

**PricewaterhouseCoopers Audit**

**Barbier Frinault & Autres**

**Ernst & Young**

**Jean-Pierre Caroff**

**Philippe Diu**

F-2

**Table of Contents****AGZ HOLDING****CONSOLIDATED BALANCE SHEET**

( thousands)

	<u>Note</u>	<u>March 31, 2003</u>
<b>ASSETS</b>		
<b>Non-current assets</b>		
Goodwill	4	351,097
<b>Intangible assets</b>		
Franchises, patents and other similar rights		15
Other intangible assets		49,246
	5	49,261
<b>Tangible assets</b>		
Land		5,798
Buildings		10,390
Machinery and equipment		180,630
Vehicles		4,176
Furniture and computers		1,182
Other tangible assets		575
Construction in progress		3,118
Advances and payments on account		1,216
	6	207,085
Investments	7	53,087
Investments accounted for under the equity method	8	6,144
<b>Total non current assets</b>		<b>666,674</b>
<b>Current assets</b>		
Inventories	9	16,556
Trade notes and accounts receivable	10	155,195
Other receivables	12	25,776
Marketable securities		44,856
Cash		20,288
<b>Total current assets</b>		<b>262,671</b>
<b>TOTAL ASSETS</b>		<b>929,345</b>

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

**Table of Contents****AGZ HOLDING****CONSOLIDATED BALANCE SHEET**

( thousands)

	<u>Note</u>	<u>March 31, 2003</u>
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
<b>Shareholders equity</b>		
Capital		60,127
Additional paid-in capital		187
Consolidated reserves		14,445
Net loss for the year		(789)
<b>Total shareholders equity</b>	13	<b>73,970</b>
Minority interests	14	15,197
Contingency and loss provisions	16	37,474
<b>Liabilities</b>		
Borrowings and other liabilities	17	441,382
Trade notes and accounts payable		106,128
Deferred income taxes	11	20,186
Other liabilities	18	235,008
<b>Total liabilities</b>		<b>802,704</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS EQUITY</b>		<b>929,345</b>

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

**Table of Contents****AGZ HOLDING****CONSOLIDATED STATEMENT OF OPERATIONS****( thousands)**

	<b>Note</b>	<b>Year Ended March 31, 2003</b>
	<u>          </u>	<u>          </u>
Net sales	20	679,161
Other income		3,968
<b>Revenues</b>		<b>683,129</b>
Purchases of materials		(333,038)
Payroll costs		(67,771)
Other operating expense	21	(146,759)
Taxes other than on income		(9,640)
Depreciation, amortization and provisions	22	(67,076)
<b>Operating expenses</b>		<b>(624,284)</b>
<b>Operating income</b>		<b>58,845</b>
Financial expense, net	23	(32,157)
<b>Income from ordinary activities</b>		<b>26,688</b>
Exceptional items, net	24	8,029
Income tax	11	(12,977)
<b>Net income from consolidated companies</b>		<b>21,740</b>
Equity in loss of associated companies		(1,923)
Goodwill amortization	4	(24,341)
<b>Net loss before minority interests</b>		<b>(4,524)</b>
Minority interests		3,735
<b>Net loss</b>		<b>(789)</b>
Basic loss per share	25	( 0.01)
Diluted loss per share		( 0.01)

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





**Table of Contents****AGZ HOLDING****CONSOLIDATED STATEMENT OF CASH FLOWS****( thousands)**

	<b>Year Ended March 31, 2003</b>
Net loss before minority interests	(4,524)
<i>Adjustments to reconcile net loss to cash flow:</i>	
Amortization, depreciation and provisions	79,778
Changes in deferred taxes	(4,112)
Equity in earnings of associated companies	1,923
Gains and losses from disposals, net of tax	1,074
Other (expenses relating to high yield bonds issuance included in net loss)	4,533
<b>Cash flow from operating activities before changes in working capital</b>	<b>78,672</b>
<i>Net changes in working capital:</i>	
Inventories	(179)
Accounts receivable	(12,121)
Accounts payable	14,921
<b>Cash flow from operating activities</b>	<b>81,293</b>
Additions to intangible assets	(1,116)
Additions to property, plant and equipment	(27,035)
Additions to investments	(683)
Proceeds from disposals of fixed assets	1,046
Net change in other investments	426
<b>Net cash used in investing activities</b>	<b>(27,362)</b>
Dividends paid to the consolidated subsidiaries minority shareholders	(233)
Increase in debt security deposit	(15,000)
High yield bonds issuance	165,000
Net change in other borrowings and liabilities	(220,438)
Other (expenses relating to high yield bonds issuance)	(11,287)
<b>Net cash used in financing activities</b>	<b>(81,958)</b>
<b>Net change in cash and cash equivalents</b>	<b>(28,027)</b>
Cash and cash equivalents at beginning of the period	90,229
Cash and cash equivalents at end of the period	62,202

Edgar Filing: UGI CORP /PA/ - Form 424B5

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

F-6

**Table of Contents**

**AGZ HOLDING**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**(All figures are expressed in thousands unless otherwise stated)**

**NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING PRINCIPLES**

**Overview**

***a) Accounting standards***

The consolidated financial statements of AGZ Holding and its subsidiaries (the Company) have been prepared in accordance with French generally accepted accounting principles, and specifically standard 99-02 issued by the *Comité de Réglementation Comptable* (CRC 99-02).

***b) Fiscal year end***

All of the Company's consolidated subsidiaries have a March 31 year-end, except Norgal and Geovexin, which have a December 31 year-end. Norgal and Geovexin have been consolidated on the basis of non-audited financial statements (most recent audited financial statements are as of December 31).

**Accounting principles**

***a) Consolidation methods***

The consolidated financial statements include the financial statements of material subsidiaries in which AGZ Holding owns directly or indirectly more than 20% of voting rights.

Companies, in which AGZ Holding owns more than 50% of the voting rights, directly or indirectly, are fully consolidated. Companies over which AGZ Holding exercises significant influence, but in which it holds less than 50% of the voting rights, directly or indirectly, are accounted for under the equity method.

***b) Goodwill***

Goodwill represents the excess of the purchase price of shares in consolidated companies over the fair value of the net assets acquired at the date of acquisition. The excess is allocated to the purchased assets and liabilities for which a fair value can be determined and the remaining is recorded as goodwill. Goodwill is amortized using the straight-line method over the estimated economic life of the asset, which does not exceed 20 years. The net value is reviewed on a regular basis and is adjusted when any triggering event indicates that the value of the asset might have been impaired.

***c) Intangible assets***

Intangible assets are stated at cost. The intangible assets relating to Antargaz's propane small bulk activity was determined based on the cost the company is willing to undertake for each new customer. The net value is reviewed on a regular basis for impairment.

Only computer software is amortized using the straight-line method. The estimated useful life ranges from 1 to 3 years.

***d) Property, plant and equipment***

Property, plant and equipment are stated at acquisition or production cost or, if applicable, at fair value at the date of a business combination. Interest expense related to the production of assets is not capitalized. Depreciation is calculated on the straight-line basis over the estimated useful life of the assets as follows:

**Table of Contents****AGZ HOLDING****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(All figures are expressed in thousands unless otherwise stated)**

	<b>Years</b>
Buildings	20 to 25
Fixtures and fittings	10
Technical equipment	10
Distribution equipment and other	5 to 10
Computer equipment	3

In addition, fixed assets which are held under capital leases are capitalized. Subsidiaries individual accounts have been adjusted to eliminate the rental expense and to recognize the interest expense, the depreciation expense and the repayment of the lease obligation. Depreciation of capital leased assets is calculated over the estimated useful lives of the respective assets as indicated above.

***e) Other investments***

Other investments primarily include non-consolidated equity interests and deposits.

Equity interests are stated at the lower of fair value or acquisition cost (purchase price excluding transaction costs). A provision is recorded when the value to the Company is lower than the carrying value. The value to the Company of investments in subsidiaries or affiliates is determined based on, notably, the Company's equity in the underlying net assets and on the entity's profitability prospects.

Deposits are stated at their nominal value.

***f) Inventories***

Inventories are valued according to the weighted average cost method. Cost includes incidental expenses.

***g) Receivables and payables***

Receivables are stated at cost. At year-end, receivables are reviewed and an allowance for bad debt is recorded based on the aging of the accounts receivable and/or the liquidity of the related customer. Receivables and payables denominated in a foreign currency are recorded based on the exchange rate in effect at year-end.

***h) Marketable securities***

Marketable securities are stated at acquisition cost and are valued based on the first-in first-out method (FIFO). A provision is recorded when the market value of the securities or, if not applicable, their estimated net realizable value, is lower than their acquisition cost.

***i) Investment grants***

Investment grants are recorded under deferred income.

***j) Contingency and loss provisions***

Since April 1, 2002, contingencies and loss provisions are recorded in conformity with the standard CRC 2000-06, which was issued by the *Comité de Réglementation Comptable*. Consequently, an amount of 3,196 has been reversed directly against shareholders' equity.

**Table of Contents**

**AGZ HOLDING**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(All figures are expressed in thousands unless otherwise stated)**

***k) Foreign currency transactions***

Unrealized gains or losses resulting from the translation to euro currency are directly recorded in earnings.

***l) Deferred income taxes***

Deferred income taxes are recognized by the liability method for timing differences between the recognition of certain items of income and expenses for financial reporting and tax purposes, as well as for consolidation adjustments (mainly purchase accounting adjustments, and the elimination of non-deductible provisions). Deferred tax assets are recognized for tax loss carry forwards and temporary differences, to the extent that they are offset by deferred liabilities. Net deferred tax assets are recognized only when it is more likely than not that such asset will be realized.

***m) Retirement obligations and other employee benefit commitments***

Retirement obligations, additional pension, contributions and other post-retirement benefits are recorded as a provision based on an actuarial valuation. A detailed actuarial valuation of these obligations is carried out, based on the Projected Unit Credit Method. The actuarial assumptions used are as follows:

All commitments except CREA:

Discount rate (early retirement plans and other): 4.5% - 5.7%.

Estimated annual salary increase: 3.2%.

Retirement age:

Non-managerial employee: 60 for employees born before January 1, 1950, and 62 for employees born afterwards.

Managers: 62 for employees born before January 1, 1950, and 64 for employees born afterwards.



## Edgar Filing: UGI CORP /PA/ - Form 424B5

Social security contributions: 45%.

Turnover:

2.5% (managers) and 1% (supervisory staff) for employees under 40 years old.

1% (managers) for employees under 50 years old.

Mortality rate: TPG 93 and INSEE 1998 tables.

CREA commitments:

Discount rate (early retirement plans and other): 5.3%.

Estimated annual salary increase: 2.3%.

Retirement age:

Non-managerial employees: 60 for employees born before January 1, 1950, and 62 for employees born afterwards.

Managers: 62 for employees born before January 1, 1950, and 64 for employees born afterwards.

Social security contributions: 45 %.

Employees still married when retiring: 80%.

F-9

**Table of Contents**

**AGZ HOLDING**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(All figures are expressed in thousands unless otherwise stated)**

Gap between the age of employees and the age of their husband or wife: 3 years.  
Reversion rate: 60%.  
Turnover:

Managers: 0% at any age.

Non-managerial employees: 8% if under 24, this rate being decreased of 2% every 5 years afterwards.

Mortality rate: TPG 93 and INSEE 1998 tables.

The provision for retirement obligations and employee benefit commitments is valued in note 16.

***n) Evaluation criteria for determining exceptional transactions***

Exceptional items include income and expense from exceptional transactions arising either from revenue or capital transactions.

**NOTE 2 CHANGE IN THE SCOPE OF CONSOLIDATION**

On June 14, 2002, the Company created a wholly owned subsidiary, AGZ Finance, with the exception of one share, which is held by Antargaz. Accordingly, AGZ Finance is included in the scope of consolidation as of that date.

The voting rights in Sigap Ouest have been reduced at year-end, decreasing from 66.67% to 66.00%, which reduced the consolidated reserves by 3.

**NOTE 3 SUBSEQUENT EVENTS**

## Edgar Filing: UGI CORP /PA/ - Form 424B5

Subsequent to the closing of accounts for the fiscal year 2003, a 25 million capital reduction of AGZ Holding was performed on June 20, 2003, as previously authorized by the Trust Deed, the Senior Credit Agreement and the Intercreditor Agreement.

Furthermore, AGZ Holding has undertaken to refinance its senior debt and revolving facility (undrawn amount of 46 million) by a new secured syndication of 220 million and a revolving facility of 50 million, with the target of reducing financing cost for the Company.

In connection with this transaction, the interest rate swaps set up pursuant to the 2001 LBO (maturing March 31, 2001) were terminated, resulting in a 5.4 million charge. We entered, concurrently, in a new swap (75% of the new facility and maturing in March 2005) to benefit from the current low level of interest rates (2.31% instead of 4.41% previously).

F-10

**Table of Contents****AGZ HOLDING****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

(All figures are expressed in thousands unless otherwise stated)

**NOTE 4 GOODWILL**

In accordance with the applicable regulations, goodwill was adjusted during the period. The adjustments were as follows:

<u>Investor</u>	<u>Investee</u>	<u>Gross value as at March 31, 2002</u>	<u>Adjustments</u>	<u>Gross value as at March 31, 2003</u>
AGZ Holding	Antargaz	389,316	(719)	388,597
Antargaz	Sobegal	1,510		1,510
Antargaz	Geovexin	5,128		5,128
<b>Total</b>		<b>395,954</b>	<b>(719)</b>	<b>395,235</b>
<u>Investor</u>	<u>Investee</u>	<u>Depreciation as at March 31, 2002</u>	<u>Amortization</u>	<u>Depreciation as at March 31, 2003</u>
AGZ Holding	Antargaz	(19,466)	(19,393)	(38,859)
Antargaz	Sobegal	(75)	(76)	(151)
Antargaz	Geovexin	(257)	(4,871)	(5,128)
<b>Total</b>		<b>(19,798)</b>	<b>(24,340)</b>	<b>(44,138)</b>
<u>Investor</u>	<u>Investee</u>	<u>Net value as at March 31, 2002</u>	<u>Adjustments</u>	<u>Net value as at March 31, 2003</u>
AGZ Holding	Antargaz	369,850	(20,112)	349,738
Antargaz	Sobegal	1,435	(76)	1,359
Antargaz	Geovexin	4,871	(4,871)	
<b>Total</b>		<b>376,156</b>	<b>(25,059)</b>	<b>351,097</b>

The above gross value adjustments detail as follows:

A reduction of the acquisition price of Antargaz shares resulting from a contractual guarantee	(221)
	(498)

## Edgar Filing: UGI CORP /PA/ - Form 424B5

A reduction of the expenses relating to the acquisition of Antargaz shares resulting from a tax regularization

The goodwill relating to Antargaz and Sobégal is amortized over 20 years, beginning April 1, 2002. Amortization expense for the period amounted to 19,393 and 76, respectively.

To align the book value of Géovexin in the consolidated statements on its fair value, the related goodwill has been depreciated at year-end. The amortization expense for the period amounted to 4,871.

F-11

**Table of Contents****AGZ HOLDING****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

(All figures are expressed in thousands unless otherwise stated)

**NOTE 5 INTANGIBLE ASSETS**

	<u>Franchises, patents</u>	<u>Customer base and other</u>	<u>Other intangible assets</u>	<u>Total</u>
Cost at March 31, 2002	655	48,116	21,387	70,158
Accumulated depreciation at March 31, 2002	(508)	(8)	(15,381)	(15,897)
<b>Net book value at March 31, 2002</b>	<b>147</b>	<b>48,108</b>	<b>6,006</b>	<b>54,261</b>
Additions	17		1,097	1,114
Reclassifications			46	46
Depreciation	(149)		(6,011)	(6,160)
Cost at March 31, 2003	462	48,116	22,494	71,072
Accumulated depreciation at March 31, 2003	(447)	(8)	(21,356)	(21,811)
<b>Net book value at March 31, 2003</b>	<b>15</b>	<b>48,108</b>	<b>1,138</b>	<b>49,261</b>

Additions mainly correspond to purchases of software equipment.

**NOTE 6 TANGIBLE ASSETS**

	<u>Land</u>	<u>Buildings</u>	<u>Machinery and equipment</u>	<u>Vehicles</u>	<u>Furniture, computers</u>	<u>Other tangible assets</u>	<u>Total</u>
Cost at March 31, 2002	6,427	24,853	576,246	6,036	6,205	6,129	627,896
Accumulated depreciation at March 31, 2002	(578)	(15,943)	(372,639)	(3,749)	(4,855)	(1,973)	(399,737)
<b>Net book value at March 31, 2002</b>	<b>5,849</b>	<b>10,910</b>	<b>203,607</b>	<b>2,287</b>	<b>1,350</b>	<b>4,156</b>	<b>228,159</b>
Additions	31	1,274	15,411	3,652	421	9,867	30,656
Disposals		(562)	(833)	(309)	(184)	(12)	(1,900)
Reclassifications		344	8,469	84	66	(9,009)	(46)

Edgar Filing: UGI CORP /PA/ - Form 424B5

Depreciation	(82)	(1,576)	(46,024)	(1,538)	(470)	(94)	(49,784)
Cost at March 31, 2003	6,458	27,305	588,217	8,604	3,847	6,898	641,329
Accumulated depreciation at March 31, 2003	(660)	(16,915)	(407,587)	(4,428)	(2,664)	(1,990)	(434,244)
<b>Net book value at March 31, 2003</b>	<b>5,798</b>	<b>10,390</b>	<b>180,630</b>	<b>4,176</b>	<b>1,183</b>	<b>4,908</b>	<b>207,085</b>

Additions primarily correspond to technical equipment ( 15,411) and construction in progress ( 9,867). Additions of vehicles ( 3,652) correspond to the assets under lease contracts recognized in the financial statements during the fiscal year. The reclassifications relate to the assets put into service during the period.

**Table of Contents****AGZ HOLDING****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

(All figures are expressed in thousands unless otherwise stated)

**NOTE 7 INVESTMENTS**

Investments include shares in non-consolidated companies in an amount of 36,671 and other non-current assets amounting to 16,416. Therefore, total investments amount to 53,087.

Shares in non-consolidated companies are as follows:

<u>Company</u>	<u>Percent Interest</u>	<u>Cost</u>	<u>Allowances</u>	<u>Net Book Value at March, 31 2003</u>
Cobogal	15.00%	1,525		1,525
Floregaz	80.00%	61		61
Géogaz	16.67%	35,063		35,063
Elf Gas Shandong(1)	100.00%	972	(972)	
Elf Gas Peru(1)	82.71%	3,884	(3,884)	
Siraga Industrie(1)	10.00%	47	(47)	
Aqualoire(1)	5.00%	23	(23)	
Sapomer(1)	5.84%	11	(11)	
Elf Gas Chile(1)	100.00%	10	(10)	
Engas	28.00%	22		22
<b>Total</b>		<b>41,618</b>	<b>(4,947)</b>	<b>36,671</b>
<i>Hereunder, the companies with no gross book value</i>				
Bus Paris	50.00%			
GPL Bus	25.00%			
Opération Reflex GPL	5.00%			
Donges	50.00%			
Queven	50.00%			
Groupement Lechnique Citerne	20.00%			

(1) Companies in liquidation

The companies that are more than 20%-owned included in the above table have not been consolidated because they are not material in relation to the Company as a whole.



Edgar Filing: UGI CORP /PA/ - Form 424B5

Changes during fiscal year were as follows:

	<u>Equity Interest</u>	<u>Receivables from controlled entities</u>	<u>Loans</u>	<u>Other investments</u>
Beginning balance	36,671	15	1,289	177
Additions			159	15,057
Disposals			(278)	(3)
Provisions				
<b>Closing balance</b>	<b>36,671</b>	<b>15</b>	<b>1,170</b>	<b>15,231</b>

The Company is required to maintain a deposit as a pledge of collateral for the benefit of the Company's creditors under the senior credit agreement, as amended in July 2002. The deposit amount is interest bearing and is not available to the Company until its obligations to the creditors under the senior credit agreement have been satisfied. Accordingly, this deposit, which totaled 15,000 at March 31, 2003, is classified as an investment in the consolidated balance sheet.

**Table of Contents****AGZ HOLDING****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(All figures are expressed in thousands unless otherwise stated)**

Loans and other investments are as follows:

	<b>March 31, 2003</b>	<b>Due in less than 1 year</b>	<b>Due between 2 and 5 years</b>	<b>Due in more than 5 years</b>
Loans	1,170	12	1,077	80
Other investments	15,231	130	45	15,056

**NOTE 8 INVESTMENTS ACCOUNTED FOR UNDER THE EQUITY METHOD**

Investments accounted for under the equity method correspond solely to shares held in Géovexin. During the fiscal year, the value of the investments was modified by the following changes:

Gross amount at March 31, 2002	8,067
Net income	(1,923)
<b>Gross amount at March 31, 2003</b>	<b>6,143</b>

Net income as above-mentioned does not include the amortization of goodwill relating to Géovexin ( 4,871). The contribution of Géovexin to the consolidated account is as follows:

Equity in consolidated net loss of Géovexin for the year	(1,923)
Amortization of goodwill	(4,871)
<b>Contribution to the consolidated equity at March 31, 2003</b>	<b>(6,794)</b>

**NOTE 9 INVENTORIES**

Inventories are valued using the weighted average cost method. Cost includes incidental expenses. The components of inventory were as follows:

	<b>March 31, 2003</b>
Raw materials and supplies	2,552
Provision on raw materials and supplies	(48)
Work-in-process	17
Provision on work-in-process	
Goods held for resale	14,047
Provision on goods held for resale	(12)
<b>Total</b>	<b>16,556</b>

**NOTE 10 TRADE NOTES AND ACCOUNTS RECEIVABLE**

This item consists of the following:

	<b>March 31, 2003</b>
Trade notes and accounts receivable	159,063
Allowance for bad debt	(3,868)
<b>Total</b>	<b>155,195</b>

Table of Contents

## AGZ HOLDING

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(All figures are expressed in thousands unless otherwise stated)

The provision for bad debt has been modified as follows:

	March 31, 2003
Beginning balance	3,494
Increase	1,701
Decrease	(1,327)
<b>Total</b>	<b>3,868</b>

## NOTE 11 DEFERRED INCOME TAXES

	March 31, 2003
Current income tax	(17,088)
Deferred income taxes	4,111
<b>Income tax (expense)</b>	<b>(12,977)</b>

*a) Effective tax rate*

The difference between the effective tax rate and the statutory tax rate applicable in France can be analyzed as follows:

	March 31, 2003
Statutory tax rate in France	35.43%

Edgar Filing: UGI CORP /PA/ - Form 424B5

Goodwill amortization	102.02%
Other	16.07%
<b>Effective tax rate</b>	<b>153.52%(1)</b>

- (1) The level of effective tax rate results from the structure of income statement, and in particular goodwill amortization effect on net loss for the period without tax credit in counterpart.

*b) Basis of income tax*

	March 31,
	2003
Untaxed provisions	(17,595)
Fair value adjustments to technical equipment	(13,966)
Transaction costs of acquisition of Antargaz shares	1,090
Provision for retirement costs	3,203
Inter-company margins on inventories	1,035
Timing differences	7,977
Other adjustments	229
<b>Net deferred taxes</b>	<b>(20,186)</b>
Of which:	
Deferred tax liabilities	(20,186)
Deferred tax assets	

Deferred tax liabilities and deferred tax assets have been compensated when relating to the same tax entity.

**Table of Contents****AGZ HOLDING****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(All figures are expressed in thousands unless otherwise stated)***c) Tax consolidation*

AGZ Holding is the parent of the tax consolidation group, which includes the following companies:

Antargaz

Aquitaine Pyrénées Gaz

Gaz Est Distribution

Nord GPL

Rhône Méditerranée Gaz

Wogégal

Following an agreement signed on March 27, 2001 with its subsidiaries, AGZ Holding benefits from the tax savings or bears the corporate income tax resulting from the application of the tax consolidated regime. The subsidiaries are liable to AGZ Holding for the income tax (including additional taxation) that they would have paid if they had not been part of the tax consolidation group.

*d) Tax proof*

	<b>March 31, 2003</b>
Net income before minority interest	(4,524)
Income tax	12,977
Income before tax	8,453
Goodwill amortization	24,341
Other permanent differences	2,881

Edgar Filing: UGI CORP /PA/ - Form 424B5

Taxable income	35,675
Income tax at the rate of 35.43%	12,640
Other	337
	<hr/>
<b>Income tax</b>	<b>12,977</b>
	<hr/>
Of which:	
Current income tax	17,088
Deferred income taxes	(4,111)

**NOTE 12 OTHER RECEIVABLES**

	<b>March 31,</b>
	<b>2003</b>
	<hr/>
Advances and payment on account	647
Prepaid and recoverable taxes	11,194
Other operating receivables	439
Other non-operating receivables	1,330
Provisions on other receivables	(1,269)
Deferred charges	10,725
Prepaid expenses	2,710
	<hr/>
<b>Net amount</b>	<b>25,776</b>
	<hr/>

**Table of Contents****AGZ HOLDING****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(All figures are expressed in thousands unless otherwise stated)**

Deferred charges include at year end:

Debt issuance cost of 4,491, amortized over the life of the related debt by the yield-to-maturity method, and

Cost related to debt restructuring achieved in July of 2002 for 6,234, amortized on a straight-line basis over the life of high yield bonds.

**NOTE 13 SHAREHOLDERS EQUITY**

In conjunction with the redemption of the redeemable bonds that occurred in July 2002, for which, part of the redemption was made in exchange for shares of AGZ Holding, the capital stock of AGZ Holding increased from 50,106 to 60,127. The Company currently has 60,126,800 shares of capital stock outstanding as of March 31, 2003.

The Company issued 1,333,928 new shares, each of them carrying 19 equity warrants, or 25,344,632 warrants in the aggregate. The issuance led to the recognition of an additional paid-in capital of 187. The conversion ratio is fixed at 13 warrants for one new share. The exercise of these warrants is conditional upon the realization of a minimum internal rate of return of 20%.

Changes in shareholders equity are presented below:

	<u>Capital</u>	<u>Additional paid-in capital</u>	<u>Consolidated reserves</u>	<u>Net income/(loss) of the year</u>	<u>Total Shareholders equity</u>
Balance as at March 31, 2002	50,106	187	(729)	12,018	61,582
Change in capital	10,021				10,021
Net income for the prior year			12,018	(12,018)	
Net loss of the year				(789)	(789)
Dividends					
Change in scope of consolidation			(3)		(3)
Other changes			3,159		3,159
<b>Balance as at March 31, 2003</b>	<b>60,127</b>	<b>187</b>	<b>14,445</b>	<b>(789)</b>	<b>73,970</b>





Other changes correspond to:

Reversal of contingency and loss provisions directly recorded in consolidated reserves in a net amount of 3,195, according to CRC 2000-06 issued by the *Comité de Réglementation Comptable* (see note 16), and

Adjustments of (36) related to goods under lease contracts for prior periods.

F-17

**Table of Contents****AGZ HOLDING****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(All figures are expressed in thousands unless otherwise stated)****NOTE 14 MINORITY INTERESTS**

The change in minority interests during the fiscal year is as follows:

	<b>Total</b>
	<b>minority</b>
	<b>interest</b>
	<b>_____</b>
Minority interests as at March 31, 2002	19,164
Net loss	(3,736)
Dividends	(234)
Other changes	3
	<b>_____</b>
<b>Minority interests as at March 31, 2003</b>	<b>15,197</b>
	<b>_____</b>

**NOTE 15 BONDS REDEEMABLE IN SHARES**

In July of 2002, the redeemable bonds were reimbursed through a \$90,188 cash payment, plus interest in an amount of \$8,113. The remaining portion of the reimbursement was affected by the redemption of \$10,021 in bonds by issuance of additional share capital.

**NOTE 16 CONTINGENCY AND LOSS PROVISIONS**

	<b>March 31,</b>						<b>March 31,</b>
	<b>2002</b>	<b>Allowances</b>	<b>Uses</b>	<b>Reversals</b>	<b>Reclassification</b>	<b>Others</b>	<b>2003</b>
	<b>_____</b>	<b>_____</b>	<b>_____</b>	<b>_____</b>	<b>_____</b>	<b>_____</b>	<b>_____</b>
Contingency provisions	17,982	6,493	(10)	(333)			24,132(1)
Loss provisions	12,324	27	(9,327)(3)	(1,259)(3)	2,158	(1,936)(2)	1,987
Provisions for retirement	11,136	953		(87)	(2,158)		9,844(4)

Provisions for other risks	4,539	111	(686)	(306)	(3,013)(2)	645
Other provisions	1,294		(428)			866
<b>Total</b>	<b>47,275</b>	<b>7,584</b>	<b>(10,451)</b>	<b>(1,985)</b>	<b>0</b>	<b>(4,949)</b>
						<b>37,474</b>

- (1) accrual mainly to cover a risk related to business tax for 23,680.
- (2) reversal recorded directly in consolidated reserves according to CRC 2000-06 issued by the *Comité de Réglementation Comptable*, corresponding to regulatory compliance ( 3,013) and to the costs resulting from the change of trademark ( 1,936).
- (3) of which 9,986 relating to reorganization plans.
- (4) of which 976 recorded in the individual statements of Antargaz and 8,868 resulting from the preparation of consolidated financial statements.

**NOTE 17 BORROWINGS AND OTHER LIABILITIES**

This item includes:

Bank borrowings. Debt issuance costs are amortized over the life of the debt.

Obligations under finance leases. The amount of the obligation corresponds to the value of the capitalized assets at the inception of the lease. It is written off on the straight-line basis over the life of the lease. The interest component is determined on the basis of the discounted present value of the future minimum lease payments at the inception of the lease.

**Table of Contents****AGZ HOLDING****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

(All figures are expressed in thousands unless otherwise stated)

	March 31, 2002	Changes		March 31, 2003	Due in less than 1 year	Due between 1 and 5 years	Due in more than 5 years
		Capital	Interests				
Senior debt	346,503	(84,851)	(189)	261,463	15,361	82,102	164,000
Subordinated debt	40,045	(39,000)	(1,045)				
Other bank borrowings	5,429	(918)	(246)	4,265	755	2,440	1,070
High yield bonds		165,000	3,437	168,437	3,437		165,000
Other borrowings	6,070	(6,238)	259	91	30	61	
Lease contract	879	2,581		3,460	1,045	2,415	
<b>Total borrowings</b>	<b>398,926</b>	<b>36,574</b>	<b>2,216</b>	<b>437,716</b>	<b>20,628</b>	<b>87,018</b>	<b>330,070</b>
Bank overdrafts	7,454	(4,909)	397	2,942	2,942		
Other debts	959	(235)		724	200	472	52
<b>Total overdrafts and other debts</b>	<b>8,413</b>	<b>(5,144)</b>	<b>397</b>	<b>3,666</b>	<b>3,142</b>	<b>472</b>	<b>52</b>
<b>Total</b>	<b>407,339</b>	<b>31,430</b>	<b>2,613</b>	<b>441,382</b>	<b>23,770</b>	<b>87,490</b>	<b>330,122</b>

In July 2002, through AGZ Finance, the Company issued 165,000 in 10% Senior Notes due 2011 (the High Yield Bonds). The interest on the High Yield Bonds is payable semi-annually on January 15 and July 15 of each year commencing January 15, 2003. The Company may redeem the bonds in whole or in part by paying a customary premium to the bondholders, of which, the amount fluctuates based upon the characteristics of reimbursement.

In connection with the issuance of the High Yield Bonds, the remaining balance of the redeemable bonds, as discussed above in Note 9, was reimbursed and payments of 75,000 and 39,000 were made against the senior debt and subordinated debt respectively. As of March 31, 2003, all of the subordinated debt and redeemable bonds has been paid in full.

Payments towards the Senior Debt included an early reimbursement totaling 75,000 as discussed above, and a scheduled principal payment of 9,851.

The Senior Debt bears interest on a rate fluctuating between Euribor plus 2% and Euribor plus 3%.

The Euribor rate for the Senior Debt has been swapped against a fixed rate of 4.41%.

**NOTE 18 OTHER LIABILITIES**

	<b>March 31, 2003</b>
Other operating liabilities(1)	169,152
Advances and payments on account	3,111
Accrued taxes and personnel costs	34,622
Other operating liabilities	5,090
Deferred income	9,537
Due to suppliers of property	10,099
Other non-operating liabilities	3,397
<b>Total</b>	<b>235,008</b>

(1) This item relates to the deposits on cylinders and tanks provided to customers.

**Table of Contents****AGZ HOLDING****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(All figures are expressed in thousands unless otherwise stated)****NOTE 19 RELATED PARTIES**

Among all non-consolidated companies in which AGZ Holding has an equity interest, only Géogaz and Cobogal have significant transactions with the Company. These Géogaz and Cobogal provide the Company with storage services, for which the outstanding amounts as at March 31, 2003 are as follows:

	<u>Géogaz</u>	<u>Cobogal</u>
Trade notes and accounts payable	286	244

**NOTE 20 SALES**

The Company sales break down as follows:

	<u>March 31,</u>
	<u>2003</u>
Sales of products	640,899
Discounts	(2,092)
Sales of services	40,354
<b>Net sales</b>	<b><u>679,161</u></b>

Net sales of products represent substantially all of the Company's activity relating to the trade on distribution of LPG. Sales of services principally represent revenues from storage, filling and loading services provided to third parties.

Except sales realized by AGZ Holding with other foreign LPG operators ( 22,622), all sales are made in France.

**NOTE 21 OTHER OPERATING EXPENSES**

Other operating expenses detail as follows:

	<b>March 31, 2003</b>
Transport	(59,396)
Repairs and maintenance	(18,373)
General subcontracting	(15,502)
Rental charges	(9,369)
Fees	(6,576)(1)
Bank charges	(5,105)(2)
Advertising and public relations	(7,683)
Travel and entertainment	(5,415)
Temporary staff	(3,756)
Mail and telecommunication costs	(3,219)
Insurance premiums	(1,757)
Other	(10,608)
<b>Other operating expenses</b>	<b>(146,759)</b>

- 
- (1) after deduction of the fees related to the debt restructuring achieved in July of 2002, integrally transferred to Deferred charges for (3,042)
- (2) after deduction of part of the bank charges related to the debt restructuring achieved in July of 2002 transferred to Deferred charges for (3,712), and including the redemption fees related to the initial debt (4,533).

Table of Contents

## AGZ HOLDING

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(All figures are expressed in thousands unless otherwise stated)

## NOTE 22 DEPRECIATION, AMORTIZATION AND PROVISIONS

Depreciation, amortization and provisions are as follows:

	<b>March 31, 2003</b>
Amortization	(60,375)
Provisions	(6,701)
<b>Amortization and provisions</b>	<b>(67,076)</b>

## NOTE 23 FINANCIAL INCOME AND EXPENSE

Financial income and expense break down as follows:

	<b>March 31, 2003</b>
<b>Financial income</b>	
Dividends received	559
Other equity interest income	7
Investment income	333
Net proceeds from sale of marketable securities	2,070
Other financial income	233
Reversals of provisions	86
<b>Financial income (excluding exchange gains)</b>	<b>3,288</b>
<b>Financial expense</b>	
Interest expense on capitalized leases	(195)
Other interest expense	(34,421)
Other financial expense	(6)



Edgar Filing: UGI CORP /PA/ - Form 424B5

<b>Financial expense (excluding exchange losses)</b>	<b>(34,622)</b>
	<hr/>
Realized exchange gains	2,165
Realized exchange losses	(2,988)
	<hr/>
<b>Income from exchange transactions</b>	<b>(823)</b>
	<hr/>
<b>Financial (expense), net</b>	<b>(32,157)</b>
	<hr/>

F-21

Table of Contents

## AGZ HOLDING

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(All figures are expressed in thousands unless otherwise stated)

## NOTE 24 EXCEPTIONAL ITEMS

Exceptional income and expense break down as follows:

	<b>March 31, 2003</b>
<b>Exceptional income</b>	
Exceptional income on revenue transactions	246
Exceptional income related to prior years	218
Proceeds from sale of assets	1,046
Investment grants	174
Other exceptional income	4
Reversals of provisions	11,954
<b>Exceptional income</b>	<b>13,642</b>
<b>Exceptional expense</b>	
Exceptional expense on revenue transactions	(713)
Exceptional expense related to prior years	(250)
Net book value of assets sold	(1,899)
Exceptional provisions	(2,660)
Other exceptional expense	(91)
<b>Exceptional expense</b>	<b>(5,613)</b>
<b>Exceptional income, net</b>	<b>8,029</b>

## NOTE 25 EARNINGS PER SHARE

Basic earnings per share is computed by dividing net income by the weighted average number of shares outstanding during the period.

The computation of diluted earnings per share includes the equivalent number of shares that have a dilutive effect, and excludes the equivalent number of shares that have an anti-dilutive effect. Net income is adjusted by the interest expense, net of tax, related to the convertible bonds. The

dilutive effect of the warrants is calculated based on the treasury stock method.

Basic and diluted loss per share totaled ( 0.01) per share.

F-22

**Table of Contents****AGZ HOLDING****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(All figures are expressed in thousands unless otherwise stated)****NOTE 26 CONSOLIDATED COMPANIES**

At March 31, 2003 :

<u>Company</u>	<u>SIRET Registration number</u>	<u>Consolidation method</u>	<u>Percent of interest</u>
AGZ HOLDING 43, avenue de l Opéra 75002 Paris	413 765 108 00027	Fully consolidated	100,00%
AGZ FINANCE 398, route d Esch L-1471 Luxembourg		Fully consolidated	100,00%
ANTARGAZ SA 3, place de Saverne 92400 Courbevoie	572 126 043 00510	Fully consolidated	100,00%
GAZ EST DISTRIBUTION 109, boulevard d Haussonville 54000 Nancy	421 283 615 00043	Fully consolidated	100,00%
NORD GPL Rue Gay Lussac 62200 Carvin	422 265 504 00023	Fully consolidated	100,00%
NORGAL GIE Route de la Chimie	777 344 623 00023	Fully consolidated	52,67%

Edgar Filing: UGI CORP /PA/ - Form 424B5

76700 HARFLEUR RHONE GAZ	969 507 235 0014	Fully consolidated	50,62%
Rue du 8 Mai 1945 69320 Feyzin			
RHONE MEDITERRANEE GAZ	382 151 272 00020	Fully consolidated	100,00%
6, rue Léon Blum 69320 Feyzin			
SIGAP OUEST	026 180 216 00017	Fully consolidated	66,00%
274, rue Jean Jaurcs 79000 Niort			
SOBEGAL	095 880 894 00076	Fully consolidated	72,00%
Rue Max Dormoy 64000 Pau			
WOGEGAL	310 095 658 00079	Fully consolidated	100,00%
19, rue Hippolyte Monteil 37700 Saint Pierre des Corps			
AQUITAINE PYRENEES GAZ	410 968 770 00033	Fully consolidated	100,00%
9, rue Aristide Briand 82000 Evreux			
GEOVEXIN	304 350 887 00036	Accounted for under the equity method	44,90%
5&7, rue Eugène et Armand Peugeot 92500 Rueil Malmaison			

F-23

Table of Contents

## AGZ HOLDING

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(All figures are expressed in thousands unless otherwise stated)

## NOTE 27 EMPLOYEES

	March 31, 2003
Managers	175
Supervisory staff	430
Employees	447
Workers	214
Personnel on secondment	102
<b>Total employees</b>	<b>1,368</b>

## NOTE 28 MANAGEMENT COMPENSATION

The total compensation (direct or indirect) paid to the members of the administration, management and supervisory boards in relation to their functions amount to 531,506.

## NOTE 29 COMMITMENTS

*a) Commitments and guarantees given*

Commitments and guarantees given break down as follows:

Real estate collateral for 0.3 million.

Customs guarantees (permit of removal or *credit enlèvement* and other) for 18.0 million.

Within the Senior Credit Agreement that was last modified on July 22, 2002 and signed with, among other banks, Deutsche Bank AG London and Barclays Capital, for an 396 million, commitment by AGZ Holding to secure the Senior Credit Agreement are as follows:

## Edgar Filing: UGI CORP /PA/ - Form 424B5

1. a pledge of financial instruments accounts relating to the shares held by AGZ Holding in Antargaz;
2. a first ranking pledge of AGZ Holding's business granted to Deutsche Bank AG London;
3. an assignment to Deutsche Bank AG London of the amounts due to AGZ Holding as warranties included in the contract dated February 16, 2001 and named *Garantie de vendeur Déclaration et garanties* of the benefit of the warranties given to AGZ Holding by the vendors under the acquisition documents;
4. a general assignment of all receivables by way of security granted to Deutsche Bank AG London; and
5. a pledge granted to Deutsche Bank AG London of a special cash collateral account for 15,000.

The Company entered into various interest rate swaps during the period. The swaps include a commitment to pay 4.41% on the following nominal amounts:

1. 256.9 million (March 31, 2003);
2. 245.7 million (April 1, 2003 through September 30, 2003); and
3. 238.3 million (October 1, 2003 through March 31, 2004).

The counterparts to these swaps are: Deutsche Bank AG, Barclays and Credit Lyonnais.

In connection with the issuance of the High Yield Bonds made by AGZ Finance on July 23, 2002 for 165,000, and also in connection with the issuance of bonds made by AGZ Holding on July 22, 2002 for 165,000, AGZ Holding is guarantor for AGZ Finance's commitments related to High Yield Bonds.

**Table of Contents**

**AGZ HOLDING**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(All figures are expressed in thousands unless otherwise stated)**

***b) Commitments received***

Commitments received break down as follows:

Customs guarantees given by Société Générale bank for 1.5 million.

Interest rate swap: commitment received to recoup the interest based on the 6-month Euribor, between April 1, 2003 and March 31, 2004. The related amounts are to be determined in the same way as above. Counterparties to these swaps are: Deutsche Bank AG, Barclays and Crédit Lyonnais.

Guarantees and collateral received from customers in an amount of 0.6 million.

9.2 million tax bond from Sofax Banque (TFE Group) relating to the business tax litigation. The tax authorities have recorded a preferential claim in respect of this litigation.

Real estate collateral for 0.3 million.

**NOTE 30 SUMMARY OF DIFFERENCES BETWEEN ACCOUNTING POLICIES GENERALLY ACCEPTED IN THE UNITED STATES OF AMERICA AND FRANCE**

The consolidated financial statements of AGZ Holding have been prepared and presented in accordance with the accounting principles described in the notes to the financial statements, which comply with accounting principles generally accepted in France ( French GAAP ). French GAAP differs in certain significant respects from accounting principles generally accepted in the United States of America ( U.S. GAAP ). The application of U.S. GAAP would have affected the Company's consolidated net income (loss) for the fiscal year ended March 31, 2003 and its consolidated shareholders' equity as of March 31, 2003, as follows:

***a) Reconciliation of consolidated net (loss)/income from French GAAP to U.S. GAAP***

**Year Ended  
March 31,**



	<u>2003</u>
<b>Consolidated net income (loss) as determined in accordance with French GAAP</b>	<b>(789)</b>
<b>U.S. GAAP reconciling adjustments :</b>	
Business combinations:	
Amortization of goodwill	19,470
Amortization of other intangible assets	(6,818)
Marketable securities	(65)
Derivative instruments	(3,750)
Deferred tax effects of above adjustments	3,767
<b>Total U.S. GAAP adjustments, net</b>	<b>12,604</b>
<b>Consolidated net income (loss) as determined in accordance with U.S. GAAP</b>	<b>11,815</b>

F-25

Table of Contents

## AGZ HOLDING

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(All figures are expressed in thousands unless otherwise stated)

*b) Reconciliation of consolidated shareholders equity from French GAAP to U.S. GAAP*

	March 31, 2003
Consolidated shareholders equity as determined in accordance with French GAAP	73,970
<b>U.S. GAAP reconciling adjustments:</b>	
Business combinations:	
Amortization of goodwill	20,391
Amortization of other intangible assets	(13,636)
Marketable securities	78
Derivative instruments	(4,800)
Deferred tax effects of above adjustments	6,504
<b>Total U.S. GAAP adjustments, net</b>	<b>8,537</b>
<b>Consolidated shareholders equity as determined in accordance with U.S. GAAP</b>	<b>82,507</b>

*c) Description of the differences between accounting principles applied to prepare the consolidated financial statements under French GAAP and under U.S. GAAP**Business combinations*

Under French GAAP and U.S. GAAP, acquisitions are generally accounted for as purchases. The cost of an acquired company is assigned to the tangible and intangible assets acquired and liabilities assumed on the basis of their estimated fair values at the date of acquisition. Any excess of purchase price over the fair value of the tangible and intangible assets acquired is allocated to goodwill. There are, however, certain differences that exist with respect to the application of the purchase method between French and U.S. GAAP that affect the allocation of purchase price, including the amounts assigned to identifiable intangible assets, deferred income taxes and goodwill.

*Amortization of goodwill*

## Edgar Filing: UGI CORP /PA/ - Form 424B5

Due to differences between U.S. GAAP and French GAAP relating to the application of the purchase method, the goodwill related to the acquisition of Antargaz by AGZ amounts to 370.9 million under U.S. GAAP compared to 388.6 million under French GAAP. Under French GAAP, the Company amortizes goodwill on a straight-line basis over its estimated useful life of twenty years. Under U.S. GAAP, prior to the application of SFAS No. 142, effective April 1, 2002, the Company amortized the goodwill over its estimated useful life of 20 years. Since April 1, 2002, in compliance with SFAS No. 142, the Company does not amortize goodwill, but reviews it for impairment at least annually, or more frequently if impairment indicators arise. According to the results of impairment tests, based both upon the market multiples as an indicator of fair value and upon the discounted cash flow method, goodwill was not impaired at March 31, 2003.

### *Amortization of other intangible assets*

Under U.S. GAAP, identifiable intangible assets, including customer lists and trademarks, are recognized. The customer lists are amortized over their estimated useful lives. Under French GAAP, trademarks have not been recognized and customer lists are not subject to amortization. Accordingly, the amortization adjustment for other intangible assets reflects the U.S. GAAP amortization of customer lists assuming an estimated useful life of 11 years.

**Table of Contents**

**AGZ HOLDING**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(All figures are expressed in thousands unless otherwise stated)**

*Deferred income taxes*

Under French GAAP, deferred income taxes are not recognized on goodwill and certain other non-amortizable intangible assets, including customer relationships. Under U.S. GAAP, deferred taxes are recognized on all intangible assets except goodwill.

*Derivative instruments*

Under French GAAP, interest rate swap agreements, which are considered to hedge the underlying debt, are not recognized in the balance sheet. Any interest rate differential is recognized as an adjustment to interest expense over the term of the related underlying debt for qualifying hedges.

Under U.S. GAAP, subsequent to the adoption of SFAS No. 133, all derivative instruments are required to be recorded in the balance sheet at fair value. Changes in fair value are recorded currently in earnings unless the item is designated, qualifies and is effective as a hedge. Fair value is defined as the amount that would be paid or received to terminate the derivative instrument at the balance sheet date. According to U.S. GAAP, the interest rate swaps mentioned in note 29 are not considered to hedge the underlying senior debt. The fair value adjustment is recognized in U.S. GAAP and amounts, at March 31, 2003, to (4,800) in shareholder's equity and to (3,750) in net income. The corresponding deferred income taxes are also recognized in U.S. GAAP shareholders' equity and income statement.

*Marketable securities*

Under French GAAP, marketable securities are valued at their historical cost. Under U.S. GAAP, the Group's marketable securities are considered as trading and, in accordance with SFAS No. 115, recognized at their fair value. The difference between the historical cost of marketable securities and their fair value at March 31, 2003, is recognized in U.S. GAAP net income and shareholders' equity. The corresponding deferred income taxes are also recognized in the U.S. GAAP income statement.

*Revenue*

Under U.S. GAAP, in accordance with EITF 99-19, revenue relating to transactions for which the Company acts as an agent is recognized on a net basis, resulting in a reduction of revenue for \$66.5 million for the year ended March 31, 2003 and a corresponding reduction of cost of sales

for the same amount. This adjustment has no effect on consolidated net income or consolidated shareholders' equity. Under French GAAP, such revenue is recognized on a gross basis.

*Exceptional items*

Certain amounts presented as exceptional income and expense (non-operating) in the consolidated statement of income under French GAAP do not qualify as non-operating items under U.S. GAAP.

*Comprehensive income*

Comprehensive income includes all changes in equity during a period except those resulting from investments by owners and distributions to owners. In consolidated financial statements under French GAAP, the concept of comprehensive income does not exist because French accounting principles do not allow any change in equity corresponding to this definition other than net income, changes in the cumulative translation adjustments related to consolidated foreign subsidiaries and changes in accounting principles.

**Table of Contents**

**AGZ HOLDING**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(All figures are expressed in thousands unless otherwise stated)**

In consolidated financial statements under U.S. GAAP, comprehensive income and its components must be displayed in a statement of comprehensive income. For the fiscal ended March 31, 2003, this statement includes only the net income.

*Classification of goodwill on equity method investees*

Under French GAAP, goodwill related to equity method investees is included within Goodwill in the consolidated balance sheet. The related amortization is included within Goodwill amortization in the statement of operations. Under U.S. GAAP, goodwill related to equity method investees would be included within the investment account in the consolidated balance sheet. The related amortization would be included within Equity in loss of associated companies in the statement of operations.

The difference described above would also require an adjustment between the French and U.S. GAAP statements of cash flows (from amortization to equity in earnings of associated companies). Cash flows from operations would not be affected in total.

*Treatment of bank overdrafts in the statement of cash flows*

Under French GAAP, bank overdrafts are netted against cash and cash equivalents for purposes of the statement of cash flows. Under U.S. GAAP, cash overdrafts, which amount to 2,942 at March 31, 2003, would be presented as part of financing activities.

*Statement of cash flows*

Under French GAAP, certain items are presented on a net basis in the statement of cash flows. Under U.S. GAAP these items would be required to be presented on a gross basis (e.g. borrowings and repayment of debt).

*New accounting pronouncements*

## Edgar Filing: UGI CORP /PA/ - Form 424B5

In January 2003, the FASB issued Interpretation No. 46, Consolidation of Variable Interest Entities. In December 2003, the FASB issued a revision to Interpretation No. 46. Interpretation No. 46, as revised, requires unconsolidated variable interest entities to be consolidated by their primary beneficiaries, as defined by Interpretation No. 46. As a non-public Company, the Company should apply the provisions of Interpretation No. 46, as revised, to variable interest entities created after December 31, 2003 upon initial involvement with the entity. The Company is required to apply the provisions of Interpretation No. 46, as revised, to variable interest entities created prior to December 31, 2003 as of April 1, 2005. The adoption is not expected to have a material effect on the Company's results of operations or financial condition when adopted.

In May 2003, the FASB issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity. SFAS No. 150 establishes standards for the classification and measurement of certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). In particular, it requires that mandatorily redeemable financial instruments be classified as liabilities and reported at fair value and that changes in their fair values be reported as interest cost. The Company does not expect SFAS No. 150 to have a material effect on the Company's financial position or results of operations.

**Table of Contents**

**AGZ Holding Unaudited Consolidated  
Financial Statements as of December 31, 2003 and for the  
Nine Months Ended December 31, 2003 and 2002**

F-29



**Table of Contents****AGZ HOLDING****UNAUDITED CONSOLIDATED BALANCE SHEETS**

( thousands)

	Note	December 31, 2003	March 31, 2003
		(Unaudited)	
<b>ASSETS</b>			
<b>Non-current assets</b>			
Goodwill		336,468	351,097
<b>Intangible assets</b>			
Franchises, patents and other similar rights		12	15
Other intangible assets		49,030	49,246
		<u>49,042</u>	<u>49,261</u>
<b>Tangible assets</b>			
Land		5,779	5,798
Buildings		10,014	10,390
Machinery and equipment		159,408	180,630
Vehicles		4,183	4,176
Furniture and computers		1,159	1,182
Other tangible assets		548	575
Construction in progress		1,211	3,118
Advances and payments on account		1,435	1,216
		<u>183,737</u>	<u>207,085</u>
Investments	2	37,970	53,087
Investments accounted for under the equity method		4,701	6,144
		<u>611,918</u>	<u>666,674</u>
<b>Total non current assets</b>			
<b>Current assets</b>			
Inventories	3	19,723	16,556
Trade notes and accounts receivable		129,265	155,195
Other receivables		25,442	25,776
Marketable securities		41,216	44,856
Cash		10,968	20,288
		<u>226,614</u>	<u>262,671</u>
<b>Total current assets</b>			
		<u>838,532</u>	<u>929,345</u>
<b>TOTAL ASSETS</b>			

See Notes to Unaudited Consolidated Interim Financial Statements



**Table of Contents****AGZ HOLDING****UNAUDITED CONSOLIDATED BALANCE SHEETS**

( thousands)

	<u>Note</u>	<u>December 31,</u> <u>2003</u>	<u>March 31,</u> <u>2003</u>
		(Unaudited)	
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>			
<b>Shareholders equity</b>			
Capital		35,127	60,127
Additional paid-in capital		187	187
Consolidated reserves		13,656	14,445
Net loss for the period		(11,795)	(789)
<b>Total shareholders equity</b>	<b>5</b>	<b>37,175</b>	<b>73,970</b>
Minority interests		11,999	15,197
Contingency and loss provisions		42,511	37,474
<b>Liabilities</b>			
Borrowings and other liabilities	6	394,914	441,382
Trade notes and accounts payable		125,186	106,128
Deferred income taxes	4	15,321	20,186
Other liabilities		211,426	235,008
<b>Total liabilities</b>		<b>746,847</b>	<b>802,704</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS EQUITY</b>		<b>838,532</b>	<b>929,345</b>

See Notes to Unaudited Consolidated Interim Financial Statements

Table of Contents

## AGZ HOLDING

## UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS

( thousands)

	Note	Nine Months Ended	
		December 31, 2003	December 31, 2002
		(Unaudited)	(Unaudited)
Net sales		367,877	417,559
Other income		1,997	1,657
<b>Revenues</b>		<b>369,874</b>	<b>419,216</b>
Purchases of materials		(143,568)	(191,798)
Payroll costs		(43,736)	(50,023)
Other operating expense		(97,761)	(109,672)
Taxes other than on income		(7,107)	(6,910)
Depreciation, amortization and provisions		(48,482)	(48,031)
<b>Operating expenses</b>		<b>(340,654)</b>	<b>(406,434)</b>
<b>Operating income</b>		<b>29,220</b>	<b>12,782</b>
Financial expense, net		(23,956)	(23,568)
<b>Income/(Loss) from ordinary activities</b>		<b>5,264</b>	<b>(10,786)</b>
Exceptional items, net		(2,301)	(443)
Income tax	4	(1,698)	3,632
<b>Net income/(loss) from consolidated companies</b>		<b>1,265</b>	<b>(7,597)</b>
Equity in loss of associated companies		(1,442)	(1,538)
Goodwill amortization		(14,629)	(14,848)
<b>Net loss before minority interest</b>		<b>(14,806)</b>	<b>(23,983)</b>
Minority interests		3,011	3,015
<b>Net loss</b>		<b>(11,795)</b>	<b>(20,968)</b>

See Notes to Unaudited Consolidated Interim Financial Statements



Table of Contents

## AGZ HOLDING

## UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

( thousands)

	Nine Months Ended	
	December 31, 2003	December 31, 2002
	(Unaudited)	(Unaudited)
Net loss before minority interests	(14,806)	(23,983)
<i>Adjustments to reconcile net loss to cash flow:</i>		
Amortization, depreciation and provisions	63,585	61,476
Changes in deferred taxes	(4,864)	(4,177)
Equity in loss of associated companies	1,442	1,538
Gains and losses from disposals, net of tax	621	820
Expenses related to high yield bonds issuance included in net loss		4,532
<b>Cash flow from operating activities before changes in working capital</b>	<b>45,978</b>	<b>40,206</b>
<i>Net change in working capital:</i>		
Inventories	(3,167)	(3,699)
Accounts receivable	23,366	(7,096)
Accounts payable	5,459	15,012
<b>Cash flow from operating activities</b>	<b>71,636</b>	<b>44,423</b>
Additions to intangible assets	(330)	(855)
Additions to property, plant and equipment	(19,443)	(19,143)
Additions to investments	(36)	(262)
Proceeds from disposals of fixed assets	110	984
Net change in other investments	104	213
<b>Net cash used in investing activities</b>	<b>(19,595)</b>	<b>(19,063)</b>
Dividends paid to the consolidated subsidiaries - minority shareholders	(187)	(233)
Capital reimbursement	(25,000)	
Decrease/(Increase) in debt security deposit	15,050	(15,000)
High yield bonds issuance		165,000
Net change in other borrowings and liabilities	(51,090)	(212,631)
Other (expenses relating to debt issuance)	(2,425)	(11,287)
<b>Net cash (used in)/provided by financing activities</b>	<b>(63,652)</b>	<b>(74,151)</b>
<b>Net change in cash and cash equivalents</b>	<b>(11,611)</b>	<b>(48,791)</b>
Cash and cash equivalents at beginning of the period	62,202	90,229
Cash and cash equivalents at end of the period	50,591	41,438

See Notes to Unaudited Consolidated Interim Financial Statements

F-33

**Table of Contents****AGZ HOLDING****NOTES TO UNAUDITED CONSOLIDATED INTERIM FINANCIAL STATEMENTS****(All figures are expressed in thousands unless otherwise stated)****NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING PRINCIPLES**

The accompanying unaudited consolidated financial statements, which include the accounts of AGZ Holding and its subsidiaries, have been prepared in accordance with generally accepted accounting principles for interim financial information and with instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included in the accompanying unaudited consolidated financial statements. All intercompany transactions have been eliminated in consolidation. Operating results for the nine-month period ended December 31, 2003 are not necessarily indicative of the results that may be expected for the year ending March 31, 2004. The March 31, 2003 balance sheet information has been derived from the 2003 financial statements.

The accompanying consolidated financial statements have been prepared in accordance with French generally accepted accounting principles, and specifically, standard 99-02 issued by the *Comité de la Réglementation Comptable* (CRC 99-02).

**NOTE 2 INVESTMENTS**

In connection with the full reimbursement of the credit facilities under the senior credit agreement signed with, among other banks, Deutsche Bank and Barclays Capital on February 15, 2001 and amended on July 22, 2002, the deposit of 15,000 maintained by the Company for the benefit of its creditors under the above mentioned senior credit agreement has been released on July 7, 2003.

**NOTE 3 INVENTORIES**

Inventories are valued using the weighted-average-cost method. Cost includes incidental expenses. The components of inventories are as follows:

	<b>December 31, 2003</b>	<b>March 31, 2003</b>
	<b>(Unaudited)</b>	
Raw materials and supplies	2,579	2,552
Provision on raw materials and supplies	(48)	(48)



Edgar Filing: UGI CORP /PA/ - Form 424B5

Work-in-process	17	17
Goods held for resale	17,187	14,047
Provision on goods held for resale	(12)	(12)
<b>Total</b>	<b>19,723</b>	<b>16,556</b>

F-34

**Table of Contents****AGZ HOLDING****NOTES TO UNAUDITED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (Continued)**

(All figures are expressed in thousands unless otherwise stated)

**NOTE 4 INCOME TAX**

Deferred income taxes are recognized using the liability method for timing differences between the recognition of certain items of income and expenses for financial reporting and tax purposes, as well as for consolidation adjustments (mainly purchase accounting adjustments and the elimination of non-deductible provisions). Deferred tax assets are recognized for ordinary and evergreen tax loss carry-forwards, to the extent that they are offset by deferred tax liabilities. Net deferred tax assets are recognized only where the related tax benefit can reasonably be expected to be realized.

	December 31, 2003	December 31, 2002
	(Unaudited)	(Unaudited)
Current income tax	(6,562)	(545)
Deferred income taxes	4,864	4,177
<b>Income tax (charge)/credit</b>	<b>(1,698)</b>	<b>3,632</b>

**a) Effective tax rate**

The difference between the effective tax rate and the statutory tax rate applicable in France can be analyzed as follows:

	December 31, 2003	December 31, 2002
	(Unaudited)	(Unaudited)
Statutory tax rate in France	35.43%	35.43%
Goodwill amortization	(39.54)%	(19.05)%
Other	(8.84)%	(3.23)%
<b>Effective tax rate</b>	<b>(12.95)%</b>	<b>13.15%</b>

**b) Tax proof**

	December 31, 2003	December 31, 2002
	(Unaudited)	(Unaudited)
Net loss	(14,806)	(23,983)
Income tax	(1,698)	3,632
Loss before tax	(13,108)	(27,615)
Goodwill amortization	14,629	14,848
Permanent differences	2,969	2,572
Taxable result	4,490	(10,195)
Income tax at the rate of 35.43 %	(1,591)	3,612
Other	(107)	20
<b>Income Tax</b>	<b>(1,698)</b>	<b>3,632</b>

F-35

Table of Contents

## AGZ HOLDING

## NOTES TO UNAUDITED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (Continued)

(All figures are expressed in thousands unless otherwise stated)

## NOTE 5 SHAREHOLDERS EQUITY

Changes in shareholders equity are presented below:

	<u>Capital</u>	<u>Additional paid in capital</u>	<u>Consolidated reserves</u>	<u>Net loss</u>	<u>Total shareholders equity</u>
<b>Balance at March 31, 2003</b>	<b>60,127</b>	<b>187</b>	<b>14,445</b>	<b>(789)</b>	<b>73,970</b>
Capital reimbursement	(25,000)				(25,000)
Prior period net loss			(789)	789	
Net loss for the period				(11,795)	(11,795)
<b>Balance at December 31, 2003 (unaudited)</b>	<b>35,127</b>	<b>187</b>	<b>13,656</b>	<b>(11,795)</b>	<b>37,175</b>

Pursuant to the debt restructuring which occurred in July 2002, the Company carried out a capital reimbursement of 25,000 in June 2003.

## NOTE 6 BORROWINGS AND OTHER LIABILITIES

Borrowings and other liabilities can be detailed as follows:

	<u>March 31, 2003</u>	<u>Changes in principal</u>	<u>Changes in interest</u>	<u>December 31, 2003</u>
				(Unaudited)
High Yield bonds	168,437		4,171	172,608
Senior debt	261,463	(50,428)	1,923	212,958
Other bank borrowings	4,265	(638)		3,627
Other borrowings	91	(29)	(1)	61
Lease contracts	3,460	(17)		3,443
<b>Total borrowings</b>	<b>437,716</b>	<b>(51,112)</b>	<b>6,093</b>	<b>392,697</b>

Edgar Filing: UGI CORP /PA/ - Form 424B5

Bank overdrafts	2,942	(904)	(444)	1,594
Other debt	724	(101)		623
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
<b>Total overdrafts and other debt</b>	<b>3,666</b>	<b>(1,005)</b>	<b>(444)</b>	<b>2,217</b>
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
<b>Total</b>	<b>441,382</b>	<b>(52,117)</b>	<b>5,649</b>	<b>394,914</b>
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>

Pursuant to a credit agreement dated June 26, 2003 signed with, among other banks, *Crédit Lyonnais* as security and facility agent, the Company has incurred on July 7, 2003 a senior debt of 220,000 (the *new senior debt*), which bears interest at Euribor. The Euribor has been swapped against a fixed rate of 2.31 % on three-quarters of the new senior debt. The new senior debt is reimbursed on a semi-annual basis, through various settlements of 9,000 on September 30 and March 31, of each year, a payment of 39,000 on March 31, 2008 and a last payment of 100,000 on June 30, 2008. The first settlement of 9,000 occurred on September 30, 2003. In connection with the new senior debt issuance, the Company has totally reimbursed, through a cash payment of 261,428 the remaining balance of the senior debt resulting from the credit agreement dated March 27, 2001 signed with, among other banks, *Deutsche Bank*, and last modified on July 22, 2002. The high yield bonds bear interest at a 10% fixed rate.

**Table of Contents**

**AGZ HOLDING**

**NOTES TO UNAUDITED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (Continued)**

**(All figures are expressed in thousands unless otherwise stated)**

**NOTE 7 COMMITMENTS**

**a) Commitments and guarantees given**

Commitments and guarantees given break down as follows:

1. Real estate collateral for 0.3 million.
2. Customs guarantees (permit of removal or *crédit d'enlèvement* and other) for 19.7 million.
3. Guarantee granted by Antargaz to Natexis in connection with loan subscribed by Norgal for 0.4 million.
4. As part of the winter 2003-2004 supply contract with SHV, AGZ Holding made term purchases of LPG with the following characteristics:
  - January 2004: 7,000 metric tons at a fixed unit price of 266,
  - February 2004: 7,000 metric tons at a fixed unit price of 270.
5. In connection with the issuance of the High Yield Bonds made by AGZ Finance on July 23, 2002 for 165.0 million, and also in connection with the issuance of bonds made by AGZ Holding on July 22, 2002 for 165.0 million, AGZ Holding is guarantor for AGZ Finance's commitments related to High Yield Bonds.
6. AGZ Holding has signed on June 26, 2003 with, among other banks, Crédit Lyonnais as security and facility agent, a senior facilities agreement for an amount of 270 million. Such agreement, which has been effective on July 7, 2003 at which time Antargaz acceded to the agreement, has been amended on July 2, 2003 and August 1, 2003. Under such agreement, the senior facilities are secured by:
  - An assignment of the benefit of the warranties given to AGZ Holding by the vendors under the acquisition documents granted by AGZ Holding;

## Edgar Filing: UGI CORP /PA/ - Form 424B5

- A general assignment of all receivables by way of security granted by AGZ Holding;
- A pledge of financial instruments accounts relating to shares held by AGZ Holding in Antargaz granted by AGZ Holding;
- A first ranking pledge of AGZ Holding's business granted by AGZ Holding;
- A pledge of shares granted by Antargaz in Sigap Ouest;
- A pledge of financial instruments accounts over shares held by Antargaz in Wogegal, Gaz Est Distribution, Nord GPL, Rhône Méditerranée Gaz, Géovexin, Sobegal, Géogaz Lavera, Cobogal and Rhône Gaz;
- A first ranking pledge of Antargaz's business granted by Antargaz;
- An assignment of all receivables granted by Antargaz.

In connection with the senior facilities, AGZ Holding has entered into an interest rate swap which includes a commitment to pay a fixed rate of 2.31 % on the following nominal amounts:

- 158.3 million from January 1st through March 30, 2004;
- 151.5 million from March 31, 2004 through September 29, 2004;
- 144.8 million from September 30, 2004 through March 30, 2005;
- 138.0 million from March 31, 2005 through June 29, 2005.

Counterpart to this swap is Crédit Lyonnais.

**Table of Contents**

**AGZ HOLDING**

**NOTES TO UNAUDITED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (Continued)**

**(All figures are expressed in thousands unless otherwise stated)**

**b) Commitments received**

Commitments received break down as follows:

1. Guarantees and collateral received from customers in an amount of 0.6 million.
2. 9.0 million tax bond from Sofax Banque (Total Group) relating to the business tax litigation. The tax authorities have recorded a preferential claim in respect of this litigation.

**NOTE 8 SUBSEQUENT EVENTS**

In January 2004, UGI Corporation communicated its offer to purchase the remaining outstanding 80.5% ownership interests of AGZ Holding, the parent company of Antargaz. As required by French law, the proposed transaction was presented to the Works Council of Antargaz, the labor representative body for Antargaz, which delivered its advice. The Share Purchase Agreement was signed on February 17, 2004.

**NOTE 9 SUMMARY OF DIFFERENCES BETWEEN ACCOUNTING POLICIES GENERALLY ACCEPTED IN THE UNITED STATES OF AMERICA AND FRANCE**

The unaudited consolidated financial statements of AGZ Holding have been prepared and presented in accordance with the accounting principles described in the notes to the financial statements, which comply with accounting principles generally accepted in France ( French GAAP ). French GAAP differs in certain significant respects from accounting principles generally accepted in the United States of America ( U.S. GAAP ). The application of U.S. GAAP would have affected the Company s unaudited consolidated net income (loss) for the nine-month-periods ended December 31, 2002 and 2003 and its consolidated shareholders equity as of March 31, 2003 and its unaudited consolidated shareholders equity as of December 31, 2003 as follows:

**a) Reconciliation of consolidated net income/(loss) from French GAAP to U.S. GAAP**

<b>Nine Months Ended December 31, 2003</b>	<b>Nine Months Ended December 31, 2002</b>
--	--



	(Unaudited)	(Unaudited)
<b>Consolidated net loss as determined in accordance with French GAAP</b>	<b>(11,795)</b>	<b>(20,968)</b>
<b>U.S. GAAP reconciling adjustments :</b>		
Business combinations:		
Amortization of goodwill	14,629	14,848
Amortization of other intangible assets	(5,114)	(5,114)
Marketable securities	(78)	(101)
Derivative instruments	5,023	(3,915)
Deferred tax effects of above adjustments	60	3,235
<b>Total U.S. GAAP adjustments, net</b>	<b>14,520</b>	<b>8,953</b>
<b>Consolidated net income/(loss) as determined in accordance with U.S. GAAP</b>	<b>2,725</b>	<b>(12,015)</b>
	<b>\$76,927</b>	<b>\$73,101</b>

Weighted Average Yield	0.00%	0.00%	0.00%	2.30%	2.30%	2.96%
------------------------	-------	-------	-------	-------	-------	-------

At September 30, 2013, the contractual maturity of 71.1% of the Company's mortgage backed securities was in excess of ten years. The actual maturity of a mortgage-backed security is typically less than its stated maturity due to scheduled principal payments and prepayments of the underlying mortgages. Prepayments that are different than anticipated will affect the yield to maturity. The yield is based upon the interest income and the amortization of any premium or discount related to the mortgage-backed security. In accordance with U.S. Generally Accepted Accounting Principles ("GAAP"), premiums and discounts are amortized over the estimated lives of the loans, which decrease and increase interest income, respectively. The prepayment assumptions used to determine the amortization period for premiums and discounts can significantly affect the yield of the mortgage-backed security, and these assumptions are reviewed periodically to reflect actual prepayments. Although prepayments of underlying mortgages depend on many factors, including the type of mortgages, the coupon rate, the age of mortgages, the geographical location of the underlying real estate collateralizing the mortgages and general levels of market interest rates, the difference between the interest rates on the underlying mortgages and the prevailing mortgage interest rates generally

is the most significant determinant of the rate of prepayments. During periods of falling mortgage interest rates, if the coupon rate of the underlying mortgages exceeds the prevailing market interest rates offered for mortgage loans, refinancing generally increases and accelerates the prepayment of the underlying mortgages and the related security. Under such circumstances, the Company may be subject to reinvestment risk because, to the extent that the Company's mortgage-backed securities amortize or prepay faster than anticipated, the Company may not be able to reinvest the proceeds of such repayments and prepayments at a comparable rate. During periods of rising interest rates, these prepayments tend to decelerate as the prevailing market interest rates for mortgage rates increase and prepayment incentives dissipate.

Management has implemented a process to identify securities that could potentially have a credit impairment that is other-than-temporary. This process involves evaluation of the length of time and extent to which the fair value has been less than the amortized cost basis, review of available information regarding the financial position of the issuer, monitoring the rating of the security, cash flow projections, and the Company's intent to sell a security or whether it is more likely than not we will be required to sell the security before the recovery of its amortized cost which, in some cases, may extend to maturity. To the extent we determine that a security is deemed to be other-than-temporarily impaired, an impairment loss is recognized.

25

---

## Table of Contents

For all securities that are considered temporarily impaired, the Company does not intend to sell these securities and it is not more likely than not that the Company will be required to sell the security before recovery of its amortized cost, which may occur at maturity. The Company believes that it will collect all principal and interest due on all investments that have amortized cost in excess of fair value that are considered only temporarily impaired.

In fiscal 2013 and 2012, there were no other-than-temporary impairments recorded.

## Sources of Funds

General. The Company's sources of funds are deposits, borrowings, amortization and repayment of loan principal, interest earned on or maturation of investment securities and short-term investments, mortgage-backed securities, and funds provided from operations.

Borrowings, including FHLB advances, repurchase agreements and funds available through the FRB Discount Window, may be used at times to compensate for seasonal reductions in deposits or deposit inflows at less than projected levels, may be used on a longer-term basis to support expanded lending activities, and may also be used to match the funding of a corresponding asset.

Deposits. The Company offers a variety of deposit accounts having a wide range of interest rates and terms. The Company's deposits consist of statement savings accounts, money market savings accounts, NOW and regular checking accounts, deposits related to prepaid cards primarily categorized as checking accounts, and certificate accounts currently ranging in terms from fourteen days to 60 days. The Company solicits deposits from its primary market area and relies primarily on competitive pricing policies, advertising and high-quality customer service to attract and retain these deposits.

The flow of deposits is influenced significantly by general economic conditions, changes in money market and prevailing interest rates, and competition.

The variety of deposit accounts offered by the Company has allowed it to be competitive in obtaining funds and to respond with flexibility to changes in consumer demand. The Company endeavors to manage the pricing of its deposits in keeping with its asset/liability management and profitability objectives. Based on its experience, the Company believes that its savings, money market accounts, NOW, regular checking accounts and deposits related to prepaid cards are relatively stable sources of deposits. However, the ability of the Company to attract and maintain certificates of deposit and the rates paid on these deposits has been and will continue to be significantly affected by market conditions and potentially by the restrictions imposed under the Consent Orders.

At September 30, 2013, \$1.1 billion of the Company's deposit portfolio was attributable to MPS. The majority of these deposits represent funds available to spend on prepaid debit cards and other stored value products, of which \$1.1 billion are included with non-interest-bearing checking accounts and \$10.0 million are included with savings accounts on the Company's Consolidated Statement of Financial Condition. Generally, these deposits do not pay interest. MPS originates debit card programs through outside sales agents and other financial institutions. As such, these deposits carry a somewhat higher degree of concentration risk than traditional consumer products. If a major client or card program were to leave the Bank, deposit outflows could be more significant than if the Bank were to lose a more traditional customer, although it is considered unlikely that all deposits related to a program would leave the Bank without significant advance notification. As such, historical results indicate, and management believes, that the Company's deposit portfolio attributable to MPS is stable. MPS has not experienced any significant net outflows thus far related to card programs over the six years prior to the imposition of the supervisory directive implemented during 2010, and, although the potential for migration is somewhat higher now due to restrictions on the Bank, the Company's low cost and no cost deposits have grown, as demonstrated below. See "Regulation - Bank Supervision and Regulation – Consent Orders and Related Matters." The Company takes this additional risk into account when planning its

investment and liquidity strategies, but no assurance can be given that our efforts will remain successful. See “Risk Factors” which is included in Item 1A of this Annual Report on Form 10-K. The increase in deposits arising from MPS has allowed the Bank to reduce its reliance on higher costing certificates of deposits and public funds.

26

---

Table of Contents

The following table sets forth the deposit flows at the Company during the periods indicated.

	September 30,		
	2013	2012	2011
	(Dollars in Thousands)		
Opening Balance	\$1,379,794	\$1,141,620	\$897,454
Deposits	180,050,543	148,719,273	124,923,489
Withdrawals	(180,115,818)	(148,482,630)	(124,681,473)
Interest Credited	764	1,531	2,150
Ending Balance	\$1,315,283	\$1,379,794	\$1,141,620
Net (Decrease) Increase	\$(64,511 )	\$238,174	\$244,166
Percent (Decrease) Increase	-4.68	% 20.86	% 27.21 %

The following table sets forth the dollar amount of deposits in the various types of deposit programs offered by the Company for the periods indicated.

	September 30,		2012		2011	
	2013	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
	(Dollars in Thousands)					
<u>Transactions and Savings Deposits:</u>						
Non-Interest Bearing Demand Accounts						
	\$1,086,258	82.59 %	\$1,181,299	85.61 %	\$945,956	82.86 %
Interest Bearing Demand Accounts						
	31,181	2.37	33,094	2.40	31,249	2.74
Savings Accounts						
	26,229	1.99	26,053	1.89	11,136	0.97
Money Market Accounts						
	40,016	3.04	38,585	2.80	36,717	3.22
Total Non-Certificate						
	1,183,684	89.99	1,279,031	92.70	1,025,058	89.79
<u>Certificates:</u>						
Variable						
	211	0.02	218	0.02	284	0.03
0.00 - 1.99%						
	122,136	9.29	68,483	4.96	74,145	5.31

Edgar Filing: UGI CORP /PA/ - Form 424B5

2.00 - 3.99%	8,839	0.67	28,694	2.08	35,189	2.52
4.00 - 5.99%	413	0.03	3,368	0.24	6,944	0.50
6.00 - 7.99%	-	-	-	-	-	-
Total						
Certificates	131,599	10.01	100,763	7.30	116,562	10.21
Total Deposits	\$1,315,283	100.00%	\$1,379,794	100.00%	\$1,141,620	100.00%

27

---

Table of Contents

The following table shows rate and maturity information for the Company's certificates of deposit as of September 30, 2013.

	Variable	0.00- 1.99%	2.00- 3.99%	4.00- 5.99%	6.00- 7.99%	Total	Percent of Total
(Dollars in Thousands)							
Certificate accounts maturing in quarter ending:							
December 31, 2013	28	46,573	872	413	-	47,886	36.4
March 31, 2014	48	34,299	564	-	-	34,911	26.5
June 30, 2014	22	9,488	632	-	-	10,142	7.7
September 30, 2014	46	2,304	1,078	-	-	3,428	2.6
December 31, 2014	33	7,223	1,451	-	-	8,707	6.6
March 31, 2015	34	1,172	856	-	-	2,062	1.6
June 30, 2015	-	2,982	997	-	-	3,979	3.0
September 30, 2015	-	1,478	180	-	-	1,658	1.3
December 31, 2015	-	3,839	1,435	-	-	5,274	4.0
March 31, 2016	-	524	209	-	-	733	0.6
June 30, 2016	-	3,532	191	-	-	3,723	2.8
September 30, 2016	-	462	344	-	-	806	0.6
Thereafter	-	8,260	30	-	-	8,290	6.3
<b>Total</b>	<b>\$211</b>	<b>\$122,136</b>	<b>\$8,839</b>	<b>\$413</b>	<b>\$-</b>	<b>\$131,599</b>	<b>100.0 %</b>
Percent of total	0.2 %	92.8 %	6.7 %	0.3 %	0.0 %	100.0 %	%

The following table indicates the amount of the Company's certificates of deposit and other deposits by time remaining until maturity as of September 30, 2013.

	Maturity				Total
	3 Months or Less	After 3 to 6 Months	After 6 to 12 Months	After 12 Months	
Certificates of deposit less than \$100,000	\$14,773	\$3,494	\$9,888	\$24,894	\$53,049
Certificates of deposit of \$100,000 or more	33,112	31,418	3,681	10,339	\$78,550
<b>Total certificates of deposit</b>	<b>\$47,885</b>	<b>\$34,912</b>	<b>\$13,569</b>	<b>\$35,233</b>	<b>\$131,599</b>

At September 30, 2013, there were \$56.0 million in deposits from governmental and other public entities included in certificates of deposit.

**Borrowings.** Although deposits are the Company's primary source of funds, the Company's policy has been to utilize borrowings when they are a less costly source of funds, can be invested at a positive interest rate spread, or when the Company desires additional capacity to fund loan demand.

The Company's borrowings historically have consisted primarily of advances from the FHLB upon the security of a blanket collateral agreement of a percentage of unencumbered loans and the pledge of specific investment securities. Such advances can be made pursuant to several different credit programs, each of which has its own interest rate and range of maturities. At September 30, 2013, the Bank had \$7.0 million of advances from the FHLB, \$190.0 million of federal funds purchased and the ability to borrow up to an approximate additional \$279.4 million. At September 30, 2013, there were \$7.0 million in advances that had maturities ranging up to 6 years.

28

---



Table of Contents

On July 16, 2001, the Company issued all of the 10,000 authorized shares of Company Obligated Mandatorily Redeemable Preferred Securities of First Midwest Financial Capital Trust I (preferred securities of subsidiary trust) holding solely subordinated debt securities. Distributions are paid semi annually. Cumulative cash distributions are calculated at a variable rate of the London Interbank Offered Rate (“LIBOR”) plus 3.75%, not to exceed 12.5%. The Company may, at one or more times, defer interest payments on the capital securities for up to 10 consecutive semi-annual periods, but not beyond July 25, 2031. At the end of any deferral period, all accumulated and unpaid distributions must be paid. The capital securities are required to be redeemed on July 25, 2031; however, the Company has a semi annual option to shorten the maturity date. The option has not been exercised as of the date of this filing. The redemption price is \$1,000 per capital security plus any accrued and unpaid distributions to the date of redemption. Holders of the capital securities have no voting rights, are unsecured, and rank junior in priority of payment to all of the Company’s indebtedness and senior to the Company’s common stock. The trust preferred securities have been includable in the Company’s capital calculations since they were issued. The preferential capital treatment of the Company’s trust preferred securities was grandfathered under the Dodd-Frank Act.

From time to time, the Company has offered retail repurchase agreements to its customers. These agreements typically range from 14 days to five years in term, and typically have been offered in minimum amounts of \$100,000. The proceeds of these transactions are used to meet cash flow needs of the Company. At September 30, 2013, the Company had \$9.1 million of retail repurchase agreements outstanding.

Historically, the Company has entered into wholesale repurchase agreements through nationally recognized broker-dealer firms. These agreements are accounted for as borrowings by the Company and are secured by certain of the Company’s investment and mortgage-backed securities. The broker-dealer takes possession of the securities during the period that the reverse repurchase agreement is outstanding. The terms of the agreements have usually ranged from 7 days to six months, but on occasion longer term agreements have been entered into. At September 30, 2013, the Company had no wholesale repurchase agreements outstanding.

The line of credit with First Tennessee Bank, NA that was in existence at September 30, 2011, was closed during the fiscal year ended September 30, 2012. See Note 8 to the “Notes to Consolidated Financial Statements,” which is included in Part II, Item 8 “Financial Statements and Supplementary Data” of this Annual Report on Form 10-K for further detail of the Company’s borrowings.

The following table sets forth the maximum month-end balance and average balance of FHLB advances, retail and reverse repurchase agreements, Subordinated Debentures and under the FRB’s Temporary Term Auction Facility (“TAF”) Program borrowings for the periods indicated.

	September 30,		
	2013	2012	2011
	(Dollars in Thousands)		
<b><u>Maximum Balance:</u></b>			
FHLB advances	\$7,000	\$11,000	\$22,000
Repurchase agreements	19,901	27,617	11,787
Subordinated debentures	10,310	10,310	10,310
Overnight fed funds purchased	325,000	165,000	95,000
<b><u>Average Balance:</u></b>			
FHLB advances	\$8,096	\$11,000	\$21,234
Repurchase agreements	10,540	15,278	6,018
Subordinated debentures	10,310	10,310	10,310
Overnight fed funds purchased	129,825	34,579	18,220



Table of Contents

The following table sets forth certain information as to the Company's FHLB advances and other borrowings at the dates indicated.

	September 30,					
	2013		2012		2011	
	(Dollars in Thousands)					
FHLB advances	\$7,000		\$11,000		\$11,000	
Repurchase agreements	9,146		26,400		8,055	
Subordinated debentures	10,310		10,310		10,310	
Overnight fed funds purchased	190,000		-		-	
Total borrowings	\$216,456		\$47,710		\$29,365	
Weighted average interest rate of FHLB advances	6.98	%	6.00	%	6.00	%
Weighted average interest rate of repurchase agreements	0.52	%	0.51	%	0.50	%
Weighted average interest rate of subordinated debentures	4.15	%	4.39	%	4.31	%
Weighted average interest rate of overnight fed funds purchased	0.54	%	0.00	%	0.00	%

Subsidiary Activities

The subsidiaries of the Company are the Bank and First Midwest Financial Capital Trust I. On September 30, 2013, the Bank had one service corporation subsidiary, First Services Financial Limited ("First Services"). At September 30, 2013, the net book value of the Bank's investment in First Services was approximately \$127,000. The Bank organized First Services in 1983. First Services had no active operations as of September 30, 2013 and was dissolved on December 3, 2013. The Company had a subsidiary in prior fiscal periods, Meta Trust, which was sold to a third party on September 30, 2010. The impact to the financial results of the Company was nominal.

Meta Payment Systems® Division

Meta Financial, through the MPS division of the Bank, is focused on the electronic payments industry and offers a complement of prepaid cards, consumer credit products and other payment industry related products and services that are marketed to consumers through financial institutions and other commercial entities. The products and services offered by MPS are generally designed to facilitate the processing and settlement of authorized electronic transactions involving the movement of funds. MPS offers specific product solutions in the following areas: (i) prepaid cards, (ii) consumer credit products, and (iii) ATM sponsorship. MPS' products and services generally target banks, card processors and third parties who market and distribute the cards.

Each line of business of MPS' business is discussed generally below. With respect to the lines of business, there can be a significant amount of cross-selling and cross-utilization of personnel and resources (e.g., a client asks MPS to develop products for both prepaid and consumer credit needs).

Table of Contents

**Prepaid Cards.** Prepaid cards take the form of credit card-sized plastics embedded with a magnetic stripe which encodes relevant card data (which may or may not include information about the user and/or purchaser of such card) or a “virtual” card where there is no actual plastic but the transaction and account records are handled in the same manner. When the holder of such a card attempts a permitted transaction, necessary information, including the authorization for such transaction, is shared between the “point of use” or “point of sale” and authorization systems maintaining the account of record.

The funds associated with such cards are typically held in pooled accounts at the Bank representing the aggregate value of all cards issued in connection with particular products or programs, further described below. Although the funds are held in pooled accounts, the account of record indicates the funds held by each individual card. The cards may work in a closed loop (e.g., the card will only work at one particular merchant and will not work anywhere else), a semi-closed loop (e.g., the card will only work at a specific set of merchants such as a shopping mall), or open loop which function as a Visa, MasterCard, or Discover branded debit card that will work wherever such cards are accepted for payment. Most of MPS’ prepaid cards are open-loop.

This segment of MPS’ business can generally be divided into three categories: reloadable cards, non-reloadable cards, and benefit/insurance cards. These programs are typically offered via a third party relationship. Government benefits are another growing application for prepaid cards; however, MPS has not focused on this category to date.

**Reloadable Cards.** The most common reloadable prepaid card programs are payroll cards, whereby an employee’s payroll is loaded to the card by their employer utilizing direct deposit. General Purpose Reloadable (GPR) cards are usually distributed by retailers and can be reloaded an indefinite number of times at participating retail load networks. Other examples of reloadable cards are travel cards which are used to replace travelers checks and can be reloaded a predetermined number of times as well as tax-related cards where a taxpayer’s refund, refund anticipation loan, or preseason tax loan proceeds are placed on the card. Reloadable cards are generally open loop cards that consumers can use to obtain cash at ATMs or purchase goods and services wherever such cards are accepted for payment.

**Non-Reloadable Cards.** Non-reloadable prepaid cards are sometimes referred to as disposable and may only be used until the funds initially loaded to the card have been exhausted. These include gift cards, rebate cards, and promotional or incentive cards. These cards may be closed loop or open loop but are generally not available to obtain cash. Under certain conditions, these cards may be anonymous, whereby no customer relationship is created and the identity of the cardholder is unknown. Except for gift cards, many non-reloadable card programs are funded by a corporation as a marketing tool rather than from consumer funds.

**Benefit/Insurance Cards.** Benefit/insurance cards are traditionally used by employers and large commercial companies (such as property insurers) to distribute benefits to persons entitled to such funds. Possible uses of benefit cards could be the distribution of money for qualified expenses related to an employer sponsored flexible spending account program (FSA) or the distribution of insurance claim proceeds to insureds who have made a payable claim against an existing insurance policy. These cards are generally open loop or semi-closed loop as in the case of an FSA card that can only be used for qualified medical expenses.

**Consumer Credit Products.** In its belief that credit programs can help meet legitimate credit needs for prime and sub-prime borrowers, and afford the Company an opportunity to diversify the loan portfolio and minimize earnings exposure due to economic downturns, the Company has offered certain credit programs that were designed to accomplish these objectives, although only one such program currently exists.

## Table of Contents

MPS has strived to offer consumers innovative payment products, including credit products. Most credit products have fallen into one of two general categories: (1) sponsorship lending and (2) portfolio lending. In a sponsorship lending model, MPS typically originates loans and sells (without recourse) the resulting receivables to third party investors equipped to take the associated credit risk. MPS's sponsorship lending program is governed by the Policy for Sponsorship Lending which has been approved by the Board of Directors. MPS discontinued most sponsorship lending programs in fiscal year 2012 with only one still in existence. A Portfolio Credit Policy which has been approved by the Board of Directors governs portfolio credit initiatives undertaken by MPS, whereby the Company retains some or all receivables and relies on the borrower as the underlying source of repayment. Several portfolio lending programs also have a contractual provision that has indemnified MPS and the Bank for credit losses that meet or exceed predetermined levels. Such a program carries additional risks not commonly found in sponsorship programs, specifically funding and credit risks. Therefore, MPS has endeavored to employ policies, procedures, and information systems that it believes are commensurate with the added risk and exposure. Our third party relationship programs have been limited to third party relationships in existence at the time the directives were issued, absent prior approval to engage in new relationships. For additional discussion, see "Regulation - Bank Supervision and Regulation – Consent Orders and Related Matters."

ATM Sponsorship. MPS sponsors financial institutions into various networks to enable them to issue network-branded debit cards and accept cards issued by other financial institutions at their ATM terminals. The division also sponsors ATM independent sales organizations ("ISOs") into various networks and provides associated sponsorships of encryption support organizations and third party processors in support of the financial institutions and the ATM ISO sponsorships. Sponsorship consists of the review and oversight of entities participating in debit and credit networks. In certain instances, MPS also has certain leasehold interests in certain ATMs which require bank ownership and registration for compliance with applicable state law.

While the Company has adopted policies and procedures to manage and monitor the risks attendant to this line of business, and the executives who manage the Company's program have years of experience, no guarantee can be made that the Company will not experience losses in this division.

As described elsewhere herein, the Bank is subject to restrictions issued by its then regulator, the OTS, the functions of which were transferred to the OCC in July 2011. For further discussions see "Regulation – Bank Supervision and Regulation – Consent Orders and Related Matters."

## Regulation

The Company is regulated as a savings and loan holding company by the Federal Reserve. As a savings and loan holding company, the Company is required to file reports with, and otherwise comply with, the rules and regulations of the Federal Reserve and of the SEC under federal securities laws. The Bank is a federally chartered thrift institution that is subject to broad federal regulation and oversight extending to all of its operations by the OCC, its primary federal regulator, and by the FDIC as deposit insurer. The Bank is also a member of the FHLB. See "Risk Factors" which is included in Item 1A of this Annual Report on Form 10-K.

The legislative and regulatory enactments described below have had and are expected to continue to have a material impact upon the operations of the Company and the Bank.

Table of Contents

Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“the Dodd-Frank Act”). In response to the current national and international economic recession and to strengthen supervision of financial institutions and systemically important nonbank financial institutions, Congress and the U.S. government have taken a variety of actions, including the enactment of the Dodd-Frank Act on July 21, 2010. The Dodd-Frank Act represents the most comprehensive change to banking laws since the Great Depression of the 1930s and mandated changes in several key areas: regulation and compliance (both with respect to financial institutions and systemically important nonbank financial companies), securities regulation, executive compensation, regulation of derivatives, corporate governance, transactions with affiliates, deposit insurance assessments and consumer protection. Importantly for the Bank, the Dodd-Frank Act also abolished the OTS on July 21, 2011, and transferred rulemaking authority and regulatory oversight to the OCC with respect to federal savings banks, such as the Bank, and to the Board of Governors of the Federal Reserve System with respect to savings and loan holding companies, such as the Company. While the changes in the law required by the Dodd-Frank Act will most significantly have a major impact on large institutions, even relatively small institutions such as ours will be affected.

Pursuant to the Dodd-Frank Act, the Bank is subject to regulations promulgated by a new consumer protection bureau housed within the Federal Reserve, known as the Consumer Financial Protection Bureau (the “Bureau”). The Bureau has consolidated rules and orders with respect to consumer financial products and services and has substantial power to define the rights of consumers and responsibilities of lending institutions, such as the Bank. The Bureau will not, however, examine or supervise the Bank for compliance with such regulations; rather, based on the Bank’s size (less than \$10 billion in assets), enforcement authority will remain with the Bank’s primary federal regulator although the Bank may be required to submit reports or other materials to the Bureau upon its request. The Bureau began to exercise its authority on July 21, 2011 with respect to insured depository institutions like the Bank.

The Dodd-Frank Act included provisions which restrict interchange fees to those which are “reasonable and proportionate” for certain debit card issuers and limits the ability of networks and issuers to restrict debit card transaction routing (known as the “Durbin Amendment”). The Federal Reserve issued final rules implementing the Durbin Amendment on June 29, 2011. In the final rule, interchange fees for debit card transactions were capped at \$0.21 plus five basis points to be eligible for a “safe harbor” such that the fee is conclusively reasonable and proportionate. Another related rule also permits an additional \$0.01 per transaction “fraud prevention adjustment” to the interchange fee if certain standards designed by the Federal Reserve are implemented including an annual review of fraud prevention policies and procedures. It should be noted that these pricing determinations are the subject of active civil litigation to which the Federal Reserve is a party. With respect to network exclusivity and merchant routing restrictions, it is now required that all debit cards participate in at least two unaffiliated networks so that the transactions initiated using those debit cards will have at least two independent routing channels. Notably, the interchange fee restrictions in the Durbin Amendment do not apply to the Bank because debit card issuers with total worldwide assets of less than \$10 billion are exempt.

The Dodd-Frank Act also included a provision that supplements the Federal Trade Commission Act’s prohibitions against practices that are unfair or deceptive by also prohibiting practices that are “abusive.” The Bureau’s Director, Richard Cordray, has publicly stated that this term will not be defined by regulation but will, instead, be illuminated by the enforcement actions the Bureau initiates. To date, only one Bureau enforcement action has referenced “abusive” acts or practices.

The extent to which the new legislation and existing and planned governmental initiatives thereunder will succeed in ameliorating tight credit conditions or otherwise result in an improvement in the national economy is uncertain. In addition, because some components of the Dodd-Frank Act have not been finalized, it is difficult to predict the ultimate effect of the Dodd-Frank Act on us or the Bank at this time. It is likely, however, that our operational expenses will increase as a result of new compliance requirements.

Table of Contents

Incentive Compensation Regulation. The OTS issued on June 21, 2010 final guidance to ensure that incentive compensation arrangements at federal savings banks take into account risk and are consistent with safe and sound banking practices. The guidance was designed to ensure that incentive compensation arrangements appropriately tie rewards to longer-term performance and do not undermine the safety and soundness of the entity or create undue risks to the financial system.

USA Patriot Act of 2001. In October 2001, the USA Patriot Act of 2001 (the “Patriot Act”) was enacted in response to the terrorist attacks in New York, Pennsylvania and Washington, D.C. which occurred on September 11, 2001. The Patriot Act is intended to strengthen U.S. law enforcement’s and the intelligence communities’ abilities to work cohesively to combat terrorism on a variety of fronts. The potential impact of the Patriot Act on financial institutions of all kinds is significant and wide-ranging. The Patriot Act contains sweeping anti-money laundering and financial transparency laws and imposes various regulations, including standards for verifying client identification at account opening, and rules to promote cooperation among financial institutions, regulators and law enforcement entities in identifying parties that may be involved in terrorism or money laundering. Among other provisions, the Patriot Act requires financial institutions to have anti-money laundering programs in place and requires banking regulators to consider a holding company’s effectiveness in combating money laundering when ruling on certain merger or acquisition applications.

Credit Card Regulation. The Credit Card Accountability Responsibility and Disclosure Act was signed into law on May 22, 2009 (the “Credit Card Act”). The Credit Card Act bans retroactive rate increases, requires that bills be due no less than 21 days from the time of mailing, requires that credit card contracts be accessible on the Internet, and allows consumers to opt-in if they choose to use a card issuer’s over-limit protection. While certain open-end credit programs of the Bank were impacted by the Credit Card Act, the operational and financial impact to the Bank were immaterial. Two of the Bank’s credit card programs had significant changes to the terms and conditions as a result of the Credit Card Act. However, the account portfolio for these programs was relatively small, and each of these programs has ceased to add any new accounts. Additionally, the Fingerhut Program, which was a significant portfolio, terminated its agreement with MetaBank as of July 2012.

Gift card provisions in the Credit Card Act took effect on August 22, 2010. These provisions impose new restrictions on the use of expiration dates and fees on gift cards, including both open-loop and closed-loop cards. Certain provisions can also apply to general purpose reloadable and promotional cards (i.e., reloadable cards that are not marketed or labeled as gift cards, cards not marketed to the general public and cards that are loyalty or award cards are not subject to the fee and expiration restrictions). If a card is subject to the Credit Card Act’s fee restrictions, then (1) fees cannot be imposed within a year after the card was issued or within a year after the cardholder’s last use, (2) only one fee is permitted in any month, and (3) certain disclosures related to the fees and the timing of their imposition must be clearly and conspicuously disclosed. If a card is subject to the Credit Card Act’s expiration provisions, then the card must give consumers a reasonable opportunity to purchase the card with at least five years remaining until the card expiration date and the funds loaded onto such card must not expire before the later of five years after the date on which the card was issued or the card expiration date (if any).

Home Affordable Refinance Program (“HARP”). Announced in November 2011, the HARP is available for refinances of existing and qualified Fannie Mae or Freddie Mac loans only. The goal of the refinance effort, as announced by the President of the United States, is “to provide access to low-cost refinancing for responsible homeowners suffering from falling home prices.” The expectation is that refinancing a qualified loan will put responsible borrowers in a better position by reducing their monthly principal and interest payments or moving them from a more risky loan structure (such as interest-only or short-term ARM) to a more stable product. It is anticipated that this program, which ends on December 31, 2015, will have minimal impact on the Company.

Table of Contents

**Privacy.** The Bank is required by statute and regulation to disclose its privacy policies to its customers on an annual basis. Pursuant to such privacy notices, the Bank’s customers may opt out of the sharing of their nonpublic personal information with nonaffiliated third parties. The Bank is also required to appropriately safeguard its customers’ personal information.

**Preemption.** On July 21, 2011, the preemption provisions of the Dodd-Frank Act became effective, requiring that federal savings associations be subject to the same preemption standards as national banks, with respect to the application of state consumer laws to the interstate activities of federally chartered depository institutions. Under the preemption standards established under the Dodd Frank Act for both national banks and federal savings associations, preemption of a state consumer financial law is permissible only if: (1) application of the state law would have a discriminatory effect on national banks or federal thrifts as compared to state banks; (2) the state law is preempted under a judicial standard that requires a state consumer financial law to prevent or significantly interfere with the exercise of the national bank’s or federal thrift’s powers before it can be preempted, with such preemption determination being made by the OCC (by regulation or order) or by a court, in either case on a “case by case” basis; or (3) the state law is preempted by another provision of federal law other than Title X of the Dodd-Frank Act. Additionally, the Dodd-Frank Act specifies that such preemption standards only apply to national banks and federal thrifts themselves, and not their non-depository institution subsidiaries or affiliates. Specifically, operating subsidiaries of national banks and federal thrifts that are not themselves chartered as a national bank or federal thrift may no longer benefit from federal preemption of state consumer financial laws, which shall apply to such subsidiaries (or affiliates) to the same extent that they apply to any person, corporation or entity subject to such state laws.

**Prohibition on Unfair, Deceptive and Abusive Acts and Practices.** July 21, 2011 was the designated transfer date under the Dodd-Frank Act for the formal transfer of rulemaking functions under the federal consumer financial laws from each of the various federal banking agencies to a new governmental entity, the Bureau, which is charged with the mission of protecting consumer interests. The Bureau is responsible for administering and carrying out the purposes and objectives of the federal consumer financial laws and to prevent evasions thereof, with respect to all financial institutions that offer financial products and services to consumers. The Bureau is also authorized to prescribe rules applicable to any covered person or service provider identifying and prohibiting acts or practices that are unfair, deceptive or abusive in connection with any transaction with a consumer for a consumer financial product or service, or the offering of a consumer financial product or service. With its broad rulemaking and enforcement powers, the Bureau has the potential to reshape the consumer financial laws through rulemaking, which may directly impact the business operations of financial institutions offering consumer financial products or services including the Bank.

**Other Regulation.** The Bank is also subject to a variety of other regulations with respect to its business operations including, but not limited to, the Truth in Lending Act, the Truth in Savings Act, the Equal Credit Opportunity Act, the Electronic Funds Transfer Act, the Fair Housing Act, the Home Mortgage Disclosure Act, the Fair Debt Collection Practices Act, and the Fair Credit Reporting Act. As discussed below, any change in the regulations affecting the Bank’s operations is not predictable and could affect the Bank’s operations and profitability.



Table of Contents

Bank Supervision & Regulation

The Bank is a federally chartered thrift institution that is subject to broad federal regulation and oversight extending to all of its operations by its primary federal regulator, the OCC, and by its deposit insurer, the FDIC. Such regulation covers all aspects of the banking business, including lending practices, safeguarding deposits, capital structure, transactions with affiliates and conduct and qualifications of personnel. The Bank is also a member of the FHLB System and is subject to certain limited regulation by the Federal Reserve.

Regulatory authorities have been granted extensive discretion in connection with their supervisory and enforcement activities which are intended to strengthen the financial condition of the banking industry, including the imposition of restrictions on the operation of an institution, the classification of assets by the institution, and the adequacy of an institution's allowance for loan losses. Typically, these actions are undertaken due to violations of laws or regulations or conduct of operations in an unsafe or unsound manner.

Any change in the nature of such regulation and oversight, whether by the OCC, the FDIC, the Federal Reserve, or legislatively by Congress, could have a material impact on the Company or the Bank and their respective operations. The discussion herein of the regulatory and supervisory structure within which the Bank operates is general and does not purport to be exhaustive or a complete description of the laws and regulations involved in the Bank's operations. The discussion is qualified in its entirety by the actual laws and regulations.

Federal Regulation of the Bank. As the primary federal regulator for federal savings associations, the OCC has extensive authority over the operations of federal savings associations, such as the Bank. This regulation and supervision establishes a comprehensive framework for activities in which a federal savings association can engage and is intended primarily for the protection of the Deposit Insurance Fund ("DIF") and depositors. The regulatory structure also gives the regulatory authorities extensive discretion in connection with their supervisory and enforcement activities and examination policies, including policies with respect to the classification of assets and the establishment of adequate loan loss reserves for regulatory purposes.

Given the extensive transfer of former OTS authority to multiple agencies, Section 316 of the Dodd-Frank Act requires the OCC to identify and publish in the Federal Register separate lists of the current OTS regulations that the OCC will continue to enforce for federal savings associations after the transfer date. In carrying out this mandate, and in connection with its assumption of responsibility for the ongoing examination, supervision, and regulation of federal savings associations, the OCC published a final rule on July 21, 2011 that republishes those OTS regulations that the OCC has the authority to promulgate and enforce as of the July 21, 2011 transfer date, with nomenclature and other technical amendments to reflect OCC supervision of federal savings associations. In addition, on May 17, 2012 and November 20, 2013, the OCC rescinded additional OTS documents that formerly applied to federal savings and loan associations, and applied new policy guidance where policy guidance did not already exist. The OCC's regulations and guidance supersede that of OTS and are indicative of the OCC's goal of one integrated policy platform for national banks and savings associations.

It is possible that additional OCC rulemaking could require significant revisions to the regulations under which the Bank operates and is supervised. Any change in such laws and regulations or interpretations thereof, whether by the OCC, the FDIC or through legislation, could have a material adverse impact on the Bank and its operations and on the Company and its stockholders.

Business Activities

The activities of federal savings associations are generally governed by federal laws and regulations. These laws and regulations delineate the nature and extent of the activities in which federal savings associations may engage. In particular, many types of lending authority for federal savings associations are limited to a specified percentage of the

institution's capital or assets.

36

---

Table of Contents

## Loan and Investment Powers

The Bank derives its lending and investment powers from the Home Owners' Loan Act (the "HOLA") and the OCC's implementing regulations thereunder. Under these laws and regulations, the Bank may invest in mortgage loans secured by residential and commercial real estate, commercial and consumer loans, certain types of debt securities and certain other assets. The Bank may also establish service corporations that are permitted to engage in activities not otherwise permissible for the Bank, including certain real estate equity investments and securities and insurance brokerage activities. These investment powers are subject to various limitations, including (i) a prohibition against the acquisition of any corporate debt security unless, prior to acquisition, the savings association has determined that the issuer has adequate capacity to meet all financial commitments under the security for the projected life of the security (a determination that is also required to be made periodically thereafter); (ii) a limit of 400% of an association's capital on the aggregate amount of loans secured by non-residential real estate property; (iii) a limit of 20% of an association's assets on the aggregate amount of commercial and agricultural loans and leases with the amount of commercial loans in excess of 10% of assets being limited to small business loans; (iv) a limit of 35% of an association's assets on the aggregate amount of secured consumer loans and acquisitions of certain debt securities, with amounts in excess of 30% of assets being limited to loans made directly to the original obligor and where no third-party finder or referral fees were paid; (v) a limit of 5% of assets on non-conforming loans (loans in excess of the specific limitations of the HOLA); and (vi) a limit of the greater of 5% of assets or an association's capital on certain construction loans made for the purpose of financing what is or is expected to become residential property. In addition, the HOLA and the OCC regulations provide that a federal savings association may invest up to 10% of its assets in tangible personal property for leasing purposes.

The Bank's general permissible lending limit to one borrower is equal to the greater of \$500,000 or 15% of unimpaired capital and surplus (except for loans fully secured by certain readily marketable collateral, in which case this limit is increased to 25% of unimpaired capital and surplus). At September 30, 2013, the Bank's lending limit under these restrictions was \$24.6 million. The Bank is in compliance with this lending limit.

## Consent Orders and Related Matters

During 2010, the OTS issued Supervisory Directives to the Bank based on the OTS' assessment of the Bank's third party relationship risk, enterprise risk management, and rapid growth (in the MPS division) and had also advised the Bank that the OTS had determined that the Bank engaged in unfair or deceptive acts or practices in violation of Section 5 of the Federal Trade Commission Act and the OTS Advertising Regulation in connection with the Bank's operation of the iAdvance line of credit program. On July 15, 2011, the Company and the Bank each stipulated and consented to a Cease and Desist Order (together, the "Orders" or the "Consent Orders") issued by the OTS. Under the Orders, the OTS and the Bank agreed upon a Remuneration Plan to provide reimbursement to iAdvance Line of Credit borrowers affected by the Bank's failure to implement a recurring use plan. The Remuneration Plan provided for an aggregate amount of \$4.8 million to be paid to iAdvance customers and such plan has been completed with no related outstanding deliverables. The Bank also stipulated and consented to an Order of Assessment of a Civil Money Penalty (the "Assessment") providing for the Bank's payment of \$400,000. The Orders and the Assessment became effective on July 15, 2011. Both sums were paid in the fourth quarter of fiscal 2011. Under the terms of the Orders and the Assessment, the OTS acknowledged that the Company and the Bank neither admitted nor denied the OTS findings in the Orders and the Assessment or that grounds existed to initiate a proceeding.

Table of Contents

On July 21, 2011, pursuant to the Dodd Frank Act, the OTS was integrated into the OCC and the functions of the OTS related to thrift holding companies were transferred to the Federal Reserve. The OCC is now responsible for the ongoing examination, supervision and regulation of the Bank, including matters with respect to the Consent Order against the Bank. The Dodd Frank Act maintains the existence of the federal savings association charter and the HOLA, the primary statute governing federal savings banks. The Federal Reserve is now responsible for the ongoing examination, supervision and regulation of the Company, including matters with respect to the Consent Order against the Company.

The Orders require the Company and the Bank to submit to the OTS (or its successor) various management and compliance plans and programs to address the matters initially identified in the Supervisory Directives as well as plans for enhancing Company and Bank capital and require non objection by OTS (or its successor) for Company cash dividends, distributions, share repurchases, payments of interest or principal on debt and incurrence of debt. Under the terms of the Order, the Bank agreed that it will cease and desist from (1) violations of certain laws and regulations and (2) unsafe or unsound practices that resulted in it operating without adequate: (a) internal controls, management information systems and internal audit reviews of its third party sponsorship arrangements; and (b) certain information technology policies and procedures. With the exception of the Supervisory Directive dated December 28, 2010, the limitations related to the Bank and the Company following the issuance of the Supervisory Directives remain in place, as do the Orders, and the Bank's and the Company's actions continue to be evaluated by the OCC, and the Federal Reserve in their roles as successors to the OTS. Such limitations include receiving the prior written approval of the OCC before the Bank may (1) enter into any new third party relationship agreement concerning any credit product, deposit product (including prepaid cards), or automatic teller machine, or materially amend any such existing agreement (except for amendments to achieve compliance with applicable laws, regulations, or regulatory guidance); (2) originate, directly or through any third party, tax refund anticipation loans; (3) offer a tax refund transfer processing service directly or through any third party; or (4) offer or originate iAdvance lines of credit to new customers or permit draws on existing iAdvance lines of credit, either directly or through any third party.

The Orders further require the Company and the Bank to submit to the OTS (now, the Federal Reserve and the OCC, respectively) various management and compliance plans and programs to address the matters identified in the Supervisory Directives and Consent Orders, as well as plans for enhancing Company and Bank capital. Since the issuance of the Supervisory Directives and the Consent Orders and the abolishment of the OTS, the Company has raised, in the aggregate, \$61.4 million in equity capital and the Company and the Bank have been cooperating with the OCC and the Federal Reserve to correct those aspects of their operations that were addressed in the Orders.

Satisfaction of the requirements of the Orders is subject to the ongoing review and supervision of the OCC with respect to the Bank and the Federal Reserve with respect to the Company. The Bank and the Company have and expect to continue to expend significant management and financial resources to address areas that were cited in the Orders; such matters include but are not limited to capital preservation and enhancement commensurate with the Bank's risk profile, improvement of core earnings from interest income, management and board oversight of the Bank, risk management and internal controls, compliance management, and Bank Secrecy Act compliance.

## Table of Contents

While we believe that the Company and the Bank have made significant progress in complying with the Orders, there can be no assurance that our regulators will ultimately determine that we have met all of the requirements of the Orders to their satisfaction. If our regulators believe that we have not made sufficient progress in complying with the Orders, they could seek to impose additional regulatory requirements, operational restrictions, enhanced supervision and/or civil money penalties. If any of these measures is imposed in the future, it could have a material adverse effect on our financial condition and results of operations and on our ability to raise additional capital. For additional information regarding compliance with the Orders, see “Risk Factors – Risks Related to the Company’s Business and – Risks Related to the Banking Industry.” For additional information with respect to certain risks related to the MPS division specifically, see “Risk Factors – Risks Related to Meta Payment Systems, a division of the Bank.”

Insurance of Accounts and Regulation by the FDIC. The Bank is a member of the DIF, which is administered by the FDIC. Deposits are insured up to applicable limits by the FDIC and such insurance is backed by the full faith and credit of the United States Government. While not our primary federal regulator, as insurer, the FDIC imposes deposit insurance premiums and is authorized to conduct examinations of and to require reporting by FDIC-insured institutions. It also may prohibit any FDIC-insured institution from engaging in any activity the FDIC determines by regulation or order to pose a serious risk to the DIF. The FDIC also has authority to initiate enforcement actions against any FDIC-insured institution after giving its primary federal regulator the opportunity to take such action, and may terminate the deposit insurance if it determines that the institution has engaged in unsafe or unsound practices or is in an unsafe or unsound condition.

The FDIC imposes an assessment against all depository institutions for deposit insurance. Pursuant to the Dodd-Frank Act, with respect to deposit insurance premiums, the new assessment base calculation will be average consolidated total assets less average tangible equity (defined as Tier 1 capital). As a small institution (one with less than \$10 billion in assets), the Bank is assigned to one of four risk categories based upon its capital level and its composite CAMELS ratings. At September 30, 2013, the Bank’s risk category assignment required a payment of \$0.04 per \$100 of its total assessment base of approximately \$1.6 billion. The FDIC’s board has the flexibility to adopt actual rates that are higher or lower than the total base assessment rates adopted without notice and comment if certain restrictions are met.

Under the Dodd-Frank Act, a permanent increase in deposit insurance was authorized to \$250,000. The coverage limit is per depositor, per insured depository institution for each account ownership category. The Dodd-Frank Act also set a new minimum DIF reserve ratio at 1.35% of estimated insured deposits. The FDIC is required to attain this ratio by September 30, 2020.

Under the Federal Deposit Insurance Act (“FDIA”), the FDIC may terminate deposit insurance upon a finding that the institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC or the OCC. Management of the Bank does not know of any practice, condition or violation that might lead to termination of deposit insurance.

A significant increase in DIF insurance premiums would have an adverse effect on the operating expenses and results of operations of the Bank.

DIF-insured institutions pay a Financing Corporation (“FICO”) assessment in order to fund the interest on bonds issued to resolve thrift failures in the 1980s. At September 30, 2013, the FICO assessment was equal to .64 basis points for each \$100 of its total assessment base of approximately \$1.6 billion. These assessments will continue until the bonds mature in 2019.

Interest Rate Risk Management. The OCC requires federal savings banks, like the Bank, to have an effective and sound interest rate risk management program, including appropriate measurement and reporting, robust and meaningful stress testing, assumption development reflecting the institution’s experience, and comprehensive model

valuation. Interest rate risk exposure is supposed to be managed using processes and systems commensurate with their earnings and capital levels; complexity; business model; risk profile; and scope of operations. As of March 31, 2012, federal savings banks are required to have an independent interest rate risk management process in place that measures both earnings and capital at risk.

39

---

Table of Contents

**Stress Testing.** Although the Dodd-Frank Act requires institutions with more than \$10 billion in assets to conduct required stress testing, the OCC expects every bank, regardless of its size or risk profile, to have an effective internal process to (1) assess its capital adequacy in relation to its overall risks at least annually, and (2) to plan for maintaining appropriate capital levels. It is the OCC's belief that stress testing permits community banks to identify their key vulnerabilities to market forces and assess how to effectively manage those risks should they emerge. If stress testing results indicate that capital ratios could fall below the level needed to adequately support the bank's overall risk profile, the OCC believes the bank's board and management should take appropriate steps to protect the bank from such an occurrence, including establishing a plan that requires closer monitoring of market information, adjusting strategic and capital plans to mitigate risk, changing risk appetite and risk tolerance levels, limiting or stopping loan growth or adjusting the portfolio mix, adjusting underwriting standards, raising more capital, and selling or hedging loans to reduce the potential impact from such stress events.

**Assessments.** The Dodd-Frank Act transferred authority to collect assessments for federal savings associations from the OTS to the OCC. This authority was effective as of the transfer date, July 21, 2011. The Dodd-Frank Act also provides that, in establishing the amount of an assessment, the Comptroller of the Currency may consider the nature and scope of the activities of the entity, the amount and type of assets it holds, the financial and managerial condition of the entity, and any other factor that is appropriate. Prior to the transfer date, the OCC and the OTS assessed banks and savings associations, respectively, using different methodologies, although the agencies' methodologies generally resulted in similar levels of assessments. Under the OTS assessment system, assessments were due each year on January 31 and July 31, and were calculated based on an institution's asset size, condition, and complexity. The Bank's assessment (standard assessment) at September 30, 2013, was \$174,612. Beginning with assessments charged in September 2012, all national banks and federal savings associations are assessed using the OCC's assessment structure. As of September 30, 2013, the bank is no longer subject to a supervisory surcharge by the OCC.

**Regulatory Capital Requirements.** Currently, federally insured financial institutions, such as the Bank, are required to maintain a minimum level of regulatory capital. These capital requirements mandate that an institution maintain at least the following ratios: (1) a core (or Tier 1) capital to adjusted total assets ratio of 4% (which can be reduced to 3% for highly rated institutions); (2) a Tier 1 capital to risk-weighted assets ratio of 4%; and (3) a risk-based capital to risk-weighted assets ratio of 8%. Core (Tier 1) capital is defined as common stockholders' equity (including retained earnings), certain noncumulative perpetual preferred stock and related surplus and minority investments in equity accounts of consolidated subsidiaries, less intangibles other than certain mortgage servicing rights and credit card relationships. Supplementary capital is currently defined to include cumulative preferred stock, long-term perpetual preferred stock, mandatory convertible securities, subordinated debt and intermediate preferred stock, the allowance for loan and lease losses limited to a maximum of 1.25% of risk-weighted assets and up to 45% of unrealized gains on available-for-sale equity securities with readily determinable fair market values. Overall, the amount of supplementary capital included as part of total capital cannot exceed 100% of core capital.

Generally, in meeting the tangible, leverage and risk-based capital standards, federal savings associations must deduct investments in and loans to subsidiaries engaged in activities as principal that are not permissible for a national bank. If a subsidiary's activities are permitted to a national bank, that subsidiary's assets are generally consolidated with those of the parent's on a line-for-line basis.

Table of Contents

Capital requirements in excess of the standards set forth above may be imposed on individual institutions on a case-by-case basis upon a determination that the association's capital level is or may become inadequate in light of the particular circumstances. The OCC and the FDIC are generally permitted to take enforcement action against a savings bank that fails to meet its capital requirements. Such action may include restrictions on operations and banking activities, the imposition of a capital directive, a cease-and-desist order, civil money penalties, or more stringent measures such as the appointment of a conservator or receiver or a forced merger with another institution.

As of September 30, 2013, the Bank exceeded all of its regulatory capital requirements with core, tangible and risk-based capital ratios of 9.38%, 9.38% and 22.99% respectively, and was designated as "well-capitalized" under federal guidelines. See Note 14 to the "Notes to Consolidated Financial Statements," which is included in Part II, Item 8 "Financial Statements and Supplementary Data" of this Annual Report on Form 10-K.

### Basel III Capital Rules

In July 2013, our primary federal regulator, the Federal Reserve, and the Bank's primary federal regulator, the OCC, approved final rules (the "Basel III Capital Rules") establishing a new comprehensive capital framework for U.S. banking organizations. The Basel III Capital Rules generally implement the Basel Committee on Banking Supervision's (the "Basel Committee") December 2010 final capital framework referred to as "Basel III" for strengthening international capital standards. The Basel III Capital Rules substantially revise the risk-based capital requirements applicable to bank holding companies and their depository institution subsidiaries, including us and the Bank, as compared to the current U.S. general risk-based capital rules. The Basel III Capital Rules revise the definitions and the components of regulatory capital, as well as address other issues affecting the numerator in banking institutions' regulatory capital ratios. The Basel III Capital Rules also address asset risk weights and other matters affecting the denominator in banking institutions' regulatory capital ratios and replace the existing general risk-weighting approach, which was derived from the Basel Committee's 1988 "Basel I" capital accords, with a more risk-sensitive approach based, in part, on the "standardized approach" in the Basel Committee's 2004 "Basel II" capital accords. In addition, the Basel III Capital Rules implement certain provisions of the Dodd-Frank Act, including the requirements of Section 939A to remove references to credit ratings from the federal agencies' rules. The Basel III Capital Rules are effective for us and the Bank on January 1, 2015, subject to phase-in periods for certain of their components and other provisions.

Among other matters, the Basel III Capital Rules: (i) introduce a new capital measure called "Common Equity Tier 1" ("CET1") and related regulatory capital ratio of CET1 to risk-weighted assets; (ii) specify that Tier 1 capital consists of CET1 and "Additional Tier 1 capital" instruments meeting certain revised requirements; (iii) mandate that most deductions/adjustments to regulatory capital measures be made to CET1 and not to the other components of capital; and (iv) expand the scope of the deductions from and adjustments to capital as compared to existing regulations. Under the Basel III Capital Rules, for most banking organizations, the most common form of Additional Tier 1 capital is non-cumulative perpetual preferred stock and the most common form of Tier 2 capital is subordinated notes and a portion of the allocation for loan and lease losses, in each case, subject to the Basel III Capital Rules' specific requirements.



Table of Contents

Pursuant to the Basel III Capital Rules, the minimum capital ratios as of January 1, 2015 will be as follows:

- 4.5% CET1 to risk-weighted assets;
- 6.0% Tier 1 capital (that is, CET1 plus Additional Tier 1 capital) to risk-weighted assets;
  - 8.0% Total capital (that is, Tier 1 capital plus Tier 2 capital) to risk-weighted assets; and
- 4% Tier 1 capital to average consolidated assets as reported on consolidated financial statements (known as the “leverage ratio”).

The Basel III Capital Rules also introduce a new “capital conservation buffer”, composed entirely of CET1, on top of these minimum risk-weighted asset ratios. The capital conservation buffer is designed to absorb losses during periods of economic stress. Banking institutions with a ratio of CET1 to risk-weighted assets above the minimum but below the capital conservation buffer will face constraints on dividends, equity repurchases and compensation based on the amount of the shortfall. Thus, when fully phased-in on January 1, 2019, the Bank and we will be required to maintain such additional capital conservation buffer of 2.5% of CET1, effectively resulting in minimum ratios of (i) CET1 to risk-weighted assets of at least 7%, (ii) Tier 1 capital to risk-weighted assets of at least 8.5%, and (iii) Total capital to risk-weighted assets of at least 10.5%.

The Basel III Capital Rules provide for a number of deductions from and adjustments to CET1. These include, for example, the requirement that deferred tax assets arising from temporary differences that could not be realized through net operating loss carrybacks and significant investments in non-consolidated financial entities be deducted from CET1 to the extent that any one such category exceeds 10% of CET1 or all such items, in the aggregate, exceed 15% of CET1.

In addition, under the current general risk-based capital rules, the effects of accumulated other comprehensive income or loss (“AOCI”) items included in shareholders’ equity (for example, mark-to-market of securities held in the available for sale portfolio) under U.S. GAAP are reversed for the purposes of determining regulatory capital ratios. Pursuant to the Basel III Capital Rules, the effects of certain AOCI items are not excluded; however, “non-advanced approaches banking organizations”, including us and the Bank, may make a one-time permanent election to continue to exclude these items. This election must be made concurrently with the first filing of certain of our and the Bank’s periodic regulatory reports in the beginning of 2015. We and the Bank expect to make this election in order to avoid significant variations in the level of capital depending upon the impact of interest rate fluctuations on the fair value of their securities portfolio. The Basel III Capital Rules also preclude certain hybrid securities, such as trust preferred securities, from inclusion in our Tier 1 capital, subject to grandfathering in the case of companies, such as us, that had less than \$15 billion in total consolidated assets as of December 31, 2009.

Implementation of the deductions and other adjustments to CET1 will begin on January 1, 2015 and will be phased-in over a 4-year period (beginning at 40% on January 1, 2015 and an additional 20% per year thereafter). The implementation of the capital conservation buffer will begin on January 1, 2016 at the 0.625% level and increase by 0.625% on each subsequent January 1, until it reaches 2.5% on January 1, 2019.

With respect to the Bank, the Basel III Capital Rules revise the “prompt corrective action” (“PCA”) regulations adopted pursuant to Section 38 of the Federal Deposit Insurance Act, by: (i) introducing a CET1 ratio requirement at each PCA category (other than critically undercapitalized), with the required CET1 ratio being 6.5% for well-capitalized status; (ii) increasing the minimum Tier 1 capital ratio requirement for each category, with the minimum Tier 1 capital ratio for well-capitalized status being 8% (as compared to the current 6%); and (iii) eliminating the current provision that provides that a bank with a composite supervisory rating of 1 may have a 3% leverage ratio and still be

adequately capitalized. The Basel III Capital Rules do not change the total risk-based capital requirement for any PCA category.

42

---

## Table of Contents

The Basel III Capital Rules prescribe a new standardized approach for risk weightings that expand the risk-weighting categories from the current four Basel I-derived categories (0%, 20%, 50% and 100%) to a larger and more risk-sensitive number of categories, depending on the nature of the assets, generally ranging from 0% for U.S. government and agency securities, to 600% for certain equity exposures, and resulting in higher risk weights for a variety of asset classes.

Should we or the Bank not meet the requirements of the Basel III Capital Rules, we and the Bank would be subject to adverse regulatory action by our regulators, which action could result in material adverse consequences for us, the Bank, and our shareholders.

We believe that the Bank will be able to meet targeted capital ratios upon implementation of the revised requirements, as finalized.

**Prompt Corrective Action.** Federal banking regulators are authorized and, under certain circumstances, required to take certain actions against banks that fail to meet their capital requirements. Effective December 19, 1992, the federal banking agencies were given additional enforcement authority with respect to undercapitalized depository institutions. Under the current regulations, which will change, becoming stricter on January 1, 2015 as described above, an institution is deemed to be (a) “well capitalized” if it has total risk-based capital of 10.0% or more, has a Tier 1 risk-based capital ratio of 6.0% or more, has a Tier 1 leverage capital ratio of 5.0% or more and is not subject to any order or final capital directive to meet and maintain a specific capital level for any capital measure; (b) “adequately capitalized” if it has a total risk-based capital ratio of 8.0% or more, a Tier 1 risk-based capital ratio of 4.0% or more and a Tier 1 leverage capital ratio of 4.0% or more (3.0% under certain circumstances) and does not meet the definition of well-capitalized; (c) “undercapitalized” if it has a total risk-based capital ratio that is less than 8.0%, a tier 1 risk-based capital ratio that is less than 4.0% or a Tier 1 leverage capital ratio that is less than 4.0% (3.0% under certain circumstances); (d) “significantly undercapitalized” if it has a total risk-based capital ratio that is less than 6.0%, a Tier 1 risk-based capital ratio that is less than 3.0% or a Tier 1 leverage capital ratio that is less than 3.0%; and (e) “critically undercapitalized” if it has a ratio of tangible equity to total assets that is equal to or less than 2.0%. In certain situations, a federal banking agency may reclassify a well-capitalized institution as adequately capitalized and may require an adequately capitalized or undercapitalized institution to comply with supervisory actions as if the institution were in the next lower category.

The federal banking agencies are generally required to take action to restrict the activities of an “undercapitalized,” “significantly undercapitalized” or “critically undercapitalized” bank. Any such bank must submit a capital restoration plan that is guaranteed by the parent holding company. Until such plan is approved, it may not increase its assets, acquire another institution, establish a branch or engage in any new activities, and generally may not make capital distributions. The banking regulators are authorized to impose additional restrictions, discussed below, that are applicable to significantly undercapitalized institutions.

Adequately capitalized banks cannot normally pay dividends or make any capital contributions that would leave it undercapitalized; they cannot pay a management fee to a controlling person if, after paying the fee, it would be undercapitalized; and they cannot accept, renew or roll over any brokered deposit unless the bank has applied for and been granted a waiver by the FDIC. The FDIC has defined the “national rate” for all interest-bearing deposits held by less-than-well capitalized institutions as “a simple average of rates paid by all insured depository institutions and branches for which data are available” and has stated that its presumption is that this national rate is the prevailing rate in any market. As such, less-than-well capitalized institutions generally may not pay an interest rate in excess of the national rate plus 75 basis points.

Table of Contents

Undercapitalized banks may not accept, renew or rollover brokered deposits, and are subject to restrictions on the soliciting of deposits over prevailing rates. In addition, undercapitalized banks are subject to certain regulatory restrictions. These restrictions include, among others, that such a bank generally may not make any capital distributions, must submit an acceptable capital restoration plan to the FDIC, may not increase its average total assets during a calendar quarter in excess of its average total assets during the preceding calendar quarter unless any increase in total assets is consistent with a capital restoration plan approved by the FDIC and the bank's ratio of equity to total assets increases during the calendar quarter at a rate sufficient to enable the bank to become adequately capitalized within a reasonable time. In addition, such banks may not acquire a business, establish or acquire a branch office or engage in a new line of business without regulatory approval. Further, as part of a capital restoration plan, the Company must generally guarantee that the bank will return to adequately capitalized status and provide appropriate assurances of performance of that guarantee. If a capital restoration plan is not approved, or if the bank fails to implement the plan in any material respect, the bank would be treated as if it were "significantly undercapitalized," which would result in the imposition of a number of additional requirements and restrictions. It should also be noted all FDIC-insured institutions are assigned an assessment risk. In general, weaker banks (those with a higher assessment risk) are subject to higher assessments than stronger banks. An adverse change in category can lead to materially higher expenses for insured institutions. Finally, bank regulatory agencies have the ability to seek to impose higher than normal capital requirements known as individual minimum capital requirements ("IMCR") for institutions with higher risk profiles. If the Bank's capital status – now well-capitalized – changes as a result of future operations or regulatory order, or if it becomes subject to an IMCR, the Company's financial condition or results of operations could be adversely affected. See "— Consent Orders and Related Matters."

Any institution that fails to comply with its capital plan or is "significantly undercapitalized" (i.e., Tier 1 risk-based or core capital ratios of less than 3% or a risk-based capital ratio of less than 6%) must be made subject to one or more of additional specified actions and operating restrictions mandated by the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA"). These actions and restrictions include requiring the issuance of additional voting securities; limitations on asset growth; mandated asset reduction; changes in senior management; divestiture, merger or acquisition of the association; restrictions on executive compensation; and any other action the OTS deems appropriate. An institution that becomes "critically undercapitalized" is subject to further mandatory restrictions on its activities in addition to those applicable to significantly undercapitalized associations. In addition, the appropriate banking regulator must appoint a receiver (or conservator with the FDIC's concurrence) for an institution, with certain limited exceptions, within 90 days after it becomes critically undercapitalized. Any undercapitalized institution is also subject to other possible enforcement actions, including the appointment of a receiver or conservator. The appropriate regulator is also generally authorized to reclassify an institution into a lower capital category and impose restrictions applicable to such category if the institution is engaged in unsafe or unsound practices or is in an unsafe or unsound condition.

The imposition of any of these measures on the Bank may have a substantial adverse effect on it and on the Company's operations and profitability. Meta Financial stockholders do not have preemptive rights and, therefore, if Meta Financial is directed by its regulators to issue additional shares of Common Stock, such issuance may result in the dilution in stockholders' percentage of ownership of Meta Financial.

## Table of Contents

**Institutions in Troubled Condition.** Certain events, including entering into a formal written agreement with a bank's regulator that requires action to improve the bank's financial condition, or simply being informed by the regulator that the bank is in troubled condition, will automatically result in limitations on so-called "golden parachute" agreements pursuant to Section 18(K) of the FDIA. In addition, organizations that are in troubled condition must give 30 days' written notice before appointing a Director or Senior Executive Officer, pursuant to Section 32 of the FDIA. The Bank and the Company are subject to these requirements.

**Branching by Federal Savings Associations.** Subject to certain limitations, the HOLA and the OCC regulations permit federally chartered savings associations to establish branches in any state of the United States. The authority to establish such branches is available if the law of the state in which the branch is located, or is to be located, would permit establishment of the branch if the savings association were a state savings association chartered by such state or if the association qualifies as a "domestic building and loan association" under the Internal Revenue Code of 1986, as amended, which imposes qualification requirements similar to those for a "qualified thrift lender" under the HOLA. See "—Qualified Thrift Lender Test." The branching authority under the HOLA and the OCC regulations preempts any state law purporting to regulate branching by federal savings associations.

**Standards for Safety and Soundness.** The federal banking agencies have adopted the Interagency Guidelines Establishing Standards for Safety and Soundness. The guidelines establish certain safety and soundness standards for all depository institutions. The operational and managerial standards in the guidelines relate to the following: (1) internal controls and information systems; (2) internal audit systems; (3) loan documentation; (4) credit underwriting; (5) interest rate exposure; (6) asset growth; (7) compensation, fees and benefits; (8) asset quality; and (9) earnings. Again, rather than providing specific rules, the guidelines set forth basic compliance considerations and guidance with respect to a depository institution. Failure to meet the standards in the guidelines, however, could result in a request by the OCC to the Bank to provide a written compliance plan to demonstrate its efforts to come into compliance with such guidelines.

**Limitations on Dividends and Other Capital Distributions.** Federal regulations govern the permissibility of capital distributions by a federal savings association. Pursuant to the Dodd-Frank Act, savings associations that are part of a savings and loan holding company structure must now file a notice of a declaration of a dividend with the Federal Reserve. In the case of cash dividends, OCC regulations require that federal savings associations that are subsidiaries of a stock savings and loan holding company must file an informational copy of that notice with the OCC at the same time it is filed with the Federal Reserve. OCC regulations further set forth the circumstances under which a federal savings association is required to submit an application or notice before it may make a capital distribution.

A federal savings association proposing to make a capital distribution is required to submit an application to the OCC if: the association does not qualify for expedited treatment pursuant to criteria set forth in OCC regulations; the total amount of all of the association's capital distributions (including the proposed capital distribution) for the applicable calendar year exceeds the association's net income for that year to date plus the association's retained net income for the preceding two years; the association would not be at least adequately capitalized following the distribution; or the proposed capital distribution would violate a prohibition contained in any applicable statute, regulation, or agreement between the association and the OCC or the Company's and Bank's former regulator, the OTS, or violate a condition imposed on the association in an application or notice approved by the OCC or the OTS.

A federal savings association proposing to make a capital distribution is required to submit a prior notice to the OCC if: the association would not be well-capitalized following the distribution; the proposed capital distribution would reduce the amount of or retire any part of the association's common or preferred stock or retire any part of debt instruments such as notes or subordinate debentures included in the association's capital (other than regular payments required under a debt instrument); or the association is a subsidiary of a savings and loan holding company and is not required to file a notice regarding the proposed distribution with the Federal Reserve, in which case only an informational copy of the notice filed with the Federal Reserve needs to be simultaneously provided to the OCC.



Table of Contents

Each of the Federal Reserve and OCC have primary reviewing responsibility for the applications or notices required to be submitted to them by savings associations relating to a proposed distribution. The Federal Reserve may disapprove of a notice, and the OCC may disapprove of a notice or deny an application, if:

- the savings association would be undercapitalized following the distribution;
- the proposed distribution raises safety and soundness concerns; or

the proposed distribution violates a prohibition contained in any statute, regulation, enforcement action or agreement between the savings association (or its holding company, in the case of the Federal Reserve) and the entity's primary federal regulator, or a condition imposed on the savings association (or its holding company, in the case of the Federal Reserve) in an application or notice approved by the entity's primary federal regulator.

Under current regulations, the Bank is not permitted to pay dividends on its stock if its regulatory capital would fall below the amount required for the liquidation account established to provide a limited priority claim to the assets of the Bank to qualifying depositors at March 31, 1992, who continue to maintain deposits at the Bank after its conversion from a federal mutual savings and loan association to a federal stock savings bank pursuant to its Plan of Conversion adopted August 21, 1991.

During the fiscal year ended September 30, 2013, the Bank paid no cash dividends to the Company, as the Company utilized existing cash holdings for payment of dividends to the Company's stockholders and other holding company expenses.

Qualified Thrift Lender Test. All savings associations, including the Bank, are required to meet a qualified thrift lender ("QTL") test to avoid certain restrictions on their operations. This test requires a savings association to have at least 65% of its portfolio assets (as defined by regulation) in qualified thrift investments (primarily residential mortgages and related investments, including certain mortgage-backed securities) on a monthly average for nine out of every 12 months on a rolling basis or meet the requirements for a domestic building and loan association under the Internal Revenue Code. Under either test, the required assets primarily consist of residential housing related to loans and investments. At September 30, 2013, the Bank met the test and always has since its inception.

Any savings association that fails to meet the QTL test must convert to a national bank charter, unless it qualifies as a QTL within one year and thereafter remains a QTL, or limits its new investments and activities to those permissible for both a savings association and a national bank. In addition, the association is subject to national bank limits for payment of dividends and branching authority. If such association has not requalified or converted to a national bank within three years after the failure, it must divest all investments and cease all activities not permissible for a national bank.

Community Reinvestment Act. Under the Community Reinvestment Act (the "CRA"), the Bank is evaluated periodically by its primary federal banking regulator to determine if it is meeting its continuing and affirmative obligation consistent with its safe and sound operation to help meet the credit needs of its entire community, including low and moderate income neighborhoods. In the Bank's most recent CRA examination on January 24, 2011, notwithstanding that the Bank's record was consistent with an overall rating of "Satisfactory," the Bank received a "Needs to Improve" rating due to the criticized credit practices associated with its iAdvance product, which the Bank is no longer offering. The CRA requires the OCC, to take such rating into account in considering an application for any of the following: (i) the establishment of a domestic branch; (ii) the relocation of its main office or of a branch; (iii) the merger or consolidation with or acquisition of assets or assumption of liabilities of an insured depository institution; or (iv) the conversion of the Bank to a national charter. If the Bank submitted any of the above-listed applications, the OCC may consider the Bank's overall "Needs to Improve" rating negatively.





Table of Contents

**Recent Volcker Rule Adoption.** On December 10, 2013, five financial regulatory agencies, including our primary federal regulators the Federal Reserve and the OCC, adopted final rules (the “Final Rules”) implementing the so-called Volcker Rule embodied in Section 13 of the Bank Holding Company Act, which was added by Section 619 of the Dodd-Frank Act. The Final Rules complete the process begun in October of 2011 when the agencies introduced proposed implementing rules for comment. The Final Rules prohibit banking entities from (1) engaging in short-term proprietary trading for their own accounts, and (2) having certain ownership interests in and relationships with hedge funds or private equity funds (“covered funds”). The Final Rules are intended to provide greater clarity with respect to both the extent of those primary prohibitions and of the related exemptions and exclusions. The Final Rules also require each regulated entity to establish an internal compliance program that is consistent with the extent to which it engages in activities covered by the Volcker Rule, which must include (for the largest entities) making regular reports about those activities to regulators. Community and small banks, such as MetaBank, are afforded some relief under the Final Rules. If such banks are engaged only in exempted proprietary trading, such as trading in U.S. government, agency, state and municipal obligations, they are exempt entirely from compliance program requirements. Moreover, even if a community or small bank engages in proprietary trading or covered fund activities under the rule, they need only incorporate references to the Volcker Rule into their existing policies and procedures. The Final Rules are effective April 1, 2014, but the conformance period has been extended from its statutory end date of July 21, 2014 until July 21, 2015. Beginning June 30, 2014, banking entities with \$50 billion or more in trading assets and liabilities must report quantitative metrics; on April 30, 2016, banking entities with at least \$25 billion but less than \$50 billion must report; and on December 31, 2016, banking entities with at least \$10 billion but less than \$25 billion must report. The Company is currently evaluating the Final Rules, which are lengthy and detailed, but does not at this time expect the Final Rules to have a material impact on its operations.

**Interstate Banking and Branching.** The FRB may approve an application of an adequately capitalized and adequately managed bank holding company to acquire control of, or acquire all or substantially all of the assets of, a bank located in a state other than such holding company’s home state, without regard to whether the transaction is prohibited by the laws of any state. In general, the FRB may not approve the acquisition of a bank that has not been in existence for the minimum time period (not exceeding five years) specified by the statutory law of the host state or if the applicant (and its depository institution affiliates) controls or would control more than 10% of the insured deposits in the United States or 30% or more of the deposits in the target bank’s home state or in any state in which the target bank maintains a branch. Iowa has adopted a five year minimum existence requirement.

The federal banking agencies are also generally authorized to approve interstate merger transactions without regard to whether such transaction is prohibited by the law of any state. Interstate acquisitions of branches or the establishment of a new branch is permitted only if the law of the state in which the branch is located permits such acquisitions. Interstate mergers and branch acquisitions are also subject to the nationwide and statewide insured deposit concentration amounts described above. Iowa permits interstate branching only by merger.

**Transactions with Affiliates.** The Bank must comply with Sections 23A and 23B of the Federal Reserve Act relative to transactions with “affiliates,” generally defined to mean any company that controls or is under common control with the institution (as such, Meta Financial is an affiliate of the Bank for these purposes). Transactions between an institution or its subsidiaries and its affiliates are required to be on terms as favorable to the Bank as terms prevailing at the time for transactions with nonaffiliates. In addition, certain of these transactions, such as loans to an affiliate, are restricted to a percentage of the institutions’ capital (e.g., the aggregate amount of covered transactions with any individual affiliate is limited to 10% of the capital and surplus of the institution; the aggregate amount of covered transactions with all affiliates is limited to 20% of the institution’s capital and surplus). In addition, a savings and loan holding company may not lend to any affiliate engaged in activities not permissible for a savings and loan holding company or acquire the securities of most affiliates. The OCC has the discretion to treat subsidiaries of savings institutions as affiliates on a case-by-case basis.

On April 1, 2003, the Federal Reserve’s Regulation W, which comprehensively amends Sections 23A and 23B of the Federal Reserve Act, became effective. The Federal Reserve Act and Regulation W are applicable to the Bank. The

Regulation unifies and updates staff interpretations issued over the years, incorporates several new interpretive proposals (such as to clarify when transactions with an unrelated third party will be attributed to an affiliate) and addresses new issues arising as a result of the expanded scope of non-banking activities engaged in by banks and bank holding companies in recent years and authorized for financial holding companies under the Financial Services Modernization Act of 1999.

The Dodd-Frank Act also included specific changes to the law related to the definition of “covered transaction” in Sections 23A and 23B and limitations on asset purchases from insiders. With respect to the definition of “covered transaction,” the Dodd-Frank Act now defines that term to include the acceptance of debt obligations issued by an affiliate as collateral for a bank’s loan or extension of credit to another person or company. In addition, a “derivative transaction” with an affiliate is now deemed to be a “covered transaction” to the extent that such a transaction causes a bank or its subsidiary to have a credit exposure to the affiliate. A separate provision of the Dodd-Frank Act states that an insured depository institution may not “purchase an asset from, or sell an asset to” a bank insider (or their related interests) unless (1) the transaction is conducted on market terms between the parties, and (2) if the proposed transaction represents more than 10 percent of the capital stock and surplus of the insured institution, it has been approved in advance by a majority of the institution’s non-interested directors.

47

---

## Table of Contents

Certain transactions with directors, officers or controlling persons are also subject to conflict of interest regulations. These conflict of interest regulations and other statutes also impose restrictions on loans to such persons and their related interests. Among other things, such loans must be made on terms substantially the same as for loans to unaffiliated individuals and must not create an abnormal risk of repayment or other unfavorable features for the Bank.

Federal Home Loan Bank System. The Bank is a member of the FHLB of Des Moines, one of 12 regional FHLBs that administers the home financing credit function of savings associations that is subject to supervision and regulation by the Federal Housing Finance Agency. All advances from the FHLB are required to be fully secured by sufficient collateral as determined by the FHLB. In addition, all long-term advances must be used for residential home financing.

As members of the FHLB System, the Bank is required to purchase and maintain activity-based capital stock in the FHLB in the amount of 4.00% to support outstanding advances and mortgage loans. At September 30, 2013, the Bank had in the aggregate \$10.0 million in FHLB stock, which was in compliance with this requirement. For the fiscal year ended September 30, 2013, dividends paid by the FHLB to the Bank totaled \$219,000.

Under federal law, the FHLBs are required to provide funds for the resolution of troubled savings associations and to contribute to low and moderately priced housing programs through direct loans or interest subsidies on advances targeted for community investment and low- and moderate-income housing projects. These contributions have affected adversely the level of FHLB dividends paid and could continue to do so in the future. These contributions could also have an adverse effect on the value of FHLB stock in the future. A reduction in value of the Bank's FHLB stock may result in a corresponding reduction in the Bank's capital. In addition, the federal agency that regulates the FHLBs has required each FHLB to register its stock with the SEC, which will increase the costs of each FHLB and may have other effects that are not possible to predict at this time.

Federal Securities Law. The common stock of Meta Financial is registered with the SEC under the Exchange Act, as amended. Meta Financial is subject to the information, proxy solicitation, insider trading restrictions and other requirements under the Exchange Act.

Meta Financial's stock held by persons who are affiliates (generally officers, directors and principal stockholders) of the Company may not be resold without registration unless sold in accordance with certain resale restrictions. If Meta Financial meets specified current public information requirements, each affiliate of the Company, subject to certain requirements, will be able to sell, in the public market, without registration, a limited number of shares in any three-month period.

## Holding Company Supervision & Regulation

We are a unitary savings and loan holding company within the meaning of the HOLA. As such, we are required to register with and be subject to Federal Reserve examination and supervision as well as certain reporting requirements. In addition, the Federal Reserve has enforcement authority over us and any of our non-savings institution subsidiaries. Among other things, this authority permits the Federal Reserve to restrict or prohibit activities that are determined to be a serious risk to the financial safety, soundness or stability of a subsidiary savings association.

Table of Contents

As noted above, pursuant to the Dodd-Frank Act, the Federal Reserve has responsibility for the primary supervision and regulation of all savings and loan holding companies, including the Company. Given the extensive transfer of former OTS authority to multiple agencies, the Dodd-Frank Act requires the Federal Reserve to identify and publish in the Federal Register separate lists of the OTS regulations that the Federal Reserve will continue to enforce for savings and loan holding companies after the transfer date. In carrying out this mandate, and in connection with its assumption of responsibility for the ongoing examination, supervision, and regulation of savings and loan holding companies, the Federal Reserve has published an interim final rule that provides for the corresponding transfer from the OTS to the Federal Reserve of the regulations necessary for the Federal Reserve to administer the statutes governing savings and loan holding companies.

Restrictions Applicable to All Savings and Loan Holding Companies.

Federal law prohibits a savings and loan holding company, including us, directly or indirectly, from acquiring:

control (as defined under the HOLA) of another savings institution (or a holding company parent) without prior Federal Reserve approval;

- through merger, consolidation, or purchase of assets, another savings institution or a holding company thereof, or acquiring all or substantially all of the assets of such institution (or a holding company) without prior Federal Reserve approval; or

control of any depository institution not insured by the FDIC (except through a merger with and into the holding company's savings institution subsidiary that is approved by the Federal Reserve).

A savings and loan holding company may not acquire as a separate subsidiary an FDIC-insured institution that has a principal office outside of the state where the principal office of its subsidiary institution is located, except:

- in the case of certain emergency acquisitions approved by the FDIC;

- if such holding company controls a savings institution subsidiary that operated a home or branch office in such additional state as of March 5, 1987; or

- if the laws of the state in which the savings institution to be acquired is located specifically authorize a savings institution chartered by that state to be acquired by a savings institution chartered by the state where the acquiring savings institution or savings and loan holding company is located, or by a holding company that controls such a state chartered association.

The HOLA also prohibits a savings and loan holding company (directly or indirectly, or through one or more subsidiaries) from acquiring or retaining, with certain exceptions, more than 5% of a non-subsidary savings association, a non-subsidary holding company, or a non-subsidary company engaged in activities other than those permitted by the HOLA. In evaluating applications by holding companies to acquire savings associations, the Federal Reserve must consider the financial and managerial resources and future prospects of the company and institution involved, the effect of the acquisition on the risk to the DIF, the convenience and needs of the community and competitive factors.

Table of Contents

Failure to Meet QTL Test.

If a banking subsidiary of a savings and loan holding company fails to meet the QTL test, the holding company must register with the FRB as a bank holding company within one year of the savings institution's failure to comply.

Activities Restrictions.

Prior to the Dodd-Frank Act, savings and loan holding companies were generally permitted to engage in a wider array of activities than those permissible for their bank holding company counterparts and may have concentrations in real estate lending that are not typical for bank holding companies. Section 606 of the Dodd-Frank Act amended the HOLA by inserting a new requirement that conditions the ability of non-grandfathered savings and loan holding companies that are not exempt from the HOLA's restrictions on activities to engage in certain activities. Pursuant to this new requirement, a covered savings and loan holding company may engage in activities that are permissible only for a financial holding company under Section 4(k) of the BHCA if the covered company meets all of the criteria to qualify as a financial holding company, and complies with all of the requirements applicable to a financial holding company as if the covered savings and loan holding company was a bank holding company. Moreover, going forward, savings and loan holding companies engaging in new activities permissible for bank holding companies will need to comply with notice and filing requirements of the Federal Reserve.

If the Federal Reserve believes that an activity of a savings and loan holding company or a nonbank subsidiary constitutes a serious risk to the financial safety, soundness or stability of a subsidiary savings association and is inconsistent with the principles of sound banking, the purposes of the HOLA or other applicable statutes, the Federal Reserve may require the savings and loan holding company to terminate the activity or divest control of the nonbanking subsidiary. This obligation is established in Section 10(g)(5) of the HOLA and bank holding companies are subject to equivalent obligations under the BHCA and the Federal Reserve's Regulation Y.

Source of Strength and Capital Requirements.

The Dodd-Frank Act requires all companies, including savings and loan holding companies, that directly or indirectly control an insured depository institution to serve as a source of financial and managerial strength to its subsidiary savings associations. Moreover, pursuant to the Dodd-Frank Act, savings and loan holding companies are generally subject to the same capital and activity requirements as those applicable to bank holding companies.

New rules related to holding company consolidated capital requirements have been announced by the FRB. For a summary of the applicable changes, see "Risk Factors – Risks Related To Our Industry and Business."

Examination.

The Federal Reserve intends, to the greatest extent possible, taking into account any unique characteristics of savings and loan holding companies and the requirements of the HOLA, to assess the condition, performance, and activities of savings and loan holding companies on a consolidated basis in a manner that is consistent with the Federal Reserve's established risk-based approach regarding bank holding company supervision. As with bank holding companies, the Federal Reserve's objective will be to ensure that a savings and loan holding company and its non-depository subsidiaries are effectively supervised and can serve as a source of strength for, and do not threaten the soundness of, its subsidiary depository institution(s).

Table of Contents

In accordance with its goal to assess the condition, performance, and activities of savings and loan holding companies on a consolidated basis in a manner that is consistent with the Federal Reserve’s established risk-based approach regarding bank holding company supervision, the Federal Reserve announced in 2013 that it will continue to use “RFI/C(D)” rating system (commonly referred to as “RFI”) to assign indicative ratings to SLHCs. The FRB has announced that it will soon issue a notice seeking public comment on the application of the RFI rating system for SLHCs. That notice will provide the public with an opportunity to comment.

Change of Control.

The federal banking laws require that appropriate regulatory approvals must be obtained before an individual or company may take actions to “control” a bank or savings association. The definition of control found in the HOLA is similar to that found in the BHCA for bank holding companies. Both statutes apply a similar three-prong test for determining when a company controls a bank or savings association. Specifically, a company has control over either a bank or savings association if the company:

- (1) directly or indirectly or acting in concert with one or more persons, owns, controls, or has the power to vote 25% or more of the voting securities of a company;
- (2) controls in any manner the election of a majority of the directors (or any individual who performs similar functions in respect of any company, including a trustee under a trust) of the board; or
- (3) directly or indirectly exercises a controlling influence over the management or policies of the bank.

The Federal Reserve adopted an interim final rule that, among other things, implements the HOLA to govern the operations of savings and loan holding companies. The new rule, known as Regulation LL, includes a specific definition of “control” similar to the statutory definition, with certain additional provisions. Additionally, Regulation LL modifies the regulations previously used by the OTS for purposes of determining when a company or natural person acquires control of a savings association or savings and loan holding company under the HOLA or the Change in Bank Control Act (“CBCA”). In light of the similarity between the statutes governing bank holding companies and savings and loan holding companies, the Federal Reserve proposes to use its established rules and processes with respect to control determinations under the HOLA and the CBCA to ensure consistency between equivalent statutes administered by the same agency.

The Federal Reserve stated in the interim final rule that it will review investments and relationships with savings and loan holding companies by companies using the current practices and policies applicable to bank holding companies to the extent possible. Overall, the indicia of control used by the Federal Reserve under the BHCA to determine whether a company has a controlling influence over the management or policies of a banking organization (which for Federal Reserve purposes, will now include savings associations and savings and loan holding companies) are similar to the control factors found in OTS regulations. However, the OTS rules weighed these factors somewhat differently and used a different review process designed to be more mechanical.

## Table of Contents

Among the differences highlighted by the Federal Reserve with respect to OTS procedures on determinations of control, the Federal Reserve noted that it does not limit its review of companies with the potential to have a controlling influence to the two largest stockholders. Specifically, the Federal Reserve reviews all investors based on all of the facts and circumstances to determine if a controlling influence is present.

Moreover, unlike the OTS control rules, the Federal Reserve does not have a separate application process for rebutting control under the BHCA and Regulation LL does not include such a process. Under the former OTS rules, investors that triggered a control factor under the rules could submit an application to the OTS requesting a determination that they have successfully rebutted control under the HOLA. This separate application process is not available under Regulation LL. Given that Federal Reserve practice is to consider potential control relationships for all investors in connection with applications submitted under the BHCA, the Federal Reserve will review potential control relationships for all investors in connection with applications submitted to the Federal Reserve under Section 10(e) or 10(o) of the HOLA. As with OTS practice, the Federal Reserve often obtains a series of commitments from investors seeking non-control determinations.

## Federal and State Taxation

Federal and State Taxation. Meta Financial and its subsidiaries file consolidated federal income tax returns and separate income or franchise tax returns as required by various states on a fiscal year basis using the accrual method of accounting. We monitor relevant tax authorities and change our estimate of accrued income tax due to changes in income or franchise tax laws and their interpretation by the courts and regulatory authorities. In addition to the regular income tax, corporations, including savings banks such as the Bank, generally are subject to a minimum tax. An alternative minimum tax is imposed at a minimum tax rate of 20% on alternative minimum taxable income, which is the sum of a corporation's regular taxable income (with certain adjustments) and tax preference items, less any available exemption. The alternative minimum tax is imposed to the extent it exceeds the corporation's regular income tax and net operating losses can offset no more than 90% of alternative minimum taxable income.

To the extent earnings appropriated to a savings bank's bad debt reserves and deducted for federal income tax purposes exceed the allowable amount of such reserves computed under the experience method and to the extent of the bank's supplemental reserves for losses on loans ("Excess"), such Excess may not, without adverse tax consequences, be utilized for the payment of cash dividends or other distributions to a stockholder (including distributions on redemption, dissolution or liquidation) or for any other purpose (except to absorb bad debt losses). As of September 30, 2013, the Bank's Excess for tax purposes totaled approximately \$6.7 million.

## Competition

The Company's Retail Banking operation faces strong competition, both in originating real estate and other loans and in attracting deposits. Competition in originating real estate loans comes primarily from commercial banks, savings banks, credit unions, captive finance companies, insurance companies, and mortgage bankers making loans secured by real estate located in the Company's market area. Commercial banks and credit unions provide vigorous competition in consumer lending. The Company competes for real estate and other loans principally on the basis of the quality of services it provides to borrowers, interest rates and loan fees it charges, and the types of loans it originates.

The Company's Retail Banking operation attracts deposits through its Retail Banking offices, primarily from the communities in which those Retail Banking offices are located; therefore, competition for those deposits is principally from other commercial banks, savings banks, credit unions and brokerage offices located in the same communities. The Company competes for these deposits by offering a variety of deposit accounts at competitive rates, convenient business hours, and convenient branch locations with interbranch deposit and withdrawal privileges at each.

## Table of Contents

The Company's MPS division serves customers nationally and also faces strong competition from large commercial banks and specialty providers of electronic payments processing and servicing, including prepaid, debit, and credit card issuers, ACH processors, and ATM network sponsors. Many of these national players are aggressive competitors, leveraging relationships and economies of scale.

## Employees

At September 30, 2013, the Company and its subsidiaries had a total of 431.5 full-time equivalent employees. The Company's employees are not represented by any collective bargaining group. Management considers its employee relations to be good.

## Executive Officers of the Company Who Are Not Directors

The following information as to the business experience during the past five years is provided with respect to the executive officers of the Company who are not serving on the Company's Board of Directors. There are no arrangements or understandings between such person named and any persons pursuant to which such officer was selected.

Mr. Glen W. Herrick, age 51, is Executive Vice President and Chief Financial Officer of the Company after being appointed to the position effective October 1, 2013. Additionally, Mr. Herrick is a member of the Executive Committees for both the Company and the Bank. Mr. Herrick previously served as SVP of Finance and Investment Management of the Company. Mr. Herrick joined the Company in March 2013 following 19 years of various finance, accounting and risk management roles at Wells Fargo & Company, including serving as CFO of Wells Fargo's student loan division. Mr. Herrick has a B.S. in Engineering Management from the United States Military Academy at West Point and an MBA from the University of South Dakota. In addition, he is a graduate of the Stonier Graduate School of Banking.

Mr. Ira D. Frericks, age 53, is Executive Vice President and Chief Operating Officer of the Company after being appointed to the position effective October 1, 2013. Additionally, Mr. Frericks is a member of the Executive Committees for both the Company and the Bank. Mr. Frericks previously served as Senior Vice President and Chief Accounting Officer of the Company. Mr. Frericks joined the Company in 2008 as Chief Accounting Officer and has over 25 years of accounting and banking operations experience. He is a CPA and has a B.S. in Business Administration from the University of South Dakota. Mr. Frericks is also a graduate of the Graduate School of Banking at the University of Wisconsin.

Mr. Ronald W. Butterfield, age 64, is Executive Vice President and Chief Administrative Officer of the Company after being appointed to the position effective October 1, 2013. Additionally, Mr. Butterfield is a member of the Executive Committees for both the Company and the Bank. Mr. Butterfield previously served as Senior Vice President and Chief of Staff. Mr. Butterfield joined MFG in 2004 to help establish the Meta Payment Systems division. Prior to joining the Company, he held various banking and credit card operations roles at BankFirst and Citibank. Mr. Butterfield is a graduate of the University of Sioux Falls with a B.S in Mathematics.

## Item 1A. Risk Factors

Factors that, individually or in the aggregate, we think could cause our actual results to differ materially from expected and historical results include those described below as well as other risks and factors identified from time to time in our SEC filings. The Company's business could be harmed by any of these risks, as well as other risks that we have not identified. The trading price of the Company's common stock could decline due to any of these risks, and you may lose all or part of your investment. In assessing these risks, you should also refer to the other information contained in this annual report on Form 10-K, including the Company's financial statements and related notes.





Table of Contents

Risks Related to Our Industry and Business

Failure to generate sufficient capital to support our anticipated growth could adversely affect our earnings and prospects.

The Company has recently experienced considerable growth, having increased its assets from \$1.3 billion to \$1.7 billion during the two fiscal years ended September 30, 2013. Funded primarily by growth of no- and low-interest bearing deposits, the proceeds thereof have been invested primarily in municipal bonds, mortgage-backed securities (“MBS”) and investment securities available for sale. While the Company believes its asset quality to be good, particularly in comparison to most banking institutions, the Company’s asset growth, if continued as expected, will generate a need for higher levels of capital which management believes may not be met through earnings retention alone. In that respect, during the third and fourth quarters of fiscal 2013, the Company issued 507,354 shares of common stock which raised \$13.6 million, net of direct selling costs, all of which qualifies as Tier 1 capital for regulatory purposes. There can be no assurance, however, that the Company will be able to continue to access sources of capital, private or public. Failure to remain well-capitalized, or to attain potentially even higher levels of capitalization that will be required in the future under regulatory initiatives mandated by Congress, our regulatory agencies, or under the Basel accords, could adversely affect the Company’s earnings and prospects.

We may have difficulty managing our growth which may divert resources and limit our ability to expand our operations successfully.

We have experienced significant growth in the amount of our assets and the level of our deposits. Our future profitability will depend in part on our continued ability to grow; however, we may not be able to sustain our historical growth rate or be able to grow. Our future success will depend on competitive factors and on the ability of our senior management to continue to improve our system of internal controls and procedures and manage a growing number of customer relationships. We may not be able to implement improvements to these internal controls and procedures in an efficient or timely manner and may discover deficiencies in existing systems and controls as occurred this fiscal year. Consequently, continued growth, if achieved, may place a strain on our operational infrastructure, which could have a material adverse effect on our financial condition and results of operations.

Our underwriting practices may not prevent losses in our loan portfolio.

Our underwriting practices are designed to mitigate risk by adhering to specific loan parameters. Components of our underwriting program include an analysis of the borrower and their creditworthiness, a financial statement review, and, if applicable, cash flow projections and a valuation of collateral. We may incur losses in our loan portfolio if our underwriting criteria fail to identify credit risks. It is possible that losses will exceed the amounts the Bank has set aside for loss reserves and result in reduced interest income and increased provision for loan losses, which could have an adverse effect on our financial condition and results of operations.

Our lending operations are concentrated in Iowa and South Dakota.

Our lending activities are largely based in Iowa and South Dakota. As a result, our financial performance depends to a great degree on the economic conditions in these areas. If local economic conditions worsen it could cause us to experience an increase in the number of borrowers who default on their loans along with a reduction in the value of the collateral securing such loans, which could have an adverse effect on our financial condition and results of operations.

Table of Contents

Difficult economic and market conditions have adversely affected our industry.

General economic trends, low growth, reduced availability of commercial credit and continued levels of high unemployment have negatively impacted the credit performance of commercial and consumer credit, resulting in additional write-downs. Concerns over the stability of the financial markets and the economy have resulted in decreased lending by financial institutions to their customers and to each other. This has led to increased commercial and consumer deficiencies, lack of customer confidence, increased market volatility and widespread reduction in general business activity. The resulting economic pressure on consumers and businesses and the lack of confidence in the financial markets may adversely affect our business, financial condition, results of operations and stock price. A worsening of these conditions would likely exacerbate the adverse effects of these difficult market conditions on us and others in the financial institutions industry. In particular, we may face the following risks in connection with these events:

Separate and apart from enforcement orders issued against the Bank and the Company, we face increased regulation of our industry. Compliance with such regulation may increase our costs and limit our ability to pursue business opportunities;

Customer demand for loans secured by real estate could be reduced due to weaker economic conditions, an increase in unemployment, a decrease in real estate values or an increase in interest rates;

The process we use to estimate losses inherent in our credit exposure requires difficult, subjective and complex judgments, including forecasts of economic conditions, and whether economic conditions might impair the ability of our borrowers to repay their loans. The level of uncertainty concerning economic conditions may adversely affect the accuracy of our estimates which may, in turn, impact the reliability of the process;

The value of the portfolio of investment securities that we hold, including our trust preferred securities, may be adversely affected; and

Due to financial setbacks or other regulatory action, we may be required to pay significantly higher FDIC insurance premiums in the future. See “– Regulation.”

The full impact of the Dodd-Frank Act is currently unknown given that many of the details and substance of the new laws will be determined through agency rulemaking.

The full compliance burden and impact on our operations and profitability with respect to the Dodd-Frank Act are still not fully known, as the Dodd-Frank Act delegates to various federal agencies the task of implementing its many provisions through regulation. Hundreds of new federal regulations, studies and reports were required under the Dodd-Frank Act and not all of them have been finalized. Although certain provisions of the Dodd-Frank Act have been implemented (such as the transfer of regulation of federal savings banks like the Bank to the OCC, and the transfer of savings and loan holding company regulation to the Federal Reserve), rules and policies in this area will be further developing for months and years to come. Based on the provisions of the Dodd-Frank Act and anticipated implementing regulations, it is highly likely that banks and thrifts as well as their holding companies will be subject to significantly increased regulation and compliance obligations that expose us to higher costs as well as noncompliance risk and consequences.

Table of Contents

Transfer of the OTS' supervisory and rulemaking functions to other federal banking agencies has changed the way that we are regulated.

Both the Bank and Company have transitioned to the jurisdiction of new primary federal regulators, which changes the way both are regulated. Specifically, the OTS' supervisory and rulemaking functions (except for consumer protection) relating to all federal savings associations were transferred to the OCC on July 21, 2011, while the OTS' supervisory and rulemaking functions relating to savings and loan holding companies and their non-depository institution subsidiaries were transferred to the FRB on the same date. The transition of supervisory functions from the OTS to these agencies has altered the operations of the Bank and Company so as to be more closely aligned with the OCC's and FRB's respective supervision of national banks and their bank holding companies. As a result of these transitions, we have experienced changes in the way we are supervised. While we believe our experience thus far has been positive, we may yet experience challenges with respect to this transition to our new regulators.

The Consumer Financial Protection Bureau may reshape the consumer financial laws through rulemaking and enforcement of prohibitions against unfair, deceptive or abusive practices, which may directly impact the business operations of depository institutions offering consumer financial products or services, including the Bank.

The Bureau has broad rulemaking authority to administer and carry out the purposes and objectives of the "Federal consumer financial laws, and to prevent evasions thereof" with respect to all financial institutions that offer financial products and services to consumers. The Bureau is also authorized to prescribe rules, applicable to any covered person or service provider, identifying and prohibiting acts or practices that are "unfair, deceptive, or abusive" in connection with any transaction with a consumer for a consumer financial product or service, or the offering of a consumer financial product or service ("UDAAP authority"). The term "abusive" is new and because Bureau officials have indicated that compliance will be achieved through enforcement actions rather than the issuance of regulations, we cannot predict to what extent the Bureau's future actions will have on the banking industry or the Company. The full reach and impact of the Bureau's broad new rulemaking powers and UDAAP authority on the operations of financial institutions offering consumer financial products or services is currently unknown. Notwithstanding the foregoing, insured depository institutions with assets of \$10 billion or less (such as the Bank) will continue to be supervised and examined by their primary federal regulators, rather than the Bureau, with respect to compliance with federal consumer protection laws.

To date, the Bureau has finalized a number of regulations affecting non-bank entities that offer consumer financial products and services, including those related to "larger participants" (over which the Bureau will have supervisory authority). In addition, with respect to all entities subject to Bureau enforcement activity, the Bureau has issued final rules with respect to the confidential treatment of privileged information and rules of practice for adjudicatory proceedings.

The Bureau issued on May 23, 2012 an advance notice of proposed rulemaking regarding prepaid cards, which are the core of the Bank's MPS business line. In its request for information, the Bureau asked for comments regarding the issuance, use and characteristics (such as FDIC insurance) of prepaid cards and the funds that are loaded onto them. It is anticipated that a proposed rule with respect to the offering of prepaid products will be issued within the next calendar year. It is not possible, however, for the Bank or the Company to project the effect of a final rule on the MPS business unit, the Bank, or on us at this time.

Table of Contents

The Bureau finalized its ability to repay (ATR) rule as well as its qualified mortgage rule in January 2013 (with clarifications adopted in July of this year). The ATR rule applies to residential mortgage loan applications received after January 20, 2014. The scope of the rule specifically applies to loans securing 1-4 unit dwellings and includes purchases, refinances and home equity loans for principal or second homes. Under the ATR rules, a lender may not make a residential mortgage loan unless the lender makes a reasonable and good faith determination that is based on verified, documented information at or before consummation that the borrower has a reasonable ability to repay. The eight underwriting factors that must be considered and verified include the following: (1) income and assets; (2) employment status; (3) monthly payment of loan; (4) monthly payment of any simultaneous loan secured by the same property; (5) monthly payment for other mortgage-related obligations like property taxes and insurance; (6) current debt obligations; (7) monthly debt to income ratio; and (8) credit history (although eight factors are delineated, the ATR rule does not dictate that a lender follow a particular underwriting model). Liability for violations of the ATR rule include actual damages, statutory damages and court costs and attorneys' fees.

Additionally, the Bureau published regulations required by the Dodd-Frank Act related to "qualified mortgages," which are mortgages for which there is a presumption that the lender has satisfied the ATR rules. Pursuant to Dodd-Frank, qualified mortgages (QMs) must have certain product-feature prerequisites and affordability underwriting requirements. Generally, to meet the QM test, the lender must calculate the monthly payments based on the highest payment that will apply in the first five years and the consumer must have a total DTI that is less than or equal to 43%. The QM rule provides a safe harbor for lenders that make loans that satisfy the definition of a QM and are not higher priced. With respect to higher-priced mortgage loans, there is a rebuttable presumption of compliance available to the lender with respect to compliance with the ATR rule.

With respect to final regulations that affect insured depository institutions such as the Bank, the Bureau also issued a final rule related to remittances, which covers entities that provide at least 100 remittance transfers per calendar year. As such, the Bank became subject to the rule, which provides a six month compliance period. The Bank is implementing a compliance solution and expects to meet the required compliance date.

Our most recent Community Reinvestment Act ("CRA") rating could have a negative effect on the OCC's review of certain banking applications.

Under the CRA, the Bank is evaluated periodically by its primary federal banking regulator to determine if it is meeting its continuing and affirmative obligation consistent with its safe and sound operation to help meet the credit needs of its entire community, including low and moderate income neighborhoods. In the Bank's most recent CRA examination on January 24, 2011, notwithstanding that the Bank's record was consistent with an overall rating of "Satisfactory," the Bank received a "Needs to Improve" rating due to the criticized credit practices associated with the iAdvance product, which the Bank no longer offers. The CRA requires the OCC to take such rating into account in considering an application for any of the following: (i) the establishment of a domestic branch; (ii) the relocation of its main office or of a branch; (iii) the merger or consolidation with or acquisition of assets or assumption of liabilities of an insured depository institution; or (iv) the conversion of the Bank to a national charter. If the Bank submits any of the above-listed applications, the OCC may consider the Bank's overall "Needs to Improve" rating negatively.

57

---

Table of Contents

Legislative and regulatory initiatives taken to date may not achieve their intended objective.

Legislative and regulatory initiatives taken to date by Congress and the federal banking regulators to address financial regulatory reform may not achieve their intended objectives, thereby requiring additional legislation or regulation of the financial services industry.

Under the final capital rule (known as “Basel III”), minimum requirements will increase for both the quantity and quality of capital held by banking organizations. Under Basel III, the rule includes a new minimum ratio of common equity tier 1 capital to risk-weighted assets of 4.5% and a common equity tier 1 capital conservation buffer of 2.5% of risk-weighted assets. The rule also imposes a minimum ratio of tier 1 capital to risk-weighted assets of 6 percent and includes a minimum leverage ratio of 4 percent for all banking organizations. The rule also emphasizes common equity tier 1 capital and implements strict eligibility criteria for regulatory capital instruments. The total capital ratio remains at 8% and the general PCA framework remains but incorporates these increased minimum requirements. In addition, the final rule changed the methodology for calculating risk-weighted assets to enhance risk sensitivity. Smaller banks like the Bank are permitted, under the general risk-based capital rule, to use a 50% risk weight for prudently underwritten first lien mortgages that are not past due, reported as nonaccrual or restructured and a 100% risk weight for all other residential mortgages. With respect to residential mortgage exposure, the new rules also provide for small banks a safe harbor from recourse treatment for loans sold with certain repurchase triggers such as early default clauses. Additionally, smaller banks with less than \$15 billion in assets are grandfathered to allow trust preferred securities as part of their Tier 1 capital (such instruments remain subject to a limit of 25% of Tier 1 capital elements, excluding non-qualifying capital instruments and for all regulatory capital deductions and adjustments have been applied to Tier 1 capital). The Basel III phase-in period for smaller, less complex banking organizations like the Company and the Bank will not begin until January 2015. The Basel III Accord was finalized and clarified that unrealized losses and gains on securities will not affect regulatory capital for those companies that opt out of the requirement, which the Company intends to do.

We have a concentration of our assets in mortgage-backed securities.

As of September 30, 2013 approximately 34.6% of the Bank’s assets were invested in mortgage backed securities. The Company’s mortgage-backed and related securities portfolio consists primarily of securities issued by U.S. government instrumentalities, including those of Fannie Mae and Freddie Mac which are in conservatorship. The Fannie Mae and Freddie Mac certificates are modified pass-through mortgage-backed securities that represent undivided interests in underlying pools of fixed-rate, or certain types of adjustable-rate, predominantly single-family and, to a lesser extent, multi-family residential mortgages issued by these U.S. government instrumentalities. Fannie Mae and Freddie Mac generally provide the certificate holder a guarantee of timely payments of interest, whether or not collected. Privately issued mortgage pass through certificates generally provide no guarantee as to timely payment of interest or principal, and reliance is placed on the creditworthiness of the issuer.

Mortgage-backed securities generally increase the quality of the Company’s assets by virtue of the insurance or guarantees that back them, are more liquid than individual mortgage loans and may be used to collateralize borrowings or other obligations of the Company.

While mortgage-backed securities carry a reduced credit risk as compared to whole loans, such securities remain subject to the risk that a fluctuating interest rate environment, along with other factors such as the geographic distribution of the underlying mortgage loans, may alter the prepayment rate of such mortgage loans and so affect both the prepayment speed, and value, of such securities. The prepayment risk associated with mortgage-backed securities is monitored periodically, and prepayment rate assumptions adjusted as appropriate to update the Company’s mortgage-backed securities accounting and asset/liability reports.

## Table of Contents

We recorded other-than-temporary impairment (“OTTI”) charges in our trust preferred securities (“TRUPS”) portfolio in the past, and we could record additional losses in the future.

We determine the fair value of our investment securities based on GAAP and three levels of informational inputs that may be used to measure fair value. The price at which a security may be sold in a market transaction could be significantly lower than the quoted market price for the security, particularly if the quoted market price is based on infrequent trading history, the market for the security is illiquid, or a significant amount of securities are being sold. In fiscal 2013, 2012 and 2011, there were no other than-temporary impairments recorded.

The valuation of our TRUPS will continue to be influenced by external market and other factors, including implementation of SEC and Financial Accounting Standards Board guidance on fair value accounting, the financial condition of specific issuers deferral and default rates of specific issuer financial institutions, rating agency actions, and the prices at which observable market transactions occur. If we are required to record additional OTTI charges on our TRUPS portfolio, we could experience potentially significant earnings losses as well as an adverse impact to our capital position.

### Risks Related to the Banking Industry

Our reputation and business could be damaged by our entry into the Consent Orders and other negative publicity.

Reputational risk, or the risk to our business, earnings and capital from negative publicity, is inherent in our business. Negative publicity can result from actual or alleged conduct in a number of areas, including legal and regulatory compliance, lending practices, corporate governance, litigation, inadequate protection of customer data, ethical behavior of our employees, and from actions taken by regulators and others as a result of that conduct. Damage to our reputation, including as a result of negative publicity associated with the Consent Orders now or in the future, could impact our ability to attract new and maintain existing loan and deposit customers, employees and business relationships, and particularly with respect to our MPS division, could result in the imposition of additional regulatory requirements, operational restrictions, enhanced supervision and/or civil money penalties. Such damage could also adversely affect our ability to raise additional capital. If any of these measures should be imposed in the future, they could have a material adverse effect on our financial condition and results of operations.

We are subject to certain operational risks, including, but not limited to, data processing system failures and errors and customer or employee fraud.

There have been a number of publicized cases involving fraud or other misconduct by employees of financial services firms in recent years. Misconduct by our employees could include hiding unauthorized activities from us, improper or unauthorized activities on behalf of our customers or improper use of confidential information. Employee fraud, errors and employee and customer misconduct could subject us to financial losses or regulatory sanctions and seriously harm our reputation. It is not always possible to prevent employee errors and misconduct, and the precautions we take to prevent and detect this activity may not be effective in all cases. Employee errors could also subject us to civil claims for negligence.

Table of Contents

Although we maintain a system of internal controls and procedures designed to reduce the risk of loss from employee or customer fraud or misconduct and employee errors as well as insurance coverage to mitigate against operational risks, including data processing system failures and errors and customer or employee fraud, these internal controls may fail to prevent or detect such an occurrence, or such an occurrence may not be insured or exceed applicable insurance limits.

In addition, there have also been a number of cases where financial institutions have been the victim of fraud related to unauthorized wire and Automated Clearinghouse transactions. The facts and circumstances of each case vary but generally involve criminals posing as customers (i.e., stealing bank customers' identities) to transfer funds out of the institution quickly in an effort to place the funds beyond recovery prior to detection. Although we have policies and procedures in place to verify the authenticity of our customers and prevent identity theft, we can provide no assurances that these policies and procedures will prevent all fraudulent transfers. In addition, although we have safeguards in place, it is possible that our computer systems could be infiltrated by hackers or other intruders. We can provide no assurances that these safeguards will prevent all unauthorized infiltrations. Identity theft, successful unauthorized intrusions, and similar unauthorized conduct could result in reputational damage and financial losses to the Company. See "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations."

Changes in economic and political conditions could adversely affect the Company's earnings, as the Company's borrowers' ability to repay loans and the value of the collateral securing the Company's loans decline.

The Company's success depends, to a certain extent, upon economic and political conditions, local and national, as well as governmental monetary policies. Conditions such as inflation, recession, unemployment, changes in interest rates, money supply and other factors beyond the Company's control may adversely affect the Company's asset quality, deposit levels and loan demand and, therefore, the Company's earnings. Because the Company has a significant amount of real estate loans, decreases in real estate values could adversely affect the value of property used as collateral. Among other things, adverse changes in the economy, including but not limited to the current economic downturn, may also have a negative effect on the ability of the Company's borrowers to make timely repayments of their loans, which would have an adverse impact on the Company's earnings. In addition, the vast majority of the Company's loans are to individuals and businesses in the Company's market area. Consequently, any economic decline in the Company's market area could have an adverse impact on the Company's earnings.

Changes in interest rates could adversely affect the Company's results of operations and financial condition.

The Company's earnings depend substantially on the Company's interest rate spread, which is the difference between (i) the rates we earn on loans, securities and other earning assets, and (ii) the interest rates we pay on deposits and other borrowings. These rates are highly sensitive to many factors beyond the Company's control, including general economic conditions and the policies of various governmental and regulatory authorities. As market interest rates rise, we will have competitive pressures to increase the rates we pay on deposits, which may result in a decrease of the Company's net interest income. Conversely, if interest rates fall, yields on loans and investments may fall. Because a significant portion of the Company's deposit portfolio is in non-interest bearing accounts, such a decrease in rates would likely result in a decrease in the Company's net interest income. Although the Bank continues to monitor its interest rate risk exposure and has undertaken additional analyses and implemented additional controls to improve its core earnings from interest income, the Bank can provide no assurance that its efforts will appropriately protect the Bank in the future from interest rate risk exposure. For additional information, see Part II, Item 7A, "Quantitative and Qualitative Disclosures About Market Risk."



Table of Contents

The Company operates in a highly regulated environment, and changes in laws and regulations to which we are subject may adversely affect the Company's results of operations.

The Company and the Bank operate in a highly regulated environment and are subject to extensive regulation, supervision and examination by the OCC, the FDIC, the Bureau, and the Federal Reserve. As of July 21, 2011, the Company has been supervised by the Federal Reserve, and the Bank has been supervised by the OCC and the FDIC. See Item 1 "Business – Regulation" herein. In addition, the Company and the Bank are subject to regulations promulgated by the Bureau. Applicable laws and regulations may change and the enforcement of existing laws and regulations may vary when actions are evaluated by these new regulators, and there is no assurance that such changes will not adversely affect the Company's business. Regulatory authorities have extensive discretion in connection with their supervisory and enforcement activities, including but not limited to the imposition of restrictions on the operation of an institution, the classification of assets by the institution and the adequacy of an institution's allowance for loan losses. Any change in such regulation and oversight, whether in the form of restrictions on activities, regulatory policy, regulations, legislation, or the evaluation of the Bank's and the Company's efforts with respect to achieving compliance with the Consent Orders, could have a material impact on the Company's operations. It is unknown at this time to what extent new legislation will be passed into law or pending or new regulatory proposals will be adopted, or the effect that such passage or adoption will have on the banking industry or the Company.

Changes in technology could be costly.

The banking industry is undergoing technological innovation at a fast pace. To keep up with its competition, the Company needs to stay abreast of innovations and evaluate those technologies that will enable it to compete on a cost-effective basis. This is especially true with respect to MPS. The cost of such technology, including personnel, has been high in both absolute and relative terms and additional funds continue to be used to enhance existing management information systems. There can be no assurance, given the fast pace of change and innovation, that the Company's technology, either purchased or developed internally, will meet or continue to meet the needs of the Company.

Risks Related to the Company's Business

The entry into the Consent Orders has imposed certain restrictions and requirements upon the Company and the Bank and we cannot predict the possibility of future regulatory action.

Satisfaction of the requirements of the Orders is subject to the ongoing review and supervision of the OCC with respect to the Bank and the Federal Reserve with respect to the Company. The Bank and the Company have and expect to continue to expend significant management and financial resources to address areas that were cited in the Orders; such matters include but are not limited to capital preservation and enhancement commensurate with the Bank's risk profile, improvement of core earnings from interest income, management and board oversight of the Bank, risk management and internal controls, compliance management, and Bank Secrecy Act compliance.

There can be no assurance that our regulators will ultimately determine that we have met all of the requirements of the Orders to their satisfaction. If our regulators believe that we have not made sufficient progress in complying with the Orders, they could seek to impose additional regulatory requirements, operational restrictions, enhanced supervision and/or civil money penalties. If any of these measures is imposed in the future, it could have a material adverse effect on our financial condition and results of operations and on our ability to raise additional capital. For additional information regarding compliance with the Orders, see "Risk Factors – Risks Related to the Company's Business." For additional information with respect to certain risks related to the MPS division specifically, see "Risk Factors – Risks Related to Meta Payment Systems, a division of the Bank."

Table of Contents

The compliance obligations and restrictions on our interest payments and dividends under the OTS Consent Orders may have an adverse effect on us and preclude payments to holders of our securities.

Among other things, the Consent Orders require the Company and Bank to submit to the OCC or the Federal Reserve, as appropriate, various management and compliance plans and programs to address the matters initially identified in the OTS supervisory directives as well as plans for enhancing Company and Bank capital, and require OTS non-objection for Company cash dividends, distributions, share repurchases, payments of interest or principal on debt and incurrence of debt. As indicated, satisfaction of the requirements of the Orders is subject to the ongoing review and supervision of our regulators. There can be no assurance our regulators will ultimately determine that we have met all of the requirements of the Orders to their satisfaction or that we will continue to receive non-objection to our payment of dividends and interest or any other activity for which non-objection or approval is required. Additional resources, both economic and in terms of personnel, will continue to be expended by the Company and the Bank in their endeavors to achieve compliance. See “Business – Regulation – Bank Supervision and Regulation – OTS Consent Orders and Related Matters” which is included in Item 1 of this Annual Report on Form 10-K.

The OCC and Federal Reserve are our primary banking regulators and we may not be able to comply with applicable banking regulations and the terms of the Consent Orders to their satisfaction.

Our regulators have broad discretionary powers to enforce banking laws and regulations and may seek to take informal or formal supervisory action if they deem such actions are necessary or required or if they believe that our efforts with respect to the Consent Orders are insufficient. If imposed in the future, corrective steps could result in additional regulatory requirements, operational restrictions, enhanced supervision and/or civil money penalties. Additional resources, both economic and in terms of personnel, will continue to be expended by the Company and the Bank in their endeavors to achieve full compliance.

Contracts with third-parties, some of which are material to the Company, may not be renewed, may be renegotiated on terms that are not as favorable, may not be fulfilled or could be subject to cancellation by regulatory authorities.

The Bank has entered into numerous contracts with third parties with respect to the operations of its business. In some instances, the third parties provide services to the Bank and MPS; in other instances, the Bank and MPS provides products and services to such third parties. Were such agreements not to be renewed by the third party or were such agreements to be renewed on terms less favorable, such actions could have an adverse material impact on the Bank, its MPS division, and, ultimately, the Company. Similarly, were one of these parties unable to meet their obligations to us for any reason (including but not limited to bankruptcy, computer or other technological interruptions or failures, personnel loss or acts of God), we may need to seek alternative service providers.

We may not be able to secure alternate service providers, and even if we do, the terms with such alternate providers may not be as favorable as those currently in place. In addition, were we to lose any of our important third service providers, it could cause a material disruption in our own ability to service our customers, which also could have an adverse material impact on the Bank, its MPS division, and ultimately the Company. Moreover, were the disruptions in our ability to provide services significant, this could negatively affect the perception of our business, which could result in a loss of confidence and other adverse effects on our business.

## Table of Contents

We are currently in negotiations for a five year agreement with our existing third party service provider whose data processing operations are important to us; the agreement is expected to cover core processing services for transaction and item processing needs. Our current contract with this third party expires on February 28, 2014, and we were recently informed that the service provider has requested significant monetary compensation that we are disputing in its entirety. We can offer no assurance that current contract negotiations will result in a contract for services past that date. If we are unable to reach agreement, we could be subject to the consequences described above. For a discussion of the monetary compensation being requested by such service provider, see the “Legal Proceedings” disclosure contained in Note 15 of “Notes to Consolidated Financial Statements,” which is included in Part II, Item 8 “Financial Statements and Supplementary Data” of this Annual Report on Form 10-K.

In addition, as described earlier, in the Consent Orders, our regulator noted deficiencies with respect to these third party relationships. As a result, we review our auditing program for third parties with whom we contract (as well as other business changes required both by the Consent Orders and general business practices) and have made certain business decisions related to determinations reached by our auditing personnel. The OCC is evaluating our progress at this time. If we are unsuccessful in the development and/or implementation of our third party auditing program, it is possible that the OCC could order us to abrogate certain contracts or take other supervisory actions against us which would further impact the MPS business and could have an adverse impact on our financial condition or results of operations. See “Business Regulation – Bank Supervision and Regulation - OTS Consent Orders and Related Matters” which is included in Item 1 of this Annual Report on Form 10-K.

The Company has identified a material weakness in its internal control over financial reporting, and if the Company fails to maintain an effective system of internal control over financial reporting, it may not be able to accurately report the Company’s financial results or prevent fraud, and, as a result, investors and depositors could lose confidence in the Company’s financial reporting, which could adversely affect the Company’s business, the trading price of the Company’s stock and the Company’s ability to attract additional deposits.

In recent years, the Company has been required to include in its annual reports filed with the SEC a report of the Company’s management regarding internal control over financial reporting. We have documented and evaluated the Company’s internal control over financial reporting in order to satisfy the requirements of Section 404 of the Sarbanes-Oxley Act of 2002 and SEC rules and regulations, which require an annual management report on the Company’s internal control over financial reporting, including, among other matters, management’s assessment of the effectiveness of internal control over financial reporting. In order to comply with this requirement, management retained outside consultants to assist the Company in (i) assessing and documenting the adequacy of the Company’s internal control over financial reporting, (ii) improving control processes, where appropriate, and (iii) verifying through testing or other means that controls are functioning as documented. Management’s Annual Report on Internal Control over Financial Reporting is contained in Item 9A below. Management has determined that a material weakness in the Company’s internal control over financial reporting existed as of September 30, 2013. Specifically, management determined that deficiencies existed in the Company’s controls over fair value measurements of certain investment securities. A detailed description of this weakness and the Company’s remediation efforts is provided in Item 9A below. If the Company fails to correct the material weakness mentioned above, or fails to identify and correct any additional significant deficiencies in the design or operating effectiveness of the Company’s internal control over financial reporting or fails to prevent fraud, current and potential stockholders and depositors could lose confidence in the Company’s financial reporting, which could adversely affect the Company’s business, financial condition and results of operations, the trading price of the Company’s stock, and the Company’s ability to attract additional deposits.

Table of Contents

The Company operates in an extremely competitive market, and the Company's business will suffer if it is unable to compete effectively.

The Company encounters significant competition in the Company's market area from other commercial banks, savings and loan associations, credit unions, mortgage banking firms, consumer finance companies, securities brokerage firms, insurance companies, money market mutual funds and other financial intermediaries. Many of the Company's competitors have substantially greater resources and lending limits and may offer services that the Company does not or cannot provide. The Company's profitability depends upon the Company's continued ability to compete successfully in the Company's market area. MPS operates on a national scale against competitors with substantially greater resources and limited barriers to entry, as well as the fact that most competitors are not operating under restrictions similar to those imposed upon the Company and the Bank in the Consent Orders. The success of MPS depends upon the Company's and the Bank's ability to satisfy the requirements set forth in their respective Consent Orders and the MPS division's ability to compete in such an environment.

The Bank is "well-capitalized" under existing bank regulations, but failure to maintain this designation could have a material adverse impact on our liquidity and results of operations. In addition, our regulator could limit our ability to raise deposits, which could produce serious adverse consequences for our liquidity, financial condition and results of operations.

By letter dated December 28, 2010, the OTS directed the Bank not to increase the amount of brokered deposits from the amount it held at December 28, 2010 without the prior written non-objection of the OTS Regional Director. The Bank believes it did not hold any brokered deposits on December 28, 2010 or thereafter and so informed OTS of its position. Consequently, the Bank does not anticipate seeking such approval. At the direction of the OTS, the Bank requested the FDIC to confirm that deposits related to a specific prepaid program were not brokered deposits. The Bank tendered its request to the FDIC in December 2010. At the time the directive was issued, OTS staff stated that it would not seek retroactively to enforce the directive for any growth that occurs subsequent to December 28, 2010, given the Bank's request to the FDIC. Thereafter, the Bank was advised that the FDIC would consider the Bank's request in the context of its now completed broader industry study of brokered deposits in general, but to date has been given no instruction to change its position. By letter dated October 11, 2013, the Bank was advised by OCC that the directive issued on December 28, 2010 had been terminated. Under current rules, if a substantial portion of the Bank's deposits are ruled to be "brokered," and should the Bank's primary federal regulator decide to impose a formal individual minimum capital requirement or similar formal requirement on the Bank notwithstanding that the Bank is well-capitalized, or should the Bank fail to be well-capitalized in the future, the Bank would be prohibited, absent waiver from the FDIC, from utilizing brokered deposits. In such event, unless the Bank receives relief from its regulator or a waiver from the FDIC, such a result could produce serious adverse consequences for the Bank from a liquidity standpoint and could also have serious adverse effects on the Company's financial condition and results of operations.

64

---

Table of Contents

We derive a significant percentage of our deposits, total assets and income from deposit accounts that we generate through MPS's customer relationships.

We derive a significant percentage of our deposits, total assets and income from deposit accounts we generate through customer relationships between such third parties and MPS. Deposits related to our top three customers (each, a significant customer) totaled \$489.0 million at September 30, 2013. We provide oversight and auditing of such third-party relationships and all such relationships must meet all internal and regulatory requirements. We may exit these relationships if such requirements are not met or if required to do so by our regulators. We perform liquidity reporting and planning daily and identify and monitor contingent sources of liquidity, such as National CDs, Fed Fund Lines, or Public Fund CDs. If one of these significant customers were to be terminated, over a period of time, it could materially reduce our deposits, assets and income. In addition, pursuant to the Bank's Consent Order, if one of these relationships were to terminate before the termination of the Consent Order, we would not be able to replace such relationship without first identifying a new contracting party and then obtaining approval to enter into such agreement from the OCC. If such significant customer was not replaced, we may be required to seek higher rate funding sources as compared to the existing customer and interest expense might increase. We may also be required to sell securities or other assets which would reduce revenues and potentially generate losses.

Our business strategy is utilized by other institutions with which we compete and the Consent Orders prevent us from actively marketing the Bank's products and services.

Several banking institutions have adopted business goals that are similar to ours, particularly with respect to the MPS division. As a consequence, we have encountered competition in this area and anticipate that we will continue to do so in the future. This competition may increase our costs, reduce our revenues or revenue growth, or make it difficult for us to compete effectively in obtaining additional customer relationships. In addition, pursuant to the Consent Orders, we are not allowed to enter into or materially amend certain agreements, originate certain loans, or offer certain services unless we are granted specific permission to do so, or until the terms of the Consent Orders are rescinded. As a result, until the terms of the Consent Orders are lifted, we are at a competitive disadvantage with respect to growing the Bank's MPS division. See "Business Regulation – Bank Supervision and Regulation - OTS Consent Orders and Related Matters" which is included in Item 1 of this Annual Report on Form 10-K.

New lines of business or new products and services may subject us to additional risks.

From time to time, to the extent permitted under the terms of the Consent Orders, we may implement new lines of business or offer new products and services within existing lines of business. Substantial risks and uncertainties are associated with developing and marketing new lines of business or new products or services, particularly in instances where the markets are not fully developed, and we may be required to invest significant time and resources. Initial timetables for the introduction and development of new lines of business or new products or services may not be achieved and price and profitability targets may not prove feasible. External factors, such as compliance with regulations, competitive alternatives and shifting market preferences, may also impact the successful implementation of a new line of business or a new product or service. Furthermore, any new line of business or new product or service could have a significant impact on the effectiveness of our system of internal controls. Failure to successfully manage these risks in the development and implementation of new lines of business or new products or services could reduce our revenues and potentially generate losses.

Existing insurance policies may not adequately protect the Company and its subsidiaries.

Fidelity, business interruption and property insurance policies are in place with respect to the operations of the Company. Should any event triggering such policies occur, however, it is possible that our policies would not fully reimburse us for the losses we could sustain due to deductible limits, policy limits, coverage limits or other factors.



Table of Contents

The loss of key members of the Company's senior management team could adversely affect the Company's business.

We believe that the Company's success depends largely on the efforts and abilities of the Company's senior management. Their experience and industry contacts significantly benefit us. The competition for qualified personnel in the financial services industry is intense, and the loss of any of the Company's key personnel or an inability to continue to attract, retain and motivate key personnel could adversely affect the Company's business.

The Company's loan portfolio includes loans with a higher risk of loss.

The Company originates commercial mortgage loans, commercial loans, consumer loans, agricultural real estate loans, agricultural loans and residential mortgage loans. Commercial mortgage, commercial, consumer, agricultural real estate and agricultural loans may expose a lender to greater credit risk than loans secured by residential real estate because the collateral securing these loans may not be sold as easily as residential real estate. These loans also have greater credit risk than residential real estate for the following reasons:

Commercial Mortgage Loans. Repayment is dependent upon income being generated in amounts sufficient to cover operating expenses and debt service.

Commercial Loans. Repayment is dependent upon the successful operation of the borrower's business.

Consumer Loans. Consumer loans (such as personal lines of credit) are collateralized, if at all, with assets that may not provide an adequate source of payment of the loan due to depreciation, damage, or loss.

Agricultural Loans. Repayment is dependent upon the successful operation of the business, which is greatly dependent on many things outside the control of either the Bank or the borrowers. These factors include weather, commodity prices, and interest rates, among others.

If the Company's actual loan losses exceed the Company's allowance for loan losses, the Company's net income will decrease.

The Company makes various assumptions and judgments about the collectibility of the Company's loan portfolio, including the creditworthiness of the Company's borrowers and the value of the real estate and other assets serving as collateral for the repayment of the Company's loans. Despite the Company's underwriting and monitoring practices, the Company's loan customers may not repay their loans according to their terms, and the collateral securing the payment of these loans may be insufficient to pay any remaining loan balance. The Company may experience significant loan losses, which could have a material adverse effect on its operating results. Because the Company must use assumptions regarding individual loans and the economy, the current allowance for loan losses may not be sufficient to cover actual loan losses, and increases in the allowance may be necessary. The Company may need to significantly increase the Company's provision for losses on loans if one or more of the Company's larger loans or credit relationships becomes impaired or if we continue to expand the Company's commercial real estate and commercial lending. In addition, federal and state regulators periodically review the Company's allowance for loan losses and may require the Company to increase the Company's provision for loan losses or recognize loan charge-offs. Material additions to the Company's allowance would materially decrease the Company's net income. The Company cannot assure you that its monitoring procedures and policies will reduce certain lending risks or that the Company's allowance for loan losses will be adequate to cover actual losses.

Table of Contents

If the Company forecloses on and takes ownership of real estate collateral property, it may be subject to the increased costs associated with the ownership of real property, resulting in reduced revenues.

The Company may have to foreclose on collateral property to protect its investment and may thereafter own and operate such property. In such case, the Company will be exposed to the risks inherent in the ownership of real estate. The amount that the Company, as a mortgagee, may realize after a default is dependent upon factors outside of the Company's control, including, but not limited to: (i) general or local economic conditions; (ii) neighborhood values; (iii) interest rates; (iv) real estate tax rates; (v) operating expenses of the mortgaged properties; (vi) supply of and demand for rental units or properties; (vii) ability to obtain and maintain adequate occupancy of the properties; (viii) zoning laws; (ix) governmental rules, regulations and fiscal policies; and (x) acts of God. Certain expenditures associated with the ownership of real estate, principally real estate taxes and maintenance costs, may adversely affect the income from the real estate. Therefore, the cost of operating a real property may exceed the rental income earned from such property, and the Company may have to advance funds in order to protect the Company's investment, or may be required to dispose of the real property at a loss. The foregoing expenditures and costs could adversely affect the Company's ability to generate revenues, resulting in reduced levels of profitability.

Our agricultural loans are subject to factors beyond the Company's control.

The agricultural community is subject to commodity price fluctuations. Although our agricultural loans are a relatively limited part of our overall portfolio, extended periods of low commodity prices, higher input costs, or poor weather conditions could result in reduced profit margins, reducing demand for goods and services provided by agriculture-related businesses, which in turn, could affect other businesses in the Company's market area.

Environmental liability associated with commercial lending could have a material adverse effect on the Company's business, financial condition and results of operations.

In the course of the Company's business, it may acquire, through foreclosure, commercial properties securing loans that are in default. There is a risk that hazardous substances could be discovered on those properties. In this event, the Company could be required to remove the substances from and remediate the properties at its own cost and expense. The cost of removal and environmental remediation could be substantial. The Company may not have adequate remedies against the owners of the properties or other responsible parties and could find it difficult or impossible to sell the affected properties. These events could have a material adverse effect on the Company's business, financial condition and operating results.

Our framework for managing risks may not be effective in mitigating risk and loss to us.

Our risk management framework seeks to mitigate risk and loss to us. We have established processes and procedures intended to identify, measure, monitor, report and analyze the types of risk to which we are subject, including liquidity risk, credit risk, market risk, interest rate risk, operational risk, legal and compliance risk, and reputational risk, among others. However, as with any risk management framework, there are inherent limitations to our risk management strategies as there may exist, or develop in the future, risks that we have not appropriately anticipated or identified. For example, the recent financial and credit crisis and resulting regulatory reform highlighted both the importance and certain limitations of managing unanticipated risks. If our risk management framework proves ineffective, we could suffer unexpected losses which could have a material adverse effect on our financial condition and results of operations.



## Table of Contents

A breach of information security or compliance breach by one of the Company's agents or vendors could negatively affect the Company's reputation and business.

The Company depends on data processing, communication and information exchange on a variety of computing platforms and networks and over the internet. Despite safeguards, no system, including ours, is entirely free from vulnerability to attack. Additionally, the Company relies on and does business with a variety of third-party service providers, agents and vendors with respect to the Company's business, data and communications needs. If information security is breached, or one of the Company's agents or vendors breaches compliance procedures, information could be lost or misappropriated, resulting in financial loss or costs to the Company or damages to others. These costs or losses could materially exceed the Company's amount of insurance coverage, if any, which would adversely affect the Company's business.

Changes in accounting policies or accounting standards, or changes in how accounting standards are interpreted or applied, could materially affect how we report our financial results and condition.

Our accounting policies are fundamental to determining and understanding our financial results and condition. Some of these policies require use of estimates and assumptions that may affect the value of our assets or liabilities and financial results. Any changes in our accounting policies could materially affect our financial statements. From time to time, the Financial Accounting Standards Board (the "FASB") and the SEC change the financial accounting and reporting standards that govern the preparation of our financial statements. In addition, accounting standard setters and those who interpret the accounting standards (such as the FASB, the SEC, banking regulators and our outside auditors) may change or even reverse their previous interpretations or positions on how these standards should be applied. Changes in financial accounting and reporting standards and changes in current interpretations may be beyond our control, can be difficult to predict and could materially affect how we report our financial results and condition. We may be required to apply a new or revised standard retroactively or apply an existing standard differently and retroactively, which may result in the Company being required to restate prior period financial statements in material amounts.

## Risks Related to the Company's Stock

The price of the Company's common stock may be volatile, which may result in losses for investors.

The market price for shares of the Company's common stock has been volatile in the past, and several factors could cause the price to fluctuate substantially in the future. These factors include:

- announcements of developments related to the Company's business,
- fluctuations in the Company's results of operations,
  - sales of substantial amounts of the Company's securities into the marketplace,
- general conditions in the Company's banking niche or the worldwide economy,
- a shortfall in revenues or earnings compared to securities analysts' expectations,
- lack of an active trading market for the common stock,

Table of Contents

- changes in analysts' recommendations or projections,
- the Company's announcement of new acquisitions or other projects, and
- negative evaluation by our regulators of our compliance with our Orders.

The market price of the Company's common stock may fluctuate significantly in the future, and these fluctuations may be unrelated to the Company's performance. General market price declines or market volatility in the future could adversely affect the price of the Company's common stock, and the current market price may not be indicative of future market prices.

An investment in Company common stock is not an insured deposit.

Our common stock is not a bank deposit and, therefore, is not insured against loss by the FDIC, any other deposit insurance fund or by any other public or private entity. Investment in our common stock is inherently risky for the reasons described in this "Risk Factors" section and is subject to market forces that affect the price of common stock in any company. As a result, if you hold or acquire our common stock, it is possible that you may lose all or a portion of your investment.

The Company's common stock is thinly traded, and thus your ability to sell shares or purchase additional shares of the Company's common stock will be limited, and the market price at any time may not reflect true value.

Your ability to sell shares of the Company's common stock or purchase additional shares largely depends upon the existence of an active market for the common stock. The Company's common stock is quoted on NASDAQ Global Market, but the volume of trades on any given day is light, and you may be unable to find a buyer for shares you wish to sell or a seller of additional shares you wish to purchase. In addition, a fair valuation of the purchase or sales price of a share of common stock also depends upon active trading, and thus the price you receive for a thinly traded stock, such as the Company's common stock, may not reflect its true value.

Future sales or additional issuances of the Company's capital stock may depress prices of shares of the Company's common stock or otherwise dilute the book value of shares then outstanding.

Sales of a substantial amount of the Company's capital stock in the public market or the issuance of a significant number of shares could adversely affect the market price for shares of the Company's common stock. As of September 30, 2013, the Company was authorized to issue up to 10,000,000 shares of common stock, of which 6,070,654 shares were outstanding, and 62,090 shares were held as treasury stock. The Company was also authorized to issue up to 3,000,000 shares of preferred stock, none of which is outstanding or reserved for issuance. This factor may affect the market price for shares of the Company's common stock.

Federal regulations may inhibit a takeover, prevent a transaction you may favor or limit the Company's growth opportunities, which could cause the market price of the Company's common stock to decline.

Certain provisions of the Company's charter documents and federal regulations could have the effect of making it more difficult for a third party to acquire, or of discouraging a third party from attempting to acquire, control of the Company. In addition, the Company must obtain approval from regulatory authorities before it can acquire control of any other company.

Table of Contents

The Company may not be able to pay dividends in the future in accordance with past practice.

The Company pays a quarterly dividend to stockholders. The payment of dividends is subject to legal and regulatory restrictions as well as a requirement for prior approval by the Federal Reserve pursuant to the Consent Orders. Any payment of dividends in the future will depend, in large part, on the Company's earnings, capital requirements, financial condition, regulatory review, and other factors considered relevant by the Company's Board of Directors.

Risks Related to Meta Payment Systems®, a division of the Bank

MPS' products and services are highly regulated financial products subject to extensive supervision and regulation and are costly to maintain.

The products and services offered by MPS are highly regulated by federal banking agencies, the Bureau, state banking agencies, and other federal and state regulators. Some of the laws and related regulations affecting its operations include consumer protection laws, escheat laws, privacy laws, anti money laundering laws and data protection laws. Compliance with the relevant legal paradigm in which the division operates is costly and requires significant personnel resources, as well as extensive contacts with outside lawyers and consultants hired by MPS to stay abreast of the applicable regulatory schemes.

In addition, Bank talent and resources have been diverted since the signing of the Consent Order in an effort to achieve compliance with certain components of the Consent Order that involve the operations of MPS. Areas the Bank must continue to address include, but are not limited to, ongoing oversight of MPS by the board and management. Efforts to satisfy the requirements of the Bank's Consent Order continue to be costly, both in economic terms and in terms of personnel resources. As described elsewhere herein, satisfaction of the requirements of the Bank's Consent Order is subject to the ongoing review of its regulator and there can be no assurance that the Bank will fully satisfy such requirements. If our regulators believe that the Company or the Bank has not made sufficient progress in satisfying the requirements of the Consent Orders, such regulators could take further supervisory action against the Bank or the Company. If taken, such actions could have a material adverse effect on the financial condition and results of operations of the MPS division segment, the Bank, and the Company and limit our ability to raise additional capital.

The Dodd-Frank Act's restrictions with respect to the cap on debit card interchange could negatively affect the Bank's business.

On June 29, 2011, the Federal Reserve issued a rule establishing standards for debit card interchange fees and prohibiting network exclusivity arrangements and routing restrictions (the "Debit Card Rule"). The issuance of the Debit Card Rule was required by the Dodd-Frank Act. Pursuant to the Debit Card Rule, the maximum permissible interchange fee that an issuer may receive for an electronic debit transaction is \$0.21 per transaction and five basis points multiplied by the value of the transaction. The Federal Reserve also approved an interim final rule that allows for an upward adjustment of no more than \$0.01 to an issuer's debit card interchange fee if the issuer develops and implements policies and procedures reasonably designed to achieve the fraud-prevention standards set out in the interim final rule. Eligibility for the assessment of this fee must be certified by the issuing bank. As set forth in the issuing release, when the maximum interchange fee is combined with fraud-prevention assessment, an issuing bank could receive an interchange fee of up to approximately 24 cents for the average debit card transaction, which is valued at \$38 according to the Federal Reserve. In accordance with the provisions of the Dodd-Frank Act, issuers that, together with their affiliates, have assets of less than \$10 billion (like the Bank) are exempt from the debit card interchange fee standards. With respect to network exclusivity and merchant routing restrictions, it is now required that all debit cards participate in at least two unaffiliated networks so that the transactions initiated using those debit cards will have at least two independent routing channels. On July 31, 2013 the United States District Court for the District of Columbia issued a summary judgment in the case of NACS et al v. Board of Governors of the Federal

Reserve System, 2013 WL 3943489 (D.D.C.), vacating the fee cap and exclusivity provisions of the rule. The decision has been stayed pending an appeal that has been filed in the United States Court of Appeals for the District of Columbia Circuit. If the District Court opinion is upheld, two additional networks may have to added to each card. The appeal is on an expedited schedule and oral arguments are scheduled for early 2014.

70

---

Table of Contents

While some proposed legislation would benefit MPS, it is possible that new legislation or more stringent focus by banking agencies could further restrict MPS' current operations or change the regulatory environment in which the division's customers operate.

Although it is possible that some legislation under consideration could have either a positive or de minimis impact on its operations and profitability, it is also possible that any new legislation affecting the operations of MPS or its customers, some of which are also regulated entities, would have a negative impact on the conduct of the relevant business. There is no way to quantify the impact that such changes could have on the profitability or operations of MPS at this time given the unpredictable nature of the risk.

In addition to the relevant legal paradigm set forth above, it should also be noted that there has been concern within the bank regulatory environment over the use of credit and, in particular, prepaid cards as a means by which to illegally launder and move money. The U.S. Treasury's Financial Crimes Enforcement Network issued rules related to providers of "prepaid access" which have left certain issues unresolved related to its regulatory requirements. Moreover, the Bureau held a "town hall" meeting on prepaid products in Raleigh, North Carolina in May 2012 to hear testimony from witnesses who provided their views on prepaid products and to issue an advanced notice of proposed rulemaking, which permitted the public to comment on issues related to the prepaid market. As of the date of this filing, the Bureau has not issued any additional proposed or final rules related to MPS and the products and services it offers; however, given that additional regulation appears likely in this area, it is also likely that our costs related to compliance will increase when such regulations are finalized. Although the Bank will continue to work with its regulators to provide information about its operations as well as the state of the prepaid card industry, we believe such concerns in general will continue for the foreseeable future for the entire banking industry, with a continued emphasis on heightened compliance expectations, resulting in higher compliance costs. See "Business Regulation – Bank Supervision and Regulation" which is included in Item 1 of this Annual Report on Form 10-K.

MPS, through the Bank, owns or is seeking a number of patents, trademarks and other forms of intellectual property with respect to the operation of its business and the protection of such intellectual property may in the future require material expenditures.

In its operations, MPS, through the Bank, is seeking protection for various forms of intellectual property. No assurance can be given that such protection will be granted. In addition, given the competitive market environment of its business, the Bank must be vigilant in ensuring that its patents and other intellectual property are protected and not exploited by unlicensed third parties.

The Bank must also protect itself and defend against intellectual property challenges initiated by third parties making various claims against MPS. With respect to these claims, regardless of whether we are pursuing our claims against perceived infringers or defending our intellectual property from third parties asserting various claims of infringement, it is possible that significant personnel time and monetary resources could be used to pursue or defend such claims.

71

---

Table of Contents

It should also be noted that intellectual property risks extend to foreign countries whose protections of such property are not as extensive as those in the United States. As such, MPS may need to spend additional sums to ensure that its intellectual property protections are maximized globally. Moreover, should there be a material, improper use of the Bank's intellectual property, this could have an impact on the division's operations.

Costs of conforming products and services to the Payment Card Industry Data Security Standards (the "PCI DSS") are costly and could continue to affect the operations of MPS.

The PCI DSS is a multifaceted standard that includes data security management, policies and procedures as well as other protective measures, that was created by the largest credit card associations in the world in an effort to protect the nonpublic personal information of all types of cardholders, including prepaid cardholders and holders of network branded credit cards (such as Discover, MasterCard, and Visa). The PCI DSS mandates a prescribed technical foundation for the collection, storage and transmission of cardholder data and also contains significant provisions regarding the testing of security protections by various entities in the payment card industry, including MPS. Compliance with the PCI DSS is costly and changes to the standards could have an equal, or greater, effect on profitability of the relevant business division.

The potential for fraud in the card payment industry is significant.

Issuers of prepaid and credit cards have suffered significant losses in recent years with respect to the theft of cardholder data that has been illegally exploited for personal gain. The theft of such information is regularly reported and affects not only individuals but businesses as well (albeit to a lesser degree). Many types of credit card fraud exist, including the counterfeiting of cards and "skimming." "Skimming" is the term for a specialized type of credit card information theft whereby, typically, an employee of a merchant will copy the cardholder's number and security code (either by handwriting the information onto a piece of paper, entering such information into a keypad or other device, or using a handheld device which "reads" and then stores the card information embedded in the magnetic strip). Once a credit card number and security code has been skimmed, the skimmer can use such information for purchases until the unauthorized use is detected either by the cardholder or the card issuer.

Losses from fraud have been substantial for certain card industry participants. Although fraud has not had a material impact on the profitability of the Bank, it is possible that such activity could impact this division at some time in the future.

Part of our business depends on sales agents who do not sell our products exclusively.

Our business model, to some degree, depends upon the use of sales agents who are not our employees. These agents sell the products and services of many different processors to merchants and other parties in need of card services. Failure to maintain good relations with such sales agents could have a negative impact on our business. In addition, new third party relationships have been restricted absent prior approval of the OCC. See "Business Regulation - Bank Supervision and Regulation – OTS Consent Orders and Related Matters" which is included in Item 1 of this Annual Report on Form 10-K.

Table of Contents

Products and services offered by MPS involve many business parties and the possibility of collusion exists.

As described above, the theft of cardholder data is a significant threat in the industry in which MPS operates. This threat also includes the possibility that there is collusion between certain participants in the card system to act illegally. Although MPS is not aware of any instances to date, it is possible that such activities could occur in the future, thereby impacting its operation and profitability.

Competition in the card industry is significant. In order to maintain an edge to its products and offerings, MPS must invest significantly in technology and research and development.

The heavy emphasis upon technology in the products and services offered by MPS requires significant expenditures with respect to research and development both to exploit technological gains and to develop new products and services to meet customers' needs. As is common with most research and development, while some efforts may yield substantial benefits for the division, others will not, thereby resulting in expenditures for which profits will not be realized. MPS is not able to predict with any degree of certainty as to the level of research and development that will be required in the future, how much those efforts will cost, or how profitable such developments will be for the division once undertaken.

Our business could suffer if there is a decline in the use of prepaid cards or there are adverse developments with respect to the prepaid financial services industry in general.

As the prepaid financial services industry evolves, consumers may find prepaid financial services to be less attractive than other financial services. Consumers might not use prepaid financial services for any number of reasons. For example, negative publicity surrounding other prepaid financial service providers could impact MPS' business and prospects for growth to the extent it adversely impacts the perception of prepaid financial services. If consumers do not continue or increase their usage of prepaid cards, MPS' operating revenues may remain at current levels or decline. Growth of prepaid financial services as an electronic payment mechanism may not occur or may occur more slowly than estimated. If there is a shift in the mix of payment forms used by consumers (i.e., cash, credit cards, traditional debit cards and prepaid cards) away from products and services offered by MPS, such a shift could have a material adverse effect on our financial condition and results of operations. In addition, the Bureau is closely monitoring developments in the prepaid card industry and it is possible that future regulation by the Bureau, whether by rule or administrative action, could adversely affect our business.

Discover, MasterCard, and Visa, as well as other electronic funds networks in which MPS operates, could change their rules.

Pursuant to the agreements between MPS and Discover, MasterCard, Visa and other card networks, these third parties typically have retained the right to prescribe certain business practices and procedures with respect to parties such as MPS. Such prescribed terms include, but are not limited to, a contracting party's level of capital as well as other business requirements.

Discover, MasterCard, and Visa also retain the right in their agreements with industry participants such as MPS to unilaterally change the rules under which such transactions are processed with little or no advance warning. This power includes the power to prevent MPS from accessing their networks in order to process transactions. Should any third party choose to invoke this right unilaterally, such changes could materially impact the operations of MPS.

Table of Contents

Our business is heavily dependent upon the Internet and any negative disruptions to its operation could negatively impact our business.

Much of our business depends upon transactions being processed through the Internet. Like nearly all other commercial enterprises, we rely upon others to provide the Internet so that commerce can be conducted. Were there to be a failure in the operation of the Internet or a significant impairment in our ability to move information on the Internet or our ability to do so in accordance with customer safeguard protocols, MPS would develop alternative processes during which time revenues and profitability may be lower.

Our ability to process transactions requires functioning communication and electricity lines.

The nature of the credit card and debit card industry is that it must be operational every day of the week every hour of the week. Any disruption in the utilities utilized by MPS could have a negative effect on our operations and extensive disruptions could materially affect our operations.

Data encryption technology has not been perfected and vigilance in MPS' information technology systems is costly.

MPS holds sensitive business and personal information with respect to the products and services it offers. This information, which is generally digitally encrypted, is passed along various technology channels, including the Internet. Although MPS encrypts its customer and other sensitive information and expends significant financial and personnel resources to maintain the integrity of its technology networks and the confidentiality of nonpublic customer information, because such information may travel on public technology and other non-secure channels, the confidential information is potentially susceptible to hacking and other illegal intrusions. Were such a security breach to occur, the provision of products and services to customers of MPS would be impaired. In addition, were a breach to occur, we could incur significant fines from the electronic funds associations involved, or from federal and/or state regulators, and be subject to other prohibitions, as well as extensive litigation from commercial parties and consumers affected by such breach.

Unclaimed funds represented by unused value on the cards presents compliance and other risks.

The concept of escheatment involves the reporting and delivery of property to states that is abandoned and its rightful owner cannot be readily located and/or identified. In the context of prepaid cards, the funds in connection with such cards can sometimes be "abandoned" or unused for the relevant period of time set forth in each applicable state's abandoned property laws. Although MPS utilizes automated programs to ensure its operations are compliant with such applicable laws and regulations, there appears to be a movement among some state regulators to interpret definitions in those statutes and regulations in a manner that is different from standard industry interpretations. Should such state regulators choose to do so, they may initiate collection or other litigation action against prepaid card issuers such as MPS for unreported abandoned property.

MPS operates in a highly competitive environment and the ability to attract and retain qualified personnel may be difficult.

MPS competes in a highly competitive environment with other larger and better capitalized financial intermediaries. In addition, the field of professionals involved in the design and production of products and services offered by MPS is highly skilled and actively sought after by financial institutions, electronic card networks and other commercial entities. As such, MPS must spend significant sums to attract employees and executives and must monitor compensation and other employment trends to ensure that compensation packages both foster the necessary creative environment and appropriately compensate such individuals in order to retain them.



Table of Contents

MPS Revenue Concentration.

MPS works with a large number of business partners to derive its revenue. The Company believes three of its partners have reached a size that, should these partners' business with the Company end or there is a significant decrease in revenues associated with any of these business relationships, the earnings attributable to them would have a material effect on the financial results of the Company.

Item 1B. Unresolved Staff Comments

Not Applicable.

Item 2. Properties

The Company conducts its business at its main office and branch office in Storm Lake, Iowa. The Company operates five offices in metro Des Moines, Iowa. The Company also operates one office in Brookings, South Dakota and three offices in Sioux Falls, South Dakota. In addition, the Company has space at another facility in Sioux Falls, South Dakota, which houses general corporate and MPS functions and a non-retail service branch in Memphis, Tennessee.

The Company owns all of its offices, except for the branch offices located in Storm Lake Plaza, Storm Lake, Iowa, on South Western Avenue, Sioux Falls, South Dakota, on West 12<sup>th</sup> Street, Sioux Falls, South Dakota, the administrative and MPS offices located on Broadband Lane in Sioux Falls and the non-retail service branch in Memphis, Tennessee. In regard to the South Western and West 12<sup>th</sup> Street locations in Sioux Falls, South Dakota, and the Westtown Parkway location in West Des Moines, Iowa, the land on which the buildings were constructed is leased. The total net book value of the Company's premises and equipment (including land, building and leasehold improvements and furniture, fixtures and equipment) at September 30, 2013 was \$17.7 million. See Note 6 to the "Notes to Consolidated Financial Statements" which is included in Part II, Item 8 "Financial Statements and Supplementary Data" of this Annual Report on Form 10-K.

Though the Company has experienced rapid growth, particularly as a result of growth of MPS, management believes current facilities are adequate to meet its present needs.

The Bank maintains an on-line data-base with a service bureau, whose primary business is providing such services to financial institutions.

Item 3. Legal Proceedings

The Bank was served on April 15, 2013, with a lawsuit captioned Inter National Bank v. NetSpend Corporation, MetaBank, BDO USA, LLP d/b/a BDO Seidman, Cause No. C-2084-12-I filed in the District Court of Hidalgo County, Texas. The Plaintiff's Second Amended Original Petition and Application for Temporary Restraining Order and Temporary Injunction adds both MetaBank and BDO Seidman to the original causes of action against NetSpend. NetSpend acts as a prepaid card program manager and processor for both INB and MetaBank. According to the Petition, NetSpend has informed Inter National Bank ("INB") that the depository accounts at INB for the NetSpend program supposedly contained \$10.5 million less than they should. INB alleges that NetSpend has breached its fiduciary duty by making affirmative misrepresentations to INB about the safety and stability of the program, and by failing to timely disclose the nature and extent of any alleged shortfall in settlement of funds related to cardholder activity and the nature and extent of NetSpend's systemic deficiencies in its accounting and settlement processing procedures. To the extent that an accounting reveals that there is an actual shortfall, INB alleges that MetaBank may be liable for portions or all of said sum due to the fact that funds have been transferred from INB to MetaBank, and thus MetaBank would have been unjustly enriched. The Bank intends to vigorously contest this matter. An estimate of a range of reasonably possible loss cannot be made at this stage of the litigation because discovery is still being

conducted.

Soneet R. Kapila, as Chapter 11 Trustee for Louis J. Pearlman, Louis J. Pearlman Enterprises, Inc., and Transcontinental Aviation, Inc. v. First International Bank & Trust, et al, Adv. No.: 6-09-ap-00106-KSJ, filed in the United States Bankruptcy Court for the Middle District of Florida, Orlando Division on March 20, 2009. This is a cause of action brought by the above-captioned Trustee to avoid and recover alleged fraudulent transfers related to loans made by First International Bank & Trust to the Debtors. First International Bank & Trust sold participations in the loans to multiple banks, including MetaBank. The action is brought by the Trustee pursuant to Bankruptcy Sections 544, 548, 550 of the Bankruptcy Code, as well as the Florida Uniform Fraudulent Transfer Act, Chapter 726 of Florida Statutes. The Company recently settled this matter with the Trustee, which settlement is pending approval of the court.

Certain corporate clients of an unrelated company named Springbok Services, Inc. (“Springbok”) requested through counsel a mediation as a means of reaching a settlement in lieu of commencing litigation against MetaBank. The results of that mediation have not led to a settlement. These claimants purchased MetaBank prepaid reward cards from Springbok, prior to Springbok’s bankruptcy. As a result of Springbok’s bankruptcy and cessation of business, some of the rewards cards which had been purchased were never activated or funded. Counsel for these companies have indicated that they are prepared to assert claims totaling approximately \$1.5 million against MetaBank based on principal/agency or failure to supervise theories. The Company denies liability with respect to these claims. The Company’s estimate of a range of reasonably possible loss is approximately \$0 to \$0.3 million.

In October 2013, the Company’s third party service provider supporting certain of the Bank’s back office operations, sent a letter to the Bank claiming that the Bank bore “ultimate responsibility” for an approximately \$9 million loss suffered by such service provider in connection with a credit card hacking and fraud incident. Such service provider alleges that in 2010 MetaBank alerted the service provider that MetaBank had set up a bank identification number (“BIN”) with MasterCard on behalf of Ingenicard, a prepaid card program manager that MetaBank had been considering as a program partner. The service provider claims that it was unaware that MetaBank ultimately decided not to activate this particular program and had deactivated Ingenicard’s BIN approximately two years later. Ultimately, Ingenicard’s processing system was hacked to inflate card limits and approximately \$9 million in improper charges were thereby placed through MasterCard. Such service provider states it had a pre-existing understanding with MasterCard that allowed MasterCard to extract this amount from such service provider, but after MasterCard debited such service provider’s account, such service provider was unable to obtain any reimbursement from Ingenicard, which ultimately filed for bankruptcy. Asserting contractual and other legal theories, the service provider claims that it allowed MasterCard to extract this money based on its reliance on MetaBank’s apparent backing of the Ingenicard program, and therefore MetaBank’s failure to notify such service provider of deactivation of Ingenicard’s BIN caused this loss. MetaBank believes it bears no liability whatsoever for such service provider’s loss. To date, such service provider has neither made a specific demand on MetaBank nor instituted legal action beyond its initial letter, but if it does so MetaBank, backed by its insurer which has agreed to defend subject to a reservation of rights, intends to defend such action vigorously. For information concerning the status of our contractual relationship with such service provider, see “Risk Factors - Risks Related to the Company’s Business,” which is included in Item 1A of this Annual Report on Form 10-K.

See Item 1 “Business – Regulation – Bank Supervision and Regulation – Consent Orders and Related Matters” for a discussion of the settlement of OTS enforcement matters and on-going compliance matters and Note 14 to Notes to Consolidated Financial Statements.

Other than the matters set forth above, there are no other material pending legal proceedings or updates to which the Company or its subsidiaries is a party other than ordinary litigation routine to their respective businesses.

Item 4. Mine Safety Disclosures

Not applicable.

75

---

Table of Contents

## PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

The Company's common stock trades on the NASDAQ Global Market® under the symbol "CASH." Quarterly dividends for 2013 and 2012 were \$0.13. The price range of the common stock, as reported on the NASDAQ Global Market, was as follows:

	Fiscal Year		Fiscal Year	
	2013		2012	
	Low	High	Low	High
First Quarter	\$22.50	\$24.90	\$14.14	\$17.13
Second Quarter	22.50	26.56	15.53	22.00
Third Quarter	26.00	27.68	19.74	21.68
Fourth Quarter	26.18	38.57	19.60	24.78

Prices disclose inter-dealer quotations without retail mark-up, mark-down or commissions, and do not necessarily represent actual transactions.

Dividend payment decisions are made with consideration of a variety of factors including earnings, financial condition, market considerations, and regulatory restrictions.

As of September 30, 2013, the Company had 6,070,654 shares of common stock outstanding, which were held by approximately 192 stockholders of record, and 318,648 shares subject to outstanding options. The stockholders of record number does not reflect approximately 1,200 persons or entities that hold their stock in nominee or "street" name.

The transfer agent for the Company's common stock is Registrar & Transfer Company, 10 Commerce Drive, Cranford, New Jersey, 07016.

There were no purchases by the Company during the fiscal year ended September 30, 2013 of equity securities that are registered by the Company pursuant to Section 12 of the Exchange Act.

Table of ContentsItem 6. Selected Financial Data

SEPTEMBER 30,	2013	2012	2011	2010	2009
<b>SELECTED FINANCIAL CONDITION DATA</b>					
(Dollars in Thousands)					
Total assets	\$1,691,989	\$1,648,898	\$1,275,481	\$1,029,766	\$834,777
Loans receivable, net	380,428	326,981	314,410	366,045	391,609
Securities available for sale	881,193	1,116,692	619,248	506,852	364,838
Securities held to maturity	288,026	-	-	-	-
Goodwill and intangible assets	2,339	2,035	1,315	2,663	2,215
Deposits	1,315,283	1,379,794	1,141,620	897,454	653,747
Total borrowings	216,456	47,710	29,365	41,214	116,796
Stockholders' equity	142,984	145,859	80,577	72,044	47,345

YEAR ENDED SEPTEMBER 30,	2013	2012	2011	2010	2009
<b>SELECTED OPERATIONS DATA</b>					
(Dollars in Thousands, Except Per Share Data)					
Total interest income	\$38,976	\$37,297	\$39,059	\$39,083	\$36,726
Total interest expense	2,954	3,563	4,747	5,993	8,907
Net interest income	36,022	33,734	34,312	33,090	27,819
Provision for loan losses	-	1,049	278	15,791	18,713
Net interest income after provision for loan losses	36,022	32,685	34,034	17,299	9,106
Total non-interest income	55,503	69,574	57,491	97,444	79,969
Total non-interest expense	74,403	75,463	83,262	94,930	91,081
Income (loss) before income tax expense (benefit)	17,122	26,796	8,263	19,813	(2,006 )
Income tax expense (benefit)	3,704	9,682	3,623	7,420	(543 )
Net income (loss)	13,418	17,114	4,640	12,393	(1,463 )

Earnings per common share:					
Basic	\$2.40	\$4.94	\$1.49	\$4.23	\$(0.56 )
Diluted	\$2.38	\$4.92	\$1.49	\$4.11	\$(0.56 )

YEAR ENDED SEPTEMBER 30,	2013	2012	2011	2010	2009	
<b>SELECTED FINANCIAL RATIOS AND OTHER DATA</b>						
<b>PERFORMANCE RATIOS</b>						
Return on average assets	0.78	% 1.22	% 0.41	% 1.22	% -0.20	%
Return on average equity	9.36	% 18.47	% 5.71	% 20.59	% -3.13	%
Net interest margin	2.48	% 2.56	% 3.21	% 3.43	% 3.50	%
<b>QUALITY RATIOS</b>						
Non-performing assets to total assets	0.05	% 0.16	% 1.24	% 0.94	% 1.76	%
	568	% 219	% 53	% 63	% 55	%

Allowance for loan losses to  
non-performing loans

**CAPITAL RATIOS**

Stockholders' equity to total assets	8.45	%	8.85	%	6.32	%	7.00	%	5.67	%
Average stockholders' equity to average assets	8.37	%	6.62	%	7.16	%	5.93	%	5.42	%

**OTHER DATA**

Book value per common share outstanding at end of year	\$23.55	\$26.79	\$25.61	\$23.15	\$17.97
Dividends declared per share at end of year	0.52	0.52	0.52	0.52	0.52
Number of full-service offices at end of year	11	12	12	12	12
Common Shares Outstanding	6,070,654	5,443,881	3,146,867	3,111,413	2,634,215

77

---

Table of Contents

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

This section should be read in conjunction with the following parts of this Form 10-K: Part II, Item 8 "Financial Statements and Supplementary Data," Part II, Item 7A, "Quantitative and Qualitative Disclosures About Market Risk," and Part I, Item 1 "Business."

General

The Company is a unitary savings and loan holding company whose primary subsidiary is the Bank. The Company focuses on two core businesses, its regional Retail Banking business and a national payments business, conducted through its MPS division. The Company's Retail Bank business is focused on establishing and maintaining long-term relationships with customers, and is committed to serving the financial service needs of the communities in its market area. The Retail Bank's primary market area includes the following counties: Buena Vista, Dallas and Polk located in central and northwestern Iowa, and Brookings, Lincoln, and Minnehaha located in east central South Dakota. The Retail Bank segment attracts retail deposits from the general public and uses those deposits, together with other borrowed funds, to originate and purchase residential and commercial mortgage loans, and to originate consumer, agricultural and other commercial loans and to purchase various investment and mortgage-backed securities.

MPS, a division of the Bank, is an industry leader in the issuance of prepaid debit cards and is also a provider of a wide range of payment related products and services, including prepaid debit cards such as those related to gift, tax refunds, rebate, travel and payroll, ATMs, and consumer credit products. MPS pursues a strategy of working with industry-leading companies in a variety of businesses to help them introduce new payment products to their customers. In addition, MPS partners with emerging companies to develop and introduce new payment products. MPS earns revenues from fees and is responsible for the bulk of the Bank's low- and no-cost demand deposits related to its prepaid card business. Certain of MPS' activities have been significantly curtailed as a result of Consent Orders issued by the OTS, our former regulator. For a description of the Consent Orders, see Item 1 "Business – Regulation – Bank Supervision and Regulation." The Consent Orders, and the related directives that preceded them, have had a significant impact on revenues, profitability, and growth of the MPS division, the Bank, and the Company as a whole.

Overview of Corporate Developments

In fiscal 2013, the Company's net interest income after provision for loan losses was \$36.0 million, the highest in its history, compared to \$32.7 million in fiscal 2012 and \$34.0 million in fiscal 2011. The Company had net income of \$13.4 million in fiscal 2013 compared to \$17.1 million in fiscal 2012. The primary reason for the decline in net income was due to a gain on sale of securities of \$13.8 million in fiscal 2012 compared to a gain on sale of securities of \$2.6 million in fiscal 2013.

MPS 2013 fiscal year net income was \$8.4 million compared to net income of \$6.5 million in the 2012 fiscal year. This increase was primarily the result of an increase in interest income of \$2.4 million and, to a lesser extent, a decrease in non-interest expense and a decrease in income tax expense, offset in part by a decrease in non-interest income. The average internal net interest yield MPS received for its deposits was 1.26% for the 2013 fiscal year-end and 1.17% in the comparable 2012 period.

MPS is developing a number of new credit products for fiscal year 2014, subject to OCC approval.

## Table of Contents

Retail Bank 2013 fiscal year net income was \$5.9 million compared to net income of \$11.0 million in the 2012 fiscal year. The decrease was primarily attributable to a decrease in non-interest income of \$11.4 million, partially offset by a decrease in income tax expense. Retail Bank checking balances continued to grow from \$62.9 million at September 30, 2012 to \$72.8 million, or 15.8%, at September 30, 2013. Retail bank total loans increased \$53.4 million during the fiscal year, or 16.3% to \$380.4 million from strong growth in the residential real estate and agricultural lending segments.

The Company's tangible book value per common share decreased by \$3.25, or 12.3%, from \$26.42 at September 30, 2012 to \$23.17 per share at September 30, 2013 primarily due to unrealized losses in securities as a result of market conditions.

Assets held for sale increased \$1.1 million at September 30, 2013 due to an expected sale of a branch in the Central Iowa market.

At September 30, 2013, non-performing assets decreased by \$1.8 million to \$0.8 million compared to \$2.6 million at September 30, 2012.

We filed a shelf registration statement on Form S-3 (the "Shelf Registration") which became effective with the Securities and Exchange Commission in June 2013. We commenced sales of common stock under the ATM Offering in June 2013 and we issued an aggregate of 507,354 shares of common stock through our ATM Offering during the year ended September 30, 2013. We utilized Sandler O'Neill + Partners, L.P., as our agent for the program. Shares were issued at an average price of \$27.58 per share, and we raised proceeds, net of direct selling costs, of \$13.6 million. The proceeds of the ATM Offering, all of which qualifies as Tier 1 capital for regulatory purposes (and also qualifies as common equity Tier 1 capital under the recently finalized Dodd-Frank and Basel III capital regulation), has been added to our general corporate funds and bolsters our regulatory capital ratios.

On September 24, 2013, the Board of Directors of the Company appointed Bradley C. Hanson, 49, to serve as President of the Company, Glen W. Herrick, 51, to serve as Executive Vice President, Chief Financial Officer, Treasurer and Secretary, Ira D. Frericks, 53, to serve as Executive Vice President and Chief Operating Officer, and Ronald W. Butterfield, 64, to serve as Executive Vice President and Chief Administrative Officer, with each of the appointments to be effective as of October 1, 2013. Mr. Herrick replaced Dave Leedom in the roles of Chief Financial Officer, Treasurer and Secretary. Mr. Leedom transitioned to a part-time role with the Company effective as of the appointment of Mr. Herrick.

On November 13, 2013, the Board of Directors of the Company appointed Douglas J. Hajek to the Company's Board for a term expiring at the 2014 Annual Meeting of stockholders, or until his respective successor is elected or qualified or until his earlier resignation or removal.

## Financial Condition

As of September 30, 2013, the Company's assets grew by \$43.1 million, or 2.6%, to \$1.7 billion compared to \$1.6 billion at September 30, 2012. The increase in assets was reflected primarily in increases in the Company's investment securities and to a lesser extent in the Company's loans receivable and bank-owned life insurance, offset in part by a decrease in the Company's cash and cash equivalents.

Total cash and cash equivalents and federal funds sold were \$40.1 million at September 30, 2013, a decrease of \$105.0 million from \$145.1 million at September 30, 2012. The decline was primarily the result of the Company executing a strategy designed to diversify the Bank's investment security portfolio. In general, the Company maintains its cash investments in interest-bearing overnight deposits with the FHLB of Des Moines and the FRB of Minneapolis. At September 30, 2013, the Company had no federal funds sold.





Table of Contents

The total of mortgage-backed securities and investment securities increased \$52.5 million, or 4.7%, to \$1.2 billion at September 30, 2013, as investment purchases exceeded related maturities, sales, and principal pay downs. The Company's portfolio of securities consists primarily of mortgage-backed securities (MBS), which have relatively short expected lives and non-bank qualified obligations of states and political subdivisions (NBQ) which mature in approximately 15 years or less. Of the total of \$658.3 million of mortgage-backed securities, \$581.4 million are classified as available for sale, and \$76.9 million are classified as held to maturity. Of the total of \$510.9 million of investment securities, \$299.8 million are classified as available for sale and \$211.1 million are classified as held to maturity. During fiscal 2013, the Company purchased \$250.7 million of mortgage-backed securities with average lives of five years or less or stated final maturities of approximately 30 years or less and sold mortgage-backed securities in the amount of \$79.6 million. In addition, the Company purchased \$264.1 million of investment securities which are primarily comprised of corporate and tax exempt bonds. On May 6, 2013, the Company reclassified approximately \$284.3 million from the AFS to the HTM category. The reclassification resulted in the recording of an unrealized gain of \$2.1 million which has been segregated within accumulated other comprehensive income and is being amortized through maturity. See Note 3 to the "Notes to Consolidated Financial Statements," which is included in Part II, Item 8 "Consolidated Financial Statements and Supplementary Data" of this Annual Report on Form 10-K.

The Company's portfolio of net loans receivable increased by \$53.4 million, or 16.3%, to \$380.4 million at September 30, 2013 from \$327.0 million at September 30, 2012. This increase primarily relates to an increase of \$33.2 million in residential mortgage loans, a \$12.8 million increase in agricultural operating loans and a \$9.7 million increase in agricultural real estate loans, partially offset by a decrease in MPS consumer loans of \$2.9 million. See Note 4 to the "Notes to Consolidated Financial Statements," which is included in Part II, Item 8 "Financial Statements and Supplementary Data" of this Annual Report on Form 10-K.

Through the Bank, the Company owns stock in the FHLB due to the Bank's membership and participation in this banking system. The FHLB requires a level of stock investment based on a pre-determined formula. The Company's investment in such stock increased \$7.9 million, or 371.4%, to \$10.0 million at September 30, 2013 from \$2.1 million at September 30, 2012. The increase was due to a modification in the FHLB stock buyback method which changed from a monthly to a daily buyback.

The Company has insurance receivables established for estimated recoveries from various lawsuits due from the Company's insurance company. This amount decreased \$0.2 million to \$0.4 million at September 30, 2013 from \$0.6 million at September 30, 2012 as management revised the expected receipt of insurance proceeds related to a settled claim. Foreclosed real estate and repossessed assets decreased to \$0.1 million as compared to \$0.8 million at September 30, 2012 due to sales and write offs exceeding the foreclosure of assets and loan collateral related to previously reported non-performing loans.

Intangible assets increased \$0.3 million, or 14.9%, to \$2.3 million at September 30, 2013, due to an increase in capitalized expense related to patents.

Assets held for sale increased \$1.1 million at September 30, 2013 due to an expected sale of a branch in the Central Iowa market.

80

---

## Table of Contents

Total deposits decreased by \$64.5 million, or 4.7%, to \$1.3 billion at September 30, 2013 from \$1.4 billion at September 30, 2012. Deposits attributable to MPS were down \$103.6 million, or 8.9%, at September 30, 2013, as compared to September 30, 2012. This decrease results from timing of the settlement of funds due to the last day of the fiscal year falling on a Monday, versus a Friday, in the prior year.

The Company's total borrowings increased \$168.8 million, or 353.7%, from \$47.7 million at September 30, 2012 to \$216.5 million at September 30, 2013, primarily due to the increase in federal funds purchased. See Notes 8, 9, and 10 to the "Notes to Consolidated Financial Statements," which are included in Part II, Item 8 "Financial Statements and Supplementary Data" of this Annual Report on Form 10-K.

At September 30, 2013, the Company's stockholders' equity totaled \$143.0 million, a decrease of \$2.9 million from \$145.9 million at September 30, 2012. Components of stockholders' equity changed due to issuances of common stock, an increase in retained earnings, and unrealized losses on investment securities due to market conditions. At September 30, 2013, the Bank continues to meet regulatory requirements for classification as a well-capitalized institution. See Note 14 to the "Notes to Consolidated Financial Statements," which is included in Part II, Item 8 "Financial Statements and Supplementary Data" of this Annual Report on Form 10-K.

## Results of Operations

The Company's results of operations are dependent on net interest income, provision for loan losses, non-interest income, non-interest expense, income tax expense, and other comprehensive loss or income. Net interest income is the difference, or spread, between the average yield on interest-earning assets and the average rate paid on interest-bearing liabilities. The interest rate spread is affected by regulatory, economic, and competitive factors that influence interest rates, loan demand, and deposit flows. Notwithstanding that a significant amount of the Company's deposits pay low rates of interest or none at all, the Company, like other financial institutions, is subject to interest rate risk to the extent that its interest-earning assets mature or reprice at different times, or on a different basis, than its interest-bearing liabilities. The Company's non-interest income decreased in fiscal 2013 as compared to fiscal 2012 following an increase from fiscal 2011 to fiscal 2012. Non-interest expense, related primarily to compensation and benefits and card processing expense, decreased in fiscal 2013 as compared to the prior two fiscal years. A more detailed explanation of the factors responsible for results of operations of the Company is presented below.

The Company's non-interest income is derived primarily from prepaid card, credit products, and ATM fees attributable to MPS and fees charged on bank loans and transaction accounts. Non-interest income is also derived from net gains on the sale of securities available for sale as well as the Company's holdings of bank owned life insurance. This income is offset by expenses, such as compensation and occupancy expenses associated with additional personnel and office locations as well as card processing expenses attributable to MPS. Non-interest expense is also impacted by occupancy and equipment expenses, regulatory expenses, and legal and consulting expenses.

## Average Balances, Interest Rates, and Yields

The following table presents, for the periods indicated, the total dollar amount of interest income from average interest-earning assets and the resulting yields, as well as the interest expense on average interest-bearing liabilities, expressed both in dollars and rates. No tax equivalent adjustments have been made. Non-Accruing loans have been included in the table as loans carrying a zero yield.

Table of Contents

Year Ended September 30,  (Dollars in Thousands)	2013			2012			2011		
	Average Outstanding Balance	Interest Earned / Paid	Yield / Rate	Average Outstanding Balance	Interest Earned / Paid	Yield / Rate	Average Outstanding Balance	Interest Earned / Paid	Yield / Rate
Interest-earning assets:									
Loans receivable	\$340,702	\$16,151	4.74%	\$327,634	\$18,058	5.51%	\$338,114	\$19,654	5.81%
Mortgage-backed securities	700,709	11,900	1.70%	756,465	16,133	2.13%	549,374	18,362	3.34%
Other investments and fed funds sold	598,003	10,925	2.61%	254,029	3,106	1.40%	181,514	1,043	0.57%
Total interest-earning assets	1,639,414	\$38,976	2.66%	1,338,128	\$37,297	2.82%	1,069,002	\$39,059	3.65%
Non-interest-earning assets	72,600			61,978			67,114		
Total assets	\$1,712,014			\$1,400,106			\$1,136,116		
Non-interest bearing deposits	\$1,192,969	\$-	0.00%	\$1,018,748	\$-	0.00%	\$780,941	\$-	0.00%
Interest-bearing liabilities:									
Interest-bearing checking	32,030	125	0.39%	33,555	252	0.75%	32,717	409	1.25%
Savings	27,907	39	0.14%	17,773	39	0.22%	11,248	37	0.33%
Money markets	40,694	100	0.25%	38,552	133	0.34%	34,975	234	0.67%
Time deposits	101,552	1,016	1.00%	105,605	1,782	1.69%	119,318	2,389	2.00%
FHLB advances	8,087	727	8.99%	11,000	670	6.09%	21,230	1,124	5.29%
Overnight fed funds purchased	129,016	423	0.33%	34,414	128	0.37%	18,086	57	0.32%
Other borrowings	20,839	524	2.51%	25,584	559	2.18%	16,322	497	3.04%
Total interest-bearing liabilities	360,125	2,954	0.82%	266,483	3,563	1.34%	253,896	4,747	1.87%
Total deposits and interest-bearing liabilities	1,553,094	\$2,954	0.19%	1,285,231	\$3,563	0.28%	1,034,837	\$4,747	0.46%
Other non-interest bearing liabilities	15,605			22,198			19,956		
Total liabilities	1,568,699			1,307,429			1,054,793		
Stockholders' equity	143,315			92,677			81,323		
Total liabilities and stockholders' equity	\$1,712,014			\$1,400,106			\$1,136,116		
Net interest income and net interest rate spread including non-interest bearing deposits		\$36,022	2.47%		\$33,734	2.54%		\$34,312	3.19%

Net interest margin	2.48%	2.56%	3.21%
---------------------	-------	-------	-------

## Rate / Volume Analysis

The following schedule presents the dollar amount of changes in interest income and interest expense for major components of interest-earning assets and interest-bearing liabilities. It distinguishes between the change related to higher outstanding balances and the change due to the levels and volatility of interest rates. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to (i) changes in volume (i.e. changes in volume multiplied by old rate) and (ii) changes in rate (i.e. changes in rate multiplied by old volume). For purposes of this table, changes attributable to both rate and volume that cannot be segregated have been allocated proportionately to the change due to volume and the change due to rate.

## Rate / Volume

Year Ended September 30,	2013 vs. 2012			2012 vs. 2011		
	Increase / (Decrease) Due to Volume	Increase / (Decrease) Due to Rate	Total Increase / (Decrease)	Increase / (Decrease) Due to Volume	Increase / (Decrease) Due to Rate	Total Increase / (Decrease)
<b>Interest-earning assets</b>						
Loans Receivable	\$697	\$ (2,604 )	\$ (1,907 )	\$ (599 )	\$ (997 )	\$ (1,596 )
Mortgage-backed securities	(1,132)	(3,101)	(4,233)	5,643	(7,872)	(2,229)
Other investments	4,773	3,046	7,819	444	1,619	2,063
Total interest-earning assets	\$4,337	\$ (2,658 )	\$ 1,679	\$5,488	\$ (7,250 )	\$ (1,762 )
<b>Interest-bearing liabilities</b>						
Interest-bearing checking	\$(11 )	\$(116 )	\$(127 )	\$10	\$(167 )	\$(157 )
Savings	17	(17)	-	17	(15)	2
Money markets	6	(39)	(33)	22	(123)	(101)
Time deposits	(66 )	(700 )	(766 )	(258 )	(349 )	(607 )
FHLB advances	(208 )	265	57	162	(545 )	(383 )
Overnight fed funds purchased	310	(15)	295	-	-	-
Other borrowings	(112 )	77	(35)	229	(167 )	62
Total interest-bearing liabilities	\$(63 )	\$(546 )	\$(609 )	\$182	\$(1,366 )	\$(1,184 )
Net effect on net interest income	\$4,400	\$ (2,112 )	\$ 2,288	\$5,306	\$ (5,884 )	\$ (578 )

Table of Contents

Comparison of Operating Results for the Years Ended  
September 30, 2013 and September 30, 2012

General. The Company recorded net income of \$13.4 million, or \$2.38 per diluted share, for the year ended September 30, 2013 compared to \$17.1 million, or \$4.92 per diluted share, for the year ended September 30, 2012, a decrease of \$3.7 million. The decrease in net income was primarily caused by a \$14.0 million decrease in non-interest income which reflected an \$11.2 million net decrease in gains on sale of securities available for sale from fiscal 2012 to fiscal 2013, offset in part by an increase in net interest income, and decreases in provision for loan loss, non-interest expense, and tax expense.

Net Interest Income. Net interest income for fiscal 2013 increased by \$2.3 million, or 6.8%, to \$36.0 million from \$33.7 million for the prior fiscal year. Net interest margin decreased to 2.48% in fiscal 2013 as compared to 2.56% in fiscal 2012.

The Company's average earning assets increased \$301.3 million, or 22.5%, to \$1.6 billion during fiscal 2013 from \$1.3 billion during fiscal 2012. The increase is primarily the result of the increase in the Company's investment securities and non-bank qualified municipal portfolios. Overall, asset yields declined by 16 basis points due to lower average rates. The increase in average earning assets was offset by a change in the mix of earning assets favoring investment securities and a decrease in yields on mortgage-backed securities.

The Company's average total deposits and interest-bearing liabilities increased \$267.9 million, or 20.8%, to \$1.6 billion during fiscal 2013 from \$1.3 billion during fiscal 2012. The increase resulted mainly from an increase in the Company's non-interest-bearing deposits and federal funds purchased. The average outstanding balance of non-interest bearing deposits increased from \$1.0 billion in fiscal 2012 to \$1.2 billion in fiscal 2013. The Company's cost of total deposits and interest-bearing liabilities declined 9 basis points to 0.19% during fiscal 2013 from 0.28% during fiscal 2012 primarily due to continued migration to low and no-cost deposits provided by MPS.

Provision for Loan Losses. In fiscal 2013, the Company did not record a provision for loan loss, compared to \$1.0 million for fiscal 2012.

Management closely monitors economic developments both regionally and nationwide, and considers these factors when assessing the adequacy of its allowance for loan losses. The economic slowdown, which recently has shown some signs of abating, continues to strain the financial condition of some borrowers. Management therefore believes that future losses in the residential portfolio may be somewhat higher than historical experience. It should be noted that a sizeable portion of the Company's consumer loan portfolio is secured by residential real estate. Over the past three years, loss rates in the commercial and multi-family real estate market have remained moderate. Management expects that future losses in this portfolio may be somewhat higher than recent historical experience. Loss rates in the agricultural real estate and agricultural operating loan portfolios have been minimal in the past three years primarily due to higher commodity prices as well as above average yields which have created positive economic conditions for most farmers in our markets. Nonetheless, management still expects that future losses in this portfolio, which have been very low, could be higher than recent historical experience. Management believes that various levels of drought weather conditions within our markets has the potential to negatively impact potential yields which would have a negative economic effect on our agricultural markets. In addition, management believes the continuing slow economic environment may also negatively impact consumers' repayment capacities.

Table of Contents

The allowance for loan losses established by MPS results from an estimation process that evaluates relevant characteristics of its credit portfolio(s). MPS also considers other internal and external environmental factors such as changes in operations or personnel and economic events that may affect the adequacy of the allowance for credit losses. Adjustments to the allowance for loan losses are recorded periodically based on the result of this estimation process. The exact methodology to determine the allowance for loan losses for each program will not be identical. Each program may have differing attributes including such factors as levels of risk, definitions of delinquency and loss, inclusion/exclusion of credit bureau criteria, roll rate migration dynamics, and other factors. Similarly, the additional capital required to offset the increased risk in subprime lending activities may vary by credit program. Each program is evaluated separately.

Management believes that, based on a detailed review of the loan portfolio, historic loan losses, current economic conditions, the size of the loan portfolio, and other factors, the current level of the allowance for loan losses at September 30, 2013 reflects an appropriate allowance against probable losses from the loan portfolio. Although the Company maintains its allowance for loan losses at a level that it considers to be adequate, investors and others are cautioned that there can be no assurance that future losses will not exceed estimated amounts, or that additional provisions for loan losses will not be required in future periods. In addition, the Company's determination of the allowance for loan losses is subject to review by its regulatory agencies, the OCC and the Federal Reserve, which can require the establishment of additional general or specific allowances.

**Non Interest Income.** Non-interest income decreased by \$14.1 million, or 20.2%, to \$55.5 million for fiscal 2013 from \$69.6 million for fiscal 2012 due primarily to a decrease in the gain on sale of securities available for sale of \$11.2 million related to the sale of the GNMA securities portfolio during fiscal year 2012. Fees earned on prepaid debit cards, credit products and other payment systems products and services decreased to \$50.8 million for fiscal 2013 as compared to \$53.2 million for fiscal 2012, primarily due to the exit from certain MPS credit sponsorship programs and a decrease in card fee income due to a temporary interruption at one MPS business partner.

**Non-Interest Expense.** Non-interest expense decreased by \$1.1 million, or 1.4%, to \$74.4 million for fiscal 2013 from \$75.5 million for the same period in fiscal 2012.

The reduction in non-interest expense was attributable to a reduction in card processing expense, which declined \$1.8 million from \$17.4 million in fiscal 2012 to \$15.6 million in fiscal 2013 due to lower volumes, a reduction in legal and consulting expenses of \$1.2 million from \$5.3 million in fiscal 2012 to \$4.1 million in fiscal 2013, and a decrease in other expenses of \$1.7 million, partially offset by an increase in compensation expense of \$3.0 million.

Compensation expense totaled \$34.1 million for fiscal 2013 as compared to \$31.1 million for fiscal 2012. Overall staffing is 5% higher than at September 30, 2012 primarily due to hiring in key areas relating to compliance and technology.

Impairment on assets held for sale was \$0.6 million for fiscal year 2013 due to an expected sale of a branch in the Central Iowa market.

**Income Tax Expense.** Income tax expense for fiscal 2013 was \$3.7 million, an effective tax rate of 21.6%, compared to a tax expense of \$9.7 million, an effective tax rate of 36.1%, in fiscal 2012. The decrease in the Company's recorded income tax expense for the current fiscal year was impacted primarily by an increase in the volume of tax exempt municipal bonds and, to a lesser extent, the purchase of additional bank-owned life insurance. The nature and timing of the items discussed above resulted in a lower effective tax rate for fiscal 2013 compared to fiscal 2012.

Table of Contents

Comparison of Operating Results for the Years Ended  
September 30, 2012 and September 30, 2011

General. The Company recorded net income of \$17.1 million, or \$4.92 per diluted share, for the year ended September 30, 2012 compared to \$4.6 million, or \$1.49 per diluted share, for the year ended September 30, 2011. The increase in net income in the current period was primarily caused by a \$12.1 million increase in non-interest income and a \$7.8 million reduction in non-interest expenses which were partially offset by a \$6.1 million increase in income tax expense.

Net Interest Income. Net interest income for fiscal 2012 decreased by \$0.6 million, or 1.7%, to \$33.7 million from \$34.3 million for the prior fiscal year. Net interest margin decreased to 2.56% in fiscal 2012 as compared to 3.21% in fiscal 2011.

The Company's average earning assets increased \$269.1 million, or 25.2%, to \$1.3 billion during fiscal 2012 from \$1.1 billion during fiscal 2011. The increase is primarily the result of the increase in the Company's mortgage-backed securities and non-bank qualified municipal portfolios. Overall, asset yields declined by 83 basis points due to lower average rates. The increase in average earning assets was offset by a change in the mix of earning assets, to more investment securities and fewer loans, and a decrease in yields on mortgage-backed securities.

The Company's average total deposits and interest-bearing liabilities increased \$250.4 million, or 24.2%, to \$1.3 billion during fiscal 2012 from \$1.0 billion during fiscal 2011. The increase resulted mainly from an increase in the Company's non-interest-bearing deposits. The average outstanding balance of non-interest bearing deposits increased from \$780.9 million in fiscal 2011 to \$1.0 billion in fiscal 2012. The Company's cost of total deposits and interest-bearing liabilities declined 18 basis points to 0.28% during fiscal 2012 from 0.46% during fiscal 2011 primarily due to continued migration to low and no-cost deposits provided by MPS. Due to stabilizing interest rates and a remix of the investment portfolio largely accomplished during the fourth fiscal quarter of 2012, we expect interest income to rebound going forward in fiscal 2013.

Provision for Loan Losses. In fiscal 2012, the Company recorded a provision for loan losses of \$1.0 million, compared to \$0.3 million for fiscal 2011.

Non-Interest Income. Non-interest income increased by \$12.1 million, or 21.0%, to \$69.6 million for fiscal 2012 from \$57.5 million for fiscal 2011 due primarily to the gain on sale of securities available for sale of \$12.0 million. Fees earned on prepaid debit cards, credit products and other payment systems products and services decreased to \$53.2 million for fiscal 2012 as compared to \$53.9 million for fiscal 2011, primarily due to the exit from certain MPS credit sponsorship programs and a decrease in card fee income due to a temporary interruption at one MPS business partner. In addition, the Bank recorded a gain on sale of securities available for sale of \$13.8 million in fiscal 2012 as compared to gain on sale of \$1.8 million in the prior fiscal year.

Non-Interest Expense. Non-interest expense decreased by \$7.8 million, or 9.4%, to \$75.5 million for fiscal 2012 from \$83.3 million for the same period in fiscal 2011.

The reduction in non-interest expense was primarily attributable to a reduction in card processing expense, which declined \$5.9 million from \$23.3 million in fiscal 2011 to \$17.4 million in fiscal 2012 due to lower volumes. These expenses primarily stem from prepaid card and credit-related programs managed by MPS.



## Table of Contents

Compensation expense totaled \$31.1 million for fiscal 2012 as compared to \$30.5 million for fiscal 2011. Overall staffing is 5% higher than at September 30, 2011 primarily due to hiring in key areas relating to compliance and technology.

Goodwill impairment expense of \$1.5 million was recorded for fiscal 2011 due to the Retail Bank segment's write off of goodwill due to impairment related primarily to the decline in the Company's stock price in the quarter ended December 31, 2010.

Income Tax Expense. Income tax expense for fiscal 2012 was \$9.7 million, or an effective tax rate of 36.1%, compared to a tax expense of \$3.6 million, or an effective tax rate of 43.8%, in fiscal 2011. The Company's recorded income tax expense for the prior fiscal year was impacted primarily by permanent differences between book and taxable income. The Company's recorded income tax expense and the effective tax rate was impacted by permanent differences between book and taxable income related to the write off of goodwill of \$1.5 million and the OTS penalty of \$0.4 million in fiscal year 2011. The nature and timing of the items discussed above resulted in a higher effective tax rate for fiscal 2011 compared to fiscal 2012.

## Critical Accounting Estimates

The Company's financial statements are prepared in accordance with U.S. GAAP. The financial information contained within these statements is, to a significant extent, financial information that is based on approximate measures of the financial effects of transactions and events that have already occurred. Based on its consideration of accounting policies that: (i) involve the most complex and subjective decisions and assessments which may be uncertain at the time the estimate was made, and (ii) different estimates that reasonably could have been used in the current period, or changes in the accounting estimate that are reasonably likely to occur from period to period, would have a material impact on the financial statements, management has identified the policies described below as Critical Accounting Policies.

Allowance for Loan Losses. The Company's allowance for loan loss methodology incorporates a variety of risk considerations, both quantitative and qualitative, in establishing an allowance for loan loss that management believes is appropriate at each reporting date. Quantitative factors include the Company's historical loss experience, delinquency and charge-off trends, collateral values, changes in nonperforming loans, and other factors. Quantitative factors also incorporate known information about individual loans, including borrowers' sensitivity to interest rate movements. Qualitative factors include the general economic environment in the Company's markets, including economic conditions throughout the Midwest and, in particular, the state of certain industries. Size and complexity of individual credits in relation to loan structure, existing loan policies, and pace of portfolio growth are other qualitative factors that are considered in the methodology. Although management believes the levels of the allowance as of both September 30, 2013 and September 30, 2012 were adequate to absorb probable losses inherent in the loan portfolio, a decline in local economic conditions or other factors could result in increasing losses.

Goodwill and Intangible Assets. Goodwill represents the excess of acquisition costs over the fair value of the net assets acquired in a purchase acquisition. Intangible assets include patents filed by the MPS Division. Goodwill and intangible assets are tested annually for impairment or more often if conditions indicate a possible impairment. Determining the fair value of a reporting unit involves the use of significant estimates and assumptions. These estimates and assumptions include revenue growth rates and operating margins used to calculate future cash flows, risk-adjusted discount rates, future economic and market conditions, comparison of the Company's market value to book value and determination of appropriate market comparables. Actual future results may differ from those estimates.

Table of Contents

Each quarter the Company evaluates the estimated useful lives of intangible assets and whether events or changes in circumstances warrant a revision to the remaining periods of amortization. In accordance with Accounting Standards Codification (“ASC”) 350, Intangibles – Goodwill and Other, recoverability of these assets is measured by comparison of the carrying amount of the asset to the future undiscounted cash flows the asset is expected to generate. If the asset is considered to be impaired, the amount of any impairment is measured as the difference between the carrying value and the fair value of the impaired asset.

Assumptions and estimates about future values and remaining useful lives of the Company’s intangible and other long-lived assets are complex and subjective. They can be affected by a variety of factors, including external factors such as industry and economic trends, and internal factors such as changes in the Company’s business strategy and internal forecasts. Although the Company believes the historical assumptions and estimates used are reasonable and appropriate, different assumptions and estimates could materially impact the reported financial results. As of September 30, 2013 and 2012, the Company had no goodwill.

Self-Insurance. The Company has a self-insured healthcare plan for its employees up to certain limits. To mitigate a portion of these risks, the Company has a stop-loss insurance policy through a commercial insurance carrier for coverage in excess of \$60,000 per individual occurrence with an unlimited lifetime maximum. The estimate of self-insurance liability is based upon known claims and an estimate of incurred, but not reported (“IBNR”) claims. IBNR claims are estimated using historical claims lag information received by a third party claims administrator. Due to the uncertainty of health claims, the approach includes a process which may differ significantly from other methodologies and still produce an estimate in accordance with U.S. GAAP. Although management believes it uses the best information available to determine the accrual, unforeseen health claims could result in adjustments to the accrual.

Deferred Tax Assets. The Company accounts for income taxes according to the asset and liability method. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to 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 the enacted tax rates applicable to income for the years in which those temporary differences are expected to be recovered or settled. Deferred tax assets are recognized subject to management’s judgment that realization is more-likely-than-not. An estimate of probable income tax benefits that will not be realized in future years is required in determining the necessity for a valuation allowance.

Security Impairment. Management continually monitors the investment security portfolio for impairment on a security by security basis. Management has a process in place to identify securities that could potentially have a credit impairment that is other-than-temporary. This process involves the length of time and extent to which the fair value has been less than the amortized cost basis, review of available information regarding the financial position of the issuer, monitoring the rating of the security, cash flow projections, and the Company’s intent to sell a security or whether it is more likely than not the Company will be required to sell the security before the recovery of its amortized cost which, in some cases, may extend to maturity. To the extent we determine that a security is deemed to be other-than-temporarily impaired, an impairment loss is recognized. If the Company intends to sell a security or it is more likely than not that the Company would be required to sell a security before the recovery of its amortized cost, the Company recognizes an other-than-temporary impairment in earnings for the difference between amortized cost and fair value. If we do not expect to recover the amortized cost basis, we do not plan to sell the security and if it is not more likely than not that the Company would be required to sell a security before the recovery of its amortized cost, the recognition of the other-than-temporary impairment is bifurcated. For those securities, the Company separates the total impairment into a credit loss component recognized in earnings, and the amount of the loss related to other factors is recognized in other comprehensive income net of taxes.

## Table of Contents

The amount of the credit loss component of a debt security impairment is estimated as the difference between amortized cost and the present value of the expected cash flows of the security. The present value is determined using the best estimate of cash flows discounted at the effective interest rate implicit to the security at the date of purchase or the current yield to accrete an asset-backed or floating rate security. Cash flow estimates for trust preferred securities are derived from scenario-based outcomes of forecasted default rates, loss severity, prepayment speeds and structural support.

In fiscal 2013, 2012 and 2011, there were no other than temporary impairment losses.

**Level 3 Fair Value Measurement.** U.S. GAAP requires the Company to measure the fair value of financial instruments under a standard which describes three levels of inputs that may be used to measure fair value. Level 3 measurement includes significant unobservable inputs that reflect the Company's own assumptions about the assumptions that market participants would use in pricing an asset or liability. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation. Although management believes that it uses a best estimate of information available to determine fair value, due to the uncertainty of future events, the approach includes a process that may differ significantly from other methodologies and still produce an estimate that is in accordance with U.S. GAAP.

## Interest Rate Risk

**Overview.** The Company actively manages interest rate risk, as changes in market interest rates can have a significant impact on reported earnings. The Bank, like other financial institutions, is subject to interest rate risk to the extent that its interest-bearing liabilities mature or reprice more rapidly than its interest-earning assets. The interest rate risk process is designed to compare income simulations in market scenarios designed to alter the direction, magnitude, and speed of interest rate changes, as well as the slope of the yield curve. The Company does not currently engage in trading activities to control interest rate risk although it may do so in the future, if deemed necessary, to help manage interest rate risk.

**Earnings at risk and economic value analysis.** As a continuing part of its financial strategy, the Bank considers methods of managing an asset/liability mismatch consistent with maintaining acceptable levels of net interest income. In order to properly monitor interest rate risk, the Board of Directors has created an Investment Committee whose principal responsibilities are to assess the Bank's asset/liability mix and implement strategies that will enhance income while managing the Bank's vulnerability to changes in interest rates.

The Company uses two approaches to model interest rate risk: Earnings at Risk (EAR analysis) and Economic Value of Equity (EVE analysis). Under EAR analysis, net interest income is calculated for each interest rate scenario to the net interest income forecast in the base case. EAR analysis measures the sensitivity of interest sensitive earnings over a one year minimum time horizon. The results are affected by projected rates, prepayments, caps and floors. Market implied forward rates and various likely and extreme interest rate scenarios can be used for EAR analysis. These likely and extreme scenarios can include rapid and gradual interest rate ramps, rate shocks and yield curve twists.

The EAR analysis used in the following table reflects the required analysis used no less than quarterly by management. It models -100, +100, +200, +300 basis point parallel shifts in market interest rates over the next one-year period. Due to the current low level of interest rates, only a -100 basis point parallel shift is represented.

88

---

Table of Contents

The Company is within Board policy limits for all scenarios. The table below shows the results of the scenario as of September 30, 2013:

## Table Net Sensitive Earnings at Risk

	Net Sensitive Earnings at Risk			
	Standard (Parallel Shift) Year 1			
	Net Interest Income at Risk%			
	-100	+100	+200	+300
Basis Point Change Scenario	-1.9 %	-3.4 %	-7.0 %	-10.6 %
Board Policy Limits	-5.0 %	-5.0 %	-10.0 %	-15.0 %

The EAR analysis reported at September 30, 2013, shows that more liabilities, (primarily the overnight federal funds purchased) than assets will reprice over the modeled one-year period.

The Company's overnight federal funds purchased fluctuates on a daily basis due to the nature of a portion of its non-interest bearing deposit base, primarily related to payroll processing timing. Interest rate risk (IRR) is a snapshot in time. The Company's IRR results vary depending on which day of the week this snapshot is taken. IRR was negatively affected because fiscal year end 2013 ended on a Monday. Due to payroll processing timing, Monday's tend to necessitate a higher than average amount of overnight federal funds purchased, which is typically paid down throughout the week. The Company anticipates improved IRR results in an upward interest rate environment based on expected non-interest bearing deposit growth from December through March.

The following table shows the income sensitivity of selected assets and liabilities to changes in market interest rates (dollars in thousands). The changes in interest income and expense is in comparison to base case figures of total interest-sensitive assets of \$40.5 million (investments and other earning assets of \$21.8 million and total loans of \$18.6 million) and total interest-sensitive expense of \$2.1 million (interest-bearing deposits of \$1.0 million and total borrowings of \$1.1 million).

	Total Earning Assets	% of Total Earning Assets	Change in Interest Income/Expense for a given change in interest rates Over / (Under) Base Case Parallel Ramp			
			-100	+100	+200	+300
Basis Point Change Scenario	Assets	Assets	-100	+100	+200	+300
Total Loans	380,265	23.9 %	18,012	19,359	20,120	20,895
Total Investments (non-TEY) and other Earning Assets	1,213,777	76.1 %	21,186	22,706	23,538	24,393
Total Interest -Sensitive Income	1,594,042	100.0 %	39,198	42,065	43,658	45,288
Total Interest-Bearing Deposits	229,025	52.6 %	705	2,008	3,061	4,166
Total Borrowerings	206,146	47.4 %	873	3,025	4,935	6,845
Total Interest-Sensitive Expense	435,171	100.0 %	1,578	5,033	7,996	11,011

The Company believes that its growing portfolio of non-interest bearing deposits provides a stable and profitable funding vehicle and a significant competitive advantage in a rising interest rate environment as the Company's cost of funds will likely remain relatively low, with less increase expected relative to other banks. Beginning in June 2012, the Company began executing a strategy designed to diversify the Bank's investment security portfolio. The largest portion of this new investment strategy involved the purchase of non-bank qualified municipal bonds. These municipal bonds are tax exempt and as such have a tax equivalent yield higher than their book yield. The tax equivalent yield calculation uses the Company's cost of funds as one of its components. With this cost of funds being low due to the volume of non-interest bearing deposits generated by the MPS division, the tax equivalent yield for these bonds is higher than a similar term investment in other investment categories and higher than many other banks

can realize on the same instruments.

89

---

Table of Contents

Under EVE analysis, the economic value of financial assets, liabilities and off-balance sheet instruments, is derived under each rate scenario. The economic value of equity is calculated as the difference between the estimated market value of assets and liabilities, net of the impact of off-balance sheet instruments.

The EVE analysis used in the following table reflects the required analysis used no less than quarterly by management. It models immediate -100, +100, +200 and +300 basis point parallel shifts in market interest rates. Due to the current low level of interest rates, only a -100 basis point parallel shift is represented.

The Company is within Board policy limits for all basis point scenarios. The table below shows the results of the scenario as of September 30, 2013:

Basis Point Change Scenario	Standard (Parallel Shift)			
	Economic Value of Equity at Risk%			
	-100	+100	+200	+300
Basis Point Change Scenario	-1.9 %	-2.4 %	-7.4 %	-13.6 %
Board Policy Limits	-10.0 %	-10.0 %	-20.0 %	-30.0 %

The EVE at risk reported at September 30, 2013, shows that as interest rates increase immediately, the economic value of equity position will decrease, since the amount of the assets is greater than the amount of liabilities.

The following table details the economic value sensitivity to changes in market interest rates at September 30, 2013, for loans, investments, deposits, borrowings, and other assets and liabilities (dollars in thousands). The analysis reflects that, in a +100 or +200 higher rate scenario, total assets are less sensitive than total liabilities. Investments and other earning assets contribute to sensitivity, largely due to fixed rate securities investments. This sensitivity is offset by the non-interest bearing deposits.

## Table Economic Value Sensitivity

Economic Value Sensitivity Basis Point Change Scenario	Book Value	% of Total Earning Assets	Change in Economic Value for a given change in interest rates Over / (Under) Base Case Parallel Ramp			
			-100	+100	+200	+300
Total Loans	380,265	22.1 %	2.1 %	-2.8 %	-5.7 %	-8.4 %
Total Investments & other Earning Assets	1,312,047	77.9 %	4.2 %	-4.5 %	-9.0 %	-13.4 %
Assets	1,692,312	100.0 %	3.7 %	-4.1 %	-8.3 %	-12.3 %
Interest Bearing Deposits	229,025	14.7 %	1.5 %	-1.5 %	-2.8 %	-3.9 %
Non-Interest Bearing Deposits	1,095,270	70.2 %	6.4 %	-6.1 %	-11.6 %	-16.5 %
Total Borrowings & Other Liabilities	222,792	15.1 %	0.2 %	-0.2 %	-0.4 %	&#1