

Eagle Bancorp Montana, Inc.  
Form 10-Q  
August 07, 2018

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**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

**FORM 10-Q**

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

For the quarterly period ended June 30, 2018

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_.

Commission file number 1-34682

Eagle Bancorp Montana, Inc.

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

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

1400 Prospect Avenue, Helena, MT 59601

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(Address of principal executive offices)

(406) 442-3080

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(Issuer's telephone number)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

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

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

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input checked="" type="checkbox"/>
(Do not check if smaller reporting company)		Emerging growth company	<input type="checkbox"/>

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

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

**APPLICABLE ONLY TO CORPORATE ISSUERS**

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

Common stock, par value \$0.01 per share 5,460,452 shares outstanding  
As of August 7, 2018

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EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

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Exhibit 31.1

Exhibit 31.2

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101.INS XBRL Instance Document

101.SCH XBRL Taxonomy Extension Schema Document

101.CAL XBRL Taxonomy Extension Calculation Linkbase Document

101.DEF XBRL Taxonomy Extension Definition Linkbase Document

101.LAB XBRL Taxonomy Extension Label Linkbase Document

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

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EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

**Note Regarding Forward-Looking Statements**

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

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

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

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

- changes in laws or government regulations or policies affecting financial institutions, including changes in regulatory fees and capital requirements;
- general economic conditions, either nationally or in our market areas, that are worse than expected;
- competition among depository and other financial institutions;
- changes in the prices, values and sales volume of residential and commercial real estate in Montana;
- inflation and changes in the interest rate environment that reduce our margins or reduce the fair value of financial instruments;
- changes or volatility in the securities markets;
- our ability to enter new markets successfully and capitalize on growth opportunities;
- our ability to successfully perform due diligence and integrate acquired businesses;
- changes in consumer spending, borrowing and savings habits;
- our ability to continue to increase and manage our commercial and residential real estate, multi-family and commercial business loans;

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

the level of future deposit insurance premium assessments;

the impact of a recurring recession on our loan portfolio (including cash flow and collateral values), investment portfolio, customers and capital market activities;

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

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

the possibility of goodwill impairment charges in the future;

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

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

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

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## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

(Dollars in Thousands, Except for Per Share Data)

(Unaudited)

	June 30, 2018	December 31, 2017
<b>ASSETS:</b>		
Cash and due from banks	\$7,583	\$5,517
Interest bearing deposits in banks	1,397	1,920
Total cash and cash equivalents	8,980	7,437
Securities available-for-sale	154,265	132,044
Federal Home Loan Bank stock	4,559	4,086
Federal Reserve Bank stock	2,019	1,465
Investment in Eagle Bancorp Statutory Trust I	155	155
Mortgage loans held-for-sale	11,700	8,949
Loans receivable, net of deferred loan fees of \$1,029 at June 30, 2018 and \$1,093 at December 31, 2017 and allowance for loan losses of \$6,150 at June 30, 2018 and \$5,750 at December 31, 2017	575,578	507,404
Accrued interest and dividends receivable	3,668	2,555
Mortgage servicing rights, net	6,716	6,578
Premises and equipment, net	27,969	21,958
Cash surrender value of life insurance	14,670	14,481
Real estate and other repossessed assets acquired in settlement of loans, net	457	525
Goodwill	12,124	7,034
Core deposit intangible, net	1,702	273
Deferred tax asset, net	2,012	1,360
Other assets	253	478
Total assets	\$826,827	\$716,782

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



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## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION (Continued)

(Dollars in Thousands, Except for Per Share Data)

(Unaudited)

	June 30, 2018	December 31, 2017
<b>LIABILITIES:</b>		
Deposit accounts:		
Noninterest bearing	\$ 133,736	\$ 99,799
Interest bearing	479,439	420,765
Total deposits	613,175	520,564
Accrued expenses and other liabilities	5,535	4,822
Federal Home Loan Bank advances and other borrowings	91,469	82,969
Other long-term debt:		
Principal amount	25,155	25,155
Unamortized debt issuance costs	(312 )	(344 )
Total other long-term debt less unamortized debt issuance costs	24,843	24,811
Total liabilities	735,022	633,166
<b>SHAREHOLDERS' EQUITY:</b>		
Preferred stock (par value \$0.01 per share; 1,000,000 shares authorized; no shares issued or outstanding)	-	-
Common stock (par value \$0.01 per share; 8,000,000 shares authorized; 5,718,942 and 5,272,168 shares issued; 5,460,452 and 5,013,678 shares outstanding at June 30, 2018 and December 31, 2017)	57	53
Additional paid-in capital	51,890	42,780
Unallocated common stock held by Employee Stock Ownership Plan	(559 )	(643 )
Treasury stock, at cost	(2,826 )	(2,826 )
Retained earnings	44,862	43,939
Net accumulated other comprehensive (loss) income	(1,619 )	313
Total shareholders' equity	91,805	83,616
Total liabilities and shareholders' equity	\$ 826,827	\$ 716,782

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



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## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF INCOME

(Dollars in Thousands, Except for Per Share Data)

(Unaudited)

	Three Months Ended		Six Months Ended	
	June 30, 2018	2017	June 30, 2018	2017
<b>INTEREST AND DIVIDEND INCOME:</b>				
Interest and fees on loans	\$7,862	\$6,174	\$14,734	\$11,744
Securities available-for-sale	1,021	714	2,010	1,443
Federal Home Loan Bank and Federal Reserve Bank dividends	74	36	153	76
Interest on deposits in banks	18	1	35	1
Other interest income	1	-	1	1
Total interest and dividend income	8,976	6,925	16,933	13,265
<b>INTEREST EXPENSE:</b>				
Deposits	494	376	920	756
Federal Home Loan Bank advances and other borrowings	315	322	652	527
Other long-term debt	357	347	704	619
Total interest expense	1,166	1,045	2,276	1,902
<b>NET INTEREST INCOME</b>	<b>7,810</b>	<b>5,880</b>	<b>14,657</b>	<b>11,363</b>
Loan loss provision	24	302	526	603
<b>NET INTEREST INCOME AFTER LOAN LOSS PROVISION</b>	<b>7,786</b>	<b>5,578</b>	<b>14,131</b>	<b>10,760</b>
<b>NONINTEREST INCOME:</b>				
Service charges on deposit accounts	214	239	440	471
Net gain on sale of loans (includes \$262 and \$341 for the three months ended June 30, 2018 and 2017, respectively, and \$587 and \$899 for the six months ended June 30, 2018 and 2017, respectively, related to accumulated other comprehensive earnings reclassification)	1,720	2,263	3,159	4,088
Mortgage loan servicing fees	563	509	1,123	1,056
Wealth management income	147	180	279	321
Interchange and ATM fees	271	228	496	434
Appreciation in cash surrender value of life insurance	146	126	270	250
	15	(14 )	(90 )	(14 )

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Net gain (loss) on sale of available-for-sale securities (includes \$15 and (\$14) for the three months ended June 30, 2018 and 2017, respectively, and (\$90) and (\$14) for the six months ended June 30, 2018 and 2017, respectively, related to accumulated other comprehensive earnings reclassification)

Net loss on sale of real estate owned and other repossessed property	(32 )	(24 )	(57 )	(25 )
Other noninterest income	40	63	143	197
Total noninterest income	3,084	3,570	5,763	6,778

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

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## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF INCOME (Continued)

(Dollars in Thousands, Except for Per Share Data)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
<b>NONINTEREST EXPENSE:</b>				
Salaries and employee benefits	5,461	4,586	10,370	9,019
Occupancy and equipment expense	835	672	1,663	1,389
Data processing	673	566	1,310	1,133
Advertising	298	269	576	458
Amortization of mortgage servicing rights	369	262	610	524
Amortization of core deposit intangible and tax credits	235	107	337	214
Loan costs	179	134	315	299
Federal insurance premiums	69	36	138	120
Postage	84	51	134	99
Legal, accounting and examination fees	184	200	326	285
Consulting fees	25	59	42	108
Acquisition costs	131	-	365	-
Write-down on real estate owned and other repossessed property	-	9	-	45
Other noninterest expense	701	669	1,382	1,366
Total noninterest expense	9,244	7,620	17,568	15,059
<b>INCOME BEFORE INCOME TAXES</b>	1,626	1,528	2,326	2,479
Income tax expense (includes (\$23) and \$858 for the three months ended June 30, 2018 and 2017, respectively, and (\$700) and \$883 for the six months ended June 30, 2018 and 2017, respectively related to income tax (benefit) expense from reclassification items)	293	462	420	650
<b>NET INCOME</b>	\$1,333	\$1,066	\$1,906	\$1,829
<b>BASIC EARNINGS PER SHARE</b>	\$0.24	\$0.28	\$0.35	\$0.48
<b>DILUTED EARNINGS PER SHARE</b>	\$0.24	\$0.27	\$0.35	\$0.47
	5,460,452	3,811,409	5,386,401	3,811,409

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

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

*5,524,912    3,869,885    5,450,861    3,872,765*

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

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## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Dollars in Thousands)

(Unaudited)

	Three Months Ended June 30, 2018		Six Months Ended June 30, 2018		
	2017	2018	2017	2018	
<b>NET INCOME</b>		\$1,333	\$1,066	\$1,906	\$1,829
<b>OTHER ITEMS OF COMPREHENSIVE (LOSS) INCOME:</b>					
Change in fair value of investment securities available-for-sale, before income taxes		(216 )	1,775	(2,799)	2,054
Reclassification for realized gains and losses on investment securities included in income, before income tax		(15 )	14	90	14
Change in fair value of derivatives designated as cash flow hedges, before income taxes		402	657	664	998
Reclassification for realized gains on derivatives designated as cash flow hedges, before income taxes		(262 )	(341 )	(587 )	(899 )
Total other items of comprehensive (loss) income		(91 )	2,105	(2,632)	2,167
Income tax benefit (expense) related to:					
Investment securities		60	(730 )	720	(843 )
Derivatives designated as cash flow hedges		(37 )	(128 )	(20 )	(40 )
Total income tax benefit (expense)		23	(858 )	700	(883 )
<b>COMPREHENSIVE INCOME (LOSS)</b>		\$1,265	\$2,313	\$(26 )	\$3,113

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

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## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

For the Six Months Ended June 30, 2018 and 2017

(Dollars in Thousands, Except for Per Share Data)

(Unaudited)

	PREFERRED STOCK	COMMON STOCK	NON-ESOP CAPITAL SHARES	UNALLOCATED ESOP SHARES	TREASURY STOCK	RETAINED EARNINGS	OTHER COMPREHENSIVE INCOME (LOSS)	TOTAL
<b>Balance at January 1, 2018</b>	\$ -	\$ 53	\$ 42,780	\$ (643 )	\$ (2,826 )	\$ 43,939	\$ 313	\$ 83,616
Net income						1,906		1,906
Other comprehensive loss							(1,932 )	(1,932 )
Dividends paid (\$0.09 per share)						(983 )		(983 )
Stock issued in connection with TwinCo acquisition		4	9,026					9,030
Employee Stock Ownership Plan shares allocated or committed to be released for allocation (8,308 shares)			84	84				168
<b>Balance at June 30, 2018</b>	\$ -	\$ 57	\$ 51,890	\$ (559 )	\$ (2,826 )	\$ 44,862	\$ (1,619 )	\$ 91,805
<b>Balance at January 1, 2017</b>	\$ -	\$ 41	\$ 22,366	\$ (809 )	\$ (2,971 )	\$ 41,240	\$ (411 )	\$ 59,456
Net income						1,829		1,829



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Other comprehensive income							1,284	1,284
Dividends paid (\$0.08 per share)						(609 )		(609 )
Employee Stock Ownership Plan shares allocated or committed to be released for allocation (8,308 shares)		78		84				162
<b>Balance at June 30, 2017</b>	\$ -	\$ 41	\$ 22,444	\$ (725 )	\$ (2,971 )	\$ 42,460	\$ 873	\$ 62,122

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

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## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in Thousands)

(Unaudited)

	Six Months Ended June 30,	
	2018	2017
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$1,906	\$1,829
Adjustments to reconcile net income to net cash provided by operating activities:		
Loan loss provision	526	603
Write-down on real estate owned and other repossessed assets	-	45
Depreciation	578	472
Net amortization of investment securities premium and discounts	648	822
Amortization of mortgage servicing rights	610	524
Amortization of core deposit intangible and tax credits	337	214
Deferred income tax provision (benefit)	240	(50 )
Net gain on sale of loans	(3,159 )	(4,088 )
Net loss on sale of available-for-sale securities	90	14
Net loss on sale of real estate owned and other repossessed assets	57	25
Net appreciation in cash surrender value of life insurance	(211 )	(194 )
Net change in:		
Accrued interest and dividends receivable	(408 )	(51 )
Loans held-for-sale	485	6,211
Other assets	167	324
Accrued expenses and other liabilities	862	738
Net cash provided by operating activities	2,728	7,438
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Activity in available-for-sale securities:		
Sales	45,080	2,749
Maturities, principal payments and calls	5,950	5,035
Purchases	(45,970)	(1,307 )
Federal Home Loan Bank stock purchased	(362 )	(829 )
Federal Reserve Bank stock purchased	(554 )	-
Cash paid for TwinCo Acquisition, net of cash received	(4,243 )	-
Loan origination and principal collection, net	(14,395)	(42,917)
Proceeds from Bank owned life insurance	205	-
Proceeds from sale of real estate and other repossessed assets acquired in settlement of loans	150	262

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Additions to premises and equipment	(4,984 )	(1,119 )
Net cash used in investing activities	(19,123)	(38,126)

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

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## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)

(Dollars in Thousands)

(Unaudited)

	Six Months Ended June 30,	
	2018	2017
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Net increase in deposits	\$10,421	\$1,470
Net short-term advances on Federal Home Loan Bank and other borrowings	23,376	11,553
Long-term advances from Federal Home Loan Bank and other borrowings	-	17,000
Payments on long-term Federal Home Loan Bank and other borrowings	(14,876)	(6,784)
Proceeds from issuance of long-term debt	-	10,000
Payments for debt issuance costs	-	(219)
Dividends paid	(983)	(609)
Net cash provided by financing activities	17,938	32,411
<b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>1,543</b>	<b>1,723</b>
<b>CASH AND CASH EQUIVALENTS, beginning of period</b>	<b>7,437</b>	<b>7,318</b>
<b>CASH AND CASH EQUIVALENTS, end of period</b>	<b>\$8,980</b>	<b>\$9,041</b>
<b>SUPPLEMENTAL CASH FLOW INFORMATION:</b>		
Cash paid during the period for interest	\$2,120	\$1,763
Cash paid during the period for income taxes	\$230	\$680
<b>NON-CASH INVESTING AND FINANCING ACTIVITIES:</b>		
(Decrease) increase in dmarket value of securities available-for-sale	\$(2,709)	\$2,068
Mortgage servicing rights recognized	\$748	\$798
Loans transferred to real estate and other assets acquired in foreclosure	\$4	\$-
Stock issued in connection with TwinCo acquisition	\$9,030	\$-
Employee Stock Ownership Plan shares released	\$168	\$162

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

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

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EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**NOTE 1. BASIS OF PRESENTATION**

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

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

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

The Company evaluated subsequent events for potential recognition and/or disclosure through *August 7, 2018* the date the unaudited consolidated financial statements were issued.

**NOTE 2. INVESTMENT SECURITIES**

Investment securities are summarized as follows:

	June 30, 2018			December 31, 2017				
	Amortized Cost (In Thousands)	Gross Unrealized Gains	Unrealized (Losses) Value	Amortized Cost	Gross Unrealized Gains	Unrealized (Losses) Value		
<b>Available-for-Sale:</b>								
U.S. government and agency obligations	\$10,650	\$-	\$(142 )	\$10,508	\$4,881	\$13	\$(37 )	\$4,857
Municipal obligations	75,102	193	(1,406 )	73,889	67,508	807	(429 )	67,886
Corporate obligations	12,931	18	(257 )	12,692	14,725	18	(99 )	14,644
Mortgage-backed securities	22,676	195	(394 )	22,477	24,770	364	(265 )	24,869
Collateralized mortgage obligations	25,083	2	(715 )	24,370	20,051	7	(270 )	19,788
Asset-backed securities	10,423	-	(94 )	10,329	-	-	-	-
Total	\$156,865	\$408	\$(3,008 )	\$154,265	\$131,935	\$1,209	\$(1,100 )	\$132,044

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## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**NOTE 2. INVESTMENT SECURITIES - continued**

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

	Three Months Ended June 30, 2018		Six Months Ended June 30, 2018	
	2017	2018	2017	2018
	(In Thousands)			
Proceeds from sale of available-for-sale securities	\$19,086	\$2,749	\$45,080	\$2,749
Gross realized gain on sale of available-for-sale securities	\$191	\$14	\$191	\$14
Gross realized loss on sale of available-for-sale securities	(176 )	(28 )	(281 )	(28 )
Net realized gain (loss) on sale of available-for-sale securities	\$15	\$(14 )	\$(90 )	\$(14 )

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

	June 30, 2018	
	Amortized Cost	Fair Value
	(In Thousands)	
Due in one year or less	\$1,756	\$1,756
Due from one to five years	18,416	18,096
Due from five to ten years	14,265	14,021
Due after ten years	74,669	73,545
	109,106	107,418
Mortgage-backed securities	22,676	22,477
Collateralized mortgage obligations	25,083	24,370
Total	\$156,865	\$154,265



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

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## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**NOTE 2. INVESTMENT SECURITIES - continued**

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

	June 30, 2018		12 Months or Longer	
	Less Than 12 Months			
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
	(In Thousands)			
U.S. government and agency	\$9,243	\$ (98 )	\$1,264	\$ (44 )
Municipal obligations	41,534	(680 )	14,236	(726 )
Corporate obligations	7,687	(243 )	987	(14 )
Mortgage-backed securities and collateralized mortgage obligations	16,641	(427 )	15,640	(682 )
Asset-backed securities	10,329	(94 )	-	-
Total	\$85,434	\$ (1,542 )	\$32,127	\$ (1,466 )

	December 31, 2017		12 Months or Longer	
	Less Than 12 Months			
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
	(In Thousands)			
U.S. government and agency	\$2,943	\$ (14 )	\$1,363	\$ (23 )
Municipal obligations	15,404	(87 )	16,675	(342 )
Corporate obligations	7,643	(71 )	3,981	(28 )
Mortgage-backed securities and collateralized mortgage obligations	9,107	(81 )	21,653	(454 )
Asset-backed securities	-	-	-	-
Total	\$35,097	\$ (253 )	\$43,672	\$ (847 )

Management evaluates securities for other-than-temporary impairment at least quarterly, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. As of *June 30, 2018* and *December 31, 2017*, there were, respectively, *121* and *87* securities in an unrealized loss position that were considered to be temporarily impaired and therefore an impairment charge has *not* been recorded.

As of *June 30, 2018*, *86* U.S. government and agency securities and municipal obligations had unrealized losses with aggregate depreciation of approximately *2.28%* from the Company's amortized cost basis of these securities. At *December 31, 2017*, *52* U.S. government and agency securities and municipal obligations had unrealized losses with aggregate depreciation of approximately *1.28%* from the Company's amortized cost basis of these securities. As of *June 30, 2018*, *10* corporate obligations had unrealized losses of approximately *2.88%* from the Company's amortized cost basis of these securities. At *December 31, 2017*, *15* corporate obligations had an unrealized loss with aggregate depreciation of approximately *0.84%* from the Company's amortized cost basis of these securities. As management has the ability to hold debt securities until maturity, or for the foreseeable future, *no* declines are deemed to be other than temporary.

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## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**NOTE 2. INVESTMENT SECURITIES - continued**

As of *June 30, 2018*, 20 mortgage-backed securities (“MBSs”) and collateralized mortgage obligations (“CMOs”) had unrealized losses with aggregate depreciation of approximately 3.32% from the Company’s amortized cost basis of these securities. At *December 31, 2017*, 20 MBSs and CMOs had unrealized losses with aggregate depreciation of approximately 1.71% from the Company’s amortized cost basis. Management’s analysis as of *June 30, 2018* revealed *no* expected credit losses on the securities and therefore, declines are *not* deemed to be other than temporary.

As of *June 30, 2018*, 5 asset-backed securities (“ABSs”) had unrealized losses with aggregate depreciation of approximately 0.90% from the Company’s amortized cost basis of these securities. The ABSs were purchased during the quarter ended *March 31, 2018*. Management’s analysis as of *June 30, 2018* revealed *no* expected credit losses on the securities and therefore, declines are *not* deemed to be other than temporary.

**NOTE 3. LOANS RECEIVABLE**

Loans receivable consisted of the following:

	June 30, 2018 (In Thousands)	December 31, 2017
Real estate loans:		
Residential 1-4 family	\$ 143,323	\$ 135,217
Commercial real estate	281,525	244,783
Other loans:		
Home equity	53,178	52,672

Consumer	16,635	15,712
Commercial	88,096	65,863
Total	582,757	514,247
Deferred loan fees, net	(1,029 )	(1,093 )
Allowance for loan losses	(6,150 )	(5,750 )
Total loans, net	\$575,578	\$507,404

Within the commercial real estate loan category, \$12,797,000 and \$13,114,000 was guaranteed by the United States Department of Agriculture Rural Development, at *June 30, 2018* and *December 31, 2017*, respectively. The commercial real estate category and the commercial category also include \$3,016,000 and \$1,480,000 of loans guaranteed by the United States Department of Agriculture Farm Service Agency at *June 30, 2018*, respectively. The United States Department of Agriculture Farm Service Agency guaranteed loans were acquired through the TwinCo acquisition. In addition, within the commercial loan category, \$256,000 and \$486,000 were in loans originated through a syndication program where the business resides outside of Montana, at *June 30, 2018*, and *December 31, 2017*, respectively.

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## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**NOTE 3. LOANS RECEIVABLE - continued**

The following table includes information regarding nonperforming assets.

	June 30, 2018 (Dollars in Thousands)	December 31, 2017		
Non-accrual loans	\$1,500	\$ 977		
Accruing loans delinquent 90 days or more	159	-		
Restructured loans, net	-	-		
Total nonperforming loans	1,659	977		
Real estate owned and other repossessed assets, net	457	525		
Total nonperforming assets	\$2,116	\$ 1,502		
Total nonperforming assets as a percentage of total assets	0.26 %	0.21 %		
Allowance for loan losses	\$6,150	\$ 5,750		
Percent of allowance for loan losses to nonperforming loans	370.71 %	588.54 %		
Percent of allowance for loan losses to nonperforming assets	290.64 %	382.82 %		

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## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**NOTE 3. LOANS RECEIVABLE - continued**

Allowance for loan losses activity was as follows:

	Residential 1-4 Family	Commercial Real Estate	Home Equity	Consumer	Commercial	Total
	(In Thousands)					
<i>Allowance for loan losses:</i>						
Beginning balance, April 1, 2018	\$1,301	\$ 3,202	\$427	\$ 200	\$ 1,000	\$6,130
Charge-offs	-	-	-	(23 )	(1 )	(24 )
Recoveries	-	4	-	8	8	20
Provision	-	24	-	-	-	24
Ending balance, June 30, 2018	\$1,301	\$ 3,230	\$427	\$ 185	\$ 1,007	\$6,150
<i>Allowance for loan losses:</i>						
Beginning balance, January 1, 2018	\$1,301	\$ 2,778	\$506	\$ 225	\$ 940	\$5,750
Charge-offs	-	-	(80 )	(50 )	(24 )	(154 )
Recoveries	-	7	1	10	10	28
Provision	-	445	-	-	81	526
Ending balance, June 30, 2018	\$1,301	\$ 3,230	\$427	\$ 185	\$ 1,007	\$6,150
Ending balance, June 30, 2018 allocated to loans individually evaluated for impairment	\$-	\$-	\$-	\$-	\$-	\$-
Ending balance, June 30, 2018 allocated to loans collectively evaluated for impairment	\$1,301	\$ 3,230	\$427	\$ 185	\$ 1,007	\$6,150
<i>Loans receivable:</i>						
Ending balance, June 30, 2018	\$143,323	\$ 281,525	\$53,178	\$ 16,635	\$ 88,096	\$582,757
Ending balance, June 30, 2018 of loans individually evaluated for impairment	\$573	\$ 527	\$207	\$ 101	\$ 92	\$1,500

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Ending balance, June 30, 2018 of loans collectively evaluated for impairment	\$142,750	\$280,998	\$52,971	\$16,534	\$88,004	\$581,257
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## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**NOTE 3. LOANS RECEIVABLE - continued**

	Residential 1-4 Family	Commercial Real Estate	Home Equity	Consumer	Commercial	Total
	(In Thousands)					
<i>Allowance for loan losses:</i>						
Beginning balance, April 1, 2017	\$ 1,251	\$ 2,278	\$ 471	\$ 210	\$ 865	\$ 5,075
Charge-offs	-	-	-	(90)	(99)	(189)
Recoveries	-	-	34	3	-	37
Provision	-	100	-	102	100	302
Ending balance, June 30, 2017	\$ 1,251	\$ 2,378	\$ 505	\$ 225	\$ 866	\$ 5,225
<i>Allowance for loan losses:</i>						
Beginning balance, January 1, 2017	\$ 1,241	\$ 2,079	\$ 460	\$ 193	\$ 797	\$ 4,770
Charge-offs	-	-	-	(99)	(99)	(198)
Recoveries	-	-	39	11	-	50
Provision	10	299	6	120	168	603
Ending balance, June 30, 2017	\$ 1,251	\$ 2,378	\$ 505	\$ 225	\$ 866	\$ 5,225
Ending balance, June 30, 2017 allocated to loans individually evaluated for impairment	\$-	\$-	\$-	\$ 38	\$-	\$38
Ending balance, June 30, 2017 allocated to loans collectively evaluated for impairment	\$ 1,251	\$ 2,378	\$ 505	\$ 187	\$ 866	\$ 5,187
<i>Loans receivable:</i>						
Ending balance, June 30, 2017	\$ 140,346	\$ 246,005	\$ 49,266	\$ 15,293	\$ 58,230	\$ 509,140
Ending balance, June 30, 2017 of loans individually evaluated for impairment	\$ 500	\$ 451	\$ 305	\$ 144	\$ 211	\$ 1,611
Ending balance, June 30, 2017 of loans collectively evaluated for impairment	\$ 139,846	\$ 245,554	\$ 48,961	\$ 15,149	\$ 58,019	\$ 507,529

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

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

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

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

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

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

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## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**NOTE 3. LOANS RECEIVABLE - continued**

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

Internal classification of the loan portfolio was as follows:

	June 30, 2018					
	Pass	Special Mention	Substandard	Doubtful	Loss	Total
	(In Thousands)					
Real estate loans:						
Residential 1-4 family	\$111,190	\$ -	\$ 1,124	\$ -	\$ -	\$112,314
Residential 1-4 family construction	30,672	-	337	-	-	31,009
Commercial real estate	213,816	-	2,448	-	-	216,264
Commercial construction and development	36,581	-	-	-	-	36,581
Farmland	28,680	-	-	-	-	28,680
Other loans:						
Home equity	52,971	-	207	-	-	53,178
Consumer	16,484	-	151	-	-	16,635
Commercial	69,837	-	114	-	-	69,951
Agricultural	17,747	-	398	-	-	18,145
Total	\$577,978	\$ -	\$ 4,779	\$ -	\$ -	\$582,757

December 31, 2017

	Pass	Special Mention	Substandard	Doubtful	Loss	Total
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(In Thousands)

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

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## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**NOTE 3. LOANS RECEIVABLE - continued**

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

	June 30, 2018			
	Restructured			
	Performing Loans	Nonperforming	Total	
	(In Thousands)			
Real estate loans:				
Residential 1-4 family	\$ 111,948	\$ -	\$ 366	\$ 112,314
Residential 1-4 family construction	30,672	-	337	31,009
Commercial real estate	215,737	-	527	216,264
Commercial construction and development	36,581	-	-	36,581
Farmland	28,680	-	-	28,680
Other loans:				
Home equity	52,971	-	207	53,178
Consumer	16,534	-	101	16,635
Commercial	69,830	-	121	69,951
Agricultural	18,145	-	-	18,145
Total	\$ 581,098	\$ -	\$ 1,659	\$ 582,757

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

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

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## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**NOTE 3. LOANS RECEIVABLE - continued**

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

	June 30, 2018					
	Loans Past Due and Still					
	Accruing					
	90					
	Days					
	30-89	and	Total	Non-Accrual	Current	Total
	Days	Greater		Loans	Loans	Loans
	Past					
	Due					
	(In Thousands)					
Real estate loans:						
Residential 1-4 family	\$241	\$ 130	\$371	\$ 236	\$111,707	\$112,314
Residential 1-4 family construction	531	-	531	337	30,141	31,009
Commercial real estate	822	-	822	527	214,915	216,264
Commercial construction and development	26	-	26	-	36,555	36,581
Farmland	-	-	-	-	28,680	28,680
Other loans:						
Home equity	340	-	340	207	52,631	53,178
Consumer	211	-	211	101	16,323	16,635
Commercial	559	29	588	92	69,271	69,951
Agricultural	-	-	-	-	18,145	18,145
Total	\$2,730	\$ 159	\$2,889	\$ 1,500	\$578,368	\$582,757

December 31, 2017

Loans Past Due and Still

Accruing

90

Days

and

Non-Accrual Current Total

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

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## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**NOTE 3. LOANS RECEIVABLE - continued**

The following tables include information regarding impaired loans.

	June 30, 2018		
	Recorded	Unpaid Principal	Related
	Investment	Balance	Allowance
	(In Thousands)		
With no related allowance:			
Real estate loans:			
Residential 1-4 family	\$236	\$ 254	\$ -
Residential 1-4 family construction	337	387	-
Commercial real estate	527	528	-
Commercial construction and development	-	-	-
Farmland	-	-	-
Other loans:			
Home equity	207	242	-
Consumer	101	153	-
Commercial	92	96	-
Agricultural	-	-	-
With a related allowance:			
Real estate loans:			
Residential 1-4 family	-	-	-
Residential 1-4 family construction	-	-	-
Commercial real estate	-	-	-
Commercial construction and development	-	-	-
Farmland	-	-	-
Other loans:			
Home equity	-	-	-
Consumer	-	-	-
Commercial	-	-	-
Agricultural	-	-	-

Total:

Real estate loans:

Residential 1-4 family	236	254	-
Residential 1-4 family construction	337	387	-
Commercial real estate	527	528	-
Commercial construction and development	-	-	-
Farmland	-	-	-
Other loans:			
Home equity	207	242	-
Consumer	101	153	-
Commercial	92	96	-
Agricultural	-	-	-
Total	\$1,500	\$ 1,660	\$ -

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## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**NOTE 3. LOANS RECEIVABLE - continued**

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

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

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## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**NOTE 3. LOANS RECEIVABLE - continued**

	Three Months Ended June 30, 2018		Six Months Ended June 30, 2018	
	2017	2018	2017	2018
	Average Recorded Investment (In Thousands)			
Real estate loans:				
Residential 1-4 family	\$553	\$360	\$356	\$360
Residential 1-4 family construction	396	-	168	-
Commercial real estate	1,026	226	264	226
Commercial construction and development	-	-	-	-
Farmland	-	-	-	-
Other loans:				
Home equity	224	320	225	323
Consumer	105	140	127	120
Commercial	127	179	99	105
Agricultural	-	-	-	-
Total	\$2,431	\$1,225	\$1,239	\$1,134

Interest income recognized on impaired loans for the *three* and *six* months ended *June 30, 2018* and *2017* is considered insignificant.

**NOTE 4. TROUBLED DEBT RESTRUCTURINGS**

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

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

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

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

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

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

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

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

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EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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

The Company previously had *one* TDR loan at *December 31, 2016* with a recorded investment of *\$43,000* and a *\$34,000* charge-off at time of restructure. The loan was a home equity loan and was on accrual status. The remaining recorded investment of *\$42,000* was paid-off during the quarter ended *June 30, 2017* and the *\$34,000* charge-off was recovered.

During the *six* months ended *June 30, 2018*, there were *no* new restructured loans.

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

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

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

**NOTE 5. DEPOSITS**

Deposits are summarized as follows:

	June 30, 2018 (In Thousands)	December 31, 2017
Noninterest checking	\$ 133,736	\$ 99,799
Interest bearing checking	101,085	99,255
Savings	108,544	88,603
Money market	106,547	89,558
Time certificates of deposit	163,263	143,349
Total	\$ 613,175	\$ 520,564

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

Other long-term debt consisted of the following:

	June 30, 2018		December 31, 2017	
	Principal Amount (In Thousands)	Unamortized Debt Issuance Costs	Principal Amount	Unamortized Debt Issuance Costs
Senior notes fixed at 5.75%, due 2022	\$ 10,000	\$ (158 )	\$ 10,000	\$ (180 )
Subordinated debentures fixed at 6.75%, due 2025	10,000	(154 )	10,000	(164 )
Subordinated debentures variable at 3-Month Libor plus 1.42%, due 2035	5,155	-	5,155	-
Total other long-term debt	\$ 25,155	\$ (312 )	\$ 25,155	\$ (344 )





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EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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

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

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

In *September 2005*, the Company completed the private placement of *\$5,155,000* in subordinated debentures to Eagle Bancorp Statutory Trust I (“the Trust”). The Trust funded the purchase of the subordinated debentures through the sale of trust preferred securities to First Tennessee Bank, N.A. with a liquidation value of *\$5,155,000*. Using interest payments made by the Company on the debentures, the Trust began paying quarterly dividends to preferred security holders in *December 2005*. The annual percentage rate of the interest payable on the subordinated debentures and distributions payable on the preferred securities was fixed at *6.02%* until *December 2010* then became variable at 3-Month LIBOR plus *1.42%*, making the rate *3.756%* and *3.114%* as of *June 30, 2018* and *December 31, 2017*, respectively. Dividends on the preferred securities are cumulative and the Trust *may* defer the payments for up to *five* years. The preferred securities mature in *December 2035* unless the Company elects and obtains regulatory approval to accelerate the maturity date.

For the *three* months ended *June 30, 2018* and *2017*, interest expense on other long-term debt was *\$357,000* and *\$347,000*, respectively. For the *six* months ended *June 30, 2018* and *2017*, interest expense on other long-term debt was *\$704,000* and *\$619,000*, respectively.

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EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**NOTE 7. EARNINGS PER SHARE**

Basic earnings per share for the *three* months ended *June 30, 2018* was computed using *5,460,452* weighted average shares outstanding. Basic earnings per share for the *three* months ended *June 30, 2017* was computed using *3,811,409* weighted average shares outstanding. Diluted earnings per share was computed using the treasury stock method by adjusting the number of shares outstanding by the shares purchased. The weighted average shares outstanding for the diluted earnings per share calculations was *5,524,912* for the *three* months ended *June 30, 2018* and *3,869,885* for the *three* months ended *June 30, 2017*.

Basic earnings per share for the *six* months ended *June 30, 2018* was computed using *5,386,401* weighted average shares outstanding. Basic earnings per share for the *six* months ended *June 30, 2017* was computed using *3,811,409* weighted average shares outstanding. Diluted earnings per share was computed using the treasury stock method by adjusting the number of shares outstanding by the shares purchased. The weighted average shares outstanding for the diluted earnings per share calculations was *5,450,861* for the *six* months ended *June 30, 2018* and *3,872,765* for the *six* months ended *June 30, 2017*.

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

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

On *July 19, 2018*, the Board authorized the repurchase of up to *100,000* shares of its common stock. Under the plan, shares *may* be purchased by the Company on the open market or in privately negotiated transactions. The extent to which the company repurchases its shares and the timing of such repurchase will depend upon market conditions and other corporate considerations. The plan expires on *July 19, 2019*.

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

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

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## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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

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

	Unrealized Gains (Losses) on Derivatives Designated as Cash Flow Hedges	Unrealized Gains (Losses) on Investment Securities Available-for-Sale	Total
	(In Thousands)		
Balance, January 1, 2018	\$ 234	\$ 79	\$ 313
Other comprehensive income (loss), before reclassifications and income taxes	262	(2,583)	) (2,321)
Amounts reclassified from accumulated other comprehensive income, before income taxes	(325)	) 105	(220)
Income tax benefit	17	660	677
Total other comprehensive loss	(46)	) (1,818)	) (1,864)
Balance, March 31, 2018	188	(1,739)	) (1,551)
Other comprehensive income (loss), before reclassifications and income taxes	402	(216)	) 186
Amounts reclassified from accumulated other comprehensive income (loss), before income taxes	(262)	) (15)	) (277)
Income tax (expense) benefit	(37)	) 60	23
Total other comprehensive income (loss)	103	(171)	) (68)
Balance, June 30, 2018	\$ 291	\$ (1,910)	) \$(1,619)
Balance, January 1, 2017	\$ 330	\$ (741)	) \$(411)
Other comprehensive income, before reclassifications and income taxes	341	279	620

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Amounts reclassified from accumulated other comprehensive income (loss), before income taxes	(558 )	-	(558 )
Income tax benefit (expense)	88	(113 )	(25 )
Total other comprehensive (loss) income	(129 )	166	37
Balance, March 31, 2017	201	(575 )	(374 )
Other comprehensive income, before reclassifications and income taxes	657	1,775	2,432
Amounts reclassified from accumulated other comprehensive income (loss), before income taxes	(341 )	14	(327 )
Income tax expense	(128 )	(730 )	(858 )
Total other comprehensive income	188	1,059	1,247
Balance, June 30, 2017	\$ 389	\$ 484	\$873

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EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**NOTE 10. DERIVATIVES AND HEDGING ACTIVITIES**

***Mortgage Loan Commitments***

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

***Interest Rate Lock Commitments***

Outstanding derivative loan commitments expose the Company to the risk that the price of the loans arising from exercise of the loan commitment might decline from inception of the rate lock to funding of the loan due to increases in mortgage interest rates. If interest rates increase, the value of these loan commitments decreases. Conversely, if interest rates decrease, the value of these loan commitments increases. The notional amount of interest rate lock commitments was \$33,997,000 and \$15,338,000 at June 30, 2018 and December 31, 2017, respectively. The fair value of such commitments was insignificant.

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

**NOTE 11. FAIR VALUE DISCLOSURES**

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

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

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

The fair value hierarchy is as follows:

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

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





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EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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

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

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

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

*Available-for-Sale Securities* – Securities classified as available-for-sale are reported at fair value utilizing Level 1 and Level 2 inputs. For these securities, the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that *may* include dealer quotes, market spreads, cash flows, the U. S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayments speeds, credit information and the bond's terms and conditions, among other things.

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

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

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

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## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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

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

	June 30, 2018			
	Level 1	Level 2	Level 3	Total
	Inputs	Inputs	Inputs	Fair
	(In Thousands)			
Financial assets:				
Available-for-sale securities				
U.S. government and agency obligations	\$-	\$10,508	\$-	\$10,508
Municipal obligations	-	73,889	-	73,889
Corporate obligations	-	12,692	-	12,692
Mortgage-backed securities	-	22,477	-	22,477
Collateralized mortgage obligations	-	24,370	-	24,370
Asset-backed securities	-	10,329	-	10,329
Loans held-for-sale	-	11,700	-	11,700

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

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

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## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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

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

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

	June 30, 2018			
	Level	Level	Level	Total
	1	2	3	Fair
	Inputs	Inputs	Inputs	Value
	(In Thousands)			
Impaired loans	\$-	\$ -	\$1,500	\$1,500
Repossessed assets	-	-	457	457

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

As of *June 30, 2018*, certain impaired loans were remeasured and reported at fair value through a specific valuation allowance allocation of the allowance for possible loan losses based upon the fair value of the underlying collateral. Impaired loans with a carrying value of *\$1,500,000* were *not* reduced by specific valuation allowance allocations, resulting in a total reported fair value of *\$1,500,000* based on collateral valuations utilizing Level 3 valuation inputs.

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

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

Instrument (Dollars In Thousands)	Fair Value at June 30, 2018	December 31, 2017	Principal Valuation Technique	Significant Unobservable Inputs	Range of Significant Input Values
Impaired loans	\$1,500	\$ 928	Appraisal of collateral <sup>(1)</sup>	Appraisal adjustments	10 - 30%
Repossessed assets	\$457	\$ 525	Appraisal of collateral <sup>(1)(3)</sup>	Liquidation expenses <sup>(2)</sup>	10 - 30%

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

<sup>(2)</sup> Appraisals *may* be adjusted for qualitative factors such as economic conditions and estimated liquidation expenses. The range of liquidation expenses and other appraisal adjustments are presented as a percent of the appraisal.

<sup>(3)</sup> Includes qualitative adjustments by management and estimated liquidation expenses.

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## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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

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

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

	June 30, 2018			Total	
	Level 1	Level 2	Level 3	Estimated	Carrying
	Inputs	Inputs	Inputs	Fair	Amount
	(In Thousands)			Value	
Financial assets:					
Cash and cash equivalents	\$8,980	\$-	\$-	\$8,980	\$8,980
Federal Home Loan Bank stock	4,559	-	-	4,559	4,559
Federal Reserve Bank stock	2,019	-	-	2,019	2,019
Loans receivable, net	-	-	570,519	570,519	574,078
Accrued interest and dividends receivable	3,668	-	-	3,668	3,668
Mortgage servicing rights	-	-	8,068	8,068	6,716
Cash surrender value of life insurance	14,670	-	-	14,670	14,670
Financial liabilities:					
Non-maturing interest bearing deposits	-	316,176	-	316,176	316,176
Noninterest bearing deposits	133,736	-	-	133,736	133,736
Time certificates of deposit	-	-	161,337	161,337	163,263
Accrued expenses and other liabilities	5,535	-	-	5,535	5,535



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Federal Home Loan Bank advances and other borrowings	-	-	90,838	90,838	91,469
Other long-term debt	-	-	23,760	23,760	25,155
Off-balance-sheet instruments	-	-	-	-	-
Forward delivery commitments	-	-	-	-	-
Commitments to extend credit	-	-	-	-	-
Rate lock commitments	-	-	-	-	-

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## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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

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

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

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

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

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

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

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

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EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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

*Mortgage Servicing Rights* – the fair value of servicing rights was determined at loan level using a discount rate of 12.50% for all investor types, prepayment speeds ranging from 80.00% to 241.00% PSA, depending on stratification of the specific loan. The weighted average prepayment speed was 120.00% PSA. The fair value was also adjusted for the effect of potential past dues and foreclosures. Individual mortgage servicing rights values were capped at a maximum of 1.25% for all investor types.

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

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

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

*Off-Balance-Sheet Instruments* - Fair values for off-balance-sheet, credit-related financial instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. The fair values of these financial instruments are considered insignificant. Additionally, those financial instruments have *no* carrying value.

**NOTE 12. MERGERS AND ACQUISITIONS**

On *September 5, 2017*, the Company entered into an Agreement and Plan of Merger with TwinCo, a Montana corporation, and TwinCo's wholly-owned subsidiary, Ruby Valley Bank, a Montana chartered commercial bank to acquire 100% of TwinCo's equity voting interests. The merger agreement provided that Ruby Valley Bank would merge with and into Opportunity Bank of Montana and that TwinCo would merge with and into the Company. Ruby Valley Bank operated 2 branches in Madison County, Montana. The transaction provided an opportunity to expand market presence and lending activities, particularly in agricultural lending. The acquisition closed *January 31, 2018*, after receipt of approvals from regulatory authorities, approval of TwinCo shareholders and the satisfaction of other closing conditions. The total consideration paid was \$18,930,000 and included cash consideration of \$9,900,000 and common stock issued of \$9,030,000.

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

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

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## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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

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

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

Goodwill resulting from acquisition      \$ 5,090

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

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## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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

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

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

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

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

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



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

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## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
	(Dollars in Thousands, Except Per Share Data)			
Pro forma net income <sup>(1)</sup>				
Net interest income after loan loss provision	\$7,786	\$6,506	\$14,414	\$12,616
Noninterest income	3,084	3,651	5,798	6,940
Noninterest expense	9,244	8,293	17,719	16,404
Income before income taxes	1,626	1,864	2,493	3,152
Income tax expense	293	522	466	883
Net income	\$1,333	\$1,342	\$2,027	\$2,269
Pro forma earnings per share <sup>(1)</sup>				
Basic earnings per share	\$0.24	\$0.35	\$0.38	\$0.60
Diluted earnings per share	\$0.24	\$0.35	\$0.37	\$0.59
Weighted average shares outstanding, basic	5,460,452	3,811,409	5,386,401	3,811,409
Weighted average shares outstanding, diluted	5,524,912	3,869,885	5,450,861	3,872,765

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



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EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**NOTE 13. RECENT ACCOUNTING PRONOUNCEMENTS**

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

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

In *February 2016*, the FASB issued ASU No. 2016-02, Leases (Topic 842) intended to improve financial reporting regarding leasing transactions. The new standard affects all companies and organizations that lease assets. The standard will require organizations to recognize on the balance sheet the assets and liabilities for the rights and

obligations created by those leases if the lease terms are more than 12 months. The guidance also will require qualitative and quantitative disclosures providing additional information about the amounts recorded in the financial statements. The amendments in this update are effective for fiscal years beginning after *December 15, 2018*, including interim periods within those fiscal years. The Company is evaluating the potential impact of the amendment on the Company's consolidated financial statements. We currently lease *four* locations that serve as full-service branches, with the longest running lease expiring in 2027. We are exploring options to use a *third* party vendor to assist with the implementation of this standard.

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

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EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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

In *January 2017*, the FASB issued ASU No. 2017-04, Intangibles – Goodwill and Other (Topic 350) to amend and simplify current goodwill impairment testing to eliminate Step 2 from the current provisions. Under the new guidance, an entity should perform the goodwill impairment test by comparing the fair value of a reporting unit with its carrying value and recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if a quantitative impairment test is necessary. The guidance will be effective for the Company on *January 1, 2020* and is *not* expected to have a significant impact on the Company's consolidated financial statements. We have improved our internal reporting systems as it relates to profitability by divisions and markets within the Company. We expect these systems to help in our evaluation of potential impairment.

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

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EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

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

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

**Overview**

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

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

Management continues to focus on improving the Bank's core earnings. Core earnings can be described as income before taxes, with the exclusion of gain on sale of loans and adjustments to the market value of the Bank's loan

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

The level and movement of interest rates impacts the Bank's earnings as well. The Federal Open Market Committee changed the federal funds target rate from 0.75% to 1.50% during the year ended December 31, 2017. The rate increased from 1.50% to 2.00% during the six months ended June 30, 2018.

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

On September 5, 2017, the Company entered into an Agreement and Plan of Merger with TwinCo Inc. ("TwinCo"), a Montana corporation, and TwinCo's wholly-owned subsidiary, Ruby Valley Bank, a Montana chartered commercial bank. The merger agreement provided that Ruby Valley Bank would merge with and into Opportunity Bank of Montana and that TwinCo would merge with and into the Company. Ruby Valley Bank operated 2 branches in Madison County, Montana. The transaction provided an opportunity to expand market presence and lending activities, particularly in agricultural lending. The acquisition closed January 31, 2018, after receipt of approvals from regulatory authorities, approval of TwinCo shareholders and the satisfaction of other closing conditions. The total consideration paid was \$18.93 million and included cash consideration of \$9.90 million and common stock issued of \$9.03 million.



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EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

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

**Financial Condition**

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

Total assets were \$826.83 million at June 30, 2018, an increase of \$110.05 million, or 15.4%, from \$716.78 million at December 31, 2017. The increase was largely due to the change in securities and loans receivable, net as a result of the acquisition of TwinCo. Securities available-for-sale increased \$22.23 million, or 16.8%, to \$154.27 million at June 30, 2018 from \$132.04 million at December 31, 2017. Loans receivable, net increased by \$68.18 million, or 13.4%, to \$575.58 million at June 30, 2018, from \$507.40 million at December 31, 2017. Total liabilities were \$735.02 million at June 30, 2018, an increase of \$101.85 million, or 16.1%, from \$633.17 million at December 31, 2017. The increase was primarily due to an increase in deposits largely due to the TwinCo acquisition, as well as an increase in Federal Home Loan Bank (“FHLB”) advances and other borrowings. Total deposits increased by \$92.62 million, or 17.8%, to \$613.18 million at June 30, 2018, from \$520.56 million at December 31, 2017. FHLB advances and other borrowings increased \$8.50 million to \$91.47 million at June 30, 2018 from \$82.97 million at December 31, 2017.

**Balance Sheet Details**

***Investment Activities***

The following table summarizes investment activities:

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

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(Dollars in Thousands)

Securities available-for-sale:						
U.S. government and agency	\$ 10,508	6.48	%	\$ 4,857	3.48	%
Municipal obligations	73,889	45.54	%	67,886	48.66	%
Corporate obligations	12,692	7.82	%	14,644	10.50	%
Mortgage-backed securities	22,477	13.86	%	24,869	17.82	%
Collateralized mortgage obligations	24,370	15.02	%	19,788	14.18	%
Asset-backed securities	10,329	6.37	%	-	0.00	%
Total securities available-for-sale	154,265	95.09	%	132,044	94.64	%
Interest bearing deposits	1,397	0.86	%	1,920	1.38	%
FHLB capital stock, at cost	4,559	2.81	%	4,086	2.93	%
FRB capital stock, at cost	2,019	1.24	%	1,465	1.05	%
Total	\$ 162,240	100.00	%	\$ 139,515	100.00	%

Securities available-for-sale were \$154.27 million at June 30, 2018, an increase of \$22.23 million, or 16.8%, from \$132.04 million at December 31, 2017. All categories of securities available-for-sale increased during the period with the exception of corporate obligations and mortgage-backed securities. The increases were mainly related to the acquisition of TwinCo. Corporate obligations decreased primarily due to maturities, and mortgage-backed securities decreased due to principal payments partially offset by net purchases.

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## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

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

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

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

	June 30, 2018		December 31, 2017	
	Amount	Percent of Total	Amount	Percent of Total
(Dollars in thousands)				
Real estate loans:				
Residential 1-4 family <sup>(1)</sup>	\$ 112,314	19.27 %	\$ 109,911	21.37 %
Residential 1-4 family construction	31,009	5.32 %	25,306	4.92 %
Commercial real estate	216,264	37.11 %	194,805	37.88 %
Commercial construction and development	36,581	6.28 %	38,351	7.46 %
Farmland	28,680	4.92 %	11,627	2.26 %
Total first mortgage loans	424,848	72.90 %	380,000	73.89 %
Other loans:				
Home equity	53,178	9.13 %	52,672	10.24 %
Consumer	16,635	2.85 %	15,712	3.06 %
Commercial	69,951	12.01 %	63,300	12.31 %
Agricultural	18,145	3.11 %	2,563	0.50 %
Total other loans	157,909	27.10 %	134,247	26.11 %
Total loans	582,757	100.00%	514,247	100.00%
Deferred loan fees	(1,029 )		(1,093 )	

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Allowance for loan losses	(6,150 )	(5,750 )
Total loans, net	\$575,578	\$507,404

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

Loans receivable, net increased \$68.18 million to \$575.58 million at June 30, 2018 largely due to the TwinCo acquisition. The TwinCo acquisition included \$55.07 million of acquired loans. Excluding acquired loans, loans receivable, net increased by \$13.12 million. Including acquired loans, commercial real estate loans increased \$21.46 million, farmland loans increased \$17.05 million, agricultural loans increased \$15.58 million, commercial loans increased \$6.65 million, residential 1-4 family construction loans increased \$5.70 million, residential 1-4 family loans increased \$2.40 million, consumer loans increased \$923,000 and home equity loans increased \$506,000. These increases were slightly offset by a decrease in commercial construction and development loans of \$1.77 million. Total loan originations were \$214.95 million for the six months ended June 30, 2018, with residential mortgage accounting for \$134.50 million of the total. Commercial real estate loan originations were \$27.91 million and commercial construction and development loan originations were \$4.42 million. Residential 1-4 family construction loan originations were \$9.68 million. Consumer loan originations were \$4.87 million and home equity originations were \$6.71 million. Farmland loan originations were \$4.36 million and agricultural loan originations were \$7.77 million. Commercial loans originations were \$14.73 million. Loans held-for-sale increased to \$11.70 million at June 30, 2018 from \$8.95 million at December 31, 2017.

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EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

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

**Financial Condition – continued**

*Lending Activities– continued*

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

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

The following table sets forth information regarding nonperforming assets:

	June 30, 2018	December 31, 2017
Non-accrual loans		

(Dollars in Thousands)

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Real estate loans:				
Residential 1-4 family	\$236	\$ 475		
Residential 1-4 family construction	337	-		
Commercial real estate	527	-		
Other loans:				
Home equity	207	242		
Consumer	101	153		
Commercial	92	107		
Accruing loans delinquent 90 days or more				
Real estate loans:				
Residential 1-4 family	130	-		
Other loans:				
Commercial	29	-		
Restructured loans	-	-		
Total nonperforming loans	1,659	977		
Real estate owned and other repossessed property, net	457	525		
Total nonperforming assets	\$2,116	\$ 1,502		
Total nonperforming loans to total loans	0.28	%	0.19	%
Total nonperforming loans to total assets	0.20	%	0.14	%
Total allowance for loan loss to nonperforming loans	370.71	%	588.54	%
Total nonperforming assets to total assets	0.26	%	0.21	%

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

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## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

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

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

The following table includes deposit accounts by category:

	June 30, 2018		December 31, 2017	
	Amount	Percent of Total	Amount	Percent of Total
	(Dollars in Thousands)			
Noninterest checking	\$133,736	21.81 %	\$99,799	19.17 %
Interest bearing checking	101,085	16.49 %	99,255	19.07 %
Savings	108,544	17.70 %	88,603	17.02 %
Money market accounts	106,547	17.37 %	89,558	17.20 %
Total	449,912	73.37 %	377,215	72.46 %
Certificates of deposit accounts:				
IRA certificates	30,783	5.02 %	28,189	5.42 %
Brokered certificates	1,266	0.21 %	4,601	0.88 %
Other certificates	131,214	21.40 %	110,559	21.24 %
Total certificates of deposit	163,263	26.63 %	143,349	27.54 %
Total deposits	\$613,175	100.00 %	\$520,564	100.00 %

Deposits increased by \$92.62 million, or 17.8%, to \$613.18 million at June 30, 2018 from \$520.56 million at December 31, 2017. The increase was mainly due to increased deposits as a result of the TwinCo acquisition. Noninterest checking increased by \$33.94 million. Savings and interest bearing checking increased by \$19.94 million and \$1.83 million, respectively. Money market accounts increased by \$16.99 million. Certificates of deposit increased by \$19.92 million.

The following table summarizes borrowing activity:

	June 30, 2018		December 31, 2017	
	Net Amount	Percent of Total	Net Amount	Percent of Total
	(Dollars in Thousands)			
FHLB advances and other borrowings	\$91,469	78.64 %	\$82,969	76.98 %
Other long-term debt, net of unamortized debt issuance costs:				
Senior notes fixed at 5.75%, due 2022	9,842	8.46 %	9,820	9.11 %
Subordinated debentures fixed at 6.75%, due 2025	9,846	8.47 %	9,836	9.13 %
Subordinated debentures variable, due 2035	5,155	4.43 %	5,155	4.78 %
Total other long-term debt	24,843	21.36 %	24,811	23.02 %
Total borrowings	116,312	100.00 %	107,780	100.00 %

FHLB advances and other borrowings increased by \$8.50 million, or 10.2%, to \$91.47 million at June 30, 2018 from \$82.97 million at December 31, 2017. The borrowings were used to help fund the continued loan growth.

### *Shareholders' Equity*

Total shareholders' equity increased \$8.19 million, or 9.8%, to \$91.81 million at June 30, 2018 from \$83.62 million at December 31, 2017. This was primarily the result of stock issued in connection with the TwinCo acquisition of \$9.03 million and net income of \$1.91 million. These increases were partially offset by other comprehensive loss of \$1.93 million and dividends paid of \$983,000.



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## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

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

Analysis of Net Interest Income

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

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

	For the Three Months Ended June 30,							
	2018			2017				
	Average Daily Balance	Interest and Dividends	Yield/ Cost <sup>(4)</sup>	Average Daily Balance	Interest and Dividends	Yield/ Cost <sup>(4)(5)</sup>		
(Dollars in Thousands)								
Assets:								
Interest earning assets:								
Investment securities	\$154,673	\$ 1,021	2.65 %	\$126,942	\$ 714	2.26 %		
FHLB and FRB stock	6,019	74	4.93 %	5,437	36	2.66 %		
Loans receivable <sup>(1)</sup>	585,366	7,862	5.39 %	512,138	6,174	4.84 %		
Other earning assets	3,667	19	2.08 %	368	1	1.09 %		
Total interest earning assets	749,725	8,976	4.80 %	644,885	6,925	4.31 %		
Noninterest earning assets	74,191			55,797				
Total assets	\$823,916			\$700,682				

Liabilities and equity:

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Interest bearing liabilities:

Deposit accounts:

Checking	\$108,339	\$ 9	0.03	%	\$94,656	\$ 8	0.03	%
Savings	103,907	12	0.05	%	84,703	11	0.05	%
Money market	110,656	56	0.20	%	91,659	34	0.15	%
Certificates of deposit	166,919	417	1.00	%	152,242	323	0.85	%
Advances from FHLB and other borrowings including long-term debt	102,128	672	2.64	%	122,619	669	2.19	%
Total interest bearing liabilities	591,949	1,166	0.79	%	545,879	1,045	0.77	%
Noninterest checking	133,464				89,476			
Other noninterest bearing liabilities	7,041				4,193			
Total liabilities	732,454				639,548			
Total equity	91,462				61,134			
Total liabilities and equity	\$823,916				\$700,682			
Net interest income/interest rate spread <sup>(2)</sup>		\$ 7,810	4.01	%		\$ 5,880	3.54	%
Net interest margin <sup>(3)</sup>			4.18	%			3.66	%
Total interest earning assets to interest bearing liabilities			126.65	%			118.14	%

(1) Includes loans held-for-sale.

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

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

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

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

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## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

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

Analysis of Net Interest Income – continued

	For the Six Months Ended June 30,							
	2018			2017				
	Average Daily Balance	Interest and Dividends	Yield/ Cost <sup>(4)</sup>	Average Daily Balance	Interest and Dividends	Yield/ Cost <sup>(4)(5)</sup>		
	(Dollars in Thousands)							
Assets:								
Interest earning assets:								
Investment securities	\$ 165,549	\$ 2,010	2.45 %	\$ 127,704	\$ 1,443	2.28 %		
FHLB and FRB stock	6,013	153	5.13 %	4,755	76	3.22 %		
Loans receivable <sup>(1)</sup>	579,191	14,734	5.13 %	493,393	11,744	4.80 %		
Other earning assets	5,132	36	1.41 %	939	2	0.43 %		
Total interest earning assets	755,885	16,933	4.52 %	626,791	13,265	4.27 %		
Noninterest earning assets	79,758			55,695				
Total assets	\$835,643			\$682,486				
Liabilities and equity:								
Interest bearing liabilities:								
Deposit accounts:								
Checking	\$ 108,588	\$ 19	0.04 %	\$ 94,462	\$ 15	0.03 %		
Savings	102,545	26	0.05 %	83,614	20	0.05 %		
Money market	108,581	104	0.19 %	92,367	59	0.13 %		
Certificates of deposit	164,577	771	0.94 %	157,615	662	0.85 %		
Advances from FHLB and other borrowings including long-term debt	130,337	1,356	2.10 %	103,241	1,146	2.24 %		
Total interest bearing liabilities	614,628	2,276	0.75 %	531,299	1,902	0.72 %		
Noninterest checking	130,009			86,996				
Other noninterest bearing liabilities	13,836			4,232				
Total liabilities	758,473			622,527				
Total equity	77,170			59,959				
Total liabilities and equity	\$835,643			\$682,486				

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Net interest income/interest rate spread <sup>(2)</sup>	\$ 14,657	3.77	%	\$ 11,363	3.55	%
Net interest margin <sup>(3)</sup>		3.91	%		3.66	%
Total interest earning assets to interest bearing liabilities		122.98%			117.97	%

(1) Includes loans held-for-sale.

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

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

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

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

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## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

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

Rate/Volume Analysis

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

	For the Three Months Ended June 30,					
	2018			2017		
	Due to Volume	Rate	Net	Due to Volume	Rate	Net
	(In Thousands)					
Interest earning assets:						
Investment securities	\$156	\$151	\$307	\$(84)	\$58	\$(26)
FHLB and FRB stock	4	34	38	6	(5)	1
Loans receivable <sup>(1)</sup>	883	805	1,688	709	510	1,219
Other earning assets	9	9	18	-	-	-
Total interest earning assets	1,052	999	2,051	631	563	1,194
Interest bearing liabilities:						
Savings, money market and checking accounts	10	14	24	1	11	12
Certificates of deposit	31	63	94	(2)	(15)	(17)
Advances from FHLB and other borrowings including long-term debt	(112)	115	3	125	137	262
Total interest bearing liabilities	(71)	192	121	124	133	257
Change in net interest income	\$1,123	\$807	\$1,930	\$507	\$430	\$937

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



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## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

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

**Rate/Volume Analysis – continued**

	For the Six Months Ended June 30,					
	2018			2017		
	Volume	Due to Rate	Net	Volume	Due to Rate	Net
	(In Thousands)					
Interest earning assets:						
Investment securities	\$428	\$139	\$567	\$(173 )	\$129	\$(44 )
FHLB and FRB stock	20	57	77	2	8	10
Loans receivable <sup>(1)</sup>	2,042	948	2,990	1,232	720	1,952
Other earning assets	9	25	34	(2 )	-	(2 )
Total interest earning assets	2,499	1,169	3,668	1,059	857	1,916
Interest bearing liabilities:						
Savings, money market and checking accounts	17	38	55	3	10	13
Certificates of deposit	29	80	109	22	(15 )	7
Advances from FHLB and other borrowings including long-term debt	301	(91 )	210	102	242	344
Total interest bearing liabilities	347	27	374	127	237	364
Change in net interest income	\$2,152	\$1,142	\$3,294	\$932	\$620	\$1,552

(1) Includes loans held-for-sale.

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

*Net Income.* Eagle's net income for the three months ended June 30, 2018 was \$1.33 million compared to \$1.07 million for the three months ended June 30, 2017. The increase of \$267,000, or 25.0%, was due to an increase in net interest

income after loan loss provision of \$2.21 million and a decrease in income tax expense of \$169,000, offset by a decrease in noninterest income of \$486,000 and an increase in noninterest expense of \$1.62 million. Basic and diluted earnings per share were \$0.24 for the current period. Basic and diluted earnings per share were \$0.28 and \$0.27, respectively, for the prior year comparable period.

*Net Interest Income.* Net interest income increased to \$7.81 million for the three months ended June 30, 2018, from \$5.88 million for the same quarter in the prior year. This increase of \$1.93 million, or 32.8%, was the result of an increase in interest and dividend income of \$2.05 million, slightly offset by an increase in interest expense of \$121,000.

*Interest and Dividend Income.* Interest and dividend income was \$8.98 million for the three months ended June 30, 2018, compared to \$6.93 million for the three months ended June 30, 2017, an increase of \$2.05 million, or 29.6%. Interest and fees on loans increased to \$7.86 million for the three months ended June 30, 2018 from \$6.17 million for the three months ended June 30, 2017. This increase of \$1.69 million, or 27.4%, was due to an increase in the average balance of loans, as well as, an increase in the average yield of loans for the quarter ended June 30, 2018. Average balances for loans receivable, including loans held-for-sale, for the three months ended June 30, 2018 were \$585.37 million, compared to \$512.14 million for the prior year period. This represents an increase of \$73.23 million, or 14.3% and was largely due to the TwinCo acquisition. The average interest rate earned on loans receivable increased by 55 basis points, from 4.84% to 5.39%. Interest and dividends on investment securities available-for-sale increased by \$307,000, or 43.0% period over period. Average balances for investments increased to \$154.67 million for the three months ended June 30, 2018, from \$126.94 million for the three months ended June 30, 2017. This increase was also largely due to the TwinCo acquisition. Average interest rates earned on investments increased to 2.65% for the three months ended June 30, 2018 from 2.26% for the three months ended June 30, 2017.



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EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

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

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

*Interest Expense.* Total interest expense was \$1.17 million for the three months ended June 30, 2018 compared to \$1.05 million for the three months ended June 30, 2017. The increase of \$121,000 or 11.6% was largely attributable to an increase in interest expense on deposits. The average balance for total deposits was \$623.29 million for three months ended June 30, 2018 compared to \$512.74 million for the three months ended June 30, 2017. This increase was largely due to the TwinCo acquisition. The overall average rate on total deposits was 0.32% for the three months ended June 30, 2018 compared to 0.29% for the three months ended June 30, 2017. The average balance for total borrowings decreased from \$122.62 million for the three months ended June 30, 2017 to \$102.13 million for the three months ended June 30, 2018. However, the average rate paid on total borrowings increased from 2.19% for the three months ended June 30, 2017, to 2.64% for the three months ended June 30, 2018.

*Loan Loss Provision.* Loan loss provisions are charged to earnings to maintain total allowance for loan losses at a level considered adequate by management of the Bank, to provide for probable loan losses based on prior loss experience, volume and type of lending conducted by the Bank and past due loans in the portfolio. The Bank's policies require review of assets on a quarterly basis. The Bank classifies loans as well as other assets if warranted. While management believes it uses the best information available to make a determination with respect to the allowance for loan losses, it recognizes that future adjustments may be necessary. The Bank recorded \$24,000 in provision for loan losses for the three months ended June 30, 2018 and \$302,000 for the three months ended June 30, 2017. Management believes the level of total allowances is adequate.

*Noninterest Income.* Total noninterest income was \$3.08 million for the three months ended June 30, 2018, compared to \$3.57 million for the three months ended June 30, 2017. The decrease of \$486,000 or 13.6% is primarily due to a decrease in net gain on sale of loans which decreased to \$1.72 million for the three months ended June 30, 2018 from \$2.26 million for the three months ended June 30, 2017. The decrease is primarily due to a decrease in gross margin on sale of mortgage loans for the three months ended June 30, 2018 compared to the three months ended June 30, 2017. The decrease in gross margin on sale of mortgage loans is due to interest rate movements in the mortgage market and strategic defensive posture due to competitive pressure.

*Noninterest Expense.* Noninterest expense was \$9.24 million for the three months ended June 30, 2018 compared to \$7.62 million for the three months ended June 30, 2017. The increase of \$1.62 million or 21.3% is largely due to increased salaries and employee benefits expense of \$875,000. The increase is due in part to higher commission-based compensation related to the continued loan growth and additional staff related to compliance with mortgage rules. Salaries and employee benefits expense was also impacted by the addition of staff related to the TwinCo acquisition.

*Income Tax Expense.* Income tax expense was \$293,000 for the three months ended June 30, 2018, compared to \$462,000 for the three months ended June 30, 2017. The effective tax rate for the three months ended June 30, 2018 was 18.0%.

### **Results of Operations for the Six Months Ended June 30, 2018 and 2017**

*Net Income.* Eagle's net income for the six months ended June 30, 2018 was \$1.91 million compared to \$1.83 million for the six months ended June 30, 2017. The slight increase of \$77,000, or 4.2%, was due to an increase in net interest income after loan loss provision of \$3.37 million and a decrease in income tax expense of \$230,000, offset by an increase in noninterest expense of \$2.51 million and a decrease in noninterest income of \$1.02 million. Basic and diluted earnings per share were \$0.35 for the current period. Basic and diluted earnings per share were \$0.48 and \$0.47, respectively, for the prior year comparable period.

*Net Interest Income.* Net interest income increased to \$14.66 million for the six months ended June 30, 2018, from \$11.36 million for the previous year's six-month period. This increase of \$3.30 million, or 29.0%, was the result of an increase in interest and dividend income of \$3.66 million, partially offset by an increase in interest expense of \$374,000.

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EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

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

**Results of Operations for the Six Months Ended June 30, 2018 and 2017 – continued**

*Interest and Dividend Income.* Interest and dividend income was \$16.93 million for the six months ended June 30, 2018, compared to \$13.27 million for the six months ended June 30, 2017, an increase of \$3.66 million, or 27.6%. Interest and fees on loans increased to \$14.73 million for the six months ended June 30, 2018 from \$11.74 million for the same period ended June 30, 2017. This increase of \$2.99 million, or 25.5%, was due to an increase in the average balance of loans, as well as, an increase in the average yield on loans. Average balances for loans receivable, including loans held-for-sale, for the six months ended June 30, 2017 were \$579.19 million, compared to \$493.39 million for the prior year period. This represents an increase of \$85.80 million, or 17.4% and was largely due to the TwinCo acquisition. The average interest rate earned on loans receivable increased by 33 basis points, from 4.80% to 5.13%. Interest and dividends on investment securities available-for-sale increased \$567,000, or 39.3% period over period. Average balances for investments increased to \$165.55 million for the six months ended June 30, 2018, from \$127.70 million for the six months ended June 30, 2017. This increase was also largely due to the TwinCo acquisition. Average interest rates earned on investments increased to 2.45% for the six months ended June 30, 2018 from 2.28% for the six months ended June 30, 2017.

*Interest Expense.* Total interest expense for the six months ended June 30, 2018 was \$2.28 million compared to \$1.90 million for the six months ended June 30, 2017. The increase of \$374,000, or 19.7%, was due to an increase in total borrowings, as well as an increase in interest expense on deposits. Interest expense on FHLB advances and other borrowings and other long-term debt increased \$210,000 for the six months ended June 30, 2018 compared to the same period in the prior year. The average borrowing balance increased from \$103.24 million for the six months ended June 30, 2017 to \$130.34 million for the six months ended June 30, 2018. However, the average rate paid decreased from 2.24% for the six months ended June 30, 2017, to 2.10% for the six months ended June 30, 2018. Borrowings have been used to help fund the continued loan growth. Interest expense on deposits increased \$164,000 for the six months ended June 30, 2018 compared to the same period in the prior year. The increase is due to higher overall average balances for total deposits which increased from \$515.05 million for the six months ended June 30, 2017 to \$614.30 million for the six months ended June 30, 2018. This increase was largely due to the TwinCo acquisition. The overall average rate on total deposits was consistent period over period.

*Loan Loss Provision.* Loan loss provisions are charged to earnings to maintain the total allowance for loan losses at a level considered adequate by management of the Bank, to provide for probable loan losses based on prior loss

experience, volume and type of lending conducted by the Bank and past due loans in the portfolio. The Bank's policies require a review of assets on a quarterly basis. The Bank classifies loans as well as other assets if warranted. While management believes it uses the best information available to make a determination with respect to the allowance for loan losses, it recognizes that future adjustments may be necessary. The Bank recorded \$526,000 in loan loss provisions for the six months ended June 30, 2018 and \$603,000 in the six months ended June 30, 2017. Management believes the level of total allowances is adequate. As of June 30, 2018, the Bank had \$457,000 in foreclosed real estate property and other repossessed property.

*Noninterest Income.* Total noninterest income decreased to \$5.76 million for the six months ended June 30, 2018, from \$6.78 million for the six months ended June 30, 2017, a decrease of \$1.02 million or 15.0%. The decrease is largely due to a decrease in net gain on sale of loans which decreased to \$3.16 million for the six months ended June 30, 2018 from \$4.09 million for the six months ended June 30, 2017. During the six months ended June 30, 2018, \$120.64 million mortgage loans were sold compared to \$129.91 million in the same period in the prior year. In addition, gross margin on sale of mortgage loans for the six months ended June 30, 2018 compared to the six months ended June 30, 2017 declined. The decrease in gross margin on sale of mortgage loans is due to interest rate movements in the mortgage market and strategic defensive posture due to competitive pressure.

*Noninterest Expense.* Noninterest expense was \$17.57 million for the six months ended June 30, 2018 compared to \$15.06 million for the six months ended June 30, 2017. The increase of \$2.51 million, or 16.7%, is largely due to increased salaries and employee benefits expense of \$1.35 million. The increase in salaries expense is due in part to higher commission-based compensation related to the continued loan growth and additional staff related to compliance with mortgage rules. Salaries and employee benefits expense was also impacted by the addition of staff related to the TwinCo acquisition. In addition, the Company incurred acquisition costs of \$365,000 during the six months ended June 30, 2018 related to the TwinCo acquisition.

*Income Tax Expense.* Income tax expense was \$420,000 for the six months ended June 30, 2018, compared to \$650,000 for the six months ended June 30, 2017. The effective tax rate for the six months ended June 30, 2018 was 18.1%. The tax was lower due to lower income before income taxes for the six months ended June 30, 2018 compared to the same period in the prior year, as well as the impact of the Tax Cuts and Job Act enacted in December 2017.

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EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

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

**Liquidity and Capital Resources**

*Liquidity*

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

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

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

### *Capital Resources*

As of June 30, 2018, the Bank's internally determined measurement of sensitivity to interest rate movements as measured by a 200 basis point rise in interest rates scenario, increased the economic value of equity ("EVE") by 2.1% compared to an increase of 2.7% at December 31, 2017. The Bank is within the guidelines set forth by the Board of Directors for interest rate risk sensitivity in rising interest rate scenarios.

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

The Bank's Tier I leverage ratio, as measured under State of Montana and FRB rules, increased from 10.39% as of December 31, 2017 to 11.261% as of June 30, 2018. The Bank's capital position helps to mitigate its interest rate risk exposure.

As of June 30, 2018, the Bank's regulatory capital was in excess of all applicable regulatory requirements. As of June 30, 2018, the Bank's total capital, Tier 1 capital, common equity Tier 1 capital and Tier 1 leverage ratios were 15.654%, 14.647%, 14.647% and 11.261%, respectively, compared to regulatory requirements of 9.875%, 7.875%, 6.375% and 4.00%, respectively. All of these ratios with the exception of the Tier 1 leverage ratio include the capital conservation buffer of 1.875% phased-in beginning January 1, 2018.

The Bank's regulatory capital was impacted by the TwinCo acquisition through an increase in paid-in capital by the amount invested in the acquired bank which was partially offset by a cash dividend to Eagle in the amount of the cash portion of the agreed upon deal with TwinCo shareholders.

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## EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

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

**Liquidity and Capital Resources – continued**

	June 30, 2018 (Unaudited)	
	Dollar Amount (Dollars in Thousands)	% of Assets
Total risk-based capital to risk weighted assets:		
Actual capital level	\$95,642	15.654%
Minimum required for capital adequacy Basel III phase-in schedule	60,335	9.875
Excess capital	\$35,307	5.779 %
Tier I capital to risk weighted assets:		
Actual capital level	\$89,492	14.647%
Minimum required for capital adequacy Basel III phase-in schedule	48,116	7.875
Excess capital	\$41,376	6.772 %
Common equity tier I capital to risk weighted assets:		
Actual capital level	\$89,492	14.647%
Minimum required for capital adequacy Basel III phase-in schedule	38,951	6.375
Excess capital	\$50,541	8.272 %
Tier I capital to adjusted total average assets:		
Actual capital level	\$89,492	11.261%
Minimum required for capital adequacy Basel III phase-in schedule	31,787	4.000
Excess capital	\$57,705	7.261 %

**Interest Rate Risk**

Interest rate risk is the potential for loss of future earnings resulting from adverse changes in the level of interest rates. Interest rate risk results from several factors and could have a significant impact on the Company's net interest income,

which is the Company primary source of income. Net interest income is affected by changes in interest rates, the relationship between rates on interest bearing assets and liabilities, the impact of interest fluctuations on asset prepayments and the mix of interest bearing assets and liabilities.

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

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



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EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

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

**Interest Rate Risk – continued**

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

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

Changes in Market Interest Rates (Basis Points)	Rate Sensitivity As of June 30, 2018		Policy Limits
	Year 1	Year 2	
+200	1.03%	2.27%	-15.00%
-100	-1.84%	-6.15%	-15.00%

**Impact of Inflation and Changing Prices**

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



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EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

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

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EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

CONTROLS AND PROCEDURES

**Item 4. Controls and Procedures**

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

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EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

**Part II - OTHER INFORMATION**

**Item 1. Legal Proceedings.**

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

**Item 1A. Risk Factors.**

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

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

On July 19, 2018, the Board authorized the repurchase of up to 100,000 shares of its common stock. Under the plan, shares may be purchased by the Company on the open market or in privately negotiated transactions. The extent to which the company repurchases its shares and the timing of such repurchase will depend upon market conditions and other corporate considerations. The plan expires on July 19, 2019.

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

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



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EAGLE BANCORP MONTANA, INC. AND SUBSIDIARIES

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

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

Not applicable.

**Item 4. Mine Safety Disclosures**

Not applicable

**Item 5. Other Information.**

None.

**Item 6. Exhibits.**

**Exhibit**

**Description**

**Number**

31.1 Certification by Peter J. Johnson, Chief Executive Officer, pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 (a) of the Sarbanes-Oxley Act of 2002.

31.2 Certification by Laura F. Clark, Chief Financial Officer, pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 (a) of the Sarbanes-Oxley Act of 2002.

32.1 Certification by Peter J. Johnson, Chief Executive Officer, and Laura F. Clark, Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

101.INS XBRL Instance Document

101.SCH XBRL Taxonomy Extension Schema Document

101.CAL XBRL Taxonomy Extension Calculation Linkbase Document

101.DEF XBRL Taxonomy Extension Definition Linkbase Document

101.LAB XBRL Taxonomy Extension Label Linkbase Document

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

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SIGNATURES

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

EAGLE BANCORP MONTANA,  
INC.

Date: August 7, 2018 By: /s/ Peter J. Johnson

Peter J. Johnson  
President/CEO

Date: August 7, 2018 By: /s/ Laura F. Clark

Laura F. Clark  
Executive Vice President/CFO