

SP Bancorp, Inc.  
Form 10-Q  
August 15, 2011

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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, 2011**

**OR**

**Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission File No. 001-34933**

**SP Bancorp, Inc.**

(Exact name of registrant as specified in its charter)

**Maryland**

(State or other jurisdiction of  
incorporation or organization)

**27-3347359**

(I.R.S. Employer  
Identification Number)

**5224 W. Plano Parkway, Plano, Texas**  
(Address of Principal Executive Offices)

**75093**  
Zip Code

**(972) 931-5311**

(Registrant's telephone number)

**N/A**

(Former name or former address, if changed since last report)

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 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

YES  NO .

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting  
company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES  NO

Shares of the Registrant's common stock, par value \$0.01 per share, issued and outstanding as of August 15, 2011 were 1,725,000.



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**Table of Contents****SP Bancorp, Inc.****Part I. Financial Information****Item 1. Financial Statements****Consolidated Balance Sheets (Unaudited)****(In thousands)**

|                                                                                                               | June 30,<br>2011  | December 31,<br>2010 |
|---------------------------------------------------------------------------------------------------------------|-------------------|----------------------|
| <b>ASSETS</b>                                                                                                 |                   |                      |
| Cash and due from banks                                                                                       | \$ 14,695         | \$ 2,384             |
| Federal funds sold                                                                                            | 12,180            | 9,430                |
| <b>Total cash and cash equivalents</b>                                                                        | <b>26,875</b>     | <b>11,814</b>        |
| Securities available for sale (amortized cost of \$22,450 at June 30, 2011 and \$22,214 at December 31, 2010) | 22,384            | 22,076               |
| Fixed annuity investment                                                                                      | 1,153             | 1,131                |
| Loans held for sale                                                                                           | 3,969             | 3,589                |
| Loans, net of allowance for losses of \$1,859 at June 30, 2011 and \$2,136 at December 31, 2010               | 194,346           | 191,065              |
| Accrued interest receivable                                                                                   | 879               | 833                  |
| Other real estate owned ( OREO )                                                                              | 1,783             |                      |
| Premises and equipment, net                                                                                   | 4,510             | 4,637                |
| Federal Home Loan Bank ( FHLB ) stock and other restricted stock, at cost                                     | 1,005             | 1,003                |
| Bank-owned life insurance ( BOLI )                                                                            | 6,076             |                      |
| Deferred tax assets                                                                                           | 1,103             | 1,131                |
| Other assets                                                                                                  | 1,921             | 1,538                |
| <b>Total assets</b>                                                                                           | <b>\$ 266,004</b> | <b>\$ 238,817</b>    |

**LIABILITIES AND STOCKHOLDERS EQUITY**

|                          |                |                |
|--------------------------|----------------|----------------|
| Deposits:                |                |                |
| Noninterest-bearing      | \$ 9,694       | \$ 5,738       |
| Interest-bearing         | 205,319        | 182,506        |
| <b>Total deposits</b>    | <b>215,013</b> | <b>188,244</b> |
| Borrowings               | 15,983         | 15,987         |
| Accrued interest payable | 51             | 39             |
| Other liabilities        | 2,465          | 2,443          |
| <b>Total liabilities</b> | <b>233,512</b> | <b>206,713</b> |

Commitments and contingencies

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Stockholders' equity:

Preferred stock, \$0.01 par value, 50,000,000 shares authorized; none issued or outstanding

Common stock, par value \$0.01 par value; 100,000,000 shares authorized; 1,725,000 shares issued and outstanding

Additional paid-in capital

Unallocated Employee Stock Ownership Plan ( ESOP ) shares

Retained earnings - substantially restricted

Accumulated other comprehensive loss

**Total stockholders' equity**

|        |        |
|--------|--------|
| 17     | 17     |
| 15,278 | 15,290 |
| (898)  | (817)  |
| 18,136 | 17,701 |
| (41)   | (87)   |
| 32,492 | 32,104 |

**Total liabilities and stockholders' equity**

|            |            |
|------------|------------|
| \$ 266,004 | \$ 238,817 |
|------------|------------|

See Notes to Consolidated Financial Statements.

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**SP Bancorp, Inc.**  
**Consolidated Statements of Operations (Unaudited)**  
(In thousands, except per share amounts)

|                                                            | Three Months Ended June 30, |              | Six Months Ended June 30, |              |
|------------------------------------------------------------|-----------------------------|--------------|---------------------------|--------------|
|                                                            | 2011                        | 2010         | 2011                      | 2010         |
| Interest income:                                           |                             |              |                           |              |
| Interest and fees on loans                                 | \$ 2,571                    | \$ 2,343     | \$ 5,189                  | \$ 4,763     |
| Securities taxable                                         | 119                         | 88           | 199                       | 190          |
| Securities nontaxable                                      | 36                          | 16           | 70                        | 29           |
| Other interest earning assets                              | 32                          | 46           | 54                        | 93           |
| <b>Total interest income</b>                               | <b>2,758</b>                | <b>2,493</b> | <b>5,512</b>              | <b>5,075</b> |
| Interest expense:                                          |                             |              |                           |              |
| Deposit accounts                                           | 365                         | 432          | 704                       | 881          |
| Borrowings                                                 | 113                         | 113          | 225                       | 231          |
| <b>Total interest expense</b>                              | <b>478</b>                  | <b>545</b>   | <b>929</b>                | <b>1,112</b> |
| <b>Net interest income</b>                                 | <b>2,280</b>                | <b>1,948</b> | <b>4,583</b>              | <b>3,963</b> |
| Provision for loan losses                                  | 291                         | 91           | 411                       | 1,171        |
| <b>Net interest income after provision for loan losses</b> | <b>1,989</b>                | <b>1,857</b> | <b>4,172</b>              | <b>2,792</b> |
| Noninterest income:                                        |                             |              |                           |              |
| Service charges                                            | 314                         | 385          | 634                       | 759          |
| Gain on sale of securities available for sale              | 174                         | 128          | 202                       | 128          |
| Gain on sale of mortgage loans                             | 306                         | 107          | 529                       | 219          |
| Other                                                      | 91                          | 36           | 213                       | 65           |
| <b>Total noninterest income</b>                            | <b>885</b>                  | <b>656</b>   | <b>1,578</b>              | <b>1,171</b> |
| Noninterest expense:                                       |                             |              |                           |              |
| Compensation and benefits                                  | 1,317                       | 1,053        | 2,603                     | 2,022        |
| Occupancy costs                                            | 257                         | 288          | 526                       | 561          |
| Equipment expense                                          | 62                          | 64           | 131                       | 111          |
| Data processing expense                                    | 123                         | 135          | 238                       | 288          |
| ATM expense                                                | 97                          | 95           | 188                       | 186          |
| Professional and outside services                          | 291                         | 136          | 523                       | 312          |
| Stationery and supplies                                    | 28                          | 33           | 66                        | 59           |



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|                                                          |         |        |         |         |
|----------------------------------------------------------|---------|--------|---------|---------|
| Marketing                                                | 44      | 25     | 88      | 63      |
| FDIC insurance assessments                               | 78      | 67     | 170     | 134     |
| Operations from OREO                                     | 29      |        | 131     | (10)    |
| Other                                                    | 266     | 163    | 503     | 318     |
| Total noninterest expense                                | 2,592   | 2,059  | 5,167   | 4,044   |
| <b>Income (loss) before income tax expense (benefit)</b> | 282     | 454    | 583     | (81)    |
| Income tax expense (benefit)                             | 64      | 173    | 148     | (39)    |
| <b>Net income (loss)</b>                                 | \$ 218  | \$ 281 | \$ 435  | \$ (42) |
| <b>Basic and diluted earnings per share</b>              | \$ 0.13 | N/A    | \$ 0.27 | N/A     |

N/A Not applicable.

See Notes to Consolidated Financial Statements.

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**SP Bancorp, Inc.**  
**Consolidated Statements of Stockholders Equity (Unaudited)**  
**(In thousands)**

|                                                                            | Common<br>Stock | Additional<br>Paid-In<br>Capital | Unallocated<br>ESOP<br>Shares | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income<br>(Loss) | Total     |
|----------------------------------------------------------------------------|-----------------|----------------------------------|-------------------------------|----------------------|-----------------------------------------------------------|-----------|
| Balance, December 31, 2009                                                 | \$              | \$                               | \$                            | \$ 17,177            | \$ 85                                                     | \$ 17,262 |
| Comprehensive loss:                                                        |                 |                                  |                               |                      |                                                           |           |
| Net loss                                                                   |                 |                                  |                               | (42)                 |                                                           | (42)      |
| Unrealized gain on securities<br>available for sale, net of tax of<br>\$25 |                 |                                  |                               |                      | 39                                                        | 39        |
| Total comprehensive loss                                                   |                 |                                  |                               |                      |                                                           | (3)       |
| <b>Balance, June 30, 2010</b>                                              | \$              | \$                               | \$                            | \$ 17,135            | \$ 124                                                    | \$ 17,259 |
| Balance, December 31, 2010                                                 | \$ 17           | \$ 15,290                        | \$ (817)                      | \$ 17,701            | \$ (87)                                                   | \$ 32,104 |
| Additional stock issuance costs                                            |                 | (15)                             |                               |                      |                                                           | (15)      |
| ESOP shares purchased in open<br>market                                    |                 |                                  | (102)                         |                      |                                                           | (102)     |
| ESOP shares allocated                                                      |                 | 3                                | 21                            |                      |                                                           | 24        |
| Comprehensive income:                                                      |                 |                                  |                               |                      |                                                           |           |
| Net income                                                                 |                 |                                  |                               | 435                  |                                                           | 435       |
| Unrealized gain on securities<br>available for sale, net of tax of<br>\$26 |                 |                                  |                               |                      | 46                                                        | 46        |
| Total comprehensive income                                                 |                 |                                  |                               |                      |                                                           | 481       |
| <b>Balance, June 30, 2011</b>                                              | \$ 17           | \$ 15,278                        | \$ (898)                      | \$ 18,136            | \$ (41)                                                   | \$ 32,492 |

See Notes to Consolidated Financial Statements.



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**SP Bancorp, Inc.**  
**Consolidated Statements of Cash Flows (Unaudited)**  
**(In thousands)**

|                                                                                                    | Six Months Ended June 30, |               |
|----------------------------------------------------------------------------------------------------|---------------------------|---------------|
|                                                                                                    | 2011                      | 2010          |
| Cash flows from operating activities:                                                              |                           |               |
| Net income (loss)                                                                                  | \$ 435                    | \$ (42)       |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: |                           |               |
| Depreciation and amortization                                                                      | 179                       | 199           |
| Amortization of premiums on investments                                                            | 244                       | 76            |
| ESOP expense                                                                                       | 24                        |               |
| Provision for loan losses                                                                          | 411                       | 1,171         |
| Gain on sale of other real estate owned                                                            |                           | (10)          |
| Gain on sale of securities available for sale                                                      | (202)                     | (128)         |
| Gains on sales of mortgage loans                                                                   | (529)                     | (219)         |
| Proceeds from sale of mortgage loans                                                               | 22,697                    | 10,114        |
| Loans originated for sale                                                                          | (21,089)                  | (10,170)      |
| Increase in cash surrender value of BOLI                                                           | (76)                      |               |
| (Increase) decrease in accrued interest receivable                                                 | (46)                      | 20            |
| Increase in other assets                                                                           | (381)                     | (707)         |
| Increase in fixed annuity investment                                                               | (22)                      | (21)          |
| Increase (decrease) in accrued interest payable and other liabilities                              | 34                        | (411)         |
| <b>Net cash provided by (used in) operating activities</b>                                         | <b>1,679</b>              | <b>(128)</b>  |
| Cash flows from investing activities:                                                              |                           |               |
| Purchase of securities available for sale                                                          | (20,147)                  | (8,196)       |
| Maturities, calls and principal paydowns on securities available for sale                          | 3,842                     | 3,774         |
| Proceeds from sale of securities available for sale                                                | 16,027                    | 2,783         |
| (Redemptions) purchases of FHLB stock                                                              | (2)                       | 654           |
| (Originations) loan repayments, net                                                                | (6,934)                   | 4,778         |
| Proceeds from sale of other real estate owned                                                      |                           | 10            |
| Purchases of premises and equipment                                                                | (52)                      | (118)         |
| Purchase of BOLI                                                                                   | (6,000)                   |               |
| <b>Net cash (used in) provided by investing activities</b>                                         | <b>(13,266)</b>           | <b>3,685</b>  |
| Cash flows from financing activities:                                                              |                           |               |
| Net increase in deposit accounts                                                                   | 26,769                    | 13,898        |
| Repayment of FHLB advances, net                                                                    | (4)                       | (4)           |
| ESOP shares purchased                                                                              | (102)                     |               |
| Additional stock issuance costs                                                                    | (15)                      |               |
| <b>Net cash provided by financing activities</b>                                                   | <b>26,648</b>             | <b>13,894</b> |

|                                                              |           |           |
|--------------------------------------------------------------|-----------|-----------|
| Net increase in cash and cash equivalents                    | 15,061    | 17,451    |
| Cash and cash equivalents at beginning of period             | 11,814    | 11,717    |
| Cash and cash equivalents at end of period                   | \$ 26,875 | \$ 29,168 |
| Supplemental cash flow information:                          |           |           |
| Cash transactions:                                           |           |           |
| Income taxes paid                                            | \$ 377    | \$ 129    |
| Interest expense paid                                        | \$ 917    | \$ 1,112  |
| Noncash transactions:                                        |           |           |
| Transfers of loans to other real estate owned                | \$ 1,783  | \$ 30     |
| Transfers of loans held for portfolio to loans held for sale | \$ 1,459  | \$        |

See Notes to Consolidated Financial Statements.

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**SP Bancorp, Inc.**

**Notes to Consolidated Financial Statements (Unaudited)**

**Note 1. Summary of Significant Accounting Policies**

**General**

SharePlus Federal Bank (the Bank), is a federal stock savings bank located in Plano, Texas. On October 29, 2010, SharePlus Federal Bank completed its conversion from a federal mutual savings bank to a federal capital stock savings bank. A new holding company, SP Bancorp, Inc (the Company), was established as part of the conversion. The public offering was consummated through the sale and issuance by SP Bancorp, Inc. of 1,725,000 shares of common stock at \$10 per share. Net proceeds of \$14.5 million were raised in the stock offering, after deduction of conversion costs of \$2.0 million and excluding \$0.8 million which was loaned by the Company to a trust for the Employee Stock Ownership Plan (the ESOP).

The Bank operates as a full-service bank, including the acceptance of checking and savings deposits, and the origination of single-family mortgage and home equity loans, commercial real estate and business loans, automobile loans, and other personal loans. In addition to the Bank's home office, the Bank has six branches, one of which is located near downtown Dallas, Texas; two are located near the Bank's headquarters in Plano, Texas; two branches are located in Louisville, Kentucky; and the other branch is located in Irvine, California. Effective July 21, 2011, the Bank is regulated by the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC). Prior to that date, the Bank was regulated by the Office of Thrift Supervision and the FDIC.

**Consolidation**

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, SharePlus Federal Bank. The Company's principal business is the business of the Bank. All significant intercompany accounts and transactions have been eliminated.

**Interim Financial Statements**

The financial statements of the Company at June 30, 2011 and for the three and six months ended June 30, 2011 and 2010 have been prepared in conformity with U.S. generally accepted accounting principles for interim financial information and predominant practices followed by the financial services industry; and are unaudited. However, in management's opinion, the interim data at June 30, 2011 and for the three and six months ended June 30, 2011 and 2010 include all adjustments, consisting of only normal recurring adjustments, necessary for a fair statement of the results of the interim periods. The results of operations for the interim periods are not necessarily indicative of the results of operations to be expected for the full year.

**Use of Estimates**

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. A material estimate that is particularly susceptible to significant change in the near term relates to the determination of the allowance for loan losses.

**Other Real Estate Owned (OREO)**

OREO represents properties acquired through foreclosure or other proceedings and is initially recorded at fair value at the date of foreclosure less estimated costs of disposal, which establishes a new cost basis. After foreclosure, OREO is held for sale and is carried at the lower of cost or fair value less estimated costs of disposal. Any write down to fair value at the time of transfer to OREO is charged to the allowance for loan losses. Property is evaluated regularly to ensure the recorded amount is supported by its current fair value and valuation allowances to reduce the carrying amount to fair value less estimated costs to dispose are recorded as necessary.

**Table of Contents****SP Bancorp, Inc.****Notes to Consolidated Financial Statements (Unaudited)****Bank-Owned Life Insurance**

Bank-owned life insurance is recorded at the amount that can be realized under the insurance contracts at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement. Changes in the net cash surrender value of the policies, as well as insurance proceeds received are reflected in noninterest income on the consolidated statements of operations and are not subject to income taxes.

**Basic and Diluted Earnings Per Share**

Earnings per share are based upon the weighted-average shares outstanding. ESOP shares, which have been committed to be released, are considered outstanding.

|                                      | Three Months<br>Ended<br>June 30, 2011 | Six Months<br>Ended<br>June 30, 2011 |
|--------------------------------------|----------------------------------------|--------------------------------------|
| Net earnings                         | \$ 218                                 | \$ 435                               |
| Weighted-average shares outstanding  | 1,640                                  | 1,640                                |
| Basic and diluted earnings per share | \$ 0.13                                | \$ 0.27                              |

Earnings per share are not presented for the three and six months ended June 30, 2010 since the stock offering was consummated subsequent to that date.

**Recent Authoritative Accounting Guidance**

In April 2011, the FASB issued Accounting Standards Update ( ASU ) No. 2011-02, A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring. The provisions of ASU 2011-02 clarify the guidance on a creditor's evaluation of whether it has granted a concession and whether a debtor is experiencing financial difficulties. The adoption of ASU 2011-02, including the disclosures deferred by ASU 2011-01, are effective for the Company's reporting period ending September 30, 2011.

In May 2011, the FASB issued ASU 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. The amendments improve consistency for measuring fair value and for disclosing information about fair value measurements in accordance with U.S. generally accepted accounting principles and International Financial Reporting Standards. For public entities, the amendments are effective during interim and annual periods beginning after December 15, 2011. Adoption of this new guidance is not expected to have any material impact on the Company's consolidated financial statements.

In June 2011, the FASB issued ASU 2011-05, Comprehensive Income (Topic 220). The amendments require that all nonowner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. For public entities, the amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. Adoption of this new guidance is not expected to have any material impact on the Company's consolidated financial statements.

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**SP Bancorp, Inc.**

**Notes to Consolidated Financial Statements (Unaudited)**

**Note 2. Stock Conversion**

On October 29, 2010, Share Plus Federal Bank completed its conversion from a federal mutual savings bank to a capital stock savings bank. A new holding company, SP Bancorp, Inc., was established as part of the conversion. The public offering was consummated through the sale and issuance by SP Bancorp, Inc. of 1,725,000 shares of common stock at \$10 per share. Net proceeds of \$14.5 million were raised in the stock offering, after deduction of conversion costs of \$2.0 million and excluding \$0.8 million which was loaned by the Company to a trust for the ESOP. The Bank's ESOP is authorized to purchase up to 138,000 shares of common stock. The ESOP purchased 67,750 of those shares in the offering and 24,947 shares in the open market through June 30, 2011. The remaining 45,303 shares are expected to be purchased in the near term. Shares of the Company's common stock purchased by the ESOP are held in a suspense account until released for allocation to participants. Shares released are allocated to each eligible participant based on the ratio of each such participant's compensation, as defined in the ESOP, to the total compensation of all eligible plan participants. As the unearned shares are released from suspense, the Bank recognizes compensation expense equal to the fair value of the ESOP shares committed to be released during the year. To the extent that the fair value of the ESOP shares differs from the cost of such shares, the difference is charged or credited to equity as additional paid-in capital.

SP Bancorp, Inc.'s common stock is traded on the NASDAQ Capital Market under the symbol SPBC. Voting rights are held and exercised exclusively by the stockholders of the new holding company. Deposit account holders continue to be insured by the FDIC. A liquidation account was established in the amount of \$17.0 million, which represented the Bank's total equity capital as of March 31, 2010, the latest balance sheet date in the final prospectus used in the conversion. The liquidation account is maintained for the benefit of eligible holders who continue to maintain their accounts at the Bank. The liquidation account is reduced annually to the extent that eligible account holders have reduced their qualifying deposits. Subsequent increases will not restore an eligible account holder's interest in the liquidation account. In the event of a complete liquidation of the Bank, and only in such event, each eligible account holder will be entitled to receive a distribution from the liquidation account in an amount proportionate to the adjusted qualifying account balances then held.

The Bank may not declare, pay a dividend on, or repurchase any of its capital stock, if the effect thereof would cause equity capital to be reduced below the liquidation account amount or regulatory capital requirements. Any purchase of the new holding company's common stock will be conducted in accordance with applicable laws and regulations.



**Table of Contents****SP Bancorp, Inc.****Notes to Consolidated Financial Statements (Unaudited)****Note 3. Securities**

Securities have been classified in the consolidated balance sheets according to management's intent. At June 30, 2011 and December 31, 2010, all of the Company's securities were classified as available for sale. The amortized cost of securities and their approximate fair values at June 30, 2011 and December 31, 2010 are as follows:

|                                                                       | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
|-----------------------------------------------------------------------|-------------------|------------------------------|-------------------------------|---------------|
| Securities Available for Sale                                         |                   |                              |                               |               |
| June 30, 2011:                                                        |                   |                              |                               |               |
| Municipal securities                                                  | \$ 5,286          | \$ 44                        | \$ (37)                       | \$ 5,293      |
| Collateralized mortgage obligations guaranteed by<br>FNMA and FHLMC   | 10,321            | 13                           | (58)                          | 10,276        |
| Mortgage-backed securities guaranteed by SBA,<br>FNMA, GNMA and FHLMC | 6,843             | 29                           | (57)                          | 6,815         |
|                                                                       | \$ 22,450         | \$ 86                        | \$ (152)                      | \$ 22,384     |
| December 31, 2010:                                                    |                   |                              |                               |               |
| Municipal securities                                                  | \$ 3,746          | \$ 4                         | \$ (165)                      | \$ 3,585      |
| Collateralized mortgage obligations guaranteed by<br>FNMA and FHLMC   | 10,447            | 70                           | (29)                          | 10,488        |
| Mortgage-backed securities guaranteed by SBA,<br>FNMA, GNMA and FHLMC | 8,021             | 29                           | (47)                          | 8,003         |
|                                                                       | \$ 22,214         | \$ 103                       | \$ (241)                      | \$ 22,076     |

Mortgage-backed securities and collateralized mortgage obligations are backed by single-family mortgage loans. The Company does not hold any securities backed by commercial real estate loans.

For the six months ended June 30, 2011, proceeds from sale of securities available for sale, gross gains and gross losses were \$16,027, \$202 and \$0, respectively.

For the six months ended June 30, 2010, proceeds from sale of securities available for sale, gross gains and gross losses were \$2,783, \$128 and \$0, respectively.

**Table of Contents****SP Bancorp, Inc.****Notes to Consolidated Financial Statements (Unaudited)**

Gross unrealized losses and fair values by investment category and length of time in a continuous unrealized loss position at June 30, 2011 and December 31, 2010 were as follows:

|                                        | Number of<br>Security<br>Positions with<br>Unrealized<br>losses | Continuous<br>Unrealized<br>Losses Existing for |                      | Continuous<br>Unrealized<br>Losses Existing for |                      | Total           |                      |
|----------------------------------------|-----------------------------------------------------------------|-------------------------------------------------|----------------------|-------------------------------------------------|----------------------|-----------------|----------------------|
|                                        |                                                                 | Less than 12 Months<br>Market<br>Value          | Unrealized<br>Losses | 12 Months or<br>Longer<br>Market<br>Value       | Unrealized<br>Losses | Market<br>Value | Unrealized<br>Losses |
| June 30, 2011:                         |                                                                 |                                                 |                      |                                                 |                      |                 |                      |
| Municipal securities                   | 5                                                               | \$ 3,034                                        | \$ (37)              | \$                                              | \$                   | \$ 3,034        | \$ (37)              |
| Collateralized mortgage<br>obligations | 5                                                               | 6,266                                           | (58)                 |                                                 |                      | 6,266           | (58)                 |
| Mortgage-backed<br>securities          | 2                                                               | 4,315                                           | (57)                 |                                                 |                      | 4,315           | (57)                 |
|                                        | 12                                                              | \$ 13,615                                       | \$ (152)             | \$                                              | \$                   | \$ 13,615       | \$ (152)             |
| December 31, 2010:                     |                                                                 |                                                 |                      |                                                 |                      |                 |                      |
| Municipal securities                   | 9                                                               | \$ 2,690                                        | \$ (165)             | \$                                              | \$                   | \$ 2,690        | \$ (165)             |
| Collateralized mortgage<br>obligations | 2                                                               | 3,344                                           | (29)                 |                                                 |                      | 3,344           | (29)                 |
| Mortgage-backed<br>securities          | 3                                                               | 6,073                                           | (47)                 |                                                 |                      | 6,073           | (47)                 |
|                                        | 14                                                              | \$ 12,107                                       | \$ (241)             | \$                                              | \$                   | \$ 12,107       | \$ (241)             |

For all of the above securities available for sale, the gross unrealized losses are generally due to changes in interest rates. The gross unrealized losses were considered to be temporary as they reflected fair values on June 30, 2011 that are subject to change daily as interest rates fluctuate. The Company does not intend to sell these securities and it is more-likely-than-not that the Company will not be required to sell prior to anticipated recovery. Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and 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 of the Company to sell or whether it would be more-likely-than-not required to sell its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.



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The scheduled maturities of securities at June 30, 2011 and December 31, 2010 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, 2011      |                 | December 31, 2010  |                 |
|--------------------------------------------------------------------|--------------------|-----------------|--------------------|-----------------|
|                                                                    | Available for Sale |                 | Available for Sale |                 |
|                                                                    | Amortized<br>Cost  | Market<br>Value | Amortized<br>Cost  | Market<br>Value |
| After 5 years through 10 years                                     | \$ 445             | \$ 444          | \$ 446             | \$ 447          |
| Due after 10 years                                                 | 4,841              | 4,849           | 3,300              | 3,138           |
|                                                                    | 5,286              | 5,293           | 3,746              | 3,585           |
| Mortgage-backed securities and Collateralized mortgage obligations | 17,164             | 17,091          | 18,468             | 18,491          |
|                                                                    | \$ 22,450          | \$ 22,384       | \$ 22,214          | \$ 22,076       |

**Note 4. Loans and Allowance for Loan Losses**

Loans at June 30, 2011 and December 31, 2010 consisted of the following:

|                           | June 30,<br>2011 | December 31,<br>2010 |
|---------------------------|------------------|----------------------|
| Commercial business       | \$ 3,594         | \$ 2,473             |
| Commercial real estate    | 31,522           | 29,303               |
| One-to-four family        | 141,029          | 140,340              |
| Home equity               | 10,117           | 10,112               |
| Consumer                  | 9,319            | 10,335               |
|                           | 195,581          | 192,563              |
| Premiums, net             | 101              | 106                  |
| Deferred loan costs, net  | 523              | 532                  |
| Allowance for loan losses | (1,859)          | (2,136)              |
|                           | \$ 194,346       | \$ 191,065           |

The Bank originates loans to individuals and businesses, geographically concentrated primarily near the Bank's offices in Dallas and Plano, Texas. Loan balances, interest rates, loan terms and collateral requirements vary according to the type of loan offered and overall credit-worthiness of the potential borrower.

Commercial business. Commercial business loans are made to customers for the purpose of acquiring equipment and other general business purposes. Commercial business loans are made based primarily on the historical and projected cash flow of the borrower and, to a lesser extent, the underlying collateral. Commercial business loans generally carry higher risk of default since their repayment generally depends on the successful operation of the business and the sufficiency of collateral.



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**Notes to Consolidated Financial Statements (Unaudited)**

Commercial real estate. Commercial loans are secured primarily by office buildings, retail centers, owner-occupied offices, condominiums, developed lots and land. Commercial real estate loans are underwritten based on the economic viability of the property and creditworthiness of the borrower, with emphasis given to projected cash flow as a percentage of debt service requirements. These loans carry significant credit risks as they involve larger balances concentrated with single borrowers or groups of related borrowers. Repayment of loans secured by income-producing properties generally depends on the successful operation of the real estate project and may be subject to a greater extent to adverse market conditions and the general economy.

One-to-four family. One-to-four family loans are underwritten based on the applicant's employment and credit history and the appraised value of the property.

Home equity. Home equity loans are underwritten similar to one-to-four family loans. Collateral value could be negatively impacted by declining real estate values.

Consumer. Consumer loans include automobile, signature and other consumer loans. Potential credit risks include rapidly depreciable assets, such as automobiles, which could adversely affect the value of the collateral.

On occasion, the Bank originates loans secured by single-family and home equity loans with high loan to value ratios exceeding 90 percent. These loans totaled \$3,262 and \$3,518 at June 30, 2011 and December 31, 2010, respectively.

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Following is an age analysis of past due loans by loan class as of June 30, 2011 and December 31, 2010:

|                             | Commercial<br>Business | Commercial<br>Real Estate | One-to-Four<br>Family | Home<br>Equity | Consumer  | Total      |
|-----------------------------|------------------------|---------------------------|-----------------------|----------------|-----------|------------|
| <b>At June 30, 2011</b>     |                        |                           |                       |                |           |            |
| Past Due:                   |                        |                           |                       |                |           |            |
| 30-59 days                  | \$                     | \$                        | \$ 453                | \$ 40          | \$ 16     | \$ 509     |
| 60-89 days                  |                        |                           | 251                   |                | 1         | 252        |
| 90 days or more             | 259                    | 531                       | 2,728                 | 100            | 8         | 3,626      |
| Total past due              | 259                    | 531                       | 3,432                 | 140            | 25        | 4,387      |
| Current                     | 3,335                  | 30,991                    | 137,597               | 9,977          | 9,294     | 191,194    |
| Total loans                 | \$ 3,594               | \$ 31,522                 | \$ 141,029            | \$ 10,117      | \$ 9,319  | \$ 195,581 |
| <b>At December 31, 2010</b> |                        |                           |                       |                |           |            |
| Past Due:                   |                        |                           |                       |                |           |            |
| 30-59 days                  | \$                     | \$ 1,844                  | \$ 1,675              | \$ 38          | \$ 49     | \$ 3,606   |
| 60-89 days                  |                        |                           | 309                   | 13             | 3         | 325        |
| 90 days or more             | 125                    | 2,498                     | 1,704                 | 101            | 20        | 4,448      |
| Total past due              | 125                    | 4,342                     | 3,688                 | 152            | 72        | 8,379      |
| Current                     | 2,348                  | 24,961                    | 136,652               | 9,960          | 10,263    | 184,184    |
| Total loans                 | \$ 2,473               | \$ 29,303                 | \$ 140,340            | \$ 10,112      | \$ 10,335 | \$ 192,563 |

The Bank utilizes a nine-point internal risk rating system for commercial real estate and commercial business loans, which provides a comprehensive analysis of the credit risk inherent in each loan. The rating system provides for five pass ratings. Rating grades six through nine comprise the adversely rated credits.

The Bank classifies problem and potential problem loans for all loan types using the regulatory classifications of special mention, substandard, doubtful and loss, which for commercial real estate and commercial business loans correspond to the risk ratings of six, seven, eight and nine, respectively. The regulatory classifications are updated, when warranted.

A loan is considered substandard if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Substandard loans include those characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Loans classified as doubtful have all of the weaknesses inherent in those classified substandard with the added characteristic that the weaknesses present make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. Loans or portions of loans classified as loss, are those considered uncollectible and of such little value that their continuance is not warranted. Loans that do not expose the Bank to risk sufficient to warrant classification in one of the aforementioned categories, but which possess potential weaknesses that deserve management's close attention, are required to be designated as special mention.





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Following is a summary of loans by grade or classification as of June 30, 2011 and December 31, 2010:

|                                                                                 | Commercial<br>Business | Commercial<br>Real Estate | One-to-Four<br>Family | Home<br>Equity | Consumer  | Total      |
|---------------------------------------------------------------------------------|------------------------|---------------------------|-----------------------|----------------|-----------|------------|
| <b>At June 30, 2011</b>                                                         |                        |                           |                       |                |           |            |
| Credit Quality Indicator:<br>Credit Risk Profile by Grade<br>or Classification: |                        |                           |                       |                |           |            |
| Pass                                                                            | \$ 3,275               | \$ 22,221                 | \$ 137,731            | \$ 9,958       | \$ 9,264  | \$ 182,449 |
| Special Mention                                                                 |                        | 1,595                     | 571                   | 59             | 47        | 2,272      |
| Substandard                                                                     | 319                    | 7,706                     | 2,727                 | 100            | 8         | 10,860     |
| Doubtful                                                                        |                        |                           |                       |                |           |            |
| Loss                                                                            |                        |                           |                       |                |           |            |
| Total                                                                           | \$ 3,594               | \$ 31,522                 | \$ 141,029            | \$ 10,117      | \$ 9,319  | \$ 195,581 |
| <b>At December 31, 2010:</b>                                                    |                        |                           |                       |                |           |            |
| Credit Quality Indicator:<br>Credit Risk Profile by Grade<br>or Classification: |                        |                           |                       |                |           |            |
| Pass                                                                            | \$ 2,088               | \$ 17,760                 | \$ 137,601            | \$ 9,969       | \$ 10,175 | \$ 177,593 |
| Special Mention                                                                 |                        | 1,607                     | 1,036                 | 42             | 138       | 2,823      |
| Substandard                                                                     | 385                    | 9,936                     | 1,703                 | 101            | 20        | 12,145     |
| Doubtful                                                                        |                        |                           |                       |                | 2         | 2          |
| Loss                                                                            |                        |                           |                       |                |           |            |
| Total                                                                           | \$ 2,473               | \$ 29,303                 | \$ 140,340            | \$ 10,112      | \$ 10,335 | \$ 192,563 |

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Impaired loans and nonperforming loans by loan class at June 30, 2011 and December 31, 2010 were summarized as follows:

|                                                                 | Commercial<br>Business | Commercial<br>Real Estate | One-to-Four<br>Family | Home<br>Equity | Consumer | Total    |
|-----------------------------------------------------------------|------------------------|---------------------------|-----------------------|----------------|----------|----------|
| <b>At June 30, 2011</b>                                         |                        |                           |                       |                |          |          |
| Impaired loans:                                                 |                        |                           |                       |                |          |          |
| Impaired loans with an allowance for loan losses                | \$                     | \$ 531                    | \$ 1,919              | \$ 33          | \$       | \$ 2,483 |
| Impaired loans with no allowance for loan losses                | 319                    | 5,258                     | 1,091                 | 79             | 23       | 6,770    |
| Total impaired loans                                            | \$ 319                 | \$ 5,789                  | \$ 3,010              | \$ 112         | \$ 23    | \$ 9,253 |
| Unpaid principal balance of impaired loans                      | \$ 319                 | \$ 5,789                  | \$ 3,010              | \$ 112         | \$ 23    | \$ 9,253 |
| Allowance for loan losses on impaired loans                     | \$                     | \$ 218                    | \$ 260                | \$ 16          | \$       | \$ 494   |
| Average recorded investment in impaired loans                   | \$ 190                 | \$ 5,360                  | \$ 2,411              | \$ 113         | \$ 40    | \$ 8,114 |
| Nonperforming loans:                                            |                        |                           |                       |                |          |          |
| Nonaccrual loans                                                | \$ 259                 | \$ 531                    | \$ 2,728              | \$ 100         | \$ 8     | \$ 3,626 |
| Loans past due 90 days and still accruing                       |                        |                           |                       |                |          |          |
| Troubled debt restructurings (not included in nonaccrual loans) |                        | 5,258                     | 604                   | 7              | 118      | 5,987    |
|                                                                 | \$ 259                 | \$ 5,789                  | \$ 3,332              | \$ 107         | \$ 126   | \$ 9,613 |
| <b>At December 31, 2010:</b>                                    |                        |                           |                       |                |          |          |
| Impaired loans:                                                 |                        |                           |                       |                |          |          |
| Impaired loans with an allowance for loan losses                | \$ 125                 | \$ 2,498                  | \$ 1,035              | \$ 33          | \$ 7     | \$ 3,698 |
| Impaired loans with no allowance for loan losses                |                        | 1,900                     | 1,634                 | 81             | 53       | 3,668    |
| Total impaired loans                                            | \$ 125                 | \$ 4,398                  | \$ 2,669              | \$ 114         | \$ 60    | \$ 7,366 |
| Unpaid principal balance of impaired loans                      | \$ 125                 | \$ 4,398                  | \$ 2,669              | \$ 114         | \$ 60    | \$ 7,366 |
| Allowance for loan losses on impaired loans                     | \$ 100                 | \$ 626                    | \$ 183                | \$ 17          | \$ 3     | \$ 929   |
|                                                                 | \$ 63                  | \$ 2,834                  | \$ 1,887              | \$ 57          | \$ 51    | \$ 4,892 |

Average recorded investment  
in impaired loans

## Nonperforming loans:

|                                                                       |    |     |    |       |    |       |    |     |    |     |    |       |
|-----------------------------------------------------------------------|----|-----|----|-------|----|-------|----|-----|----|-----|----|-------|
| Nonaccrual loans                                                      | \$ | 125 | \$ | 2,498 | \$ | 1,704 | \$ | 101 | \$ | 20  | \$ | 4,448 |
| Loans past due 90 days and<br>still accruing                          |    |     |    |       |    |       |    |     |    |     |    |       |
| Troubled debt restructurings<br>(not included in nonaccrual<br>loans) |    |     |    |       |    | 841   |    | 7   |    | 149 |    | 997   |
|                                                                       | \$ | 125 | \$ | 2,498 | \$ | 2,545 | \$ | 108 | \$ | 169 | \$ | 5,445 |

Interest income on impaired loans recognized on a cash basis was insignificant for the six months ended June 30, 2011 and 2010.

For the six months ended June 30, 2011 and 2010, gross interest income that would have been recorded had our non-accruing loans been current in accordance with their original terms was \$119 and \$163, respectively. Interest income recognized on such loans for the six months ended June 30, 2011 and 2010 was \$30 and \$6, respectively. Troubled debt restructurings are loans for which a portion of the interest or principal has been forgiven or loans modified at interest rates materially less than current market rates.

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Following is a summary of the activity in the allowance for loan losses by loan class for the six months ended June 30, 2011 and 2010 and total investment in loans at June 30, 2011, December 31, 2010 and June 30, 2010:

|                                                       | Commercial<br>Business | Commercial<br>Real Estate | One-to-Four<br>Family | Home<br>Equity | Consumer  | Total      |
|-------------------------------------------------------|------------------------|---------------------------|-----------------------|----------------|-----------|------------|
| <b>Six Months Ended June 30, 2011:</b>                |                        |                           |                       |                |           |            |
| Allowance for Loan Losses:                            |                        |                           |                       |                |           |            |
| Balance, beginning of period                          | \$ 131                 | \$ 1,081                  | \$ 736                | \$ 60          | \$ 128    | \$ 2,136   |
| Provision for loan losses                             | 51                     | 112                       | 254                   | 10             | (16)      | 411        |
| Loans charged to the allowance                        | (125)                  | (467)                     | (73)                  |                | (31)      | (696)      |
| Recoveries of loans previously charged off            |                        |                           |                       |                | 8         | 8          |
| Balance, end of period                                | \$ 57                  | \$ 726                    | \$ 917                | \$ 70          | \$ 89     | \$ 1,859   |
| Ending balance: individually evaluated for impairment | \$                     | \$ 218                    | \$ 260                | \$ 16          | \$        | \$ 494     |
| Ending balance: collectively evaluated for impairment | \$ 57                  | \$ 508                    | \$ 657                | \$ 54          | \$ 89     | \$ 1,365   |
| <b>At June 30, 2011:</b>                              |                        |                           |                       |                |           |            |
| Loans:                                                |                        |                           |                       |                |           |            |
| Ending balance                                        | \$ 3,594               | \$ 31,522                 | \$ 141,029            | \$ 10,117      | \$ 9,319  | \$ 195,581 |
| Ending balance individually evaluated for impairment  | \$ 319                 | \$ 5,789                  | \$ 3,010              | \$ 112         | \$ 23     | \$ 9,253   |
| Ending balance collectively evaluated for impairment  | \$ 3,275               | \$ 25,733                 | \$ 138,019            | \$ 10,005      | \$ 9,296  | \$ 186,328 |
| <b>At December 31, 2010:</b>                          |                        |                           |                       |                |           |            |
| Loans:                                                |                        |                           |                       |                |           |            |
| Ending balance                                        | \$ 2,473               | \$ 29,303                 | \$ 140,340            | \$ 10,112      | \$ 10,335 | \$ 192,563 |
| Ending balance individually evaluated for impairment  | \$ 125                 | \$ 4,398                  | \$ 2,669              | \$ 114         | \$ 60     | \$ 7,366   |
| Ending balance collectively evaluated for impairment  | \$ 2,348               | \$ 24,905                 | \$ 137,671            | \$ 9,998       | \$ 10,275 | \$ 185,197 |

**At June 30, 2010:**

## Loans:

|                                                      |    |     |    |        |    |         |    |       |    |        |    |         |
|------------------------------------------------------|----|-----|----|--------|----|---------|----|-------|----|--------|----|---------|
| Ending balance                                       | \$ | 638 | \$ | 24,090 | \$ | 121,027 | \$ | 8,903 | \$ | 11,345 | \$ | 166,003 |
| Ending balance individually evaluated for impairment | \$ |     | \$ | 5,761  | \$ | 1,739   | \$ | 27    | \$ | 72     | \$ | 7,599   |
| Ending balance collectively evaluated for impairment | \$ | 638 | \$ | 18,329 | \$ | 119,288 | \$ | 8,876 | \$ | 11,273 | \$ | 158,404 |

**Six Months Ended June 30, 2010:**

## Allowance for Loan Losses:

|                                                       |    |    |    |       |    |       |    |    |    |      |    |       |
|-------------------------------------------------------|----|----|----|-------|----|-------|----|----|----|------|----|-------|
| Balance, beginning of period                          | \$ | 12 | \$ | 293   | \$ | 455   | \$ | 33 | \$ | 147  | \$ | 940   |
| Provision for loan losses                             |    | 42 |    | 726   |    | 366   |    | 8  |    | 29   |    | 1,171 |
| Loans charged to the allowance                        |    |    |    |       |    | (117) |    |    |    | (44) |    | (161) |
| Recoveries of loans previously charged off            |    |    |    |       |    |       |    |    |    | 13   |    | 13    |
| Balance, end of period                                | \$ | 54 | \$ | 1,019 | \$ | 704   | \$ | 41 | \$ | 145  | \$ | 1,963 |
| Ending balance: individually evaluated for impairment | \$ |    | \$ | 604   | \$ | 230   | \$ |    | \$ | 13   | \$ | 847   |
| Ending balance: collectively evaluated for impairment | \$ | 54 | \$ | 415   | \$ | 474   | \$ | 41 | \$ | 132  | \$ | 1,116 |

The \$760 decrease in the provision for loan losses was primarily attributable to the recognition of a specific allowance of \$604 on a commercial real estate loan during the six months ended June 30, 2010.

The Bank originated \$21,089 and \$10,170 in loans during the six months ended June 30, 2011 and 2010, respectively, which were placed with various correspondent lending institutions. Proceeds on sales of these loans were \$22,697 and \$10,114 for the six months ended June 30, 2011 and 2010, respectively. Gains on sales of these loans were \$529 and \$219 for the six months ended June 30, 2011 and 2010, respectively. These loans were sold with servicing rights released.

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Loans serviced for the benefit of others amounted to \$2,578, \$2,640 and \$2,657 at June 30, 2011, December 31, 2010 and June 30, 2010, respectively.

**Note 5. Borrowings**

The Bank periodically borrows from the FHLB of Dallas. At June 30, 2011, the Bank had a total of fourteen such advances which totaled \$15,983. These advances have various maturities ranging from August 8, 2011 through November 17, 2014 at interest rates from 0.42% to 3.09%.

At December 31, 2010, the Bank had a total of fourteen such advances which totaled \$15,987. These advances have various maturities ranging from August 8, 2011 through November 17, 2014 at interest rates from 0.49% to 3.09%. These advances are secured by FHLB of Dallas stock, real estate loans and securities of \$113,250 and \$116,532, at June 30, 2011 and December 31, 2010, respectively. The Bank had remaining credit available under the FHLB advance program of \$97,095 and \$100,332 at June 30, 2011 and December 31, 2010, respectively.

**Note 6. Income Taxes**

The effective tax rate was 25.4% for the six months ended June 30, 2011, compared to 48.1% for the six months ended June 30, 2010. The decrease in the effective tax rate was primarily attributable to certain factors, including permanent differences related to tax exempt income consisting of interest on municipal obligations and BOLI income. There were no significant changes in deferred tax items during the six months ended June 30, 2011.

**Note 7. Financial Instruments With Off-Balance Sheet Risk**

The Bank is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet.

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit is represented by the contractual amount of these instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

At June 30, 2011 and December 31, 2010, the approximate amounts of these financial instruments were as follows:

|                              | June 30,<br>2011 | December 31,<br>2010 |
|------------------------------|------------------|----------------------|
| Commitments to extend credit | \$ 16,083        | \$ 14,315            |

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**Notes to Consolidated Financial Statements (Unaudited)**

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained if deemed necessary by the Bank upon extension of credit is based on management's credit evaluation of the counterparty. Collateral held varies but may include cattle, accounts receivable, inventory, property, single and multi-family residences, plant and equipment and income-producing commercial properties. At June 30, 2011 and December 31, 2010, commitments to fund fixed rate loans of \$6,215 and \$6,120, respectively, were included in the commitments to extend credit. Interest rates on these commitments to fund fixed rate loans ranged from 3.90% to 7.50% at June 30, 2011 and from 3.25% to 6.50% at December 31, 2010.

The Bank has not incurred any significant losses on its commitments in the six months ended June 30, 2011 or 2010. Although the maximum exposure to loss is the amount of such commitments, management anticipates no material losses from such activities.

**Note 8. Regulatory Capital**

The Bank is subject to various regulatory capital requirements administered by the federal and state banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy requires the Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), of core capital (as defined) to adjusted tangible assets (as defined) and of tangible capital (as defined) to tangible assets. Management believes, as of June 30, 2011 and December 31, 2010, that the Bank meets all capital adequacy requirements to which it is subject.

At June 30, 2011 and December 31, 2010, the most recent regulatory notification categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the institution's category.

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The following table sets forth the Bank's capital ratios as of June 30, 2011 and December 31, 2010:

|                                        | Actual    |        | Minimum for Capital Adequacy Purposes |       | Minimum To Be Well Capitalized Under Prompt Corrective Action Provision |        |
|----------------------------------------|-----------|--------|---------------------------------------|-------|-------------------------------------------------------------------------|--------|
|                                        | Amount    | Ratio  | Amount                                | Ratio | Amount                                                                  | Ratio  |
| As of June 30, 2011:                   |           |        |                                       |       |                                                                         |        |
| Tangible capital to tangible assets    | \$ 28,724 | 10.80% | \$ 3,989                              | 1.50% | N/A                                                                     | N/A    |
| Total capital to risk weighted assets  | 30,089    | 17.33% | 13,893                                | 8.00% | \$ 17,366                                                               | 10.00% |
| Tier 1 capital to risk weighted assets | 28,724    | 16.54% | 6,947                                 | 4.00% | 10,420                                                                  | 6.00%  |
| Tier 1 capital to average assets       | 28,724    | 10.80% | 10,637                                | 4.00% | 13,296                                                                  | 5.00%  |
| As of December 31, 2010:               |           |        |                                       |       |                                                                         |        |
| Tangible capital to tangible assets    | \$ 28,129 | 11.78% | \$ 3,581                              | 1.50% | N/A                                                                     | N/A    |
| Total capital to risk weighted assets  | 29,336    | 18.46% | 12,716                                | 8.00% | \$ 15,894                                                               | 10.00% |
| Tier 1 capital to risk weighted assets | 28,129    | 17.70% | 6,358                                 | 4.00% | 9,537                                                                   | 6.00%  |
| Tier 1 capital to average assets       | 28,129    | 11.78% | 9,548                                 | 4.00% | 11,936                                                                  | 5.00%  |

The following is a reconciliation of the Bank's equity capital under U.S. generally accepted accounting principles to Tangible and Tier 1 capital and Total capital (as defined by the OCC) at June 30, 2011 and December 31, 2010:

|                                      | June 30, 2011 | December 31, 2010 |
|--------------------------------------|---------------|-------------------|
| Equity capital                       | \$ 28,808     | \$ 28,292         |
| Disallowed deferred tax asset        | (125)         | (250)             |
| Unrealized losses on securities, net | 41            | 87                |
| Tangible and Tier 1 capital          | 28,724        | 28,129            |
| General allowance for loan losses    | 1,365         | 1,207             |
| Total capital                        | \$ 30,089     | \$ 29,336         |

**Note 9. Fair Value Measurements**

Accounting standards define 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 (1) independent, (2) knowledgeable, (3) able to transact and (4) willing to transact.

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**SP Bancorp, Inc.**

**Notes to Consolidated Financial Statements (Unaudited)**

The guidance 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 cost). 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, the guidance 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.

**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 might 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 (such as interest rates, volatilities, prepayment speeds, credit risks, etc.) or inputs that are derived principally from or corroborated by market data by correlation or other means.

**Level 3 Inputs** Unobservable inputs for determining the fair values of assets or liabilities that reflect an entity's own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

**Table of Contents****SP Bancorp, Inc.****Notes to Consolidated Financial Statements (Unaudited)**

The following table represents assets and liabilities reported on the consolidated balance sheet at their fair value as of June 30, 2011 and December 31, 2010 by level within the ASC 820 fair value measurement hierarchy:

|                                     | Fair Value Measurements at Reporting Date Using     |                                                                                     |                                                           |                                                    |
|-------------------------------------|-----------------------------------------------------|-------------------------------------------------------------------------------------|-----------------------------------------------------------|----------------------------------------------------|
|                                     | Assets/<br>Liabilities<br>Measured<br>At Fair Value | Quoted<br>Prices in<br>Active<br>Markets<br>for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| June 30, 2011:                      |                                                     |                                                                                     |                                                           |                                                    |
| Measured on a recurring basis:      |                                                     |                                                                                     |                                                           |                                                    |
| Assets:                             |                                                     |                                                                                     |                                                           |                                                    |
| Securities available for sale:      |                                                     |                                                                                     |                                                           |                                                    |
| Municipal securities                | \$ 5,293                                            | \$ 5,293                                                                            | \$ 5,293                                                  | \$                                                 |
| Collateralized mortgage obligations | 10,276                                              |                                                                                     | 10,276                                                    |                                                    |
| Mortgage-backed securities          | 6,815                                               |                                                                                     | 6,815                                                     |                                                    |
| Measured on a nonrecurring basis:   |                                                     |                                                                                     |                                                           |                                                    |
| Assets:                             |                                                     |                                                                                     |                                                           |                                                    |
| Impaired loans                      | 1,989                                               |                                                                                     |                                                           | 1,989                                              |
| Other real estate owned             | 1,783                                               |                                                                                     |                                                           | 1,783                                              |
| December 31, 2010:                  |                                                     |                                                                                     |                                                           |                                                    |
| Measured on a recurring basis:      |                                                     |                                                                                     |                                                           |                                                    |
| Assets:                             |                                                     |                                                                                     |                                                           |                                                    |
| Securities available for sale:      |                                                     |                                                                                     |                                                           |                                                    |
| Municipal securities                | \$ 3,585                                            | \$ 3,585                                                                            | \$ 3,585                                                  | \$                                                 |
| Collateralized mortgage obligations | 10,488                                              |                                                                                     | 10,488                                                    |                                                    |
| Mortgage-backed securities          | 8,003                                               |                                                                                     | 8,003                                                     |                                                    |
| Measured on a nonrecurring basis:   |                                                     |                                                                                     |                                                           |                                                    |
| Assets:                             |                                                     |                                                                                     |                                                           |                                                    |
| Impaired loans                      | 2,769                                               |                                                                                     |                                                           | 2,769                                              |

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

Securities available for sale are classified within Level 2 of the valuation hierarchy. The Company obtains fair value measurements for securities 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 prepayment spreads, credit information and the bond's terms and conditions, among other things.



**Table of Contents****SP Bancorp, Inc.****Notes to Consolidated Financial Statements (Unaudited)**

Certain financial assets and financial liabilities are measured at fair value on a nonrecurring basis. 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). Certain impaired loans are reported at the fair value of underlying collateral if repayment is expected solely from the collateral. Other real estate owned is initially recorded at fair value less estimated costs of disposal, which establishes a new cost basis. Collateral values are estimated using Level 2 inputs based on observable market data such as independent appraisals or level 3 inputs based on customized discounting.

At June 30, 2011 and December 31, 2010, impaired loans (with allocated allowance for losses) had principal balances of \$2,483 and \$3,698, respectively, and allocated allowance for losses of \$494 and \$929, respectively. The allocated allowance for losses decreased due primarily to a partial charge-off of a loan secured by undeveloped land, which was foreclosed in February 2011.

**Note 10. Disclosure About the Fair Value of Financial Instruments**

The estimated fair values of the Company's financial instruments at June 30, 2011 and December 31, 2010 were as follows:

|                               | June 30,<br>2011   |                         | December 31,<br>2010 |                         |
|-------------------------------|--------------------|-------------------------|----------------------|-------------------------|
|                               | Carrying<br>Amount | Estimated<br>Fair Value | Carrying<br>Amount   | Estimated<br>Fair Value |
| Financial assets:             |                    |                         |                      |                         |
| Cash and cash equivalents     | \$ 26,875          | \$ 26,875               | \$ 11,814            | \$ 11,814               |
| Securities available for sale | 22,384             | 22,384                  | 22,076               | 22,076                  |
| Fixed annuity investment      | 1,153              | 1,153                   | 1,131                | 1,131                   |
| Restricted stock              | 1,005              | 1,005                   | 1,003                | 1,003                   |
| Loans and loans held for sale | 198,315            | 197,826                 | 194,654              | 194,707                 |
| Accrued interest receivable   | 879                | 879                     | 833                  | 833                     |
| Financial liabilities:        |                    |                         |                      |                         |
| Deposit accounts              | 215,013            | 210,362                 | 188,244              | 183,738                 |
| Accrued interest payable      | 51                 | 51                      | 39                   | 39                      |
| Borrowings                    | 15,983             | 16,340                  | 15,987               | 16,151                  |

**Fair Values of Financial Instruments**

The fair value of a financial instrument is the current amount that would be exchanged between willing parties, other than in a forced liquidation. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument. ASC 820 excludes certain financial instruments and all nonfinancial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Company.

*Cash and short-term instruments*

The carrying amounts of cash and short-term instruments approximate their fair value.



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**SP Bancorp, Inc.**

**Notes to Consolidated Financial Statements (Unaudited)**

*Securities*

See Note 9 to Consolidated Financial Statements for methods and assumptions used to estimate fair values for securities.

The carrying value of Federal Home Loan Bank stock and other restricted equities approximate fair value based on the redemption provisions of the Federal Home Loan Bank.

*Fixed annuity investment*

The carrying amount approximates fair value.

*Loans and loans held for sale*

For variable-rate loans that reprice frequently and have no significant changes in credit risk, fair values are based on carrying values. Fair values for real estate and commercial loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Fair values for impaired loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable. Fair value of loans held for sale is based on commitments on hand from investors or prevailing market rates.

*Deposits*

The fair values disclosed for demand deposits are, by definition, equal to the amount payable on demand at the reporting date (that is their carrying amounts). The carrying amounts of variable-rate, fixed term money market accounts and variable-rate certificates of deposit (CD s) approximate their fair values at the reporting date. Fair values for fixed-rate CD s are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits.

*Advances from Federal Home Loan Bank*

The fair value of advances from the Federal Home Loan Bank maturing within 90 days approximates carrying value. Fair value of other advances is based on the discounted value of contractual cash flows based on the Bank s current incremental borrowing rate for similar borrowing arrangements.

*Accrued interest*

The carrying amounts of accrued interest approximate their fair values.

*Off-balance sheet instruments*

Commitments to extend credit and standby letters of credit have short maturities and therefore have no significant fair value.

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**Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

Management's discussion and analysis of financial condition and results of operations at June 30, 2011 and for the three and six months ended June 30, 2011 and 2010 is intended to assist in understanding the financial condition and results of operations of the Company. The information contained in this section should be read in conjunction with the Unaudited Consolidated Financial Statements and the notes thereto, appearing in Part 1, Item 1 of this report.

**CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS**

This Form 10-Q contains forward-looking statements, which can be identified by the use of words such as estimate, project, believe, intend, anticipate, plan, seek, expect, will, may and words of similar meaning. These 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 our current beliefs and expectations 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. We are under no duty to and do not take any obligation to update any forward-looking statements after the date of this Form 10-Q.

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

- 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 interest rate environment that reduce our margins or reduce the fair value of financial instruments;
- adverse changes in the securities markets;



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changes in laws or government regulations or policies affecting financial institutions, including changes in regulatory fees and capital requirements;  
our ability to enter new markets successfully and capitalize on growth opportunities;  
our ability to successfully integrate acquired entities, if any;  
changes in consumer spending, borrowing and savings habits;  
changes in accounting policies and practices, as may be adopted by the bank regulatory agencies, the Financial Accounting Standards Board, the Securities and Exchange Commission and the Public Company Accounting Oversight Board;  
changes in our organization, compensation and benefit plans;  
changes in our financial condition or results of operations that reduce capital; and  
changes in the financial condition or future prospects of issuers of securities that we own.

Because of these and a wide variety of other uncertainties, our actual future results may be materially different from the results indicated by these forward-looking statements.

**Overview**

On October 29, 2010, Share Plus Federal Bank completed its conversion from a federal mutual savings bank to a capital stock savings bank. A new holding company, SP Bancorp, Inc., was established as part of the conversion. The public offering was consummated through the sale and issuance by SP Bancorp, Inc. of 1,725,000 shares of common stock at \$10 per share. Net proceeds of \$14.5 million were raised in the stock offering, after deduction of conversion costs of \$2.0 million and excluding \$0.8 million which was loaned by the Company to a trust for the Employee Stock Ownership Plan (the ESOP). The Bank's ESOP is authorized to purchase up to 138,000 shares of common stock. The ESOP purchased 67,750 of those shares in the offering and 24,947 in the open market through June 30, 2011. The remaining 45,303 shares are expected to be purchased in the near term.

At June 30, 2011, we had total assets of \$266.0 million, compared to \$238.8 million at December 31, 2010. This increase was primarily the result of an increase in cash and cash equivalents, investment in bank-owned life insurance and loans, funded by customer deposits.

During the three months ended June 30, 2011, we had net income of \$218,000, compared to a net income of \$281,000 for the three months ended June 30, 2010. Lower net income resulted from higher noninterest expense and provision for loan losses, partially offset by higher net interest income and noninterest income and lower tax expense. During the six months ended June 30, 2011, we had net income of \$435,000, compared to a net loss of \$42,000 for the six months ended June 30, 2010. Higher net income resulted from a higher level of net interest income and noninterest income and a lower provision for loan losses, partially offset by higher noninterest expense and income tax expense. Our results of operations depend mainly on our net interest income, which is the difference between the interest income we earn on our loan and investment portfolios and the interest expense we incur on our deposits and, to a lesser extent, our borrowings. Results of operations are also affected by service charges and other fees, provision for loan losses, commissions, gains on sales of securities and loans and other income. Our noninterest expense consists primarily of compensation and benefits, occupancy costs, equipment expense, data processing, ATM expense, professional and outside services, FDIC insurance assessments, marketing and income tax expense.

Our results of operations are also significantly affected by general economic and competitive conditions (such as changes in energy prices and real estate values which have an impact on our Texas market area), as well as changes in interest rates, government policies and actions of regulatory authorities. Future changes in applicable laws, regulations or government policies may materially affect our financial condition and results of operations.

**Critical Accounting Policies.** There are no material changes to the critical accounting policies disclosed in SP Bancorp, Inc.'s Form 10-K dated December 31, 2010, as filed on March 29, 2011 with the Securities and Exchange Commission.

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**Economy.** Like the national economy, the Texas economy has been in a recession, but the Texas unemployment rate has been below the national rate for several months. The Dallas-Fort Worth Metroplex unemployment rate declined from 8.5% in June 2010 to 7.9% in May 2011. While the state's seasonally adjusted unemployment rate rose from 8.1% in June 2010 to 8.2% in June 2011, the corresponding U.S. rate decreased from 9.5% to 9.2% during the same period.

**Comparison of Financial Condition at June 30, 2011 and December 31, 2010****Summary of Selected Balance Sheet Data.**

| (Dollars in thousands)                                                     | June 30,<br>2011 | December<br>31,<br>2010 | Increase<br>(Decrease) | % Change |
|----------------------------------------------------------------------------|------------------|-------------------------|------------------------|----------|
| Total assets                                                               | \$ 266,004       | \$ 238,817              | \$ 27,187              | 11.38%   |
| Total cash and cash equivalents                                            | 26,875           | 11,814                  | 15,061                 | 127.48   |
| Securities available for sale, at fair value                               | 22,384           | 22,076                  | 308                    | 1.40     |
| Loans held for sale                                                        | 3,969            | 3,589                   | 380                    | 10.59    |
| Loans, net                                                                 | 194,346          | 191,065                 | 3,281                  | 1.72     |
| Other real estate owned                                                    | 1,783            |                         | 1,783                  | NM       |
| Premises and equipment, net                                                | 4,510            | 4,637                   | (127)                  | (2.74)   |
| Federal Home Loan Bank of Dallas stock and other restricted stock, at cost | 1,005            | 1,003                   | 2                      | 0.20     |
| Bank-owned life insurance                                                  | 6,076            |                         | 6,076                  | NM       |
| Other assets (1)                                                           | 5,056            | 4,633                   | 423                    | 9.13     |
| Deposits                                                                   | 215,013          | 188,244                 | 26,769                 | 14.22    |
| Borrowings                                                                 | 15,983           | 15,987                  | (4)                    | (0.03)   |
| Stockholders' equity                                                       | 32,492           | 32,104                  | 388                    | 1.21     |

1) Includes fixed annuity investment, accrued interest receivable, deferred tax assets and other assets.

NM Not meaningful.

Total assets increased primarily as a result of an increase in cash and cash equivalents, investment in bank-owned life insurance and loans, which were funded by customer deposits. In addition, certain loans were transferred to other real estate owned.

Net loans increased primarily in commercial real estate loans.

The BOLI investment was purchased to offset costs associated with benefit plans and to generate competitive investment returns. The BOLI investment was made equally between three insurance carriers, which had Standard & Poor's ratings ranging from A+ to AAA.

Deposits increased primarily from deposit inflows from existing customers.

Stockholders' equity increased primarily as a result of net income of \$435,000 for the six months ended June 30, 2011.

**Comparison of Operating Results for the Three Months Ended June 30, 2011 and 2010**

**General.** We recorded net income of \$218,000 for the three months ended June 30, 2011, compared to net income of \$281,000 for the same period last year. Noninterest expense increased by \$533,000 and our provision for loan losses increased by \$200,000, which were partially offset by net interest income which increased by \$332,000 to \$2.3 million for the three months ended June 30, 2011 from \$1.9 million for the three months ended June 30, 2010, noninterest income which increased by \$229,000 and income tax expense which decreased by \$109,000.



**Table of Contents****Summary of Net Interest Income.**

| (Dollars in thousands)        | Three Months Ended June |                 | Increase<br>(Decrease) | % Change      |
|-------------------------------|-------------------------|-----------------|------------------------|---------------|
|                               | 2011                    | 30,<br>2010     |                        |               |
| Interest income:              |                         |                 |                        |               |
| Interest and fees on loans    | \$ 2,571                | \$ 2,343        | \$ 228                 | 9.73%         |
| Securities taxable            | 119                     | 88              | 31                     | 35.23         |
| Securities nontaxable         | 36                      | 16              | 20                     | 125.00        |
| Other interest earning assets | 32                      | 46              | (14)                   | (30.43)       |
| Total interest income         | 2,758                   | 2,493           | 265                    | 10.63         |
| Interest expense:             |                         |                 |                        |               |
| Savings deposits              | 22                      | 22              |                        | 0.00          |
| Money market                  | 43                      | 76              | (33)                   | (43.42)       |
| Demand deposit account        | 30                      | 35              | (5)                    | (14.29)       |
| Certificates of deposit       | 270                     | 299             | (29)                   | (9.70)        |
| Total deposits                | 365                     | 432             | (67)                   | (15.51)       |
| Borrowings                    | 113                     | 113             |                        | 0.00          |
| Total interest expense        | 478                     | 545             | (67)                   | (12.29)       |
| <b>Net interest income</b>    | <b>\$ 2,280</b>         | <b>\$ 1,948</b> | <b>\$ 332</b>          | <b>17.04%</b> |

**Table of Contents****Summary of Average Yields, Average Rates and Average Balances.****Average Yields and Rates**

|                                    | Three Months Ended June |             | Increase<br>(decrease) |
|------------------------------------|-------------------------|-------------|------------------------|
|                                    | 2011                    | 30,<br>2010 |                        |
| Loans                              | 5.27%                   | 5.62%       | (0.35)%                |
| Securities taxable                 | 2.51%                   | 2.78%       | (0.27)                 |
| Securities nontaxable              | 3.59%                   | 3.99%       | (0.40)                 |
| Other interest earning assets      | 0.45%                   | 0.55%       | (0.10)                 |
| Total interest-earning assets      | 4.48%                   | 4.63%       | (0.15)                 |
| Savings deposits                   | 0.25%                   | 0.25%       | 0.00                   |
| Money market                       | 0.40%                   | 0.83%       | (0.43)                 |
| Demand deposit account             | 0.21%                   | 0.26%       | (0.05)                 |
| Certificates of deposit            | 1.59%                   | 2.01%       | (0.42)                 |
| Total deposits                     | 0.71%                   | 0.93%       | (0.22)                 |
| Borrowings                         | 2.83%                   | 2.83%       | 0.00                   |
| Total interest-bearing liabilities | 0.87%                   | 1.08%       | (0.21)                 |
| Net interest rate spread           | 3.61%                   | 3.55%       | 0.06                   |
| Net interest margin                | 3.70%                   | 3.62%       | 0.08%                  |

**Average Balances**

| (Dollars in thousands)        | Three Months Ended June |             | Increase<br>(Decrease) | % Change |
|-------------------------------|-------------------------|-------------|------------------------|----------|
|                               | 2011                    | 30,<br>2010 |                        |          |
| Loans                         | \$ 195,069              | \$ 166,832  | \$ 28,237              | 16.93%   |
| Securities taxable            | 18,968                  | 12,683      | 6,285                  | 49.55    |
| Securities nontaxable         | 4,009                   | 1,606       | 2,403                  | 149.63   |
| Other interest earning assets | 28,388                  | 34,132      | (5,744)                | (16.83)  |
| Total interest-earning assets | 246,434                 | 215,253     | 31,181                 | 14.49    |
| Savings deposits              | 34,860                  | 34,732      | 128                    | 0.37     |
| Money market                  | 42,948                  | 36,722      | 6,226                  | 16.95    |
| Demand deposit account        | 58,526                  | 54,484      | 4,042                  | 7.42     |
| Certificates of deposit       | 67,926                  | 59,517      | 8,409                  | 14.13    |
| Total deposits                | 204,260                 | 185,455     | 18,805                 | 10.14    |
| Borrowings                    | 15,979                  | 15,988      | (9)                    | (0.06)   |

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|                                    |           |           |           |        |
|------------------------------------|-----------|-----------|-----------|--------|
| Total interest-bearing liabilities | 220,239   | 201,443   | 18,796    | 9.33   |
| Net interest-earning assets        | \$ 26,195 | \$ 13,810 | \$ 12,385 | 89.68% |

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**Interest Income.** Interest income increased primarily due to proceeds from our common stock offering in October 2010 and increased customer deposits that were invested in loans, our highest earning asset. Interest income and fees on loans increased as the increase in the average balance of loans more than offset a decrease in the average yield on our loans. The average yield on our loan portfolio decreased, reflecting a lower market interest rate environment.

Interest income on taxable securities increased primarily from an increase in our average balance, which more than offset the decrease in the average yield of our taxable securities. The decline in the average yield on our taxable securities portfolio resulted from lower market interest rates.

**Interest Expense.** Interest expense decreased as the decrease in the average cost of deposits more than offset the increase in the average balance of deposits. The average rate we paid on deposits decreased as we were able to reprice our deposits downward in the declining market interest rate environment. The increase in the average balance of our deposits resulted primarily from increases in the average balance of money market accounts, and to a lesser extent, certificates of deposit, reflecting our successful marketing efforts.

During the June 2011 quarter, we utilized deposits to a higher degree and relied less on overnight and short-term advances to fund loans.

**Net Interest Income.** Net interest income increased as our net interest-earning assets increased. The increase in our net interest-earning assets, interest rate spread and net interest margin is attributable primarily to proceeds from sale of our common stock that were invested in loans.

**Provision for Loan Losses.** We recorded a provision for loan losses of \$291,000 for the three months ended June 30, 2011, compared to \$91,000 for the same period in 2010. The increase was, in part, attributable to increased loss exposures in the loan portfolio, and included a specific allowance of \$133,000 on a first and second mortgage loan secured by a single-family dwelling.

**Summary of Noninterest Income.**

| (Dollars in thousands)                        | Three Months Ended June |             | Increase<br>(Decrease) | % Change |
|-----------------------------------------------|-------------------------|-------------|------------------------|----------|
|                                               | 2011                    | 30,<br>2010 |                        |          |
| Noninterest income:                           |                         |             |                        |          |
| Service charges                               | \$ 314                  | \$ 385      | \$ (71)                | (18.44)% |
| Gain on sale of securities available for sale | 174                     | 128         | 46                     | 35.94    |
| Gain on sale of mortgage loans                | 306                     | 107         | 199                    | 185.98   |
| Other                                         | 91                      | 36          | 55                     | 152.78   |
| Total noninterest income                      | \$ 885                  | \$ 656      | \$ 229                 | 34.91%   |

**Noninterest Income.** Noninterest income increased primarily due to gains on sale of mortgage loans and securities. Our origination, sale and resulting gains on one-to-four family residential loans in the secondary market is dependent upon relative customer demand, which is affected by current and anticipated market interest rates. Gains on sale of securities are not stable sources of income and there is no assurance that the Company will generate such gains in the future.

Service charges decreased as a result of lower NSF charges and other deposit fees driven by new regulations related to overdraft protection programs, partially offset by higher ATM fees. Other noninterest income increased due to higher fees from sales of investment and insurance products and an increase in the cash surrender value of the BOLI investment.

**Table of Contents****Summary of Noninterest Expense.**

| (Dollars in thousands)            | Three Months Ended June |             | Increase<br>(Decrease) | % Change |
|-----------------------------------|-------------------------|-------------|------------------------|----------|
|                                   | 2011                    | 30,<br>2010 |                        |          |
| Noninterest expense:              |                         |             |                        |          |
| Compensation and benefits         | \$ 1,317                | \$ 1,053    | \$ 264                 | 25.07%   |
| Occupancy costs                   | 257                     | 288         | (31)                   | (10.76)  |
| Equipment expense                 | 62                      | 64          | (2)                    | (3.13)   |
| Data processing expense           | 123                     | 135         | (12)                   | (8.89)   |
| ATM expense                       | 97                      | 95          | 2                      | 2.11     |
| Professional and outside services | 291                     | 136         | 155                    | 113.97   |
| Stationery and supplies           | 28                      | 33          | (5)                    | (15.15)  |
| Marketing                         | 44                      | 25          | 19                     | 76.00    |
| FDIC insurance assessments        | 78                      | 67          | 11                     | 16.42    |
| Operations from OREO              | 29                      |             | 29                     | NM       |
| Other                             | 266                     | 163         | 103                    | 63.19    |
| Total noninterest expense         | \$ 2,592                | \$ 2,059    | \$ 533                 | 25.89%   |

NM Not meaningful.

**Noninterest Expense.** Noninterest expense increased due primarily to an increase in compensation and benefits, professional and outside services and other noninterest expense.

Compensation and benefits increased due to higher salary levels and mortgage commission expenses, an additional commercial loan officer and additional personnel associated with the start up of the mortgage warehouse business. Occupancy costs decreased as a result of primarily lower maintenance costs, real estate taxes and depreciation expense. Professional and outside services reflects costs associated with the Company's public filing requirements with the SEC and outside consultant fees incurred for general corporate purposes. Operations from OREO increased due to various holding costs related to other real estate owned. Other noninterest expense increased due primarily to higher legal expenses related to loan and corporate matters and various other company expenses.

**Income Tax Expense.** We recorded a \$64,000 income tax expense for the three months ended June 30, 2011, compared to a \$173,000 income tax expense for the same period in 2010. Our effective tax rate was 22.7% for the three months ended June 30, 2011, compared to 38.1% for the three months ended June 30, 2010. The decrease in the effective tax rate was primarily attributable to certain factors, including permanent differences related to tax exempt income consisting of interest on municipal obligations and BOLI income.

**Comparison of Operating Results for the Six Months Ended June 30, 2011 and 2010**

**General.** We recorded net income of \$435,000 for the six months ended June 30, 2011, compared to a net loss of \$42,000 for the same period last year. Net interest income increased by \$620,000 to \$4.6 million for the six months ended June 30, 2011 from \$4.0 million for the six months ended June 30, 2010, noninterest income increased by \$407,000 and our provision for loan losses decreased by \$760,000, which was partially offset by higher noninterest expense of \$1.1 million and income tax expense of \$187,000.



**Table of Contents*****Summary of Net Interest Income***

| <b>(Dollars in thousands)</b> | <b>Six Months Ended June 30,</b> |                 | <b>Increase</b>   | <b>% Change</b> |
|-------------------------------|----------------------------------|-----------------|-------------------|-----------------|
|                               | <b>2011</b>                      | <b>2010</b>     | <b>(Decrease)</b> |                 |
| Interest income:              |                                  |                 |                   |                 |
| Interest and fees on loans    | \$ 5,189                         | \$ 4,763        | \$ 426            | 8.94%           |
| Securities taxable            | 199                              | 190             | 9                 | 4.74            |
| Securities nontaxable         | 70                               | 29              | 41                | 141.38          |
| Other interest earning assets | 54                               | 93              | (39)              | (41.94)         |
| <b>Total interest income</b>  | <b>5,512</b>                     | <b>5,075</b>    | <b>437</b>        | <b>8.61</b>     |
| Interest expense:             |                                  |                 |                   |                 |
| Savings deposits              | 41                               | 42              | (1)               | (2.38)          |
| Money market                  | 85                               | 149             | (64)              | (42.95)         |
| Demand deposit account        | 57                               | 73              | (16)              | (21.92)         |
| Certificates of deposit       | 521                              | 617             | (96)              | (15.56)         |
| <b>Total deposits</b>         | <b>704</b>                       | <b>881</b>      | <b>(177)</b>      | <b>(20.09)</b>  |
| Borrowings                    | 225                              | 231             | (6)               | (2.60)          |
| <b>Total interest expense</b> | <b>929</b>                       | <b>1,112</b>    | <b>(183)</b>      | <b>(16.46)</b>  |
| <b>Net interest income</b>    | <b>\$ 4,583</b>                  | <b>\$ 3,963</b> | <b>\$ 620</b>     | <b>15.64%</b>   |

**Table of Contents****Summary of Average Yields, Average Rates and Average Balances.****Average Yields and Rates**

|                                           | <b>Six Months Ended June 30,</b> |              | <b>Increase</b>   |
|-------------------------------------------|----------------------------------|--------------|-------------------|
|                                           | <b>2011</b>                      | <b>2010</b>  | <b>(decrease)</b> |
| Loans                                     | 5.32%                            | 5.66%        | (0.34)%           |
| Securities taxable                        | 2.07%                            | 3.09%        | (1.02)            |
| Securities nontaxable                     | 3.61%                            | 3.90%        | (0.29)            |
| Other interest earning assets             | 0.49%                            | 0.52%        | (0.03)            |
| <b>Total interest-earning assets</b>      | <b>4.59%</b>                     | <b>4.66%</b> | <b>(0.07)</b>     |
| Savings deposits                          | 0.25%                            | 0.25%        | 0.00              |
| Money market                              | 0.41%                            | 0.86%        | (0.45)            |
| Demand deposit account                    | 0.21%                            | 0.28%        | (0.07)            |
| Certificates of deposit                   | 1.61%                            | 2.10%        | (0.49)            |
| <b>Total deposits</b>                     | <b>0.72%</b>                     | <b>0.98%</b> | <b>(0.26)</b>     |
| Borrowings                                | 2.82%                            | 1.94%        | 0.88              |
| <b>Total interest-bearing liabilities</b> | <b>0.88%</b>                     | <b>1.09%</b> | <b>(0.21)</b>     |
| Net interest rate spread                  | 3.71%                            | 3.57%        | 0.14              |
| Net interest margin                       | 3.82%                            | 3.64%        | 0.18%             |

**Average Balances**

| <b>(Dollars in thousands)</b>             | <b>Six Months Ended June 30,</b> |                | <b>Increase</b>   |                 |
|-------------------------------------------|----------------------------------|----------------|-------------------|-----------------|
|                                           | <b>2011</b>                      | <b>2010</b>    | <b>(Decrease)</b> | <b>% Change</b> |
| Loans                                     | \$ 195,076                       | \$ 168,412     | \$ 26,664         | 15.83%          |
| Securities taxable                        | 19,219                           | 12,285         | 6,934             | 56.44           |
| Securities nontaxable                     | 3,878                            | 1,488          | 2,390             | 160.62          |
| Other interest earning assets             | 22,071                           | 35,688         | (13,617)          | (38.16)         |
| <b>Total interest-earning assets</b>      | <b>240,244</b>                   | <b>217,873</b> | <b>22,371</b>     | <b>10.27</b>    |
| Savings deposits                          | 33,211                           | 33,513         | (302)             | (0.90)          |
| Money market                              | 41,212                           | 34,574         | 6,638             | 19.20           |
| Demand deposit account                    | 55,223                           | 52,621         | 2,602             | 4.94            |
| Certificates of deposit                   | 64,618                           | 58,779         | 5,839             | 9.93            |
| <b>Total deposits</b>                     | <b>194,264</b>                   | <b>179,487</b> | <b>14,777</b>     | <b>8.23</b>     |
| Borrowings                                | 15,980                           | 23,835         | (7,855)           | (32.96)         |
| <b>Total interest-bearing liabilities</b> | <b>210,244</b>                   | <b>203,322</b> | <b>6,922</b>      | <b>3.40</b>     |

|                             |    |        |    |        |    |        |         |
|-----------------------------|----|--------|----|--------|----|--------|---------|
| Net interest-earning assets | \$ | 30,000 | \$ | 14,551 | \$ | 15,449 | 106.17% |
|-----------------------------|----|--------|----|--------|----|--------|---------|

**Interest Income.** Interest income increased primarily due to proceeds from our common stock offering in October 2010 and increased customer deposits that were invested in loans, our highest earning asset. Interest income and fees on loans increased as the increase in the average balance of loans more than offset a decrease in the average yield on our loans. The average yield on our loan portfolio decreased, reflecting a lower market interest rate environment.

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Interest income on nontaxable securities increased primarily from an increase in our average balance, which more than offset the decrease in the average yield of our nontaxable securities. The decline in the average yield on our nontaxable securities portfolio resulted from lower market interest rates.

**Interest Expense.** Interest expense decreased as the decrease in the average cost of deposits more than offset the increase in the average balance of deposits. The average rate we paid on deposits decreased as we were able to reprice our deposits downward in the declining market interest rate environment. The increase in the average balance of our deposits resulted primarily from increases in the average balance of money market accounts and certificates of deposit, reflecting our successful marketing efforts.

During the six months ended June 30, 2011, we utilized deposits to a higher degree and relied less on overnight and short-term advances to fund loans.

**Net Interest Income.** Net interest income increased as our net interest-earning assets increased. The increase in our net interest-earning assets, interest rate spread and net interest margin is attributable primarily to proceeds from sale of our common stock that were invested in loans.

**Provision for Loan Losses.** We recorded a provision for loan losses of \$411,000 for the six months ended June 30, 2011, compared to \$1.2 million for the same period in 2010.

The \$760,000 decrease in the provision for loan losses was primarily attributable to a specific allowance of \$604,000 on a commercial real estate loan established in the first quarter of 2010.

**Summary of Noninterest Income.**

| (Dollars in thousands)                        | Six Months Ended June 30, |          | Increase   | % Change |
|-----------------------------------------------|---------------------------|----------|------------|----------|
|                                               | 2011                      | 2010     | (Decrease) |          |
| Noninterest income:                           |                           |          |            |          |
| Service charges                               | \$ 634                    | \$ 759   | \$ (125)   | (16.47)% |
| Gain on sale of securities available for sale | 202                       | 128      | 74         | 57.81    |
| Gain on sale of mortgage loans                | 529                       | 219      | 310        | 141.55   |
| Other                                         | 213                       | 65       | 148        | 227.69   |
| Total noninterest income                      | \$ 1,578                  | \$ 1,171 | \$ 407     | 34.76%   |

**Noninterest Income.** Noninterest income increased primarily due to gains on sale of mortgage loans and securities. Our origination, sale and resulting gains on one-to-four family residential loans in the secondary market is dependent upon relative customer demand, which is affected by current and anticipated market interest rates. Gains on sale of securities are not stable sources of income and there is no assurance that the Company will generate such gains in the future.

Service charges decreased as a result of lower NSF charges and other deposit fees driven by new regulations related to overdraft protection programs, partially offset by higher ATM fees. Other noninterest income increased due to higher fees from sales of investment and insurance products and an increase in the cash surrender value of the BOLI investment.

**Table of Contents****Summary of Noninterest Expense.**

| (Dollars in thousands)            | Six Months Ended June 30, |                 | Increase        | % Change      |
|-----------------------------------|---------------------------|-----------------|-----------------|---------------|
|                                   | 2011                      | 2010            | (Decrease)      |               |
| Noninterest expense:              |                           |                 |                 |               |
| Compensation and benefits         | \$ 2,603                  | \$ 2,022        | \$ 581          | 28.73%        |
| Occupancy costs                   | 526                       | 561             | (35)            | (6.24)        |
| Equipment expense                 | 131                       | 111             | 20              | 18.02         |
| Data processing expense           | 238                       | 288             | (50)            | (17.36)       |
| ATM expense                       | 188                       | 186             | 2               | 1.08          |
| Professional and outside services | 523                       | 312             | 211             | 67.63         |
| Stationery and supplies           | 66                        | 59              | 7               | 11.86         |
| Marketing                         | 88                        | 63              | 25              | 39.68         |
| FDIC insurance assessments        | 170                       | 134             | 36              | 26.87         |
| Operations from OREO              | 131                       | (10)            | 141             | NM            |
| Other                             | 503                       | 318             | 185             | 58.18         |
| <b>Total noninterest expense</b>  | <b>\$ 5,167</b>           | <b>\$ 4,044</b> | <b>\$ 1,123</b> | <b>27.77%</b> |

NM Not meaningful.

**Noninterest Expense.** Noninterest expense increased due primarily to an increase in compensation and benefits, professional and outside services, operations from OREO and other noninterest expense.

Compensation and benefits increased due to reversal of a bonus accrual in the 2010 period, higher salary levels and mortgage commission expenses, an additional commercial loan officer and additional personnel associated with the start up of the mortgage warehouse business, partially offset by a higher level of deferred loan origination costs.

Occupancy costs decreased as a result of primarily lower maintenance costs, real estate taxes and depreciation expense. Equipment expense increased due to higher maintenance costs. Data processing decreased primarily as a result of lower costs following a contract renegotiation. Professional and outside services reflects costs associated with the Company's public filing requirements with the SEC and outside consultant fees incurred for general corporate purposes. FDIC insurance assessments increased as a result of a higher level of deposits. Operations from OREO increased due primarily to real estate taxes incurred on one commercial real estate property and various other holding costs related to other real estate owned. Other noninterest expense increased due primarily to higher legal expenses related to loan and corporate matters, travel costs, charitable contributions and various other company expenses.

**Income Tax Expense.** We recorded a \$148,000 income tax expense for the six months ended June 30, 2011, compared to a \$39,000 income tax benefit for the same period in 2010. Our effective tax rate was 25.4% for the six months ended June 30, 2011, compared to 48.1% for the six months ended June 30, 2010. The decrease in the effective tax rate was primarily attributable to certain factors, including permanent differences related to tax exempt income consisting of interest on municipal obligations and BOLI income.

**Table of Contents****Average Balances and Yields**

The following tables set forth average balance sheets, average yields and costs, and certain other information for the periods indicated. Tax-equivalent yield adjustments have not been made for tax-exempt securities. All average balances are daily average balances. Nonaccrual loans were included in the computation of average balances, but have been reflected in the table as loans carrying a zero yield. The yields set forth below include the effect of deferred fees, discounts and premiums that are amortized or accreted to interest income or expense.

|                                      | For the Three Months Ended June 30, |          |                               |                                   |          |                               |
|--------------------------------------|-------------------------------------|----------|-------------------------------|-----------------------------------|----------|-------------------------------|
|                                      | 2011                                |          |                               | 2010                              |          |                               |
|                                      | Average<br>Outstanding<br>Balance   | Interest | Yield/<br>Rate <sup>(1)</sup> | Average<br>Outstanding<br>Balance | Interest | Yield/<br>Rate <sup>(1)</sup> |
| <b>Interest-earning assets:</b>      |                                     |          |                               |                                   |          |                               |
| Loans, net                           | \$ 195,069                          | \$ 2,571 | 5.27%                         | \$ 166,832                        | \$ 2,343 | 5.62%                         |
| Taxable investment securities        | 18,968                              | 119      | 2.51%                         | 12,683                            | 88       | 2.78%                         |
| Nontaxable investment securities     | 4,009                               | 36       | 3.59%                         | 1,606                             | 16       | 3.99%                         |
| Total other interest earning assets  | 27,434                              | 31       | 0.45%                         | 32,974                            | 45       | 0.55%                         |
| FHLB of Dallas stock                 | 954                                 | 1        | 0.42%                         | 1,158                             | 1        | 0.35%                         |
| Total interest-earning assets        | 246,434                             | 2,758    | 4.48%                         | 215,253                           | 2,493    | 4.63%                         |
| Non-interest-earning assets          | 18,073                              |          |                               | 10,280                            |          |                               |
| Total assets                         | \$ 264,507                          |          |                               | \$ 225,533                        |          |                               |
| <b>Interest-bearing liabilities:</b> |                                     |          |                               |                                   |          |                               |
| Savings deposits                     | \$ 34,860                           | \$ 22    | 0.25%                         | \$ 34,732                         | \$ 22    | 0.25%                         |
| Money market                         | 42,948                              | 43       | 0.40%                         | 36,722                            | 76       | 0.83%                         |
| Demand deposit accounts              | 58,526                              | 30       | 0.21%                         | 54,484                            | 35       | 0.26%                         |
| Certificates of deposit              | 67,926                              | 270      | 1.59%                         | 59,517                            | 299      | 2.01%                         |
| Total deposits                       | 204,260                             | 365      | 0.71%                         | 185,455                           | 432      | 0.93%                         |
| Borrowings                           | 15,979                              | 113      | 2.83%                         | 15,988                            | 113      | 2.83%                         |
| Total interest-bearing liabilities   | 220,239                             | 478      | 0.87%                         | 201,443                           | 545      | 1.08%                         |
| Non-interest-bearing liabilities     | 11,832                              |          |                               | 7,013                             |          |                               |
| Total liabilities                    | 232,071                             |          |                               | 208,456                           |          |                               |
| Equity                               | 32,436                              |          |                               | 17,077                            |          |                               |

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|                                                                 |            |         |            |
|-----------------------------------------------------------------|------------|---------|------------|
| Total liabilities and equity                                    | \$ 264,507 |         | \$ 225,533 |
| Net interest income                                             | \$ 2,280   |         | \$ 1,948   |
| Net interest rate spread <sup>(2)</sup>                         |            | 3.61%   | 3.55%      |
| Net interest-earning assets <sup>(3)</sup>                      | \$ 26,195  |         | \$ 13,810  |
| Net interest margin <sup>(4)</sup>                              |            | 3.70%   | 3.62%      |
| Average interest-earning assets to interest-bearing liabilities |            | 111.89% | 106.86%    |

- (1) Yields and rates for the three months ended June 30, 2011 and 2010 are annualized.
- (2) Interest rate spread represents the difference between the yield on average interest-earning assets and the cost of average interest-bearing liabilities.
- (3) Net interest-earning assets represent total interest-earning assets less total interest-bearing liabilities.
- (4) Net interest margin represents net interest income divided by average total interest-earning assets.

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|                                            | For the Six Months Ended June 30, |          |                           |                                   |          |                           |
|--------------------------------------------|-----------------------------------|----------|---------------------------|-----------------------------------|----------|---------------------------|
|                                            | 2011                              |          |                           | 2010                              |          |                           |
|                                            | Average<br>Outstanding<br>Balance | Interest | Yield/Rate <sup>(1)</sup> | Average<br>Outstanding<br>Balance | Interest | Yield/Rate <sup>(1)</sup> |
| <b>Interest-earning assets:</b>            |                                   |          |                           |                                   |          |                           |
| Loans, net                                 | \$ 195,076                        | \$ 5,189 | 5.32%                     | \$ 168,412                        | \$ 4,763 | 5.66%                     |
| Taxable investment securities              | 19,219                            | 199      | 2.07%                     | 12,285                            | 190      | 3.09%                     |
| Nontaxable investment securities           | 3,878                             | 70       | 3.61%                     | 1,488                             | 29       | 3.90%                     |
| Total other interest earning assets        | 21,118                            | 52       | 0.49%                     | 34,312                            | 89       | 0.52%                     |
| FHLB of Dallas stock                       | 953                               | 2        | 0.42%                     | 1,376                             | 4        | 0.58%                     |
| Total interest-earning assets              | 240,244                           | 5,512    | 4.59%                     | 217,873                           | 5,075    | 4.66%                     |
| Non-interest-earning assets                | 14,338                            |          |                           | 9,755                             |          |                           |
| Total assets                               | \$ 254,582                        |          |                           | \$ 227,628                        |          |                           |
| <b>Interest-bearing liabilities:</b>       |                                   |          |                           |                                   |          |                           |
| Savings deposits                           | \$ 33,211                         | \$ 41    | 0.25%                     | \$ 33,513                         | \$ 42    | 0.25%                     |
| Money market                               | 41,212                            | 85       | 0.41%                     | 34,574                            | 149      | 0.86%                     |
| Demand deposit accounts                    | 55,223                            | 57       | 0.21%                     | 52,621                            | 73       | 0.28%                     |
| Certificates of deposit                    | 64,618                            | 521      | 1.61%                     | 58,779                            | 617      | 2.10%                     |
| Total deposits                             | 194,264                           | 704      | 0.72%                     | 179,487                           | 881      | 0.98%                     |
| Borrowings                                 | 15,980                            | 225      | 2.82%                     | 23,835                            | 231      | 1.94%                     |
| Total interest-bearing liabilities         | 210,244                           | 929      | 0.88%                     | 203,322                           | 1,112    | 1.09%                     |
| Non-interest-bearing liabilities           | 11,955                            |          |                           | 7,027                             |          |                           |
| Total liabilities                          | 222,199                           |          |                           | 210,349                           |          |                           |
| Equity                                     | 32,383                            |          |                           | 17,279                            |          |                           |
| Total liabilities and equity               | \$ 254,582                        |          |                           | \$ 227,628                        |          |                           |
| Net interest income                        |                                   | \$ 4,583 |                           |                                   | \$ 3,963 |                           |
| Net interest rate spread <sup>(2)</sup>    |                                   |          | 3.71%                     |                                   |          | 3.57%                     |
| Net interest-earning assets <sup>(3)</sup> | \$ 30,000                         |          |                           | \$ 14,551                         |          |                           |



|                                                                 |         |         |
|-----------------------------------------------------------------|---------|---------|
| Net interest margin <sup>(4)</sup>                              | 3.82%   | 3.64%   |
| Average interest-earning assets to interest-bearing liabilities | 114.27% | 107.16% |

- (1) Yields and rates for the six months ended June 30, 2011 and 2010 are annualized.
- (2) Interest rate spread represents the difference between the yield on average interest-earning assets and the cost of average interest-bearing liabilities.
- (3) Net interest-earning assets represent total interest-earning assets less total interest-bearing liabilities.
- (4) Net interest margin represents net interest income divided by average total interest-earning assets.

### **Liquidity and Capital Resources**

Liquidity is the ability to meet current and future financial obligations of a short-term nature. Our primary sources of funds consist of deposit inflows, loan sales and repayments, advances from the Federal Home Loan Bank of Dallas, and maturities and sales of securities. While maturities and scheduled amortization of loans and securities are predictable sources of funds, deposit flows and mortgage prepayments are greatly influenced by general interest rates, economic conditions and competition. Our Asset/Liability Management Committee is responsible for establishing and monitoring our liquidity targets and strategies in order to ensure that sufficient liquidity exists for meeting the borrowing needs and deposit withdrawals of our customers as well as unanticipated contingencies. For the six months ended June 30, 2011, our liquidity ratio averaged 16.8%. We believe that we have enough sources of liquidity to satisfy our short- and long-term liquidity needs as of June 30, 2011.

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We regularly monitor and adjust our investments in liquid assets based upon our assessment of: (i) expected loan demand; (ii) expected deposit flows; (iii) yields available on interest-earning deposits and securities; and (iv) the objectives of our asset/liability management program. Excess liquid assets are invested generally in interest-earning deposits and short- and intermediate-term securities.

Our most liquid assets are cash and cash equivalents. The levels of these assets are affected by our operating, financing, lending and investing activities during any given period. At June 30, 2011, cash and cash equivalents totaled \$26.9 million. Securities classified as available-for-sale, which provide additional sources of liquidity, totaled \$22.4 million at June 30, 2011.

Our cash flows are derived from operating activities, investing activities and financing activities as reported in our Consolidated Statements of Cash Flows included in our consolidated financial statements.

At June 30, 2011, we had \$16.1 million in loan commitments outstanding, including \$11.1 million in unused lines of credit to borrowers. Certificates of deposit due within one year of June 30, 2011 totaled \$43.4 million, or 20.2% of total deposits. If these deposits do not remain with us, we will be required to seek other sources of funds, including loan sales and Federal Home Loan Bank advances. Depending on market conditions, we may be required to pay higher rates on such deposits or other borrowings than we currently pay on the certificates of deposit due on or before June 30, 2012. We believe, however, that based on past experience, a significant portion of such deposits will remain with us. We have the ability to attract and retain deposits by adjusting the interest rates offered.

Our primary investing activity is originating loans. During the six months ended June 30, 2011 and 2010 we originated \$78.4 million and \$10.2 million of loans, respectively. We purchased \$20.1 million and \$8.2 million of securities during the six months ended June 30, 2011 and 2010, respectively.

Financing activities consist primarily of activity in deposit accounts and Federal Home Loan Bank advances. We had a net increase in total deposits of \$26.8 million and \$13.9 million for the six months ended June 30, 2011 and 2010, respectively. Deposit flows are affected by the overall level of interest rates, the interest rates and products offered by us and our local competitors, and by other factors. Borrowings decreased by \$4,000 for both the six months ended June 30, 2011 and 2010.

Liquidity management is both a daily and long-term function of business management. If we require funds beyond our ability to generate them internally, borrowing agreements exist with the Federal Home Loan Bank of Dallas, which provides an additional source of funds. Federal Home Loan Bank advances were \$16.0 million at June 30, 2011 unchanged from December 31, 2010. At June 30, 2011, we had remaining credit available under the FHLB of Dallas program of \$97.1 million.

SharePlus Federal Bank is subject to various regulatory capital requirements, including a risk-based capital measure. The risk-based capital guidelines include both a definition of capital and a framework for calculating risk-weighted assets by assigning balance sheet assets and off-balance sheet items to broad risk categories. At June 30, 2011, SharePlus Federal Bank exceeded all regulatory capital requirements. SharePlus Federal Bank is considered well capitalized under regulatory guidelines. See Note 8 Regulatory Capital of the notes to the consolidated financial statements.

**Table of Contents****Nonperforming Assets**

**Nonperforming Loans.** At June 30, 2011, our nonaccrual loans totaled \$3.6 million. The non-accrual loans consisted primarily of one commercial real estate loan, six single-family residential loans and three commercial business loans. The first loan has an outstanding balance of \$531,000 and is secured by a retail center in Sherman, Texas. This loan is a second lien with the first lien held by another bank with an outstanding balance of \$221,000. In July, 2011, the Bank bought out the first lien and foreclosed on the property. The first of the six single-family residential loans has an outstanding balance of \$559,000 and is secured by a residential property located in Orlando, Florida. At June 30, 2011, we had a specific allowance of \$18,000 for this loan based upon the net proceeds projected from a short sale that the Bank has agreed to. This sale is scheduled to close in August, 2011. The second loan is a residential property located in Dallas, Texas with an outstanding balance of \$778,000 and a specific allowance of \$18,000. The borrower has committed to make at least one payment per month while the Bank evaluates a possible restructure of this credit. The third and fourth loans consist of a first and a second lien on a residential property in Chandler, Arizona that total to an outstanding balance of \$339,000. At June 30, 2011, we had a specific allowance of \$133,000 against these loans based upon the net proceeds projected from a short sale that the Bank agreed to. This sale closed in July, 2011. The fifth and sixth loans are to the same borrower and consist of residential properties located in Temple and Killeen, Texas that are being rented as investment properties. These loans total \$468,000 and both were deemed to be adequately collateralized at June 30, 2011. The Bank agreed to a modification of terms for both loans, and these transactions were consummated in July, 2011. Both credits are now current. The three commercial business loans are to a specific borrower who has experienced financial difficulties over the past two years but had continued to show a commitment to repay his obligations. Recently, the borrower requested additional concessions which are currently under evaluation. These loans total \$259,000 and were deemed to be adequately collateralized at June 30, 2011. For the six months ended June 30, 2011, gross interest income that would have been recorded had our non-accruing loans been current in accordance with their original terms was \$119,000. Interest income recognized on such loans for the six months ended June 30, 2011 was \$30,000.

At June 30, 2011, we had a total of 17 loans that were not currently classified as nonaccrual, 90 days past due or troubled debt restructurings, but where known information about possible credit problems of borrowers caused management to have serious concerns as to the ability of the borrowers to comply with present loan repayment terms and that could result in disclosure as nonaccrual, 90 days past due or troubled debt restructurings. All of these loans are being monitored on our Watch List at June 30, 2011. Four of these loans are automobile loans, with an aggregate loan balance of \$7,000, and were made to individuals who have declared personal bankruptcy. Ten of these loans, with an aggregate balance of \$411,000, are collateralized by one- to four-family residential mortgages of borrowers who have, on occasion, been late with scheduled payments. One of these loans is a commercial business loan with a balance of \$60,000 that matured in June but was extended short term as the borrower is currently in discussions with the Bank regarding future disposition due to continued weakness in his primary business of residential construction. Two of these loans are commercial real estate loans totaling \$3.5 million secured by land and were current at June 30, 2011. Concerns generally stem from the nature of the collateral and the lack of sales activity in the market. One of these loans is a commercial real estate loan collateralized by a building with a principal loan balance of \$1.6 million. Management believes that the borrower will successfully re-tenant the building after the prior tenant filed bankruptcy in October 2010. However management has increased monitoring on the loan, which is current according to its terms. One of these loans is a commercial real estate loan totaling \$1.9 million which has been impacted by slower than projected leasing activity and rental rates below projections at the time of origination. This property is now 73% leased. This loan is current and continues to maintain significant interest and tax reserves at the Bank.

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**Troubled Debt Restructurings.** Troubled debt restructurings include loans for which either a portion of interest or principal has been forgiven, or for loans modified at interest rates or on terms materially less favorable than current market rates. We periodically modify loans to extend the term or make other concessions to help a borrower stay current on their loan and to avoid foreclosure. We generally do not forgive principal or interest on loans or modify the interest rates on loans to rates that are below market rates. At June 30, 2011, we had \$6.0 million of troubled debt restructurings (not included in nonaccrual loans) related to 15 consumer loans totaling \$118,000, four residential loans totaling \$611,000 and three commercial real estate loans totaling \$5.3 million. The three commercial real estate loans were modified during the first quarter of 2011, and included significant principal repayments from the borrowers, as well as interest rate reductions on each loan. The borrowers continued to make interest payments throughout the modification process. Management believes these modifications will allow for continued performance and additional time to market the properties, and recent appraisals on the properties indicate that the loans are adequately collateralized. Of this \$6.0 million in troubled debt restructurings (not included in nonaccrual loans), two loans totaling \$3,000 were past due between 30-89 days.

**Other Real Estate Owned.** At June 30, 2011, we had \$1.8 million in other real estate owned, consisting of undeveloped land, with a carrying value of \$1.5 million and two single-family dwellings.

**Classification of Assets.** Assets that do not expose us to risk sufficient to warrant classification, but which possess potential weaknesses that deserve our close attention, are required to be designated as special mention. As of June 30, 2011, we had \$2.3 million of assets designated as special mention with specific allowance of \$0.

When we classify assets as either substandard or doubtful, we allocate a portion of the related general loss allowances to such assets as we deem prudent. The allowance for loan losses is the amount estimated by management as necessary to absorb credit losses incurred in the loan portfolio that are both probable and reasonably estimable at the balance sheet date. When we classify a problem asset as doubtful, we charge the asset off. For other classified assets, we provide a specific allowance for that portion of the asset that is considered uncollectible. Our determination as to the classification of our assets and the amount of our loss allowances are subject to review by our principal federal regulator, the Office of the Comptroller of the Currency, which can require that we establish additional loss allowances. We regularly review our asset portfolio to determine whether any assets require classification in accordance with applicable regulations. On the basis of our review of our assets at June 30, 2011, substandard assets consisted of loans of \$10.9 million with specific allowance of \$495,000 and other real estate owned of \$1.8 million. There were no doubtful or loss assets at June 30, 2011.

As of June 30, 2011, our largest substandard asset was a \$2.0 million commercial real estate loan collateralized by 119 acres of raw land located in Celina, Texas. The loan was originated in February 2008 to a developer who purchased the property for residential development. The land was appraised at \$4.4 million in early 2008 with a loan to cost value of 67% at the time the loan was originated. The land was re-appraised in April 2010 for \$2.6 million, and at that date no sales had occurred due to the general market downturn. The loan was originally structured on a five-year term, with interest payable quarterly and a minimum 5% principal reduction, from sales or investor contribution, due at the end of each of years 3 and 4. This loan was modified in March of 2011, and the borrower reduced the principal by \$105,000. Terms were further modified to allow for continued performance and additional time to market the property. Following the loan modification, management also identified this loan as a troubled debt restructuring.

**Allowance for Loan Losses**

**Analysis and Determination of the Allowance for Loan Losses.** Our allowance for loan losses is the amount considered necessary to reflect probable incurred losses in our loan portfolio. We evaluate the need to establish allowances against losses on loans on a quarterly basis. When additional allowances are necessary, a provision for loan losses is charged to earnings.

Our methodology for assessing the appropriateness of the allowance for loan losses consists of two key elements: (1) specific allowances for impaired loans; and (2) a general valuation allowance on the remainder of the loan portfolio. Although we determine the amount of each element of the allowance separately, the entire allowance for loan losses is available for the entire portfolio.



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**Specific Allowances for Identified Problem Loans.** We establish a specific allowance when loans are determined to be impaired. Loss is measured by determining the present value of expected future cash flows or, for collateral-dependent loans, the fair value of the collateral adjusted for market conditions and selling expenses. Factors in identifying a specific problem loan include: (1) the strength of the customer's personal or business cash flows; (2) the availability of other sources of repayment; (3) the amount due or past due; (4) the type and value of collateral; (5) the strength of our collateral position; (6) the estimated cost to sell the collateral; and (7) the borrower's effort to cure the delinquency. In addition, for loans secured by real estate, we consider the extent of any past due and unpaid property taxes applicable to the property serving as collateral on the mortgage.

**General Valuation Allowance on the Remainder of the Loan Portfolio.** We establish a general allowance for loans that are not evaluated for impairment to recognize the inherent losses associated with lending activities, but which, unlike specific allowances, has not been allocated to particular problem assets. This general valuation allowance is determined by segregating the loans by loan category and assigning allowance percentages based on our historical loss experience, adjusted for qualitative factors that could impact the allowance for loan losses. These qualitative factors may include changes in lending policies and procedures, existing general economic and business conditions affecting our primary market area, credit quality trends, collateral value, loan volumes and concentrations, seasoning of the loan portfolio, recent loss experience in particular segments of the portfolio, duration of the current business cycle and bank regulatory examination results. The applied loss factors are re-evaluated quarterly to ensure their relevance in the current real estate environment. Although our policy allows for a general valuation allowance on certain smaller-balance, homogenous pools of loans classified as substandard, we have historically evaluated every loan classified as substandard, regardless of size, for impairment in establishing a specific allowance.

In addition, as an integral part of their examination process, the Office of the Comptroller of the Currency will periodically review our allowance for loan losses. Such agency may require that we recognize additions to the allowance based on their judgments of information available to them at the time of their examination.

The allowance for loan losses decreased \$277,000, or 13.0%, to \$1.9 million at June 30, 2011 from \$2.1 million at December 31, 2010. In addition, the allowance for loan losses to total loans receivable decreased to .93% at June 30, 2011 as compared to 1.09% at December 31, 2010. The allowance for loan losses as a percentage of nonperforming loans decreased to 19.3% at June 30, 2011 from 39.2% at December 31, 2010. The decline was attributable primarily to the partial charge-off of a loan secured by undeveloped land, which was foreclosed in February 2011. Substandard loans decreased to \$10.9 million at June 30, 2011 from \$12.1 million at December 31, 2010. Nonperforming loans, including troubled debt restructurings not included in nonaccrual loans, increased to \$9.6 million at June 30, 2011 from \$5.4 million at December 31, 2010 resulting from an increase in troubled debt restructurings of \$5.0 million, primarily related to three commercial real estate loans deemed to be adequately collateralized, and an \$822,000 million decrease in nonaccrual loans. Nonperforming loans are evaluated to determine impairment. Impaired loans with specific valuation allowances were \$2.5 million at June 30, 2011, and the related specific valuation allowance for loan losses was \$494,000. Impaired loans without specific valuation allowances were \$6.8 million at June 30, 2011.

To the best of our knowledge, we have provided for all losses that are both probable and reasonable to estimate at June 30, 2011 and December 31, 2010.

Appraisals are performed by a rotating list of independent, certified appraisers to obtain fair values on non-homogenous loans secured by real estate. The appraisals are generally obtained when market conditions change, annually for criticized loans, and at the time a loan becomes impaired.

We periodically evaluate the carrying value of loans and the allowance is adjusted accordingly. While we use the best information available to make evaluations, future adjustments to the allowance may be necessary if conditions differ substantially from the information used in making the evaluations.

There were no changes in our nonaccrual or charge-off policies during the six months ended June 30, 2011 or 2010. The accrual of interest on loans is discontinued at the time the loan is 90 days delinquent unless the credit is well secured and in the process of collection. Loans are placed on nonaccrual status or charged-off at an earlier date if collection of principal or interest is considered doubtful.



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All interest accrued but not collected for loans, including troubled debt restructurings, that are placed on nonaccrual status or charged off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

**Off-Balance Sheet Arrangements and Aggregate Contractual Obligations**

**Commitments.** As a financial services provider, we routinely are a party to various financial instruments with off-balance-sheet risks, such as commitments to extend credit and unused lines of credit. While these contractual obligations represent our future cash requirements, a significant portion of commitments to extend credit may expire without being drawn upon. Such commitments are subject to the same credit policies and approval process accorded to loans we make. For additional information, see Note 7 Financial Instruments with Off-Balance Sheet Risk of the notes to the consolidated financial statements.

**Contractual Obligations.** In the ordinary course of our operations, we enter into certain contractual obligations. Such obligations include operating leases for premises and equipment, agreements with respect to borrowed funds and deposit liabilities.

**Impact of Inflation and Changing Prices**

Our consolidated financial statements and related notes have been prepared in accordance with U.S. GAAP. U.S. GAAP generally requires the measurement of financial position and operating results in terms of historical dollars without consideration of changes in the relative purchasing power of money over time due to inflation. The impact of inflation is reflected in the increased cost of our operations. Unlike industrial companies, our assets and liabilities are primarily monetary in nature. As a result, changes in market interest rates have a greater impact on performance than the effects of inflation.

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

Not applicable, as the Registrant is a smaller reporting company.

**Item 4. Controls and Procedures**

An evaluation was performed under the supervision and with the participation of the Company's management, including the Chief Executive Officer and the Senior Vice President and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) promulgated under the Securities and Exchange Act of 1934, as amended) as of June 30, 2011. Based on that evaluation, the Company's management, including the Chief Executive Officer and the Senior Vice President and Chief Financial Officer, concluded that the Company's disclosure controls and procedures were effective.

During the quarter ended June 30, 2011, there have been no changes in the Company's internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.



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**Part II Other Information**

**Item 1. Legal Proceedings**

The Company is subject to various legal actions arising in the normal course of business. In the opinion of management, the resolution of these legal actions is not expected to have a material adverse effect on the Company's financial condition or results of operations.

**Item 1A. Risk Factors**

Not applicable, as the Registrant is a smaller reporting company.

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

None.

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. [Reserved]**

**Item 5. Other Information**

None.

**Item 6. Exhibits**

|          |                                                                                                                                |
|----------|--------------------------------------------------------------------------------------------------------------------------------|
| 3.1      | Articles of Incorporation of SP Bancorp Inc. (1)                                                                               |
| 3.2      | Bylaws of SP Bancorp, Inc. (1)                                                                                                 |
| 4.0      | Form of Common Stock Certificate of SP Bancorp, Inc. (1)                                                                       |
| 10.1     | 2010 Incentive Compensation Plan (1)                                                                                           |
| 10.2     | 2008 Nonqualified Deferred Compensation Plan (1)                                                                               |
| 10.3     | Phantom Stock Plan (1)                                                                                                         |
| 31.1     | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                             |
| 31.2     | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                             |
| 32.1     | Certification of Chief Executive Officer and Chief Financial Officer 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                                                                         |

- (1) Incorporated by reference into this document from the Exhibits filed with the Securities Exchange Commission in the Registration Statement on Form S-1, and any amendments thereto, Registration No. 333-167967.

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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.

**SP BANCORP, INC.**

Date: August 15, 2011

/s/ Jeffrey Weaver

Jeffrey Weaver  
President and Chief Executive Officer

Date: August 15, 2011

/s/ Suzanne C. Salls

Suzanne C. Salls  
Senior Vice President and Chief Financial Officer