

MALVERN BANCORP, INC.
Form 10-Q
February 09, 2018

UNITED STATES OF AMERICA

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended December 31, 2017

OR

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

For the transition period from _____ to _____

Commission File Number: 000-54835

MALVERN BANCORP, INC.

(Exact Name of Registrant as Specified in Its Charter)

Pennsylvania **45-5307782**
(State or Other Jurisdiction of (IRS Employer

Incorporation or Organization) Identification No.)

42 Lancaster Avenue, Paoli, Pennsylvania 19301

(Address of Principal Executive Offices) (Zip Code)

(610) 644-9400

(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

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

Non-accelerated filer

Large accelerated filer Accelerated filer (Do not check if smaller Smaller reporting company
reporting company)

Emerging growth company

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

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

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

Common Stock, par value \$0.01:	6,572,684 shares
(Title of Class)	(Outstanding as of February 9, 2018)

Table of Contents

	Page
<u>PART I – FINANCIAL INFORMATION</u>	3
<u>Item 1. Financial Statements</u>	
<u>Consolidated Statements of Financial Condition at December 31, 2017 (unaudited) and September 30, 2017</u>	4
<u>Consolidated Statements of Operations for the three months ended December 31, 2017 and 2016 (unaudited)</u>	5
<u>Consolidated Statements of Comprehensive Income for the three months ended December 31, 2017 and 2016 (unaudited)</u>	6
<u>Consolidated Statements of Changes in Shareholders' Equity for the three months ended December 31, 2017 and 2016 (unaudited)</u>	7
<u>Consolidated Statements of Cash Flows for the three months ended December 31, 2017 and 2016 (unaudited)</u>	8
<u>Notes to Unaudited Consolidated Financial Statements</u>	9
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	40
<u>Item 3. Qualitative and Quantitative Disclosures about Market Risks</u>	58
<u>Item 4. Controls and Procedures</u>	58
<u>PART II – OTHER INFORMATION.</u>	
<u>Item 1. Legal Proceedings</u>	58
<u>Item 1A. Risk Factors</u>	58
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	58
<u>Item 3. Default Upon Senior Securities</u>	58
<u>Item 4. Mine Safety Disclosure</u>	58
<u>Item 5. Other Information</u>	58
<u>Item 6. Exhibits</u>	59
<u>SIGNATURES</u>	60

PART I – FINANCIAL INFORMATION

The following unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X, and, accordingly, do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. However, in the opinion of management, all adjustments (consisting only of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three months ended December 31, 2017 are not necessarily indicative of the results that may be expected for the full year ending September 30, 2018, or for any other interim period. The Malvern Bancorp, Inc. Annual Report on Form 10-K for the fiscal year ended September 30, 2017 should be read in conjunction with these financial statements.

Item 1. Financial Statements**MALVERN BANCORP, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION****(Unaudited)**

	December 31, 2017	September 30, 2017
	(Dollars in thousands, except per share data)	
Assets		
Cash and due from depository institutions	\$ 1,636	\$ 1,615
Interest bearing deposits in depository institutions	127,006	115,521
Cash and Cash Equivalents	128,642	117,136
Investment securities available for sale, at fair value	44,503	14,587
Investment securities held to maturity, at cost (fair value of \$33,291 and \$34,566, respectively)	33,893	34,915
Restricted stock, at cost	5,930	5,559
Loans receivable, net of allowance for loan losses of \$8,437 and \$8,405, respectively	806,764	834,331
Accrued interest receivable	3,344	3,139
Property and equipment, net	7,374	7,507
Deferred income taxes, net	3,791	6,671
Bank-owned life insurance	19,045	18,923
Other assets	3,872	3,244
Total Assets	\$ 1,057,158	\$ 1,046,012
Liabilities and Shareholders' Equity		
Liabilities		
Deposits:		
Deposits-noninterest-bearing	\$ 45,756	\$ 42,121
Deposits-interest-bearing	751,343	748,275
Total Deposits	797,099	790,396
FHLB advances	118,000	118,000
Other short-term borrowings	5,000	5,000
Subordinated debt	24,342	24,303
Advances from borrowers for taxes and insurance	2,895	1,553
Accrued interest payable	1,099	694
Other liabilities	5,527	3,546
Total Liabilities	953,962	943,492

Commitments and Contingencies	—		—
Shareholders' Equity			
Preferred stock, \$0.01 par value, 10,000,000 shares authorized, none issued	—		—
Common stock, \$0.01 par value, 40,000,000 shares authorized, issued and outstanding: 6,572,684 shares at December 31, 2017 and 6,572,684 shares at September 30, 2017	66		66
Additional paid-in-capital	60,811		60,736
Retained earnings	43,542		43,139
Unearned Employee Stock Ownership Plan (ESOP) shares	(1,447	)	(1,483
Accumulated other comprehensive income	224		62
Total Shareholders' Equity	103,196		102,520
Total Liabilities and Shareholders' Equity	\$ 1,057,158		\$ 1,046,012

See accompanying notes to unaudited consolidated financial statements.

MALVERN BANCORP, INC. AND SUBSIDIARIES**CONSOLIDATED STATEMENTS OF OPERATIONS****(Unaudited)**

(Dollars in thousands, except for per share data)	Three Months Ended	
	2017	2016
Interest and Dividend Income		
Loans, including fees	\$8,701	\$6,313
Investment securities, taxable	230	472
Investment securities, tax-exempt	65	163
Dividends, restricted stock	69	64
Interest-bearing cash accounts	446	93
Total Interest and Dividend Income	9,511	7,105
Interest Expense		
Deposits	2,155	1,324
Short-term borrowings	19	—
Long-term borrowings	563	542
Subordinated debt	392	—
Total Interest Expense	3,129	1,866
Net interest income	6,382	5,239
Provision for Loan Losses	—	660
Net Interest Income after Provision for Loan Losses	6,382	4,579
Other Income		
Service charges and other fees	271	223
Rental income-other	66	55
Net gains on sale of real estate	1,186	—
Net gains on sale of loans	67	45
Earnings on bank-owned life insurance	121	130
Total Other Income	1,711	453
Other Expense		
Salaries and employee benefits	1,990	1,712
Occupancy expense	562	494
Federal deposit insurance premium	76	4
Advertising	54	51
Data processing	278	302
Professional fees	788	401
Other operating expenses	723	606
Total Other Expense	4,471	3,570
Income before income tax expense	3,622	1,462
Income tax expense	3,219	489
Net Income	\$403	\$973

Earnings Per Common Share:

Basic	\$0.06	\$0.15
Diluted	\$0.06	0.15
Weighted Average Common Shares Outstanding:		
Basic	6,445,264	6,418,583
Diluted	6,450,513	6,419,012
Dividends Declared Per Share	\$0.00	\$0.00

See accompanying notes to unaudited consolidated financial statements.

MALVERN BANCORP, INC. AND SUBSIDIARIES**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME****(Unaudited)**

	Three Months Ended December 31,	
	2017	2016
(Dollars in thousands)		
Net Income	\$403	\$973
Other Comprehensive (Loss) Income, Net of Tax:		
Unrealized holding losses on available-for-sale securities	(83)	(1,098)
Tax effect	25	374
Net of tax amount	(58)	(724)
Accretion of unrealized holding losses on securities transferred from available-for-sale to held-to-maturity ⁽¹⁾	2	4
Tax effect	(1)	(1)
Net of tax amount	1	3
Fair value adjustments on derivatives	242	945
Tax effect	(23)	(321)
Net of tax amount	219	624
Total other comprehensive income (loss)	162	(97)
Total comprehensive income	\$565	\$876

⁽¹⁾ Amounts are included in interest and dividends on investment securities on the Consolidated Statements of Operations.

See accompanying notes to unaudited consolidated financial statements.

MALVERN BANCORP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(Unaudited)

	Common	Additional Paid-In Capital	Retained Earnings	Unearned ESOP Shares	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
<i>(Dollars in thousands, except share data)</i>						
Balance, October 1, 2016	\$66	\$ 60,461	\$ 37,322	\$ (1,629)	) \$ (63)	) \$ 96,157
Net Income	—	—	973	—	—	973
Other comprehensive loss	—	—	—	—	(97)	(97)
Committed to be released ESOP shares (3,600 shares)	—	32	—	37	—	69
Stock based compensation	—	2	—	—	—	2
Balance, December 31, 2016	\$66	\$ 60,495	\$ 38,295	\$ (1,592)	) \$ (160)	) \$ 97,104
Balance, October 1, 2017	\$66	\$ 60,736	\$ 43,139	\$ (1,483)	) \$ 62	) \$ 102,520
Net Income	—	—	403	—	—	403
Other comprehensive income	—	—	—	—	162	162
Committed to be released ESOP shares (3,600 shares)	—	60	—	36	—	96
Stock based compensation	—	15	—	—	—	15
Balance, December 31, 2017	\$66	\$ 60,811	\$ 43,542	\$ (1,447)	) \$ 224	) \$ 103,196

See accompanying notes to unaudited consolidated financial statements.

MALVERN BANCORP, INC. AND SUBSIDIARIES**CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)**

(Dollars in thousands)	Three Months Ended	
	December 31, 2017	2016
Cash Flows from Operating Activities		
Net income	\$403	\$973
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation expense	187	179
Provision for loan losses	—	660
Deferred income taxes expense	2,849	428
ESOP expense	96	69
Stock based compensation	15	2
Amortization of premiums and discounts on investment securities, net	294	456
Amortization (accretion) of loan origination fees and costs	8	(514)
Amortization of mortgage service rights	13	15
Net gain on sale of real estate	(1,186)	—
Net gain on sale of secondary market loans	(67)	(45)
Proceeds on sale of secondary market loans	5,112	2,287
Originations of secondary market loans	(5,045)	(2,242)
Earnings on bank-owned life insurance	(121)	(130)
Increase in accrued interest receivable	(205)	(341)
Increase in accrued interest payable	405	21
Increase (decrease) in other liabilities	1,981	(690)
(Increase) decrease in other assets	(367)	88
Amortization of subordinated debt	39	—
Net Cash Provided by Operating Activities	4,411	1,216
Cash Flows from Investing Activities		
Investment securities available-for-sale:		
Purchases	(30,140)	—
Maturities, calls and principal repayments	123	446
Investment securities held-to-maturity:		
Maturities, calls and principal repayments	747	2,121
Loan originations and principal collections, net	27,559	(94,413)
Net (increase) decrease in restricted stock	(371)	8
Proceeds from sale of real estate	1,315	—
Purchases of property and equipment	(183)	(311)
Net Cash Used in Investing Activities	(950)	(92,149)
Cash Flows from Financing Activities		
Net increase in deposits	6,703	56,577
Proceeds from long-term borrowings	35,000	35,000

Edgar Filing: MALVERN BANCORP, INC. - Form 10-Q

Repayment of long-term borrowings	(35,000)	(35,000)
Increase in advances from borrowers for taxes and insurance	1,342	875
Net Cash Provided by Financing Activities	8,045	57,452
Net Increase (Decrease) in Cash and Cash Equivalents	11,506	(33,481)
Cash and Cash Equivalent – Beginning	117,136	96,762
Cash and Cash Equivalent – Ending	\$ 128,642	\$ 63,281
Supplementary Cash Flows Information		
Interest paid	\$ 2,724	\$ 1,845

See accompanying notes to unaudited consolidated financial statements.

-8-

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Note 1 – Basis of Presentation

The consolidated financial statements of Malvern Bancorp, Inc. (the “Company” or “Malvern Bancorp”) include the accounts of the Company and its wholly-owned subsidiary, Malvern Federal Savings Bank (“Malvern Federal Savings” or the “Bank”) and the Bank’s wholly-owned subsidiary, Malvern Insurance Associates, LLC (“Malvern Insurance”). All significant intercompany accounts and transactions have been eliminated from the accompanying consolidated financial statements.

Malvern Federal Savings Bank is a federally chartered, FDIC-insured savings bank that was originally organized in 1887. The Bank conducts business from its headquarters in Paoli, Pennsylvania, a suburb of Philadelphia, as well as eight full service financial center offices in Chester and Delaware Counties, Pennsylvania and a Private Banking Loan Production headquarters office in Morristown, New Jersey. Malvern Insurance offers a full line of business and personal insurance products.

In October 2017, the Bank filed an application with the OCC to convert from a federal savings bank to a national bank, with the name Malvern Bank, National Association. In connection with the charter conversion of the Bank, also in October 2017, the Company filed an application with the Federal Reserve Bank to convert to a bank holding company from a savings and loan holding company.

The conversion remains subject to the receipt of all required regulatory approvals. The Company and the Bank filed the conversion application in order to better match the Bank’s regulatory charter to its current and planned business activity.

In preparing the unaudited consolidated financial statements, management has made estimates and assumptions that affect the reported amounts of assets and liabilities as of the dates of the unaudited consolidated statements of condition and that affect the results of operations for the periods presented. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to change in the near term relate to the determination of the allowance for loan losses, other real estate owned, the evaluation of deferred tax assets and the other-than-temporary impairment evaluation of securities. The unaudited consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles (“U.S. GAAP”).

Note 2 – Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2014-09, Revenue from Contracts with Customers (Topic 606). This ASU supersedes the revenue recognition requirements in ASC 605, Revenue Recognition. ASU No. 2014-09 will require an entity to recognize revenue when it transfers promised goods or services to customers using a five-step model that requires entities to exercise judgment when considering the terms of the contracts. In August 2015, the FASB issued ASU No. 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date. This amendment defers the effective date of ASU 2014-09 by one year. In March 2016, the FASB issued ASU 2016-08, Principal versus Agent Considerations (Reporting Gross versus Net), which amends the principal versus agent guidance and clarifies that the analysis must focus on whether the entity has control of the goods or services before they are transferred to the customer. In addition, the FASB issued ASU Nos. 2016-20, Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers and 2016-12, Narrow-Scope Improvements and Practical Expedients, both of which provide additional clarification of certain provisions in Topic 606. These ASC updates are effective for public business entities in annual and interim reporting periods in fiscal years beginning after December 15, 2017. Early application is permitted for all entities, but not before annual reporting periods beginning after December 15, 2016. The standard permits the use of either the retrospective or retrospectively with the cumulative effect transition method. The Company will adopt the standard on October 1, 2018. The Company is currently evaluating the effect the standard will have on its consolidated financial statements and related disclosures.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Note 2 - Summary of Significant Accounting Policies (Continued)

In October 2016, the FASB issued ASU No. 2016-16, "Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory". The ASU requires an entity to recognize the income tax consequences of intra-entity transfers of assets other than inventory at the time that the transfer occurs. Current guidance does not require recognition of tax consequences until the asset is eventually sold to a third party. ASU 2016-16 is effective for fiscal years, and interim periods within, beginning after December 15, 2017, with early adoption permitted as of the first interim period presented in a year. The Company does not expect the adoption of this guidance to have a material impact on its consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-15, "Statement of Cash Flows (Topic 230)". The ASU is intended to reduce the diversity in practice around how certain transactions are classified within the statement of cash flows. For public companies, this update will be effective for interim and annual periods beginning after December 15, 2017. The Company does not expect the adoption of this guidance to have a material impact on its consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, "Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments." The ASU requires an organization to measure all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. Organizations will continue to use judgment to determine which loss estimation method is appropriate for their circumstances. Additionally, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. For public companies, this update will be effective for interim and annual periods beginning after December 15, 2019. The Company has not yet determined the impact the adoption of ASU 2016-13 will have on the consolidated financial statements and related disclosures.

In May 2016, the FASB issued ASU No. 2016-12 "Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients." The guidance is intended to clarify the guidance previously issued in May 2014 related to the recognition of revenue from contracts with customers. The updated guidance includes narrow-scope improvements intended to address implementation issues and to provide additional practical expedients in the guidance. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2017, with early adoption permitted for interim and annual reporting periods beginning after December 15, 2016. The Company does not expect the adoption of this guidance to have a material impact on its consolidated

financial statements.

In April 2016, the FASB issued ASU No. 2016-10 “Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing.” The guidance is intended to clarify the guidance previously issued in May 2014 related to the recognition of revenue from contracts with customers. The updated guidance is intended to reduce the cost and complexity of applying the guidance on identifying promised goods or services in a contract and to improve the operability and understandability of the implementation guidance regarding the licensing of intellectual property. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2017, with early adoption permitted for interim and annual reporting periods beginning after December 15, 2016. The Company does not expect the adoption of this guidance to have a material impact on its consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, “Leases (Topic 842).” The guidance in this update supersedes the current lease accounting guidance for both the lessees and lessors under ASC 840, Leases. The new guidance requires lessees to evaluate whether a lease is a finance lease using criteria that are similar to what lessees use today to determine whether they have a capital lease. Leases not classified as finance leases are classified as operating leases. This classification will determine whether the lease expense is recognized based on an effective interest method or on a straight-line basis over the term of the lease. The lessee is also required to record a right-of-use asset and a lease liability for all leases with a term of greater than 12 months regardless of their classification. Leases with a term of 12 months or less will be accounted for similar to today’s guidance for operating leases. The new guidance will require lessors to account for leases using an approach that is substantially similar to the existing guidance for sales-type, direct financing leases and operating leases. This new guidance will be effective for the Company for the first reporting period beginning after December 15, 2018, with earlier adoption permitted. Adoption of the amendment must be applied on a modified retrospective approach. The Company is currently evaluating the effect that the standard will have on its consolidated financial statements and related disclosures.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Note 2 - Summary of Significant Accounting Policies (Continued)

In August 2017, the FASB issued ASU No. 2017-12 “Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities.” The guidance is intended to update and better align an entity’s risk management activities and financial reporting for hedging relationships through changes to both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results. To meet that objective, the amendments expand and refine hedge accounting for both nonfinancial and financial risk components and align the recognition and presentation of the effects of the hedging instrument and the hedged item in the financial statements. The updated guidance is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. The Company is currently evaluating the effect of the standard will have on its consolidated financial statements and related disclosures.

In May 2017, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2017-09, “Scope of Modification Accounting”, to provide clarity and reduce both (1) diversity in practice and (2) cost and complexity when applying the guidance in Topic 718, Compensation—Stock Compensation, to a change to the terms or conditions of a share-based payment award. The amendments in this update provide guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in Topic 718. An entity should account for the effects of a modification unless all the following are met: (1) the fair value (or calculated value or intrinsic value, if such an alternative measurement method is used) of the modified award is the same as the fair value (or calculated value or intrinsic value, if such an alternative measurement method is used) of the original award immediately before the original award is modified. If the modification does not affect any of the inputs to the valuation technique that the entity uses to value the award, the entity is not required to estimate the value immediately before and after the modification; (2) the vesting conditions of the modified award are the same as the vesting conditions of the original award immediately before the original award is modified; (3) the classification of the modified award as an equity instrument or a liability instrument is the same as the classification of the original award immediately before the original award is modified. The current disclosure requirements in Topic 718 apply regardless of whether an entity is required to apply modification accounting under the amendments in this update. For public business entities, the amendments in this update become effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. Early adoption is permitted, including adoption in an interim period. An entity should apply the amendments in this update prospectively to an award modified on or after the adoption date. The Company is currently evaluating the impact of adopting the new guidance on the Consolidated Financial Statements, but it is not expected to have a material impact.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Note 2 - Summary of Significant Accounting Policies (Continued)

In March 2017, the FASB issued ASU No. 2017-08, "Premium Amortization on Purchased Callable Debt Securities." This ASU shortens the amortization period for the premium on certain purchased callable debt securities to the earliest call date. Today, entities generally amortize the premium over the contractual life of the security. The new guidance does not change the accounting for purchased callable debt securities held at a discount; the discount continues to be amortized to maturity. ASU No. 2017-08 is effective for interim and annual reporting periods beginning after December 15, 2018; early adoption is permitted. The guidance calls for a modified retrospective transition approach under which a cumulative-effect adjustment will be made to retained earnings as of the beginning of the first reporting period in which the guidance is adopted. The Company is currently evaluating the provisions of ASU No. 2017-08 to determine the potential impact the new standard will have on the Company's Consolidated Financial Statements.

In March 2017, the FASB issued ASU No. 2017-07, "Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost." The new guidance requires that the service cost component of net benefit costs of pension and postretirement benefit plans be reported in the same line item as other compensation costs in the Consolidated Statements of Income. The other components of net benefit cost will be required to be presented in a separate line item. The guidance also specifies that only the service cost component will be eligible for capitalization. This guidance is effective for fiscal years beginning after December 15, 2017 and interim periods within those fiscal years. The Company is currently evaluating the impact of adopting the new guidance on the Consolidated Financial Statements, but is not expected to have a material impact.

In November 2016, the FASB issued ASU 2016-18, "Statement of Cash Flows (Topic 230) Restricted Cash". The new guidance requires restricted cash and restricted cash equivalents to be included with cash and cash equivalents when reconciling the beginning-of-period and end-of period total amounts shown on the statement of cash flows. If restricted cash is presented separately from cash and cash equivalents on the balance sheet, companies will be required to reconcile the amounts presented on the statement of cash flows to the amounts on the balance sheet. Companies will also need to disclose information about the nature of the restrictions. The amendments in this update do not provide a definition of restricted cash or restricted cash equivalents. The guidance is effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. The Company is currently evaluating the impact of adopting the new guidance on the Consolidated Financial Statements.

Note 3 – Earnings Per Share

Basic earnings per common share is computed based on the weighted average number of shares outstanding reduced by unearned ESOP shares. Diluted earnings per share is computed based on the weighted average number of shares

outstanding and common stock equivalents (“CSEs”) that would arise from the exercise of dilutive securities reduced by unearned ESOP shares. During the three months ended December 31, 2017, the Company granted stock options to purchase 4,664 shares of common stock and 4,768 restricted shares.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**Note 3 - Earnings Per Share (Continued)**

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

(Dollars in thousands, except for per share data)	Three Months Ended December 31,	
	2017	2016
Net Income	\$403	\$973
Weighted average shares outstanding	6,572,605	6,560,324
Average unearned ESOP shares	(127,341)	(141,741)
Basic weighted average shares outstanding	6,445,264	6,418,583
Plus: effect of dilutive options	5,249	429
Diluted weighted average common shares outstanding	6,450,513	6,419,012
Earnings per share:		
Basic	\$0.06	\$0.15
Diluted	\$0.06	0.15

Note 4 – Employee Stock Ownership Plan

The Company established an employee stock ownership plan (“ESOP”) for substantially all of its full-time employees. The current ESOP trustee is Pentegra. Shares of the Company’s common stock purchased by the ESOP are held until released for allocation to participants. Shares released are allocated to each eligible participant based on the ratio of each such participant’s base compensation to the total base compensation of all eligible plan participants. As the unearned shares are committed to be released and allocated among participants, the Company recognizes compensation expense equal to the fair value of the ESOP shares during the periods in which they become committed to be released. To the extent that the fair value of the ESOP shares released differs from the cost of such shares, the difference is charged or credited to additional paid-in capital. During the period from May 20, 2008 to September 30, 2008, the ESOP purchased 241,178 shares of the common stock for approximately \$2.6 million, an average price of \$10.86 per share, which was funded by a loan from Malvern Federal Bancorp, Inc. (the Company’s predecessor). The ESOP loan is being repaid principally from the Bank’s contributions to the ESOP. The loan, which bears an interest rate of 5%, is being repaid in quarterly installments through 2026. Shares are released to participants proportionately

as the loan is repaid. During the three months ended December 31, 2017 and 2016, there were 3,600 and 3,600 shares, respectively, committed to be released. At December 31, 2017, there were 125,565 unallocated shares and 133,653 allocated shares held by the ESOP. The unallocated shares had an aggregate fair value of approximately \$3.3 million at December 31, 2017.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Note 5 - Investment Securities

The Company's investment securities are classified as available-for-sale or held-to-maturity at December 31, 2017 and at September 30, 2017. Investment securities available-for-sale are reported at fair value with unrealized gains or losses included in equity, net of tax. Accordingly, the carrying value of such securities reflects their fair value at the balance sheet date. Fair value is based upon either quoted market prices, or in certain cases where there is limited activity in the market for a particular instrument, assumptions are made to determine their fair value.

Transfers of debt securities from the available-for-sale category to the held-to-maturity category are made at fair value at the date of transfer. The unrealized holding gain or loss at the date of transfer remains in accumulated other comprehensive income and in the carrying value of the held-to-maturity investment security. Premiums or discounts on investment securities are amortized or accreted using the effective interest method over the life of the security as an adjustment of yield. Unrealized holding gains or losses that remain in accumulated other comprehensive income are amortized or accreted over the remaining life of the security as an adjustment of yield, offsetting the related amortization of the premium or accretion of the discount.

The following tables present information related to the Company's investment securities at December 31, 2017 and September 30, 2017.

	December 31, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	<i>(Dollars in thousands)</i>			
Investment Securities Available-for-Sale:				
U.S. treasury notes	\$30,013	\$ —	\$ (39)	) \$29,974
State and municipal obligations	6,982	22	(16)	) 6,988
Single issuer trust preferred security	1,000	—	(70)	) 930
Corporate debt securities	6,622	—	(261)	) 6,361
Mutual fund	250	—	—	) 250
Total	44,867	22	(386)	) 44,503
Investment Securities Held-to-Maturity:				
U.S. government agencies	\$1,999	\$ —	\$ (19)	) \$1,980
State and municipal obligations	9,510	34	(24)	) 9,520
Corporate debt securities	3,792	37	—	) 3,829

Mortgage-backed securities:

Collateralized mortgage obligations, fixed-rate	18,592	—	(630	)	17,962
Total	\$33,893	\$ 71	\$ (673	)	\$33,291
Total investment securities	\$78,760	\$ 93	\$ (1,059	)	\$77,794

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Note 5 - Investment Securities – (Continued)

	September 30, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Investment Securities Available-for-Sale:				
State and municipal obligations	\$ 6,992	\$ 39	\$ (2)	\$ 7,029
Single issuer trust preferred security	1,000	—	(66)	934
Corporate debt securities	6,627	—	(253)	6,374
Mutual fund	250	—	—	250
Total	14,869	39	(321)	14,587
Investment Securities Held-to-Maturity:				
U.S. government agencies	\$ 1,999	\$ —	\$ (8)	\$ 1,991
State and municipal obligations	9,574	89	—	9,663
Corporate debt securities	3,818	26	—	3,844
Mortgage-backed securities:				
Collateralized mortgage obligations, fixed-rate	19,524	1	(457)	19,068
Total	\$ 34,915	\$ 116	\$ (465)	\$ 34,566
Total investment securities	\$ 49,784	\$ 155	\$ (786)	\$ 49,153

For the three months ended December 31, 2017 and 2016, no available-for-sale investment securities were sold.

The following tables indicate gross unrealized losses not recognized in income and fair value, aggregated by investment category and the length of time individual securities have been in a continuous unrealized loss position at December 31, 2017 and September 30, 2017:

	December 31, 2017					
	Less than 12 Months		More than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair value	Unrealized Losses
	(Dollars in thousands)					
Investment Securities Available-for-Sale:						

Edgar Filing: MALVERN BANCORP, INC. - Form 10-Q

U.S. treasury notes	\$29,974	\$ (39)	\$ —	\$ —	\$29,974	\$ (39)
State and municipal obligations	1,713	(12)	497	(4)	2,210	(16)
Single issuer trust preferred security	—	—	930	(70)	930	(70)
Corporate debt securities	—	—	6,361	(261)	6,361	(261)
Total	\$31,687	\$ (51)	\$ 7,788	\$ (335)	\$39,475	\$ (386)
Investment Securities Held-to-Maturity:						
U.S. government agencies	—	—	1,980	(19)	1,980	(19)
State and municipal obligations	5,559	(24)	—	—	5,559	(24)
Mortgage-backed securities:						
CMO, fixed-rate	—	—	17,962	(630)	17,962	(630)
Total	5,559	(24)	19,942	(649)	25,501	(673)
Total investment securities	\$37,246	\$ (75)	\$ 27,730	\$ (984)	\$64,976	\$ (1,059)

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Note 5 - Investment Securities – (Continued)

	September 30, 2017					
	Less than 12 Months		More than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair value	Unrealized Losses
	<i>(Dollars in thousands)</i>					
Investment Securities Available-for-Sale:						
State and municipal obligations	\$—	\$—	\$500	\$ (2)	\$500	\$ (2)
Single issuer trust preferred security	—	—	934	(66)	934	(66)
Corporate debt securities	—	—	6,375	(253)	6,375	(253)
Total	\$—	\$—	\$7,809	\$ (321)	\$7,809	\$ (321)
Investment Securities Held-to-Maturity:						
U.S. government agencies	—	—	1,991	(8)	1,991	(8)
State and municipal obligations	—	—	—	—	—	—
Mortgage-backed securities:						
CMO, fixed-rate	—	—	18,902	(457)	18,902	(457)
Total	—	—	20,893	(465)	20,893	(465)
Total investment securities	\$—	\$—	\$28,702	\$ (786)	\$28,702	\$ (786)

As of December 31, 2017, the estimated fair value of the securities disclosed above was primarily dependent upon the movement in market interest rates, particularly given the negligible inherent credit risk associated with these securities. These investment securities are comprised of securities that are rated investment grade by at least one bond credit rating service. Although the fair value will fluctuate as market interest rates move, management believes that these fair values will recover as the underlying portfolios mature and are reinvested in market rate yielding investments. As of December 31, 2017, the Company held three U.S. treasury notes, two U.S. government agency securities, eight municipal bonds, three corporate securities, 37 mortgage-backed securities and one single issuer trust preferred security which were in an unrealized loss position. The Company does not intend to sell and expects that it is not more likely than not that it will be required to sell these securities until such time as the value recovers or the securities mature. Management does not believe any individual unrealized loss as of December 31, 2017 represents other-than-temporary impairment.

Investment securities having a carrying value of approximately \$9.1 million and \$9.6 million at December 31, 2017 and September 30, 2017 were pledged to secure deposits. In addition, investment securities having a carrying value of \$6.0 million and \$6.2 million, respectively, were pledged to secure short-term borrowings at December 31, 2017 and September 30, 2017.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Note 5 - Investment Securities – (Continued)

The following table presents information for investment securities at December 31, 2017, based on scheduled maturities. Actual maturities can be expected to differ from scheduled maturities due to prepayment or early call options of the issuer.

	December 31, 2017	
	Amortized Cost	Fair Value
	<i>(Dollars in thousands)</i>	
Investment Securities Available-for-Sale:		
Due in one year or less	\$30,013	\$29,974
Due after one year through five years	4,449	4,442
Due after five years through ten years	8,950	8,702
Due after ten years	1,455	1,385
Total	\$44,867	\$44,503
Investment Securities Held-to-Maturity:		
Due after one year through five years	\$1,999	\$1,980
Due after five years through ten years	6,231	6,285
Due after ten years	25,663	25,026
Total	\$33,893	\$33,291
Total investment securities	\$78,760	\$77,794

Note 6 - Loans Receivable and Related Allowance for Loan Losses

Loans receivable in the Company's portfolio consisted of the following at the dates indicated below:

	December 31, 2017	September 30, 2017
	<i>(Dollars in thousands)</i>	

Edgar Filing: MALVERN BANCORP, INC. - Form 10-Q

Residential mortgage	\$ 186,831	\$ 192,500
Construction and Development:		
Residential and commercial	34,627	35,622
Land	18,599	18,377
Total Construction and Development	53,226	53,999
Commercial:		
Commercial real estate	427,610	437,760
Farmland	1,711	1,723
Multi-family	32,716	39,768
Other	71,933	74,837
Total Commercial	533,970	554,088
Consumer:		
Home equity lines of credit	16,811	16,509
Second mortgages	21,304	22,480
Other	2,435	2,570
Total Consumer	40,550	41,559
Total loans	814,577	842,146
Deferred loan fees and cost, net	624	590
Allowance for loan losses	(8,437)	(8,405)
Total loans receivable, net	\$ 806,764	\$ 834,331

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Note 6 - Loans Receivable and Related Allowance for Loan Losses – (Continued)

The following tables summarize the primary classes of the allowance for loan losses (“ALLL”), segregated into the amount required for loans individually evaluated for impairment and the amount required for loans collectively evaluated for impairment as of December 31, 2017 and September 30, 2017. Activity in the allowance is presented for the three months ended December 31, 2017 and 2016 and the year ended September 30, 2017, respectively.

	Three Months Ended December 31, 2017										
	Residential Mortgage	Residential and Commercial	Construction and Development Land	Commercial Real Estate	Farmland	Multi-family	Other	Consumer Home Equity Lines of Credit	Second Mortgages	Other	Unallocated
	(Dollars in thousands)										
Allowance for loan losses:											
Beginning balance	\$1,004	\$523	\$132	\$3,581	\$9	\$224	\$541	\$90	\$402	\$27	\$1,872
Charge-offs	—	—	—	—	—	—	—	—	—	(2)	—
Recoveries	2	—	—	9	—	—	1	1	19	2	—
Provisions	23	9	(2)	670	3	(24)	(93)	3	42	3	(634)
Ending Balance	\$1,029	\$532	\$130	\$4,260	\$12	\$200	\$449	\$94	\$463	\$30	\$1,238
Ending balance: individually evaluated for impairment	\$—	\$—	\$—	\$156	\$—	\$—	\$—	\$—	\$156	\$1	\$—
Ending balance: collectively evaluated for impairment	\$1,029	\$532	\$130	\$4,104	\$12	\$200	\$449	\$94	\$307	\$29	\$1,238

Loans receivable:											
Ending balance	\$186,831	\$34,627	\$18,599	\$427,610	\$1,711	\$32,716	\$71,933	\$16,811	\$21,304	\$2,435	
Ending balance: individually evaluated for impairment	\$2,438	\$—	\$89	\$1,347	\$—	\$—	\$239	\$10	\$578	\$1	
Ending balance: collectively evaluated for impairment	\$184,393	\$34,627	\$18,510	\$426,263	\$1,711	\$32,716	\$71,694	\$16,801	\$20,726	\$2,434	

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Note 6 - Loans Receivable and Related Allowance for Loan Losses – (Continued)

	Three Months Ended December 31, 2016										Total
	Residential Mortgage	Construction and Development Residential and Commercial	Land	Commercial Real Estate	Multi-family	Other	Consumer Home Equity Lines of Credit	Second Mortgages	Other	Unallocated	
	(Dollars in thousands)										
Allowance for loan losses:											
Beginning balance	\$1,201	\$199	\$97	\$1,874	\$109	\$158	\$116	\$467	\$34	\$1,179	\$5,434
Charge-offs	—	—	—	—	—	—	—	(71)	(5)	—	(76
Recoveries	—	90	—	3	—	5	1	57	3	—	159
Provisions	(39)	585	(7)	338	(3)	45	(6)	(45)	(4)	(204)	660
Ending Balance	\$1,162	\$874	\$90	\$2,215	\$106	\$208	\$111	\$408	\$28	\$975	\$6,177
Ending balance: individually evaluated for impairment	\$—	\$—	\$—	\$—	\$—	\$—	\$—	\$50	\$—	\$—	\$50
Ending balance: collectively evaluated for impairment	\$1,162	\$874	\$90	\$2,215	\$106	\$208	\$111	\$358	\$28	\$975	\$6,127
Loans receivable:											
Ending balance	\$205,668	\$28,296	\$10,117	\$307,821	\$19,805	\$53,587	\$19,729	\$26,971	\$1,697		\$673,691
Ending balance: individually evaluated	\$2,104	\$109	\$—	\$760	\$—	\$—	\$62	\$220	\$—		\$3,255

for
impairment
Ending
balance:
collectively
evaluated
for
impairment

\$203,564	\$28,187	\$10,117	\$307,061	\$19,805	\$53,587	\$19,667	\$26,751	\$1,697	\$670,436
-----------	----------	----------	-----------	----------	----------	----------	----------	---------	-----------

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Note 6 - Loans Receivable and Related Allowance for Loan Losses – (Continued)

	Year Ended September 30, 2017										
	Residential Mortgage	Construction and Development Residential and Commercial	Land	Commercial Real Estate	Farmland	Multi-family	Other	Consumer Home Equity Lines of Credit	Second Mortgages	Other	Unallocated
	(Dollars in thousands)										
Allowance for loan losses:											
Beginning balance	\$1,201	\$199	\$97	\$1,874	\$—	\$109	\$158	\$116	\$467	\$34	\$1,179
Charge-offs	—	—	—	—	—	—	—	—	(218)	(5)	—
Recoveries	2	90	—	40	—	—	9	18	232	12	—
Provisions	(199)	234	35	1,667	9	115	374	(44)	(79)	(14)	693
Ending Balance	\$1,004	\$523	\$132	\$3,581	\$9	\$224	\$541	\$90	\$402	\$27	\$1,872
Ending balance: individually evaluated for impairment	\$—	\$—	\$—	\$—	\$—	\$—	\$109	\$—	\$128	\$—	\$—
Ending balance: collectively evaluated for impairment	\$1,004	\$523	\$132	\$3,581	\$9	\$224	\$432	\$90	\$274	\$27	\$1,872
Loans receivable:											
Ending balance	\$192,500	\$35,622	\$18,377	\$437,760	\$1,723	\$39,768	\$74,837	\$16,509	\$22,480	\$2,570	
Ending balance: individually evaluated	\$2,262	\$—	\$94	\$555	\$—	\$—	\$243	\$10	\$356	\$—	

for
impairment
Ending
balance:
collectively
evaluated
for
impairment

\$190,238	\$35,622	\$18,283	\$437,205	\$1,723	\$39,768	\$74,594	\$16,499	\$22,124	\$2,570
-----------	----------	----------	-----------	---------	----------	----------	----------	----------	---------

In assessing the adequacy of the ALLL, it is recognized that the process, methodology and underlying assumptions require a significant degree of judgment. The estimation of credit losses is not precise; the range of factors considered is wide and is significantly dependent upon management’s judgment, including the outlook and potential changes in the economic environment. At present, components of the commercial loan segments of the portfolio are new originations and the associated volumes continue to see increased growth. At the same time, historical loss levels have decreased as factors in assessing the portfolio. The combination of these factors has given rise to an increase in the unallocated level within the allowance. Any unallocated portion of the allowance in conjunction with the quarterly review and changes to the qualitative factors to adjust for the risk due to current economic conditions, reflects management’s estimate of probable inherent but undetected losses within the portfolio due to uncertainties in economic conditions, delays in obtaining information, including unfavorable information about a borrower’s financial condition, the difficulty in identifying triggering events that correlate perfectly to subsequent loss rates, and risk factors that have not yet manifested themselves in loss allocation factors.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Note 6 - Loans Receivable and Related Allowance for Loan Losses – (Continued)

The following table presents impaired loans in portfolio by class, segregated by those for which a specific allowance was required and those for which a specific allowance was not necessary as of December 31, 2017 and September 30, 2017.

	Impaired Loans With Specific Allowance		Impaired Loans With No Specific Allowance	Total Impaired Loans	Unpaid Principal Balance
	Recorded Investment	Related Allowance	Recorded Investment	Recorded Investment	
(Dollars in thousands)					
December 31, 2017:					
Residential mortgage	\$—	\$ —	\$ 2,438	\$2,438	\$ 2,561
Construction and Development:					
Land	—	—	89	89	89
Commercial:					
Commercial real estate	796	156	551	1,347	1,347
Other	—	—	239	239	239
Consumer:					
Home equity lines of credit	—	—	10	10	11
Second mortgages	298	156	280	578	611
Other	1	1	—	1	1
Total impaired loans	\$1,095	\$ 313	\$ 3,607	\$4,702	\$ 4,859
September 30, 2017:					
Residential mortgage	\$—	\$ —	\$ 2,262	\$2,262	\$ 2,379
Construction and Development:					
Land	—	—	94	94	94
Commercial:					
Commercial real estate	—	—	555	555	555
Other	243	109	—	243	243
Consumer:					
Home equity lines of credit	—	—	10	10	11
Second mortgages	131	128	225	356	385
Total impaired loans	\$374	\$ 237	\$ 3,146	\$3,520	\$ 3,667

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Note 6 - Loans Receivable and Related Allowance for Loan Losses – (Continued)

The following table presents the average recorded investment in impaired loans in portfolio and related interest income recognized for the three months ended December 31, 2017 and 2016.

(Dollars in thousands)	Three Months Ended December 31, 2017	
	Average Impaired Loans	Interest Recognized on Impaired Loans
Residential mortgage	\$2,390	\$ 12
Construction and Development:		
Land	91	1
Commercial:		
Commercial real estate	820	6
Other	241	3
Consumer:		
Home equity lines of credit	10	—
Second mortgages	495	2
Other	1	—
Total	\$4,048	\$ 24

(Dollars in thousands)	Three Months Ended December 31, 2016	
	Average Impaired Loans	Interest Recognized on Impaired Loans
Residential mortgage	\$1,997	\$ 20
Construction and Development:		
Residential and commercial	109	1
Commercial:		
Commercial real estate	1,602	4
Consumer:		
Home equity lines of credit	70	—

Second mortgages	226	—
Total	\$4,004	\$ 25

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Note 6 - Loans Receivable and Related Allowance for Loan Losses – (Continued)

The following table presents the classes of the loan portfolio summarized by loans considered to be rated as pass and the categories of special mention, substandard and doubtful within the Company's internal risk rating system as of December 31, 2017 and September 30, 2017.

	December 31, 2017				
	Pass	Special Mention	Substandard	Doubtful	Total
	(Dollars in thousands)				
Residential mortgage	\$184,093	\$ 112	\$ 2,626	\$ —	\$186,831
Construction and Development:					
Residential and commercial	34,627	—	—	—	34,627
Land	14,090	—	4,509	—	18,599
Commercial:					
Commercial real estate	421,647	3,220	2,743	—	427,610
Farmland	1,711	—	—	—	1,711
Multi-family	32,363	353	—	—	32,716
Other	71,003	45	885	—	71,933
Consumer:					
Home equity lines of credit	16,667	—	144	—	16,811
Second mortgages	20,215	109	980	—	21,304
Other	2,429	5	1	—	2,435
Total	\$798,845	\$ 3,844	\$ 11,888	\$ —	\$814,577

	September 30, 2017				
	Pass	Special Mention	Substandard	Doubtful	Total
	(Dollars in thousands)				
Residential mortgage	\$189,925	\$ 114	\$ 2,461	\$ —	\$192,500
Construction and Development:					
Residential and commercial	35,622	—	—	—	35,622
Land	13,207	—	5,170	—	18,377
Commercial:					
Commercial real estate	431,336	4,456	1,968	—	437,760
Farmland	1,723	—	—	—	1,723
Multi-family	39,410	358	—	—	39,768

Edgar Filing: MALVERN BANCORP, INC. - Form 10-Q

Other	73,935	—	902	—	74,837
Consumer:					
Home equity lines of credit	16,399	—	110	—	16,509
Second mortgages	21,611	112	757	—	22,480
Other	2,563	6	1	—	2,570
Total	\$825,731	\$ 5,046	\$ 11,369	\$ —	\$842,146

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Note 6 - Loans Receivable and Related Allowance for Loan Losses – (Continued)

The following table presents loans that are no longer accruing interest by portfolio class.

	December 31, 2017	September 30, 2017
	(Dollars in thousands)	
Residential mortgage	\$1,048	\$ 826
Commercial:		
Commercial real estate	796	—
Consumer:		
Home equity lines of credit	10	10
Second mortgages	387	202
Total non-accrual loans	\$2,241	\$ 1,038

Under the Bank's loan policy, once a loan has been placed on non-accrual status, we do not resume interest accruals until the loan has been brought current and has maintained a current payment status for not less than six consecutive months. Interest income that would have been recognized on nonaccrual loans had they been current in accordance with their original terms was approximately \$10,000 and \$10,000 for the three months ended December 31, 2017 and 2016, respectively. At December 31, 2017 and September 30, 2017 there were approximately \$345,000 and \$173,000, respectively, of loans past due 90 days or more and still accruing interest.

Management further monitors the performance and credit quality of the loan portfolio by analyzing the age of the portfolio as determined by whether a loan payment is "current," that is, it is received from a borrower by the scheduled due date, or the length of time a scheduled payment is past due. The following table presents the classes of the loan portfolio summarized by the aging categories as of December 31, 2017 and September 30, 2017.

Current	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past	Total Past Due	Total Loans Receivable	Accruing 90 Days or More Past
---------	------------------------------	------------------------------	----------------------------------	----------------------	------------------------------	---

Edgar Filing: MALVERN BANCORP, INC. - Form 10-Q

	Due					Due	
	(Dollars in thousands)						
December 31, 2017:							
Residential mortgage	\$181,911	\$1,462	\$2,471	\$987	\$4,920	\$186,831	\$300
Construction and Development:							
Residential and commercial	34,627	—	—	—	—	34,627	—
Land	18,599	—	—	—	—	18,599	—
Commercial:							
Commercial real estate	426,814	—	—	796	796	427,610	—
Farmland	1,711	—	—	—	—	1,711	—
Multi-family	32,716	—	—	—	—	32,716	—
Other	71,888	—	—	45	45	71,933	45
Consumer:							
Home equity lines of credit	16,629	88	94	—	182	16,811	—
Second mortgages	20,073	882	60	289	1,231	21,304	—
Other	2,414	20	1	—	21	2,435	—
Total	\$807,382	\$2,452	\$2,626	\$2,117	\$7,195	\$814,577	\$345

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Note 6 - Loans Receivable and Related Allowance for Loan Losses – (Continued)

	Current	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Total Loans Receivable	Accruing 90 Days or More Past Due
(Dollars in thousands)							
September 30, 2017:							
Residential mortgage	\$ 189,272	\$ 1,442	\$ 1,145	\$ 641	\$ 3,228	\$ 192,500	\$ 31
Construction and Development:							
Residential and commercial	35,622	—	—	—	—	35,622	—
Land	18,377	—	—	—	—	18,377	—
Commercial:							
Commercial real estate	436,804	160	796	—	956	437,760	—
Farmland	1,723	—	—	—	—	1,723	—
Multi-family	39,768	—	—	—	—	39,768	—
Other	74,837	—	—	—	—	74,837	—
Consumer:							
Home equity lines of credit	16,122	350	37	—	387	16,509	—
Second mortgages	21,183	844	182	271	1,297	22,480	141
Other	2,561	7	1	1	9	2,570	1
Total	\$ 836,269	\$ 2,803	\$ 2,161	\$ 913	\$ 5,877	\$ 842,146	\$ 173

Restructured loans deemed to be TDRs are typically the result of extension of the loan maturity date or a reduction of the interest rate of the loan to a rate that is below market, a combination of rate and maturity extension, or by other means including covenant modifications, forbearance and other concessions. However, the Company generally only restructures loans by modifying the payment structure to require payments of interest only for a specified period or by reducing the actual interest rate. Once a loan becomes a TDR, it will continue to be reported as a TDR during the term of the restructure.

The Company had twelve loans classified as TDRs at both December 31, 2017 and September 30, 2017 with an aggregate outstanding balance of \$2.2 million and \$2.3 million, respectively. At December 31, 2017, these loans were also classified as impaired. Eleven of the TDR loans continue to perform under the restructured terms through December 31, 2017 and we continued to accrue interest on such loans through such date.

All of such loans have been classified as TDRs since we modified the payment terms and in some cases interest rate from the original agreements and allowed the borrowers, who were experiencing financial difficulty, to make interest only payments for a period of time in order to relieve some of their overall cash flow burden. Some loan modifications classified as TDRs may not ultimately result in the full collection of principal and interest, as modified, and result in potential incremental losses. These potential incremental losses have been factored into our overall estimate of the allowance for loan losses. The level of any defaults will likely be affected by future economic conditions. A default on a troubled debt restructured loan for purposes of this disclosure occurs when the borrower is 90 days past due or a foreclosure or repossession of the applicable collateral has occurred.

TDRs may arise in which, due to financial difficulties experienced by the borrower, the Company obtains through physical possession one or more collateral assets in satisfaction of all or part of an existing credit. Once possession is obtained, the Company reclassifies the appropriate portion of the remaining balance of the credit from loans to OREO, which is included within other assets in the Consolidated Statements of Condition. For any residential real estate property collateralizing a consumer mortgage loan, the Company is considered to possess the related collateral only if legal title is obtained upon completion of foreclosure, or the borrower conveys all interest in the residential real estate property to the Company through completion of a deed in lieu of foreclosure or similar legal agreement. Excluding OREO, the Company had \$252,000 and \$252,000 of residential real estate properties in the process of foreclosure at December 31, 2017 and September 30, 2017, respectively.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Note 6 - Loans Receivable and Related Allowance for Loan Losses – (Continued)

	Total Troubled Debt Restructurings		Number of Loans	Recorded Investment	Troubled Debt Restructured Loans That Have Defaulted on Modified Terms Within The Past 12 Months	Number of Loans	Recorded Investment
(Dollars in thousands)							
At December 31, 2017:							
Residential mortgage	6	\$ 1,457	—	\$ —			
Construction and Development:							
Land	1	89					
Commercial:							
Commercial real estate	2	551	—	—			
Consumer							
Second mortgages	3	145	1	20			
Total	12	\$ 2,242	1	\$ 20			
At September 30, 2017:							
Residential mortgage	6	\$ 1,464	—	\$ —			
Construction and Development:							
Land	1	94	—	—			
Commercial:							
Commercial real estate	2	554	—	—			
Consumer							
Second mortgages	3	148	1	22			
Total	12	\$ 2,260	1	\$ 22			

The following table reports the performing status all of TDR loans. The performing status is determined by the loans compliance with the modified terms.

	December 31, 2017	September 30, 2017
	Performing Non-Performing	Performing Non-Performing

Edgar Filing: MALVERN BANCORP, INC. - Form 10-Q

	(Dollars in thousands)					
Residential mortgage	\$1,457	\$	—	\$1,464	\$	—
Construction and Development:						
Land	89		—	94		—
Commercial:						
Commercial real estate	551		—	554		—
Consumer						
Second mortgages	125		20	126		22
Total	\$2,222	\$	20	\$2,238	\$	22

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Note 6 - Loans Receivable and Related Allowance for Loan Losses – (Continued)

	For the Three Months Ended December 31,			
	2017		2016	
	Restructured During Period			
	Pre-Modifications	Post-Modifications	Pre-Modifications	Post-Modifications
Number	Number	Number	Number	Number
of	of	of	of	of
Loans	Loans	Loans	Loans	Loans
Recorded	Recorded	Recorded	Recorded	Recorded
Investments	Investments	Investments	Investments	Investments
	(Dollars in thousands)			
Troubled Debt Restructurings:				
Residential mortgage	—\$	—	\$	—
Total	—\$	—	\$	—
			3	\$ 760
			3	\$ 760

Note 7 - Regulatory Matters

The Bank is subject to various regulatory capital requirements administered by the federal 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 classifications are also subject to qualitative judgments by the regulators about components, risk-weightings and other factors.

In July of 2013, the respective U.S. federal banking agencies issued final rules implementing Basel III and the Dodd-Frank Act capital requirements to be fully phased in on a global basis on January 1, 2019. The new regulations establish a new tangible common equity capital requirement, increase the minimum requirement for the current Tier 1 risk-weighted asset ("RWA") ratio, phase out certain kinds of intangibles treated as capital and certain types of instruments and change the risk weightings of certain assets used to determine required capital ratios. The new common equity Tier 1 capital component requires capital of the highest quality – predominantly composed of retained earnings and common stock instruments. For community banks such as Malvern Federal Savings Bank, a common equity Tier 1 capital ratio of 4.5% became effective on January 1, 2015. The new capital rules also increased the minimum Tier 1 capital ratio from 4.0% to 6.0% beginning on January 1, 2015. The rules also establish a capital conservation buffer of 2.5% above the new regulatory minimum capital requirements, which must consist entirely of common equity Tier 1 capital and would result in the following minimum ratios: (1) a common equity Tier 1 capital

ratio of 7.0%, (2) a Tier 1 capital ratio of 8.5%, and (3) a total capital ratio of 10.5%. The new capital conservation buffer requirement was phased in beginning in January 2016 at 0.625% of risk-weighted assets and will increase by that amount each year until fully implemented in January 2019. An institution is also subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses if its capital level falls below the buffer amount. These limitations establish a maximum percentage of eligible retained income that could be utilized for such actions.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of tangible and core capital (as defined in the regulations) to total adjusted tangible assets (as defined) and of risk-based capital (as defined) to risk-weighted assets (as defined).

As of December 31, 2017, the Company's and the Bank's current capital levels exceed the required capital amounts to be considered "well capitalized" and we believe they also meet the fully-phased in minimum capital requirements, including the related capital conservation buffers, as required by the Basel III capital rules.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Note 7 - Regulatory Matters – (Continued)

The following table summarizes the Company's compliance with applicable regulatory capital requirements as of December 31, 2017 and September 30, 2017:

(Dollars in thousands)	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Capital Amount	Ratio	Capital Amount	Ratio	Capital Amount	Ratio
As of December 31, 2017:						
Tier 1 Leverage (Core) Capital (to average assets)	\$ 102,952	9.64 %	\$ 42,720	4.00 %	n/a	n/a
Common Equity Tier 1 Capital (to risk weighted assets)	102,952	12.89 %	35,944	4.50 %	n/a	n/a
Tier 1 Capital (to risk weighted assets)	102,952	12.89 %	47,925	6.00 %	n/a	n/a
Total Risk Based Capital (to risk weighted assets)	135,794	17.00 %	63,900	8.00 %	n/a	n/a
As of September 30, 2017:						
Tier 1 Leverage (Core) Capital (to average assets)	\$ 100,779	10.00 %	\$ 40,315	4.00 %	n/a	n/a
Common Equity Tier 1 Capital (to risk weighted assets)	100,779	12.28 %	36,945	4.50 %	n/a	n/a
Tier 1 Capital (to risk weighted assets)	100,779	12.28 %	49,260	6.00 %	n/a	n/a
Total Risk Based Capital (to risk weighted assets)	133,549	16.27 %	65,679	8.00 %	n/a	n/a

The following table summarizes the Bank's compliance with applicable regulatory capital requirements as of December 31, 2017 and September 30, 2017:

(Dollars in thousands)	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Capital Amount	Ratio	Capital Amount	Ratio	Capital Amount	Ratio

Edgar Filing: MALVERN BANCORP, INC. - Form 10-Q

As of December 31, 2017:

Tier 1 Leverage (to average assets)	\$ 123,508	11.57%	\$42,695	4.00%	\$53,368	5.00%
Common Equity Tier 1 Capital (to risk weighted assets)	123,508	15.48%	35,908	4.50%	51,868	6.50%
Tier 1 Capital (to risk weighted assets)	123,508	15.48%	47,878	6.00%	63,837	8.00%
Total Risk Based Capital (to risk weighted assets)	132,007	16.54%	63,837	8.00%	79,797	10.00%

As of September 30, 2017:

Tier 1 Leverage (to average assets)	\$ 120,902	12.02%	\$40,234	4.00%	\$50,292	5.00%
Common Equity Tier 1 Capital (to risk weighted assets)	120,902	14.75%	36,894	4.50%	53,292	6.50%
Tier 1 Capital (to risk weighted assets)	120,902	14.75%	49,192	6.00%	65,590	8.00%
Total Risk Based Capital (to risk weighted assets)	129,369	15.78%	65,590	8.00%	81,987	10.00%

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Note 8 – Derivatives and Hedging Activities

The Company is exposed to certain risks arising from both its business operations and economic conditions. The Company principally manages its exposures to a wide variety of business and operational risks through management of its core business activities. The Company manages economic risks, including interest rate, liquidity, and credit risk primarily by managing the amount, sources, and duration of its debt funding and the use of derivative financial instruments. Specifically, the Company enters into derivative financial instruments to manage exposures that arise from business activities that result in the payment of future uncertain cash amounts, the value of which are determined by interest rates.

The Company's objectives in using interest rate derivatives are to add stability to interest expense and to manage its exposure to interest rate movements. To accomplish this objective, the Company primarily uses interest rate swaps as part of its interest rate risk management strategy. Interest rate swaps designated as cash flow hedges involve the receipt of variable amounts from a counterparty in exchange for the Company making fixed-rate payments over the life of the agreements without exchange of the underlying notional amount.

The effective portion of changes in the fair value of derivatives designated and that qualify as cash flow hedges is recorded in Accumulated Other Comprehensive Income and is subsequently reclassified into earnings in the period that the hedged forecasted transaction affects earnings. At December 31, 2017, such derivatives were used to hedge the variable cash flows associated with FHLB advances. The ineffective portion of the change in fair value of the derivatives is recognized directly in earnings. The Company's derivatives did not have any hedge ineffectiveness recognized in earnings during the three months ended December 31, 2017 and 2016.

Amounts reported in accumulated other comprehensive income related to derivatives will be reclassified to interest expense as interest payments are made on the Company's variable-rate debt. During the next twelve months, the Company estimates approximately \$121,000 to be reclassified to earnings in interest expense. The Company is hedging its exposure to the variability in future cash flows for forecasted transactions over a maximum period of twenty months (excluding forecasted transactions related to the payment of variable interest on existing financial instruments).

The table below presents the fair value of the Company's derivative financial instruments as well as their classification on the Balance Sheet as of December 31, 2017 and September 30, 2017:

	December 31, 2017			
	Notional Amount	Fair Value	Balance Sheet Location	Expiration Date
	(Dollars in thousand)			
Derivatives designated as hedging instruments				
Interest rate swaps by effective date:				
August 3, 2015	\$ 15,000	\$ 117	Other assets	August 3, 2020
February 5, 2016	20,000	502	Other assets	February 1, 2021

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Note 8 – Derivatives and Hedging Activities – (Continued)

	September 30, 2017		Balance Sheet Location	Expiration Date
	Notional Amount	Fair Value		
Derivatives designated as hedging instruments				
Interest rate swaps by effective date:				
August 3, 2015	\$15,000	\$ 9	Other assets	August 3, 2020
February 5, 2016	20,000	367	Other assets	February 1, 2021

The table below presents the net gains (losses) recorded in accumulated other comprehensive income and the Consolidate Statements of Income relating to the cash flow derivative instruments for the three months ended December 31, 2017 and 2016.

	For the Three Months Ended December 31, 2017		
	Amount of Gain (Loss) Recognized in OCI (Effective Portion)	Amount of Gain (Loss) Reclassified from OCI to Interest Expense	Amount of Gain (Loss) Recognized in Other Non-Interest Income (Ineffective Portion)
August 3, 2015	\$91	\$ (16)	\$ —
February 5, 2016	139	3	—

	For the Three Months Ended December 31, 2016		
	Amount of Gain (Loss) Recognized in OCI (Effective Portion)	Amount of Gain (Loss) Reclassified from OCI to Interest Expense	Amount of Gain (Loss) Recognized in Other Non-Interest Income (Ineffective Portion)
August 3, 2015	\$91	\$ (16)	\$ —
February 5, 2016	139	3	—

	in	Expense	Income
	OCI	(Effective	(Ineffective
	(Effective	Portion)	Portion)
	Portion)		
	(Dollars in thousands)		
August 3, 2015	\$338	\$ (36)	\$ —
February 5, 2016	548	(23)	—

The Company has agreements with each of its derivative counterparties that contain a provision where if the Company defaults on any of its indebtedness, including default where repayment of the indebtedness has not been accelerated by the lender, then the Company could also be declared in default on its derivative obligations.

At December 31, 2017 and September 30, 2017, the fair value of derivatives was in a net asset position, which includes accrued interest but excludes any adjustment for nonperformance risk, related to these agreements was zero for both periods. At December 31, 2017 and September 30, 2017, the Company has minimum collateral posting thresholds with certain of its derivative counterparties and has posted collateral of zero for both periods, respectively, against its obligations under these agreements. If the Company had breached any of these provisions at December 31, 2017, it could have been required to settle its obligations under the agreements at the termination value and would have been required to pay any additional amounts due in excess of amounts previously posted as collateral with the respective counterparty.

Note 9 - Fair Value Measurements

The Company follows FASB ASC Topic 820 "Fair Value Measurement," to record fair value adjustments to certain assets and to determine fair value disclosures for the Company's financial instruments. Investment and mortgage-backed securities available for sale are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record at fair value other assets on a nonrecurring basis, such as impaired loans, real estate owned and certain other assets. These nonrecurring fair value adjustments typically involve application of lower-of-cost-or-market accounting or write-downs of individual assets.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Note 9 – Fair Value Measurements – (Continued)

The Company groups its assets at fair value in three levels, based on the markets in which the assets are traded and the reliability of the assumptions used to determine fair value. These levels are:

Level 1— Valuation is based upon quoted prices for identical instruments traded in active markets.

Level 2—Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

Level 3—Valuation is generated from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect the Company's own estimates of assumptions that market participants would use in pricing the asset.

The Company bases its fair values on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. It is our policy to maximize the use of observable inputs and minimize the use of unobservable inputs when developing fair value measurements, in accordance with the fair value hierarchy.

Fair value measurements for assets where there exists limited or no observable market data and, therefore, are based primarily upon the Company's or other third-party's estimates, are often calculated based on the characteristics of the asset, the economic and competitive environment and other factors. Therefore, the results cannot be determined with precision and may not be realized in an actual sale or immediate settlement of the asset. Additionally, there may be inherent weaknesses in any calculation technique, and changes in the underlying assumptions used, including discount rates and estimates of future cash flows, could significantly affect the results of current or future valuations.

FASB ASC Topic 825 "Financial Instruments" provides an option to elect fair value as an alternative measurement for selected financial assets and financial liabilities not previously recorded at fair value. The fair value of a financial

instrument is the current amount that would be exchanged between willing parties, other than in a forced liquidation.

The Company monitors and evaluates available data to perform fair value measurements on an ongoing basis and recognizes transfers among the levels of the fair value hierarchy as of the date event or a change in circumstances that affects the valuation method chosen. There were no changes in valuation technique or transfers between levels at December 31, 2017 or September 30, 2017.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Note 9 - Fair Value Measurements – (Continued)

The tables below present the balances of assets measured at fair value on a recurring basis at December 31, 2017 and September 30, 2017:

	December 31, 2017			
	Total	Level 1	Level 2	Level 3
	(Dollars in thousands)			
Assets:				
Investment securities available-for-sale:				
Debt securities:				
U.S. treasury notes	\$29,974	\$29,974	\$—	\$—
State and municipal obligations	6,988	—	6,988	—
Single issuer trust preferred security	930	—	930	—
Corporate debt securities	6,361	—	6,361	—
Mutual funds	250	—	—	250
Total investment securities available-for-sale	44,503	29,974	14,279	250
Derivative instruments	\$619	\$—	\$619	\$—

	September 30, 2017			
	Total	Level 1	Level 2	Level 3
	(Dollars in thousands)			
Assets:				
Investment securities available-for-sale:				
Debt securities:				
State and municipal obligations	\$7,029	\$ —	\$7,029	\$—
Single issuer trust preferred security	934	—	934	—
Corporate debt securities	6,374	—	6,374	—
Mutual funds	250	—	—	250
Total investment securities available-for-sale	14,587	—	14,337	250
Derivative instruments	\$376	\$ —	\$376	\$—

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Note 9 - Fair Value Measurements – (Continued)

For assets measured at fair value on a nonrecurring basis that were still held at the end of the period, the following tables provide the level of valuation assumptions used to determine each adjustment and the carrying value of the related individual assets or portfolios at December 31, 2017 and September 30, 2017:

	December 31, 2017		
Total	Level 1	Level 2	Level 3
	(Dollars in thousands)		
Impaired loans ⁽¹⁾	\$782	\$ —	—\$782
Total	\$782	\$ —	—\$782

	December 31, 2017			
	Fair Value at December 31, 2017	Valuation Technique	Unobservable Input	Range/(Weighted Average)
	(Dollars in thousands)			
Impaired loans ⁽¹⁾	\$782	Appraisal of collateral ⁽²⁾	Collateral discounts ⁽³⁾	0%/(0%)
Total	\$782			

(1) At December 31, 2017, consisted of eight loans with an aggregate balance of \$1.1 million and with \$313,000 in specific loan loss allowance.

(2) Fair value is generally determined through independent appraisals of the underlying collateral primarily using comparable sales.

(3) Appraisals may be adjusted by management for qualitative factors such as time, changes in economic conditions and estimated liquidation expense.

	September 30, 2017		
Total	Level 1	Level 2	Level 3

	(Dollars in thousands)			
Impaired loans ⁽¹⁾	\$ 137	\$ —	\$ —	\$ 137
Total	\$ 137	\$ —	\$ —	\$ 137

	September 30, 2017			
	Fair Value			
	at September 30, 2017			
		Valuation Technique	Unobservable Input	Range/(Weighted Average)
	<i>(Dollars in thousands)</i>			
Impaired loans ⁽¹⁾	\$ 137	Appraisal of collateral ⁽²⁾	Collateral discounts ⁽³⁾	0%/(0%)
Total	\$ 137			

(1) At September 30, 2017, consisted of five loans with an aggregate balance of \$374,000 and with \$237,000 in specific loan loss allowance.

(2) Fair value is generally determined through independent appraisals of the underlying collateral primarily using comparable sales.

(3) Appraisals may be adjusted by management for qualitative factors such as time, changes in economic conditions and estimated liquidation expense.

At December 31, 2017 and September 30, 2017, the Company did not have any additions to our mortgage servicing assets. At December 31, 2017 and September 30, 2017, the Company only sold loans with servicing released.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Note 9 - Fair Value Measurements – (Continued)

The following disclosure of the estimated fair value of financial instruments is made in accordance with the requirements of FASB ASC 825. The estimated fair value amounts have been determined by the Company using available market information and appropriate valuation methods. However, considerable judgment is necessarily required to interpret market data to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Company would realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts. FASB ASC 825 excludes certain financial instruments and all non-financial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Company.

The fair value estimates presented herein are based on pertinent information available to management as of December 31, 2017 and September 30, 2017. Although management is not aware of any factors that would significantly affect the estimated fair value amounts, such amounts have not been comprehensively revalued for purposes of these financial statements since December 31, 2017 and September 30, 2017 and, therefore, current estimates of fair value may differ significantly from the amounts presented herein.

The following assumptions were used to estimate the fair value of the Company's financial instruments:

Cash and Cash Equivalents—These assets are carried at historical cost. The carrying amount is a reasonable estimate of fair value because of the relatively short time between the origination of the instrument and its expected realization.

Investment Securities—Investment and mortgage-backed securities available for sale (carried at fair value) and held to maturity (carried at amortized cost) are measured at fair value on a recurring basis. Fair value measurements for these securities are typically obtained from independent pricing services that we have engaged for this purpose. When available, we, or our independent pricing service, use quoted market prices to measure fair value. If market prices are not available, fair value measurement is based upon models that incorporate available trade, bid and other market information and for structured securities, cash flow and, when available, loan performance data. Because many fixed income securities do not trade on a daily basis, our independent pricing service's applications apply available information through processes such as benchmark curves, benchmarking of like securities, sector groupings and matrix pricing to prepare evaluations. For each asset class, pricing applications and models are based on information from market sources and integrate relevant credit information. All of our securities available for sale are valued using

either of the foregoing methodologies to determine fair value adjustments recorded to our financial statements. The fair value of the Level 1 securities was \$30.0 million as of December 31, 2017. The Company had no Level 1 securities as of September 30, 2017. The fair value of the Level 3 security was \$250,000 both as of December 31, 2017 and as of September 30, 2017.

Loans Receivable—We do not record loans at fair value on a recurring basis. As such, valuation techniques discussed herein for loans are primarily for estimating fair value for FASB ASC 825 disclosure purposes. However, from time to time, we record nonrecurring fair value adjustments to loans to reflect partial write-downs for impairment or the full charge-off of the loan carrying value. The valuation of impaired loans is discussed below. The fair value estimate for FASB ASC 825 purposes differentiates loans based on their financial characteristics, such as product classification, loan category, pricing features and remaining maturity. Prepayment and credit loss estimates are evaluated by loan type and rate. The fair value of loans is estimated by discounting contractual cash flows using discount rates based on current industry pricing, adjusted for prepayment and credit loss estimates.

Impaired Loans—Impaired loans are valued utilizing independent appraisals that rely upon quoted market prices for similar assets in active markets. These appraisals include adjustments to comparable assets based on the appraisers' market knowledge and experience. The appraisals are adjusted downward by management, as necessary, for changes in relevant valuation factors subsequent to the appraisal date and are considered level 3 inputs.

Accrued Interest Receivable—This asset is carried at historical cost. The carrying amount is a reasonable estimate of fair value because of the relatively short time between the origination of the instrument and its expected realization.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Note 9 - Fair Value Measurements – (Continued)

Restricted Stock—Although restricted stock is an equity interest in the FHLB, it is carried at cost because it does not have a readily determinable fair value as its ownership is restricted and it lacks a market. The estimated fair value approximates the carrying amount.

Other Real Estate Owned—Assets acquired through foreclosure or deed in lieu of foreclosure are recorded at estimated fair value less estimated selling costs when acquired, thus establishing a new cost basis. Fair value is generally based on independent appraisals. These appraisals include adjustments to comparable assets based on the appraisers' market knowledge and experience, and are considered level 3 inputs. When an asset is acquired, the excess of the loan balance over fair value, less estimated selling costs, is charged to the allowance for loan losses. If the estimated fair value of the asset declines, a write-down is recorded through expense. The valuation of foreclosed assets is subjective in nature and may be adjusted in the future because of, among other factors, changes in the economic conditions.

Deposits—Deposit liabilities are carried at cost. As such, valuation techniques discussed herein for deposits are primarily for estimating fair value for FASB ASC 825 disclosure purposes. The fair value of deposits is discounted based on rates available for borrowings of similar maturities. A decay rate is estimated for non-time deposits. The discount rate for non-time deposits is adjusted for servicing costs based on industry estimates.

Long-Term Borrowings—Advances from the FHLB are carried at amortized cost. However, we are required to estimate the fair value of long-term debt under FASB ASC 825. The fair value is based on the contractual cash flows discounted using rates currently offered for new notes with similar remaining maturities.

Derivatives— The fair value of derivatives are based on valuation models using observable market data as of the measurement date (level 2). Our derivatives are traded in an over-the-counter market where quoted market prices are not always available. Therefore, the fair values of derivatives are determined using quantitative models that utilize multiple market inputs. The inputs will vary based on the type of derivative, but could include interest rates, prices and indices to generate continuous yield or pricing curves, prepayment rate, and volatility factors to value the position. The majority of market inputs is actively quoted and can be validated through external sources, including brokers, market transactions and third-party pricing services.

Accrued Interest Payable—This liability is carried at historical cost. The carrying amount is a reasonable estimate of fair value because of the relatively short time between the origination of the instrument and its expected realization.

Commitments to Extend Credit and Letters of Credit—The majority of the Company's commitments to extend credit and letters of credit carry current market interest rates if converted to loans. Because commitments to extend credit and letters of credit are generally unassignable by either the Bank or the borrower, they only have value to the Company and the borrower. The estimated fair value approximates the recorded deferred fee amounts, which are not significant.

Mortgage Servicing Rights—The fair value of mortgage servicing rights is based on observable market prices when available or the present value of expected future cash flows when not available. Assumptions, such as loan default rates, costs to service, and prepayment speeds significantly affect the estimate of future cash flows. Mortgage servicing rights are carried at the lower of cost or fair value.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Note 9 - Fair Value Measurements – (Continued)

The carrying amount and estimated fair value of the Company's financial instruments as of December 31, 2017 and September 30, 2017 are presented below:

	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
(Dollars in thousands)					
December 31, 2017:					
Financial assets:					
Cash and cash equivalents	\$128,642	\$128,642	\$128,642	\$—	\$—
Investment securities available-for-sale	44,503	44,503	29,974	14,279	250
Investment securities held-to-maturity	33,893	33,291	—	33,291	—
Loans receivable, net (including impaired loans)	806,764	806,529	—	—	806,529
Accrued interest receivable	3,344	3,344	—	3,344	—
Restricted stock	5,930	5,930	—	5,930	—
Mortgage servicing rights (included in Other Assets)	255	264	—	264	—
Derivatives	619	619	—	619	—
Financial liabilities:					
Savings accounts	41,631	41,631	—	41,631	—
Checking and NOW accounts	207,034	207,034	—	207,034	—
Money market accounts	293,674	293,674	—	293,674	—
Certificates of deposit	254,760	257,153	—	257,153	—
Borrowings (excluding sub debt)	123,000	123,155	—	123,155	—
Subordinated debt	24,342	24,342	—	24,342	—
Accrued interest payable	1,099	1,099	—	1,099	—
September 30, 2017:					
Financial assets:					
Cash and cash equivalents	\$117,136	\$117,136	\$117,136	\$—	\$—
Investment securities available-for-sale	14,587	14,587	—	14,337	250
Investment securities held-to-maturity	34,915	34,566	—	34,566	—
Loans receivable, net (including impaired loans)	834,331	839,242	—	—	839,242
Accrued interest receivable	3,139	3,139	—	3,139	—
Restricted stock	5,559	5,559	—	5,559	—
Mortgage servicing rights (included in Other)	268	271	—	271	—
Derivatives	376	376	—	376	—
Financial liabilities:					
Savings accounts	44,526	44,526	—	44,526	—

Edgar Filing: MALVERN BANCORP, INC. - Form 10-Q

Checking and NOW accounts	197,700	197,700	—	197,700	—
Money market accounts	276,404	276,404	—	276,404	—
Certificates of deposit	271,766	273,723	—	273,723	—
Borrowings (excluding sub debt)	123,000	123,658	—	123,658	—
Subordinated debt	24,303	24,303	—	24,303	—
Accrued interest payable	694	694	—	694	—

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**Note 10 – Income Taxes**

In the first quarter of fiscal 2018, the Company revised its estimated annual effective rate to reflect a change in the federal statutory rate from 35% to 21%, resulting from legislation that was enacted on December 22, 2017. The rate change is administratively effective at the beginning of our calendar year, using a blended rate for the annual period. As a result, the blended statutory tax rate for the year is 24.5%.

In addition, we recognized a tax expense in our tax provision for the period ended December 31, 2017 related to adjusting our deferred tax balance to reflect the new corporate tax rate. As a result, income tax expense reported for the first three months was adjusted to reflect the effects of the change in the tax law and resulted in an increase in income tax expense of \$2.0 million during the quarter ended December 31, 2017. This amount is the result of a reduction of \$323,000 in income tax expense for the three-month period ended December 31, 2017 related to the lower corporate rate and a \$2.3 million increase from the application of the newly enacted rates to existing deferred tax assets balances.

The accounting for the effects of the rate change on deferred tax balances is complete and no provisional amounts were recorded for this item.

Reconciliation of income tax provision for three months ended December 31, 2017:

	For the Three Months Ended December 31, 2017 (Dollars in thousands)
Income tax provision calculated at blended federal tax rate (24.5%)	\$ 878
State income tax provision	170
Income tax provision due to re-measurement of DTAs/DTLs	2,206
Other	(35)
Total	\$ 3,219

Note 11 – Comprehensive Income (Loss)

The components of accumulated other comprehensive income included in shareholders' equity are as follows:

	December 31, 2017	September 30, 2017
	(Dollars in thousands)	
Net unrealized holding (losses) gains on available-for-sale securities	\$(364)	\$ (282)
Tax effect	121	96
Net of tax amount	(243)	(186)
Fair value adjustments on derivatives	619	376
Tax effect	(152)	(128)
Net of tax amount	467	248
Total accumulated other comprehensive income	\$224	\$ 62

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**Note 11 – Comprehensive Income (Loss) – (Continued)**

Other comprehensive income (loss) and related tax effects are presented in the following table:

	Three Months Ended December 31, 2017 2016 (Dollars in thousands)	
Net unrealized holding (losses) gains on available-for-sale securities	\$(83)	\$(1,098)
Net realized gain on securities available-for-sale	—	—
Amortization of unrealized holding losses on securities available-for-sale transferred to held-to-maturity	2	4
Fair value adjustments on derivatives	242	945
Other comprehensive income (loss) before taxes	161	(149)
Tax effect	1	52
Total comprehensive income (loss)	\$162	\$(97)

Note 12 – Equity Based Incentive Compensation Plan

The Company maintains the Malvern Bancorp, Inc. 2014 Long-Term Incentive Compensation Plan (the “2014 Plan”), which permits the grant of long-term incentive and other stock and cash awards. The purpose of the 2014 Plan is to promote the success of the Company and the Bank by providing incentives to officers, employees and directors of the Company and the Bank that will link their personal interests to the financial success of the Company and to growth in shareholder value. The maximum total number of shares of the Company’s common stock available for grants under the 2014 Plan is 400,000. As of December 31, 2017, there were 365,357 remaining shares available for future grants.

Restricted stock and option awards granted vest in 20% increments beginning on the one year anniversary of the grant date, and accelerate upon a change in control of the Company. The options generally expire ten years from the date of

grant. All issuances are subject to forfeiture if the recipient leaves or is terminated prior to the award's vesting. Shares of restricted stock have the same dividend and voting rights as common stock while options do not.

All awards are issued at fair value of the underlying shares at the grant date. The Company expenses the cost of the awards, which is determined to be the fair market value of the awards at the date of grant.

During the three months ended December 31, 2017, stock options covering a total of 4,664 shares of common stock were granted. No options were granted for the three months ended December 31, 2016. Total compensation expense related to options granted under the 2014 Plan was \$4,000 for the three months ended December 31, 2017 and \$1,000 for the three months ended December 31, 2016.

During the three months ended December 31, 2017 a total of 4,768 restricted shares were awarded. During the three months ended December 31, 2016 no restricted shares were awarded. The compensation expense related to restricted stock awards was approximately \$11,000 during the three months ended December 31, 2017 and \$1,000 during the three months ended December 31, 2016.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Note 12 – Equity Based Incentive Compensation Plan – (Continued)

Stock-based compensation expense for the cost of the awards granted is based on the grant-date fair value. For stock option awards, the fair value is estimated at the date of grant using the Black-Scholes option-pricing model. This model requires the input of highly subjective assumptions, changes to which can materially affect the fair value estimate. Additionally, there may be other factors that would otherwise have a significant effect on the value of employee stock options granted but are not considered by the model. Accordingly, while management believes that the Black-Scholes option-pricing model provides a reasonable estimate of fair value, the model does not necessarily provide the best single measure of fair value for the Company's employee stock options.

The following is a summary of stock option activity for the three months ended December 31, 2017:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (In Years)	Aggregate Intrinsic Value
Outstanding, beginning of year	11,000	\$ 19.19		\$ 83,170
Granted	4,664	26.20		—
Exercised	—	—		—
Forfeited/cancelled/expired	—	—		—
Outstanding, at December 31, 2017	15,664	\$ 21.28	9.209	\$ 77,120
Exercisable at December 31, 2017	800	\$ 16.02	8.246	\$ 8,144
Nonested at December 31, 2017	14,864	\$ 21.28	9.209	\$ 77,120

The table below summarizes the activity for the Company's restricted stock outstanding during the three months ended December 31, 2017:

Shares	Weighted Average Fair
--------	-----------------------------

		Value
Outstanding, beginning of year	10,711	\$ 20.36
Granted	4,768	26.20
Vested	(337)	17.40
Forfeited/cancelled/expired	—	—
Outstanding, at December 31, 2017	15,142	\$ 22.16

As of December 31, 2017, there was \$304,000 of total unrecognized compensation cost related to nonvested shares of restricted stock granted under the Plan. The cost is expected to be recognized over a weighted average period of 4.44 years. As of December 31, 2017, there was \$91,000 of total unrecognized compensation cost related to nonvested options under the Plan. The cost is expected to be recognized over a weighted average period of 4.39 years.

Item 2 – Management’s Discussion and Analysis of Financial Condition and Results of Operations

The purpose of this analysis is to provide the reader with information relevant to understanding and assessing the Company’s results of operations for the periods presented herein and financial condition as of December 31, 2017 and September 30, 2017. In order to fully understand this analysis, the reader is encouraged to review the consolidated financial statements and accompanying notes thereto appearing elsewhere in this report.

Forward-Looking Statements

This Quarterly Report on Form 10-Q contains certain forward looking statements (as defined in the Securities Exchange Act of 1934, as amended, and the regulations thereunder). Forward looking statements are not historical facts but instead represent only the beliefs, expectations or opinions of Malvern Bancorp, Inc. and its management regarding future events, many of which, by their nature, are inherently uncertain. Forward looking statements may be identified by the use of such words as: “believes,” “expects,” “anticipates,” “plans,” “trend,” “objective,” “continue,” “or words of similar meaning, or future or conditional terms such as “will,” “would,” “should,” “could,” “might,” “can,” “Forward looking statements include, but are not limited to, financial projections and estimates and their underlying assumptions; statements regarding plans, objectives and expectations with respect to future operations, products and services; and statements regarding future performance. Such statements are subject to certain risks, uncertainties and assumptions, many of which are difficult to predict and generally are beyond the control of Malvern Bancorp, Inc. and its management, that could cause actual results to differ materially from those expressed in, or implied or projected by, forward looking statements. 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: (1) competitive pressures among depository institutions may increase significantly; (2) changes in the interest rate environment may reduce interest margins; (3) prepayment speeds, loan origination and sale volumes, charge-offs and loan loss provisions may vary substantially from period to period; (4) general economic conditions may be less favorable than expected; (5) political developments, wars or other hostilities may disrupt or increase volatility in securities markets or other economic conditions; (6) legislative or regulatory changes or actions may adversely affect the businesses in which Malvern Bancorp, Inc. is engaged; (7) changes and trends in the securities markets may adversely impact Malvern Bancorp, Inc.; (8) a delayed or incomplete resolution of regulatory issues could adversely impact our planning; (9) difficulties in integrating any businesses that we may acquire, which may increase our expenses and delay the achievement of any benefits that we may expect from such acquisitions; (10) the impact of reputation risk created by the developments discussed above on such matters as business generation and retention, funding and liquidity could be significant; and (11) the outcome of regulatory and legal investigations and proceedings may not be anticipated.

As used in this report, unless the context otherwise requires, the terms “we,” “our,” “us,” or the “Company” refer to Malvern Bancorp, Inc., a Pennsylvania corporation, and the term the “Bank” refers to Malvern Federal Savings Bank, a federally chartered savings bank and wholly owned subsidiary of the Company. In addition, unless the context otherwise

requires, references to the operations of the Company include the operations of the Bank.

This report contains certain financial information determined by methods other than in accordance with accounting principles generally accepted in the United States of America (“GAAP”). These measures include net interest income on a fully tax equivalent basis and net interest margin on a fully tax equivalent basis, including the efficiency ratio. Our management uses these non-GAAP measures, together with the related GAAP measures, in its analysis of our performance and in making business decisions. Management also uses these measures for peer comparisons. The tax equivalent adjustment to net interest income recognizes the income tax savings when comparing taxable and tax-exempt assets and assumes a 34% tax rate. Management believes that it is standard practice in the banking industry to present net interest income and net interest margin on a fully tax equivalent basis, and accordingly believes that providing these measures may be useful for peer comparison purposes. These disclosures should not be viewed as substitutes for the results determined to be in accordance with GAAP, nor are they necessarily comparable to non-GAAP performance measures that may be represented by other companies. Reconciliations of net interest income on a fully tax equivalent basis to net interest income and net interest margin on a fully tax equivalent basis to net interest margin are contained in the tables under “Earnings-Net Interest Income and Margin.”

Critical Accounting Policies

The accounting and reporting policies followed by Malvern Bancorp, Inc. and its subsidiaries (the “Company”) conform, in all material respects, to U.S. generally accepted accounting principles. In preparing the consolidated financial statements, management has made estimates, judgments and assumptions that affect the reported amounts of assets and liabilities as of the dates of the consolidated statements of condition and for the periods indicated in the statements of operations. Actual results could differ significantly from those estimates.

The Company’s accounting policies are fundamental to understanding Management’s Discussion and Analysis (“MD&A”) of financial condition and results of operations. The Company has identified the determination of the allowance for loan losses, other real estate owned, fair value measurements, deferred tax assets, the other-than-temporary impairment evaluation of securities and the valuation of our derivative positions to be critical because management must make subjective and/or complex judgments about matters that are inherently uncertain and could be most subject to revision as new information becomes available. Additional information on these policies is provided below.

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

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

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as impaired. For loans that are classified as impaired, a charge-off is recognized when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers pools of loans by loan class including commercial loans not considered impaired, as well as smaller balance homogeneous loans, such as residential real estate, home equity and other consumer loans. These pools of loans are evaluated for loss exposure based upon historical loss rates for each of these categories of loans, as adjusted for qualitative factors.

An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio. Once all factor adjustments are applied, general reserve allocations for each segment are calculated, summarized and reported on the ALLL summary. ALLL final schedules, calculations and the resulting evaluation process are reviewed quarterly.

In addition, Federal bank regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses and may require the Company to recognize additions to the allowance based on their judgments about information available to them at the time of their examination, which may not previously have been available to management. Based on management's comprehensive analysis of the loan portfolio, management believes the level of the allowance for loan losses at December 31, 2017 was appropriate under GAAP.

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

The allowance is adjusted for other significant factors that affect the collectability of the loan portfolio as of the evaluation date including changes in lending policy and procedures, loan volume and concentrations, seasoning of the portfolio, loss experience in particular segments of the portfolio, and bank regulatory examination results. Other factors include changes in economic and business conditions affecting our primary lending areas and credit quality trends. Loss factors are reevaluated each reporting period to ensure their relevance in the current economic environment. We review key ratios such as the allowance for loan losses to total loans receivable and as a percentage of non-performing loans; however, we do not try to maintain any specific target range for these ratios.

While management uses the best information available to make loan loss allowance evaluations, adjustments to the allowance may be necessary based on changes in economic and other conditions or changes in accounting guidance. In addition, the OCC, as an integral part of its examination processes, periodically reviews our allowance for loan losses. The OCC may require the recognition of adjustments to the allowance for loan losses based on their judgment of information available to them at the time of their examinations. To the extent that actual outcomes differ from management's estimates, additional provisions to the allowance for loan losses may be required that would adversely impact earnings in future periods.

Other Real Estate Owned. Assets acquired through foreclosure typically consist of other real estate owned and financial assets acquired from debtors. Other real estate owned is carried at the lower of cost or fair value, less estimated selling costs. The fair value of other real estate owned is determined using current market appraisals obtained from approved independent appraisers, agreements of sale, and comparable market analysis from real estate brokers, where applicable. Changes in the fair value of assets acquired through foreclosure at future reporting dates or at the time of disposition will result in an adjustment in assets acquired through foreclosure expense or net gain (loss) on sale of assets acquired through foreclosure, respectively.

Fair Value Measurements. The Company uses fair value measurements to record fair value adjustments to certain assets to determine fair value disclosures. Investment and mortgage-backed securities available for sale are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record at fair value

other assets on a nonrecurring basis, such as impaired loans, real estate owned and certain other assets. These nonrecurring fair value adjustments typically involve application of lower-of-cost-or-market accounting or write-downs of individual assets.

Under the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) Topic 820, Fair Value Measurements, the Company groups its assets at fair value in three levels, based on the markets in which the assets are traded and the reliability of the assumptions used to determine fair value. These levels are:

Level 1 – Valuation is based upon quoted prices for identical instruments traded in active markets.

Level 2 – Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

Level 3 – Valuation is generated from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect the Company’s own estimates of assumptions that market participants would use in pricing the asset.

Under FASB ASC Topic 820, the Company bases its fair values on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. It is our policy to maximize the use of observable inputs and minimize the use of unobservable inputs when developing fair value measurements, in accordance with the fair value hierarchy in FASB ASC Topic 820.

Fair value measurements for assets where there exists limited or no observable market data and, therefore, are based primarily upon the Company’s or other third-party’s estimates, are often calculated based on the characteristics of the asset, the economic and competitive environment and other such factors. Therefore, the results cannot be determined with precision and may not be realized in an actual sale or immediate settlement of the asset. Additionally, there may be inherent weaknesses in any calculation technique, and changes in the underlying assumptions used, including discount rates and estimates of future cash flows, that could significantly affect the results of current or future valuations. At December 31, 2017, the Company had \$782,000 of assets that were measured at fair value on a non-recurring basis using Level 3 measurements.

Deferred Tax Assets. We make estimates and judgments to calculate some of our tax liabilities and determine the recoverability of some of our deferred tax assets (“DTAs”), which arise from temporary differences between the tax and financial statement recognition of revenues and expenses. We also estimate a reserve for deferred tax assets if, based on the available evidence, it is more likely than not that some portion of the recorded deferred tax assets will not be realized in future periods. These estimates and judgments are inherently subjective. Historically, our estimates and judgments to calculate our deferred tax accounts have not required significant revision to our initial estimates.

In evaluating our ability to recover deferred tax assets, we consider all available positive and negative evidence, including our past operating results and our forecast of future taxable income. In determining future taxable income, we make assumptions for taxable income, the reversal of temporary differences and the implementation of feasible and prudent tax planning strategies. These assumptions require us to make judgments about our future taxable income and are consistent with the plans and estimates we use to manage our business. Any reduction in estimated future taxable income may require us to record a valuation allowance against our deferred tax assets. An increase in the valuation allowance would result in additional income tax expense in the period and could have a significant impact on our future earnings.

Realization of a deferred tax asset requires us to exercise significant judgment and is inherently uncertain because it requires the prediction of future occurrences. Our net deferred tax asset amounted to \$3.8 million and \$6.7 million at December 31, 2017 and at September 30, 2017, respectively.

On December 22, 2017, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act (the "Tax Act"). The Tax Act makes broad and complex changes to the U.S. tax code that will affect our fiscal year ending September 30, 2018 and future periods, including reducing the U.S. federal corporate statutory tax rate to 21.0% beginning January 1, 2018, which results in a blended federal corporate statutory tax rate of 24.5% for the Company's fiscal year ending September 30, 2018 that is based on the applicable tax rates before and after the Tax Act and the number of days in the year.

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

Derivatives. The Company enters into derivative financial instruments to manage exposures that arise from business activities that result in the payment of future uncertain cash amounts, the value of which are determined by interest rates. The Company is exposed to certain risks arising from both its business operations and economic conditions. The Company principally manages its exposures to a wide variety of business and operational risks through management of its core business activities. The Company manages economic risks, including interest rate, liquidity, and credit risk primarily by managing the amount, sources, and duration of its debt funding and the use of derivative financial instruments. The Company primarily uses interest rate swaps as part of its interest rate risk management strategy.

Interest rate swaps are valued by a third party, using models that primarily use market observable inputs, such as yield curves, and are validated by comparison with valuations provided by the respective counterparties. The credit risk associated with derivative financial instruments that are subject to master netting agreements is measured on a net basis by counterparty portfolio. The significant assumptions used in the models, which include assumptions for interest rates, are independently verified against observable market data where possible. Where observable market data is not available, the estimate of fair value becomes more subjective and involves a high degree of judgment. In this circumstance, fair value is estimated based on management's judgment regarding the value that market participants would assign to the asset or liability. This valuation process takes into consideration factors such as market illiquidity. Imprecision in estimating these factors can impact the amount recorded on the balance sheet for a particular asset or liability with related impacts to earnings or other comprehensive income.

Earnings

Net income available to common shareholders for the three months ended December 31, 2017 amounted to \$403,000, or \$0.06 per fully diluted common share, a decrease of \$570,000, or 58.6 percent, as compared with net income of \$973,000, or \$0.15 per common share, for the quarter ended December 31, 2016. The annualized return on average assets was 0.15 percent for the three months ended December 31, 2017, compared to annualized return on average assets of 0.47 percent for three months ended December 31, 2016. The annualized return on average shareholders' equity was 1.55 percent for the three-month period ended December 31, 2017, compared to 4.03 percent in annualized return on average shareholders' equity for the three months ended December 31, 2016.

Net Interest Income and Margin

Net interest income is the difference between the interest earned on the portfolio of earning assets (principally loans and investments) and the interest paid for deposits and borrowings, which support these assets. Net interest income is presented on a fully tax-equivalent basis by adjusting tax-exempt income (primarily interest earned on obligations of state and political subdivisions) by the amount of income tax which would have been paid had the assets been invested in taxable issues. We believe this to be the preferred measurement of net interest income as it provides a relevant comparison between taxable and non-taxable amounts.

The following table presents the components of net interest income on a fully tax-equivalent basis, a non-GAAP measure, for the periods indicated, together with a reconciliation of net interest income as reported under GAAP.

Net Interest Income (tax-equivalent basis)

(Dollars in thousands)	Three Months Ended December 31,			
	2017	2016	Increase (Decrease)	Percent Change
Interest income:				
Loans, including fees	\$8,702	\$6,315	\$ 2,387	37.80 %
Investment securities	305	686	(381)	(55.54)
Dividends, restricted stock	69	64	5	7.81
Interest-bearing cash accounts	446	93	353	379.57
Total interest income	9,522	7,158	2,364	33.03
Interest expense:				
Deposits	2,155	1,324	831	62.76
Short-term borrowings	19	—	19	100.00
Long-term borrowings	563	542	21	3.87
Subordinated debt	392	—	392	100.00
Total interest expense	3,129	1,866	1,263	67.68
Net interest income on a fully tax-equivalent basis	6,393	5,292	1,101	20.80
Tax-equivalent adjustment ⁽¹⁾	(11)	(53)	42	(79.25)
Net interest income, as reported under GAAP	\$6,382	\$5,239	\$ 1,143	21.82 %

⁽¹⁾ Computed using a federal income tax rate of 24.5 percent and 34 percent, respectively, for the three months ended December 31, 2017 and 2016.

Net interest income on a fully tax-equivalent basis increased \$1.0 million or 20.8 percent to \$6.4 million for the three months ended December 31, 2017 as compared to the same period in fiscal 2017. For the three months ended December 31, 2017, the net interest margin (which is defined as net interest income as a percentage of total average interest-earnings assets) on a fully tax-equivalent basis decreased 17 basis points to 2.47 percent from 2.64 percent during the three months ended December 31, 2016. For the three months ended December 31, 2017, an increase in the average yield on interest-earning assets of 11 basis points together with an increase of 30 basis points in the average cost of interest-bearing liabilities, resulted in a decrease in the Company's net interest spread of 19 basis points for the period.

For the three-month period ended December 31, 2017, total interest income on a tax-equivalent basis increased by \$2.4 million or 33.0 percent, to \$9.5 million, compared to the same three-month period in fiscal 2017. This increase in interest income was due primarily to an increase in the average volume of interest-earning assets, due primarily to an increase in the average balances of the loan portfolio. The average balance of the loan portfolio increased by \$210.6 million, to \$822.9 million, from an average of \$612.4 million in the same quarter in fiscal 2017, primarily reflecting net increases in construction loans and commercial loans. Average loans represented approximately 79.5 percent of average interest-earning assets during the first quarter of fiscal 2018 compared to 76.4 percent in the same quarter in fiscal 2017. Average investment securities volume decreased during the first three months of fiscal 2018 by \$45.2 million, to \$59.5 million, compared to the first quarter of fiscal 2017.

For the three months ended December 31, 2017, interest expense increased \$1.3 million, or 67.7 percent, to \$3.1 million, compared to the same three-month period in fiscal 2017. The average rate of total interest-bearing liabilities increased 30 basis points to 1.37 percent for the three months ended December 31, 2017, from 1.07 percent for the three months ended December 31, 2016. At the same time, the average balance of total interest-bearing liabilities increased by \$213.3 million. This increase primarily reflects an increase in the average balance of money market accounts of \$107.7 million, a \$61.0 million increase in the average balance of other interest-bearing deposit accounts and an increase in the average balance of borrowings of \$29.1 million. For the three months ended December 31, 2017, the Company's net interest spread on a tax-equivalent basis decreased to 2.31 percent, from 2.50 percent for the three months ended December 31, 2016.

The following table quantifies the impact on net interest income on a tax-equivalent basis resulting from changes in average balances and average rates during the periods presented. Any change in interest income or expense attributable to both changes in volume and changes in rate has been allocated in proportion to the relationship of the absolute dollar amount of change in each category.

Analysis of Variance in Net Interest Income Due to Changes in Volume and Rates

<i>(Tax-equivalent basis,</i>	Three Months Ended		
	December 31, 2017 and 2016 Increase (Decrease)		
	Due to Changes in:		
	Average	Average	Net
<i>Dollars in thousands)</i>	Volume	Rate	Change
Interest-earning assets:			
Loans, including fees	\$2,172	\$ 215	\$ 2,387
Investment securities	(296)	(85)	(381)
Interest-bearing cash accounts	80	273	353
Dividends, restricted stock	4	1	5
Total interest-earning assets	1,960	404	2,364
Interest-bearing liabilities:			
Money market deposits	189	317	506
Savings deposits	—	—	—
Certificates of deposit	60	47	107
Other interest-bearing deposits	32	186	218
Total interest-bearing deposits	281	550	831
Borrowings	133	299	432
Total interest-bearing liabilities	414	849	1,263
Change in net interest income	\$ 1,546	\$ (445)	\$ 1,101

Average Balances, Net Interest Income, and Yields Earned and Rates Paid. The following table shows for the periods indicated the total dollar amount of interest from average interest-earning assets and the resulting yields, as well as the interest expense on average interest-bearing liabilities, expressed both in dollars and rates, and the net interest margin (net interest income as a percentage of average interest-earning assets). Tax-exempt income and yields have been adjusted to a tax-equivalent basis. All average balances are based on monthly balances. Management does not believe that the monthly averages differ significantly from what the daily averages would be.

	Three Months Ended December 31, 2017				2016		
	Average Balance	Interest Income/ Expense	Average Yield/ Rate		Average Balance	Interest Income/ Expense	Average Yield/ Rate
(Tax-equivalent basis)	(Dollars in thousands)						
Assets							
Interest-earning assets:							
Loans, including fees(1)	\$822,941	\$ 8,702	4.23	%	\$612,388	\$ 6,315	4.12 %
Investment securities	59,453	305	2.05		104,645	686	2.62
Interest-bearing cash accounts	147,591	446	1.21		79,067	93	0.47
Dividends, restricted stock	5,782	69	4.77		5,419	64	4.72
Total interest-earning assets	1,035,767	9,522	3.68		801,519	7,158	3.57
Non interest-earning assets:							
Cash and due from banks	1,533				1,334		
Bank-owned life insurance	18,994				18,483		
Other assets	20,117				19,759		
Allowance for loan losses	(8,419)				(5,650)		
Total non interest-earning assets	32,225				33,926		
Total assets	\$1,067,992				\$835,445		
Liabilities and Shareholders' Equity							
Interest-bearing liabilities:							
Money market deposits	\$288,843	\$ 821	1.14	%	\$181,100	\$ 315	0.70 %
Savings deposits	43,663	10	0.09		44,445	10	0.09
Certificates of deposit	274,785	1,054	1.53		258,504	947	1.47
Other interest-bearing deposits	158,814	270	0.68		97,789	52	0.21
Total interest-bearing deposits	766,105	2,155	1.13		581,838	1,324	0.91
Borrowings	147,322	974	2.64		118,245	542	1.83
Total interest-bearing liabilities	913,427	3,129	1.37		700,083	1,866	1.07
Non interest-bearing liabilities:							
Demand deposits	42,760				33,330		
Other liabilities	8,086				5,503		
Total non interest-bearing liabilities	50,846				38,833		
Shareholders' equity	103,719				96,529		
Total liabilities and shareholders' equity	\$1,067,992				\$835,445		
Net interest income (tax equivalent basis)		6,393				5,292	

Edgar Filing: MALVERN BANCORP, INC. - Form 10-Q

Net interest spread	2.31	%	2.50	%
Net interest margin (tax equivalent basis)	2.47	%	2.64	%
Tax equivalent effect	0.01	%	0.03	%
Net interest margin on a GAAP basis	2.46	%	2.61	%
Tax-equivalent adjustment (2)	(11	)	(53)
Net interest income	\$ 6,382		\$ 5,239	

(1) Includes non-accrual loans during the respective periods. Calculated net of deferred loan fees and loan discounts.

(2) Computed using a federal income tax rate of 24.5 percent and 34 percent, respectively, for the periods ended December 31, 2017 and December 31, 2016.

Investment Portfolio

At December 31, 2017, the average volume of investment securities decreased by \$45.2 million to approximately \$59.5 million or 5.7 percent of average earning assets, from \$104.6 million on average, or 13.1 percent of average earning assets, for the comparable period in fiscal 2017. At December 31, 2017, the total investment portfolio amounted to \$78.4 million, an increase of \$28.9 million, or 58.4 percent, from September 30, 2017. The increase in the investment portfolio was primarily due to purchase of U.S. treasury notes during the first quarter of fiscal 2018. At December 31, 2017, the principal components of the investment portfolio were government treasury notes, government agency obligations, Federal agency obligations including mortgage-backed securities, obligations of U.S. states and political subdivision, corporate bonds and notes, and equity securities.

During the three-month period ended December 31, 2017, the volume-related factors decreased investment revenue by approximately \$296,000, while rate-related factors decreased investment revenue by approximately \$85,000 from the same period in fiscal 2017. The tax-equivalent yield on investments decreased by 57 basis points to 2.05 percent for the three-month period ended December 31, 2017 as compared to the three-month period ended December 31, 2016 at 2.62 percent. The yield on the portfolio increased in fiscal 2018 compared to fiscal 2017 due primarily to lower average volume of investment securities.

Loan Portfolio

Lending is one of the Company's primary business activities. The Company's loan portfolio consists of residential, construction and development, commercial and consumer loans, serving the diverse customer base in its market area. The composition of the Company's portfolio continues to change due to the local economy. Factors such as the economic climate, interest rates, real estate values and employment all contribute to these changes. Growth is generated through business development efforts, repeat customer requests for new financings, penetration into existing markets and entry into new markets.

The Company seeks to create growth in commercial lending by offering customer-focused products and competitive pricing and by capitalizing on the positive trends in its market area. Products offered are designed to meet the financial requirements of the Company's customers. It is the objective of the Company's credit policies to diversify the commercial loan portfolio to limit concentrations in any single industry.

At December 31, 2017, total gross loans amounted to \$814.6 million, a decrease of \$27.6 million or 3.3 percent as compared to September 30, 2017. For the three-month period ended December 31, 2017, there was a decrease of \$20.1 million in commercial loans, a decrease of \$773,000 in construction and development loans, a \$16.7 million

decrease in residential mortgage loans and \$1.0 million decrease in total consumer loans. Total gross loans recorded in the quarter ended December 31, 2017 included new loan volume of \$36.7 million, which was offset by loan payoffs of \$45.3 million and prepayments and maturities totaling \$19.0 million. Even though the Company continues to be challenged by the competition for lending relationships that exists within its market, growth in volume has been achieved through successful lending sales efforts to build on continued customer relationships.

At December 31, 2017, the Company had \$121.1 million in overall undisbursed loan commitments, which consisted primarily of unused commercial lines of credit, home equity lines of credit and available usage from active construction facilities. The Company's current "Approved, Accepted but Unfunded" pipeline, includes approximately \$8.5 million in construction and \$56.5 million in commercial real estate loans, \$16.7 million in commercial term loans and lines of credit and \$6.4 million in residential mortgage loans expected to fund over the next 90 days.

The average balance of our total loans increased \$210.6 million or 34.4 percent for the three months ended December 31, 2017 as compared to the same period in fiscal 2017, while the average yield on loans increased 11 basis points for the three months ended December 31, 2017 compared with the same period in fiscal 2017. The increase in average total loan volume was due primarily to the volume of new loan originations. During the first quarter of fiscal 2018 compared to the same period fiscal 2017, the volume-related factors during the period contributed to an increase of interest income on loans of \$2.2 million, while the rate-related changes increased interest income by \$215,000.

Allowance for Loan Losses and Related Provision

The purpose of the allowance for loan losses (the “allowance”) is to absorb the impact of losses inherent in the loan portfolio. Additions to the allowance are made through provisions charged against current operations and through recoveries made on loans previously charged-off. The allowance for loan losses is maintained at an amount considered adequate by management to provide for probable credit losses inherent in the loan portfolio based upon a periodic evaluation of the portfolio’s risk characteristics. In establishing an appropriate allowance, an assessment of the individual borrowers, a determination of the value of the underlying collateral, a review of historical loss experience and an analysis of the levels and trends of loan categories, delinquencies and problem loans are considered. Such factors as the level and trend of interest rates and current economic conditions and peer group statistics are also reviewed. Given the extraordinary economic volatility impacting national, regional and local markets, the Company’s analysis of its allowance for loan losses takes into consideration the potential impact that current trends may have on the Company’s borrower base.

Although management uses the best information available, the level of the allowance for loan losses remains an estimate, which is subject to significant judgment and short-term change. Various regulatory agencies, as an integral part of their examination process, periodically review the Company’s allowance for loan losses. Such agencies may require the Company to increase the allowance based on their analysis of information available to them at the time of their examination. Furthermore, the majority of the Company’s loans are secured by real estate in the State of Pennsylvania. Future adjustments to the allowance may be necessary due to economic factors impacting Pennsylvania real estate and the economy in general, as well as operating, regulatory and other conditions beyond the Company’s control.

For both December 31, 2017 and September 30, 2017, the allowance for loan losses amounted to approximately \$8.4 million, or 1.0 percent of total loans. We recorded no provision for loan losses during the quarter ended December 31, 2017 compared to \$660,000 for the quarter ended December 31, 2016. The net recoveries were \$32,000 for the three months ended December 31, 2017 compared to \$83,000 in net recoveries for the three months ended December 31, 2016.

The level of the allowance for the respective periods of fiscal 2018 and fiscal 2017 reflects the credit quality within the loan portfolio, the loan volume recorded during the periods, the changing composition of the commercial and residential real estate loan portfolios and other related factors. In management’s view, the level of the allowance at December 31, 2017 was adequate to cover losses inherent in the loan portfolio. Actual results could differ materially from management’s analysis, based principally upon the factors considered by management in establishing the allowance.

Changes in the allowance for loan losses are presented in the following table for the periods indicated.

	Three Months Ended December 31,	
	2017	2016
	(Dollars in thousands)	
Average loans outstanding	822,941	612,388
Total gross loans at end of period	814,577	673,691
Analysis of the Allowance of Loan Losses:		
Balance at beginning of period	\$8,405	\$5,434
Charge-offs:		
Residential mortgage	—	—
Commercial:		
Commercial real estate	—	—
Consumer:		
Second mortgages	—	71
Other	2	5
Total charge-offs	2	76
Recoveries:		
Construction and Development:		
Residential and commercial	2	90
Commercial:		
Commercial real estate	9	3
Other	1	5
Consumer:		
Home equity lines of credit	1	1
Second mortgages	19	57
Other	2	3
Total recoveries	34	159
Net (recoveries) charge-offs	(32)	(83)
Provisions for loan loss	—	660
Balance at end of period	\$8,437	\$6,177
Ratios:		
Ratio of net (recoveries) charge-offs to average loans outstanding in portfolio ⁽¹⁾	(0.02)%	(0.04)%
Ratio of net (recoveries) charge-offs to total allowance for loan losses ⁽¹⁾	1.53 %	5.36 %

⁽¹⁾Annualized

Asset Quality

The Company manages asset quality and credit risk by maintaining diversification in its loan portfolio and through review processes that include analysis of credit requests and ongoing examination of outstanding loans, delinquencies, and potential problem loans, with particular attention to portfolio dynamics and mix. The Company strives to identify loans experiencing difficulty early enough to correct the problems, to record charge-offs promptly based on realistic assessments of current collateral values and cash flows, and to maintain an adequate allowance for loan losses at all times.

It is generally the Company's policy to discontinue interest accruals once a loan is past due as to interest or principal payments for a period of ninety days. When a loan is placed on non-accrual status, interest accruals cease and uncollected accrued interest is reversed and charged against current income. Payments received on non-accrual loans are applied against principal. A loan may be restored to an accruing basis when it again becomes well-secured, all past due amounts have been collected and the borrower continues to make payments for the next six months on a timely basis. Accruing loans past due 90 days or more are generally well-secured and in the process of collection. For additional information regarding loans, see Note 6 of the Notes to the Unaudited Consolidated Financial Statements.

Non-Performing Assets and Troubled Debt Restructured Loans

Non-performing loans include non-accrual loans and accruing loans which are contractually past due 90 days or more. Non-accrual loans represent loans on which interest accruals have been suspended. In general, it is the policy of management to consider the charge-off of loans at the point they become past due in excess of 90 days, with the exception of loans that are both well-secured and in the process of collection. Non-performing assets include non-performing loans and other real estate owned. Troubled debt restructured loans represent loans to borrowers experiencing financial difficulties on which a concession was granted, such as a reduction in interest rate which is lower than the current market rate for new debt with similar risks, or modified repayment terms, and are performing under the restructured terms. Such loans, as long as they are performing in accordance with their restructured terms, are not included within the Company's non-performing loans. For additional information regarding loans, see Note 6 of the Notes to the Unaudited Consolidated Financial Statements.

The following table sets forth, as of the dates indicated, the amount of the Company's non-accrual loans, accruing loans past due 90 days or more, other real estate owned and troubled debt restructured loans.

	December 31, 2017	September 30, 2017
	(Dollars in thousands)	
Non-accrual loans	\$2,242	\$ 1,038
Accruing loans past due 90 days or more	345	173
Total non-performing loans	2,587	1,211
Other real estate owned	—	—
Total non-performing assets	\$2,587	\$ 1,211
Troubled debt restructured loans — performing	\$2,222	\$ 2,238

Non-accrual loans were \$2.2 million at December 31, 2017, as compared to \$1.0 million at September 30, 2017 and \$1.8 million at December 31, 2016. Other real estate owned ("OREO") was zero at December 31, 2017, September 30, 2017, and December 31, 2016, respectively. Total performing troubled debt restructured loans were \$2.2 million at December 31, 2017, \$2.2 million at September 30, 2017 and \$1.4 million at December 31, 2016, respectively.

At December 31, 2017, non-performing assets totaled \$2.6 million, or 0.24 percent of total assets, as compared with \$1.2 million, or 0.12 percent, at September 30, 2017 and \$2.0 million, or 0.22 percent, at December 31, 2016. Non-performing assets increased by \$1.4 million at December 31, 2017 from September 30, 2017. The increase in non-performing assets during the first quarter of fiscal 2018, was primarily attributable to the addition of three single

residential loans with an aggregate outstanding balance of \$231,000, one commercial real estate loan with an outstanding balance of \$796,000 and five consumer loans with an aggregate outstanding balance of \$188,000 into non-accrual status.

Overall credit quality in the Bank's loan portfolio at December 31, 2017 remained relatively strong. Credit quality risk ratings include categories of "pass," "special mention," "substandard" and "doubtful." Assets classified as "Pass" are those protected by the current net worth and paying capacity of the obligor or by the value of the underlying collateral. Assets which do not currently expose the insured institution to sufficient risk to warrant classification as substandard or doubtful but possess certain identified weaknesses are required to be designated "special mention." If uncorrected, the potential weaknesses may result in deterioration of the repayment prospects. An asset is considered "substandard" if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. "Substandard" assets include those characterized by the "distinct possibility" that the insured institution will sustain "some loss" if the deficiencies are not corrected. Assets classified as "doubtful" have all of the weaknesses inherent in those classified "substandard" with the added characteristic that the weaknesses present make "collection or liquidation in full," on the basis of currently existing facts, conditions, and values, "highly questionable and improbable."

At December 31, 2017, special mention loans were \$3.8 million compared to \$5.0 million at September 30, 2017. The decrease of approximately \$1.2 million in special mention loans was attributable to one commercial real estate loan designated as a special mention loan with an outstanding balance of \$446,000 at September 30, 2017 being classified as a pass loan during the first quarter of fiscal 2018. In addition, one commercial real estate loan with an outstanding balance of \$796,000 at September 30, 2017 was classified as a substandard loan from special mention during the first quarter of fiscal 2018.

Substandard loans were \$11.9 million and \$11.4 million, respectively, at December 31, 2017 and September 30, 2017, respectively. The increase of approximately \$485,000 from September 30, 2017 to December 31, 2017, was attributable to three single residential loans with an aggregate outstanding balance of \$379,000 and three consumer loans with an aggregate outstanding balance of \$153,000 being classified as substandard loans at December 31, 2017 and one substandard loan with an outstanding balance of \$796,000 at December 31, 2017 being classified a substandard loan from special mention loan. Additionally, one substandard loan with an outstanding balance of \$105,000 at September 30, 2017 was paid-off. Our loans which have been identified as specially mentioned or substandard are considered potential problem loans due to a variety of changing conditions affecting the credits, including general economic conditions and/or conditions applicable to the specific borrowers. The Company has no foreign loans.

At December 31, 2017, other than the loans set forth above, the Company is not aware of any loans which present serious doubts as to the ability of its borrowers to comply with present loan repayment terms and which are expected to fall into one of the categories set forth in the tables or descriptions above.

Other Income

The following table presents the principal categories of other income for the periods indicated.

(Dollars in thousands)	Three Months Ended December 31,			
	2017	2016	Increase (Decrease)	Percent Change
Service charges and other fees	\$271	\$223	\$ 48	21.52 %
Rental income-other	66	55	11	20.00
Gain on sale of real estate, net	1,186	—	1,186	100.00
Gain on sale of loans, net	67	45	22	48.89
Earnings on bank-owned life insurance	121	130	(9)	(6.92)
Total other income	\$1,711	\$453	\$ 1,258	277.70%

For the three months ended December 31, 2017, total other income amounted to \$1.7 million, compared to total other income of \$453,000 for the same period in fiscal 2017. The increase of \$1.3 million for the three months ended December 31, 2017 was primarily a result of a \$1.2 million net gain on the sale of real-estate. Other increases included an increase of \$48,000 in service charges and other fees primarily due to net gains on sale of loans of \$22,000 and rental income of \$11,000, offset by a decrease of \$9,000 in earnings on bank-owned insurance.

Excluding net gains on sale of real estate, a non-GAAP measure, the Company recorded total other income of \$525,000 for the three months ended December, 2017, compared to \$453,000 for the three months ended December 31, 2016.

Other Expense

The following table presents the principal categories of other expense for the periods indicated.

(Dollars in thousands)	Three Months Ended December 31,			
	2017	2016	Increase (Decrease)	Percent Change
Salaries and employee benefits	\$1,990	\$1,712	\$ 278	16.24 %
Occupancy expense	562	494	68	13.77
Federal deposit insurance premium	76	4	72	1800.00
Advertising	54	51	3	5.88
Data processing	278	302	(24)	(7.95)
Professional fees	788	401	387	96.51
Other operating expenses	723	606	117	19.31
Total other expense	\$4,471	\$3,570	\$ 901	25.24 %

For the three months ended December 31, 2017, total other expense increased \$901,000, or 25.2 percent, from the comparable three months ended December 31, 2016. The primarily reflected increases in salaries and employee benefits of \$278,000 due to added staff to support overall franchise growth. Other increases included professional fees of \$387,000 as a result of expense related to increased legal and accounting fees, and \$117,000 in other operating expense which included \$39,000 relating to subordinated debt and \$21,000 in business related expenses. In addition the Federal Deposit insurance premium increased \$72,000 due to the new regulatory calculation.

The Company's efficiency ratio, a non-GAAP financial measure, was 63.6 percent for the first quarter of fiscal 2018 on an annualized based, compared to 61.6 percent in the first quarter of fiscal 2017. The increase in the efficiency ratio reflects an increase in other expense, excluding non-core items, as well as an increase in total income.

The “efficiency ratio” is defined as other expense, excluding certain non-core items, as a percentage of net interest income on a tax equivalent basis plus other income, excluding net securities gains, calculated as follows:

	Three Months Ended December 31, 2017 2016 (Dollars in thousands)	
Other expense	\$4,471	\$ 3,570
Less: Non-core items ⁽¹⁾	72	29
Other expense, excluding non-core items	\$4,399	\$ 3,541
Net interest income (tax equivalent basis)	\$6,393	\$ 5,292
Other income, excluding net investment securities gains and gains on sale of real estate	525	453
Total	\$6,918	\$ 5,745
Efficiency ratio	63.6 %	61.6 %

(1) Included in non-core items are costs which include expenses related to the Company’s corporate restructuring initiatives, such as professional fees, litigation and settlement costs, severance costs, and external payroll development costs related to such restructuring initiatives. The Company believes these adjustments are necessary to provide the most accurate measure of core operating results as a means to evaluated comparative results.

The Company’s efficiency ratio, calculated on a GAAP basis without excluding net investment securities gains and without deducting non-core items from other expense, follows:

	Three Months Ended December 31, 2017 2016	
Efficiency ratio on a GAAP Basis	55.2 %	62.7 %

Provision for Income Taxes

The Company recorded a provision for income taxes of \$3.2 million for the quarter ended December 31, 2017, reflecting an effective tax rate of 88.9%, compared to \$489,000, or an effective tax rate of 33.4%, for the quarter ended December 31, 2016. The changes in the income tax provision and effective tax rate were primarily due to the enactment of the Tax Act that required the Company to revalue its net deferred tax asset.

Recent Accounting Pronouncements

Note 2 of the Notes to Unaudited Consolidated Financial Statements discusses the expected impact of accounting pronouncements recently issued or proposed but not yet required to be adopted.

Asset and Liability Management

Asset and Liability management encompasses an analysis of market risk, the control of interest rate risk (interest sensitivity management) and the ongoing maintenance and planning of liquidity and capital. The composition of the Company's statement of condition is planned and monitored by the Asset and Liability Committee ("ALCO"). In general, management's objective is to optimize net interest income and minimize market risk and interest rate risk by monitoring the components of the statement of condition and the interaction of interest rates.

Short-term interest rate exposure analysis is supplemented with an interest sensitivity gap model. The Company utilizes interest sensitivity analysis to measure the responsiveness of net interest income to changes in interest rate levels. Interest rate risk arises when an earning asset matures or when its interest rate changes in a time period different than that of a supporting interest-bearing liability, or when an interest-bearing liability matures or when its interest rate changes in a time period different than that of an earning asset that it supports. While the Company matches only a small portion of specific assets and liabilities, total earning assets and interest-bearing liabilities are grouped to determine the overall interest rate risk within a number of specific time frames. The difference between interest-sensitive assets and interest-sensitive liabilities is referred to as the interest sensitivity gap. At any given point in time, the Company may be in an asset-sensitive position, whereby its interest-sensitive assets exceed its interest-sensitive liabilities, or in a liability-sensitive position, whereby its interest-sensitive liabilities exceed its interest-sensitive assets, depending in part on management's judgment as to projected interest rate trends.

The Company's interest rate sensitivity position in each time frame may be expressed as assets less liabilities, as liabilities less assets, or as the ratio between rate sensitive assets ("RSA") and rate sensitive liabilities ("RSL"). For example, a short-funded position (liabilities repricing before assets) would be expressed as a net negative position, when period gaps are computed by subtracting repricing liabilities from repricing assets. When using the ratio method, a RSA/RSL ratio of 1 indicates a balanced position, a ratio greater than 1 indicates an asset-sensitive position and a ratio less than 1 indicates a liability-sensitive position.

A negative gap and/or a rate sensitivity ratio less than 1 tends to expand net interest margins in a falling rate environment and reduce net interest margins in a rising rate environment. Conversely, when a positive gap occurs, generally margins expand in a rising rate environment and contract in a falling rate environment. From time to time, the Company may elect to deliberately mismatch liabilities and assets in a strategic gap position.

At December 31, 2017, the Company reflected a positive interest sensitivity gap with an interest sensitivity ratio of 157.67:1.00 at the cumulative one-year position. Based on management's perception of interest rising through 2018, emphasis has been, and is expected to continue to be, placed on controlling liability costs while extending the maturities of liabilities in our efforts to insulate the net interest spread from rising interest rates in the future. However, no assurance can be given that this objective will be met.

Estimates of Fair Value

The estimation of fair value is significant to a number of the Company's assets, including investment securities available-for-sale. These are all recorded at either fair value or the lower of cost or fair value. Fair values are volatile and may be influenced by a number of factors. Circumstances that could cause estimates of the fair value of certain assets and liabilities to change include a change in prepayment speeds, discount rates, or market interest rates. Fair values for most available-for-sale investment securities are based on quoted market prices. If quoted market prices are

not available, fair values are based on judgments regarding future expected loss experience, current economic condition risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature, involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Impact of Inflation and Changing Prices

The financial statements and notes thereto presented elsewhere herein have been prepared in accordance with generally accepted accounting principles, which require the measurement of financial position and operating results in terms of historical dollars without considering the change in the relative purchasing power of money over time due to inflation. The impact of inflation is reflected in the increased cost of operations; unlike most industrial companies, nearly all of the Company's assets and liabilities are monetary. As a result, interest rates have a greater impact on performance than do the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or to the same extent as the prices of goods and services.

Liquidity

The liquidity position of the Company is dependent primarily on successful management of the Bank's assets and liabilities so as to meet the needs of both deposit and credit customers. Liquidity needs arise principally to accommodate possible deposit outflows and to meet customers' requests for loans. Scheduled principal loan repayments, maturing investments, short-term liquid assets and deposit inflows, can satisfy such needs. The objective of liquidity management is to enable the Company to maintain sufficient liquidity to meet its obligations in a timely and cost-effective manner.

Management monitors current and projected cash flows, and adjusts positions as necessary to maintain adequate levels of liquidity. Under its liquidity risk management program, the Company regularly monitors correspondent bank funding exposure and credit exposure in accordance with guidelines issued by the banking regulatory authorities. Management uses a variety of potential funding sources and staggering maturities to reduce the risk of potential funding pressure. Management also maintains a detailed contingency funding plan designed to respond adequately to situations which could lead to stresses on liquidity. Management believes that the Company has the funding capacity to meet the liquidity needs arising from potential events. The Company maintains borrowing capacity through the Federal Home Loan Bank of Pittsburgh secured with loans and marketable securities.

The Company's primary sources of short-term liquidity consist of cash and cash equivalents and investment securities available-for-sale.

At December 31, 2017, the Company had \$128.6 million in cash and cash equivalent compared to \$117.1 million at September 30, 2017. In addition, our available for sale investment securities amounted to \$44.5 million at December 31, 2017 and \$14.6 million at September 30, 2017.

Deposits

Total deposits increased to \$797.1 million at December 31, 2017 from \$790.4 million at September 30, 2017. Deposit growth during the period is a result of business development efforts, expanded market, and the higher visibility of the Bank, which have resulted in increased deposits and a broadened depositor base. Total interest-bearing deposits increased from \$748.3 million at September 30, 2017 to \$751.3 million at December 31, 2017, an increase of \$3.1 million. Interest-bearing demand, savings and time deposits under \$100,000 increased \$19.6 million to a total of \$577.3 million at December 31, 2017 as compared to \$557.7 million at September 30, 2017. Time deposits \$100,000 and over decreased \$16.5 million as compared to September 30, 2017. Time deposits \$100,000 and over represented 21.8 percent of total deposits at December 31, 2017 compared to 24.1 percent at September 30, 2017. We had brokered deposits totaling \$122.7 million at December 31, 2017 compared to \$103.7 million at September 30, 2017.

Core Deposits

The Company derives a significant proportion of its liquidity from its core deposit base. Total demand deposits, savings and money market accounts of \$542.3 million at December 31, 2017 increased by \$23.7 million, or 4.6 percent, from September 30, 2017. Total demand deposits, savings and money market accounts were 68.0 percent of total deposits at December 31, 2017 and 65.6 percent at September 30, 2017. Alternatively, the Company uses a more stringent calculation for the management of its liquidity positions internally, which calculation consists of total

demand, savings accounts and money market accounts (excluding money market accounts greater than \$100,000 and time deposits) as a percentage of total deposits. This number increased by \$5.9 million, or 1.7 percent, from \$337.7 million at September 30, 2017 to \$343.6 million at December 31, 2017 and represented 43.1 percent of total deposits at December 31, 2017 as compared with 42.7 percent at September 30, 2017.

The Company continues to place the main focus of its deposit gathering efforts in the maintenance, development, and expansion of its core deposit base. Management believes that the emphasis on serving the needs of our communities will provide a long-term relationship base that will allow the Company to efficiently compete for business in its market. The success of this strategy is reflected in the growth of deposits during the first three-month period of fiscal 2018.

The following table depicts the Company's core deposit mix at December 31, 2017 and September 30, 2017 based on the Company's alternative calculation:

	December 31, 2017		September 30, 2017		Dollar
	Amount	Percentage	Amount	Percentage	Change
	(Dollars in thousands)				
Non interest-bearing demand	\$45,756	13.3	% \$42,121	12.5	% \$3,635
Interest-bearing demand	161,278	46.9	155,579	46.1	5,699
Savings	41,631	12.1	44,526	13.2	(2,895)
Money market deposits under \$100,000	14,261	4.2	14,299	4.2	(38)
Certificates of deposits under \$100,000	80,677	23.5	81,166	24.0	(489)
Total core deposits	\$343,603	100.0	% \$337,691	100.0	% \$5,912
Total deposits	\$797,099		\$790,396		\$6,703
Core deposits to total deposits		43.1	%	42.7	%

Borrowings

Borrowings from the Federal Home Loan Bank ("FHLB") of Pittsburgh are available to supplement the Company's liquidity position and, to the extent that maturing deposits do not remain with the Company, management may replace such funds with advances. As of December 31, 2017 and September 30, 2017, the Company's outstanding balance of FHLB advances, totaled \$118.0 million and \$118.0 million, respectively. Of the \$118.0 million in advances, \$28.0 million represent long-term, fixed-rate advances maturing in 2020 that have terms enabling the FHLB to call the borrowing at their option prior to maturity. The remaining balance of long-term, fixed rate advances totaled \$55.0 million, representing five separate advances maturing during fiscal year 2019. At December 31, 2017, there were two short-term FHLB advances totaling \$35.0 million of fixed-rate borrowing with rollover of 90 days.

During fiscal 2017 the Company had purchased securities sold under agreements to repurchase as a short-term funding source. At December 31, 2017 and September 30, 2017, the Company had \$5.0 million in securities sold under agreements to repurchase at a rate of 1.46%.

Payments Due Under Contractual Obligations

The following table presents information relating to the Company's payments due under contractual obligations as of December 31, 2017.

	Payments Due by Period				Total
	Less than One Year	One to Three Years	Three to Five Years	More than Five Years	
	(Dollars in thousands)				
Long-term debt obligations ⁽¹⁾	\$35,043	\$85,658	\$—	\$—	\$120,701
Certificates of deposit ⁽¹⁾	149,614	72,445	16,056	20,688	258,803
Operating lease obligations	484	940	971	1,574	3,969
Total contractual obligations	\$185,141	\$159,043	\$17,027	\$22,262	\$383,473

⁽¹⁾Includes interest payments

We anticipate that we will continue to have sufficient funds and alternative funding sources to meet our current commitments.

Cash Flows

The Consolidated Statements of Cash Flows present the changes in cash and cash equivalents resulting from the Company's operating, investing and financing activities. During the three months ended December 31, 2017, cash and cash equivalents increased by \$11.5 million over the balance at September 30, 2017. Net cash of \$4.4 million was provided by operating activities, primarily, net income as adjusted to net cash. Net income of \$403,000 was adjusted principally by amortization of premiums and accretion of discounts on investment securities net of \$294,000 and an increase in other liabilities of \$2.0 million. Net cash used by investing activities amounted to approximately \$950,000, primarily reflecting a net increase in investment securities of \$29.6 million and a net decrease in loans of \$27.6 million. Net cash of \$8.0 million was provided by financing activities, primarily from the increase in deposits of \$6.7 million.

Shareholders' Equity

Total shareholders' equity amounted to \$103.2 million, or 9.8 percent of total assets, at December 31, 2017, compared to \$102.5 million or 9.8 percent of total assets at September 30, 2017. Book value per common share was \$15.70 at December 31, 2017, compared to \$15.60 at September 30, 2017.

	December 31, 2017	September 30, 2017
	(Dollars in thousands, except for share data)	
Shareholders' equity	\$ 103,196	\$ 102,520
Book value per common share	\$ 15.70	\$ 15.60

Capital

At December 31, 2017, the Bank's common equity tier 1 ratio was 15.48 percent, tier 1 leverage ratio was 11.57 percent, tier 1 risk-based capital ratio was 15.48 percent and the total risk-based capital ratio was 16.54 percent. At September 30, 2017, the Bank's common equity tier 1 ratio was 14.75 percent, tier 1 leverage ratio was 12.02 percent, tier 1 risk-based capital ratio was 14.75 percent and the total risk-based capital ratio was 15.78 percent. At December 31, 2017, the Bank was in compliance with all applicable regulatory capital requirements.

Item 3 - Quantitative and Qualitative Disclosures About Market Risk

For a discussion of the Company's asset and liability management policies as well as the methods used to manage its exposure to the risk of loss from adverse changes in market prices and rates market, see Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations – Asset and Liability Management" in the Company's Annual Report on Form 10-K for the year ended September 30, 2017. There has been no material change in the Company's asset and liability position since September 30, 2017.

Item 4. Controls and Procedures

Our management evaluated, with the participation of our Chief Executive Officer and our Chief Financial Officer, the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report. Our disclosure controls and procedures are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and regulations and that such information is accumulated and communicated to management including the Chief Executive Officer and the Chief Financial Officer, to allow timely decisions regarding required disclosures. Based on such evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that our disclosure controls and procedures were not effective as of December 31, 2017 because of the material weakness described below.

Item 9A of the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2017 (the "Fiscal 2017 10-K") set forth management's conclusion that because of the material weakness and related matters described in Item 9A of the Fiscal 2017 10-K, the Company's internal control over financial reporting was not effective as of September 30, 2017. The matters described in Item 9A of the Fiscal 2017 10-K related to the Company's income tax account balances. Management is in the process of implementing a more formal review and documentation process around the accounting for income tax which management believes will strengthen the Company's overall internal control over financial reporting. During the quarter ended December 31, 2017, the Company is continuing the remediation efforts described in Item 9A of its Annual Report on Form 10-K.

Except as described above, no change in our internal control over financial reporting (as defined in Rules 13a-15(f) or 15(d)-15(f) under the Securities Exchange Act of 1934) occurred during the most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1 - Legal Proceedings

Not applicable.

Item 1A - Risk Factors

See Item 1A, "Risk Factors" in the Company's Annual Report on Form 10-K for the year ended September 30, 2017. There have been no material changes from the risk factors previously disclosed in the Company's Annual Report on Form 10-K for the year ended September 30, 2017.

Item 2 - Unregistered Sales of Equity Securities and Use of Proceeds

Not applicable.

Item 3 - Defaults Upon Senior Securities

Not applicable.

Item 4 - Mine Safety Disclosure

Not applicable.

Item 5 - Other Information

Not applicable.

Item 6 - Exhibits

31.1 Rule 13a-14(a)/15d-14(a) Section 302 Certification

31.2 Rule 13a-14(a)/15d-14(a) Section 302 Certification

32.0 Section 1350 Certification

101.INS XBRL Instance Document.

101.SCH XBRL Taxonomy Extension Schema Document.

101.CAL XBRL Taxonomy Extension Calculation Linkbase Document.

101.LAB XBRL Taxonomy Extension Label Linkbase Document.

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document.

101.DEF XBRL Taxonomy Extension Definitions Linkbase Document.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

MALVERN BANCORP, INC.

February 9, 2018 By: /s/ Anthony C. Weagley
Anthony C. Weagley
President and Chief Executive Officer

February 9, 2018 By: /s/ Joseph D. Gangemi
Joseph D. Gangemi
Senior Vice President and Chief Financial
Officer