

HMN FINANCIAL INC  
Form 10-Q  
May 03, 2019

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**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q**

**(Mark One)**

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

For the quarterly period ended **March 31, 2019**

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 **0-24100**

**HMN FINANCIAL, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or Other Jurisdiction of Incorporation or Organization)

**41-1777397**

(I.R.S. Employer Identification No.)

**1016 Civic Center Drive N.W., Rochester, MN**

(Address of Principal Executive Offices)

**55901**

(Zip Code)

Registrant's Telephone Number, Including Area Code:

**(507) 535-1200**

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class      Trading Symbol(s)

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		Name of Each Exchange on Which Registered
<b>Common Stock</b>	<b>HMNF</b>	<b>NASDAQ</b>

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 every Interactive Data File required to be submitted 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 such files). Yes No

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

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

If an emerging growth company, indicate by checkmark 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

**APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PRECEDING FIVE YEARS:**

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes No

**APPLICABLE ONLY TO CORPORATE ISSUERS**

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

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Class	Outstanding at April 24, 2019
Common stock, \$0.01 par value	4,843,822

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HMN FINANCIAL, INC.

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Consolidated Balance Sheets**

<i>(Dollars in thousands)</i>	March 31, 2019 (unaudited)	December 31, 2018
<b>Assets</b>		
Cash and cash equivalents	\$ 15,121	20,709
Securities available for sale:		
Mortgage-backed and related securities (amortized cost \$7,748 and \$8,159)	7,743	8,023
Other marketable securities (amortized cost \$73,035 and \$73,343)	72,189	71,957
	79,932	79,980
Loans held for sale	3,292	3,444
Loans receivable, net	599,462	586,688
Accrued interest receivable	2,326	2,356
Real estate, net	444	414
Federal Home Loan Bank stock, at cost	853	867
Mortgage servicing rights, net	1,831	1,855
Premises and equipment, net	9,551	9,635
Goodwill	802	802
Core deposit intangible	231	255
Prepaid expenses and other assets	6,446	2,668
Deferred tax asset, net	2,454	2,642
Total assets	\$ 722,745	712,315
<b>Liabilities and Stockholders' Equity</b>		
Deposits	\$ 626,592	623,352
Accrued interest payable	332	346
Customer escrows	2,637	1,448
Accrued expenses and other liabilities	7,834	4,022
Total liabilities	637,395	629,168
Commitments and contingencies		
Stockholders' equity:		
Serial-preferred stock: (\$.01 par value) authorized 500,000 shares; issued 0	0	0
Common stock (\$.01 par value): authorized 16,000,000 shares; issued 9,128,662	91	91
Additional paid-in capital	40,076	40,090
Retained earnings, subject to certain restrictions	101,374	99,754
Accumulated other comprehensive loss	(612 )	(1,096 )

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Unearned employee stock ownership plan shares	(1,788 )	(1,836 )
Treasury stock, at cost 4,286,516 and 4,292,838 shares	(53,791 )	(53,856 )
Total stockholders' equity	85,350	83,147
Total liabilities and stockholders' equity	\$ 722,745	712,315

See accompanying notes to consolidated financial statements.

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**HMN  
FINANCIAL,  
INC. AND  
SUBSIDIARIES**  
**Consolidated  
Statements of  
Comprehensive  
Income**  
(unaudited)

	Three Months Ended	
	March 31,	
<i>(Dollars in thousands, except per share data)</i>	2019	2018
Interest income:		
Loans receivable	\$7,268	6,778
Securities available for sale:		
Mortgage-backed and related	46	42
Other marketable	292	272
Other	126	66
Total interest income	7,732	7,158
Interest expense:		
Deposits	690	468
Advances and other borrowings	0	2
Total interest expense	690	470
Net interest income	7,042	6,688
Provision for loan losses	27	(125 )
Net interest income after provision for loan losses	7,015	6,813
Non-interest income:		
Fees and service charges	700	766
Loan servicing fees	315	301
Gain on sales of loans	379	444
Other	297	265
Total non-interest income	1,691	1,776
Non-interest expense:		
Compensation and benefits	3,910	3,824
Occupancy and equipment	1,060	1,097
Data processing	301	295
Professional services	272	249
Other	903	1,089
Total non-interest expense	6,446	6,554
Income before income tax expense	2,260	2,035



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Income tax expense	640	590
Net income	1,620	1,445
Other comprehensive income (loss), net of tax	484	(346 )
Comprehensive income available to common shareholders	\$2,104	1,099
Basic earnings per share	\$0.35	0.34
Diluted earnings per share	\$0.35	0.29

See accompanying notes to consolidated financial statements.

Table of Contents**HMN FINANCIAL, INC. AND SUBSIDIARIES****Consolidated Statement of Stockholders' Equity****For the Three Month Period Ended March 31, 2019 and 2018**

(unaudited)

<i>(Dollars in thousands)</i>	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Unearned Employee Stock Ownership Plan Shares	Treasury Stock	Total Stock- Holders' Equity
Balance, December 31, 2018	\$ 91	40,090	99,754	(1,096 )	(1,836 )	(53,856 )	83,147
Net income			1,620				1,620
Other comprehensive income				484			484
Restricted stock awards		(110 )				110	0
Stock awards withheld for tax withholding						(45 )	(45 )
Amortization of restricted stock awards		42					42
Earned employee stock ownership plan shares		54			48		102
Balance, March 31, 2019	\$ 91	40,076	101,374	(612 )	(1,788 )	(53,791 )	85,350

See accompanying notes to consolidated financial statements.

<i>(Dollars in thousands)</i>	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Unearned Employee Stock Ownership Plan Shares	Treasury Stock	Total Stock- Holders' Equity
Balance, December 31, 2017	\$ 91	50,623	91,448	(957 )	(2,030 )	(58,357 )	80,818
Amounts reclassified from accumulated other comprehensive loss			71	(71 )			0
Net income			1,445				1,445
Other comprehensive loss				(346 )			(346 )
Stock compensation expense		4					4
Restricted stock awards		(174 )				174	0

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Amortization of restricted stock awards		39						39	
Earned employee stock ownership plan shares		48				48		96	
Balance, March 31, 2018	\$ 91	50,540	92,964	(1,374	)	(1,982	)	(58,183)	82,056

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(unaudited)

	Three Months Ended	
	March 31, 2019	2018
<i>(Dollars in thousands)</i>		
Cash flows from operating activities:		
Net income	\$1,620	1,445
Adjustments to reconcile net income to cash provided by operating activities:		
Provision for loan losses	27	(125 )
Depreciation	273	258
Amortization of (discounts) premiums, net	(4 )	28
Amortization of deferred loan fees	13	19
Amortization of core deposit intangible	24	25
Amortization of purchased loan fair value adjustments	(8 )	(12 )
Amortization of mortgage servicing rights	140	126
Capitalized mortgage servicing rights	(116 )	(126 )
Securities gains	(24 )	(18 )
Gain on sales of loans	(379 )	(444 )
Proceeds from sale of loans held for sale	13,599	17,291
Disbursements on loans held for sale	(12,370)	(13,558)
Amortization of restricted stock awards	42	39
Amortization of unearned employee stock ownership plan shares	48	48
Earned employee stock ownership plan shares priced above original cost	54	48
Stock option compensation expense	0	4
Decrease in accrued interest receivable	30	240
(Decrease) increase in accrued interest payable	(14 )	51
Decrease (increase) in other assets	668	(457 )
Decrease in other liabilities	(572 )	(616 )
Other, net	1	(4 )
Net cash provided by operating activities	3,052	4,262
Cash flows from investing activities:		
Principal collected on securities available for sale	443	384
Proceeds collected on maturities of securities available for sale	300	310
Purchases of securities available for sale	0	(4,888 )
Purchase of Federal Home Loan Bank stock	0	(322 )
Redemption of Federal Home Loan Bank stock	14	272
Net increase in loans receivable	(13,592)	(9,580 )
Purchases of premises and equipment	(189 )	(378 )
Net cash used by investing activities	(13,024)	(14,202)

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Cash flows from financing activities:		
Increase (decrease) in deposits	3,240	(1,796 )
Stock awards withheld for tax withholding	(45 )	0
Proceeds from borrowings	0	6,800
Repayment of borrowings	0	(6,800 )
Increase in customer escrows	1,189	748
Net cash provided (used) by financing activities	4,384	(1,048 )
Decrease in cash and cash equivalents	(5,588 )	(10,988)
Cash and cash equivalents, beginning of period	20,709	37,564
Cash and cash equivalents, end of period	\$15,121	26,576
Supplemental cash flow disclosures:		
Cash paid for interest	\$704	420
Cash paid for income taxes	0	427
Supplemental noncash flow disclosures:		
Loans transferred to loans held for sale	759	3,719
Transfer of loans to real estate	30	74
Right to use assets and lease obligations	4,387	0

See accompanying notes to consolidated financial statements.

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**HMN FINANCIAL, INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements**

(unaudited)

***(1) HMN Financial, Inc.***

HMN Financial, Inc. (HMN or the Company) is a stock savings bank holding company that owns 100 percent of Home Federal Savings Bank (the Bank). The Bank has a community banking philosophy and operates retail banking and loan production facilities in Minnesota, Iowa and Wisconsin. The Bank has two wholly owned subsidiaries, Osterud Insurance Agency, Inc. (OIA), which does business as Home Federal Investment Services and offers financial planning products and services, and HFSB Property Holdings, LLC (HPH), which is currently inactive but has acted in the past as an intermediary for the Bank in holding and operating certain foreclosed properties.

The consolidated financial statements included herein are for HMN, the Bank, OIA and HPH. All significant intercompany accounts and transactions have been eliminated in consolidation.

***(2) Basis of Preparation***

The accompanying unaudited consolidated financial statements were prepared in accordance with instructions for Form 10-Q and, therefore, do not include all disclosures necessary for a complete presentation of the consolidated balance sheets, consolidated statements of comprehensive income, consolidated statement of stockholders' equity and consolidated statements of cash flows in conformity with U.S. Generally Accepted Accounting Principles (GAAP). However, all normal recurring adjustments which are, in the opinion of management, necessary for the fair presentation of the interim financial statements have been included. The results of operations for the three month period ended March 31, 2019 are not necessarily indicative of the results which may be expected for the entire year.

***(3) New Accounting Standards***

In June 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-13, *Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. The amendments in this ASU affect all entities that measure credit losses on financial instruments including loans, debt securities, trade receivables, net investments in leases, off-balance sheet credit exposures, reinsurance receivables, and any other financial asset that has a contractual right to receive cash that is not specifically excluded. The main objective of this ASU is to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity

at each reporting date. To achieve this objective, the amendments in this ASU replace the incurred loss impairment methodology required in current GAAP with a methodology that reflects expected credit losses that requires consideration of a broader range of reasonable and supportable information to estimate credit losses. The amendments in this ASU will affect entities to varying degrees depending on the credit quality of the assets held by the entity, the duration of the assets held, and how the entity applies the current incurred loss methodology. The amendments in this ASU, for public business entities that are filers with the Securities and Exchange Commission (SEC), are effective for fiscal years beginning after December 15, 2019, including interim periods within those annual periods. All entities may adopt the amendments in the ASU early as of the fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Amendments should be applied using a modified retrospective transition method by means of a cumulative-effect adjustment to equity as of the beginning of the period in which the guidance is adopted. Management has accumulated the charge off information necessary to calculate the appropriate life of loan loss percentages for the various loan categories, has identified several key metrics to help identify and project anticipated changes in the credit quality of our loan portfolio upon enactment, and is in the process of evaluating the determination of potential qualitative reserve amounts and the impact that the adoption of this ASU in the first quarter of 2020 will have on the Company's consolidated financial statements.

In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820), Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement*. The Amendments in this ASU apply to all entities that are required, under existing GAAP, to make disclosures about recurring or nonrecurring fair value measurements and modify the disclosure requirements on fair value measurements in *Topic 820, Fair Value Measurement*, including the consideration of costs and benefits. The ASU removed, modified, and added various disclosure requirements in Topic 820. The amendments also eliminate *at a minimum* from the phrase *an entity shall disclose at a minimum* to promote the appropriate exercise of discretion by entities when considering fair value measurement disclosures and to clarify that materiality is an appropriate consideration of entities and their auditor when evaluating disclosure requirements. The amendments in the ASU are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. An entity is permitted to early adopt the implementation of any removed or modified disclosures upon issuance of the ASU and delay adoption of the additional disclosures until their effective date. The Company has not opted to early adopt any portion of this ASU and the adoption in the first quarter of 2020 is not anticipated to have a material impact on the Company's consolidated financial statements.

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ASC 820, *Fair Value Measurements*, establishes a framework for measuring the fair value of assets and liabilities using a hierarchy system consisting of three levels, based on the markets in which the assets and liabilities 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 that the Company has the ability to access.

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 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 and are used only to the extent that observable inputs are not available. These unobservable assumptions reflect our own estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flow models and similar techniques.

The following table summarizes the assets of the Company for which fair values are determined on a recurring basis as of March 31, 2019 and December 31, 2018.

	Carrying value at March 31, 2019			
	Total	Level 1	Level 2	Level 3
<i>(Dollars in thousands)</i>				
Securities available for sale	\$79,932	0	79,932	0
Mortgage loan commitments	99	0	99	0