

Eagle Bancorp Montana, Inc.  
Form 10-K  
March 12, 2019

Table of Contents

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-K**

(Mark One)

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

For the fiscal year ended December 31, 2018  
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 1-34682

Eagle Bancorp Montana, Inc.  
(Exact name of registrant as specified in its charter)

Delaware

27-1449820

Edgar Filing: Eagle Bancorp Montana, Inc. - Form 10-K

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

1400 Prospect Avenue, Helena, MT 59601  
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code 406-442-3080

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

Title of each class	Name of each exchange on which registered
Common stock, par value \$0.01	The Nasdaq Stock Market LLC

---

Securities registered pursuant to section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes No

---

Table of Contents

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 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 Act).

Yes No

The aggregate market value of the common stock held by non-affiliates of Eagle, computed by reference to the closing price at which the stock was sold as of June 30, 2018 was \$93,805,000. The outstanding number of shares of common stock of Eagle as of February 1, 2019, was 6,460,192.

#### DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Company's definitive Proxy Statement relating to its 2019 annual meeting of stockholders ("2019 Proxy Statement") are incorporated by reference into Part III of this Form 10-K. The 2019 Proxy Statement will be filed with the Securities and Exchange Commission within 120 days after the Company's fiscal year end to which this report relates.

---

Table of Contents

**TABLE OF CONTENTS**

<u>Page</u>		
	<b><u>PART I</u></b>	
ITEM 1.	<u>DESCRIPTION OF BUSINESS</u>	2
ITEM 1A.	<u>RISK FACTORS</u>	16
ITEM 1B.	<u>UNRESOLVED STAFF COMMENTS</u>	21
ITEM 2.	<u>PROPERTIES</u>	22
ITEM 3.	<u>LEGAL PROCEEDINGS</u>	22
ITEM 4.	<u>MINE SAFETY DISCLOSURES</u>	22
	<b><u>PART II</u></b>	
ITEM 5.	<u>MARKET FOR REGISTRANT’S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES</u>	23
ITEM 6.	<u>SELECTED FINANCIAL DATA</u>	23
ITEM 7.	<u>MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	24
ITEM 7A.	<u>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	47
ITEM 8.	<u>FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA</u>	47
ITEM 9.	<u>CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE</u>	47
ITEM 9A.	<u>CONTROLS AND PROCEDURES</u>	48
ITEM 9B.	<u>OTHER INFORMATION</u>	48
	<b><u>PART III</u></b>	
ITEM 10.	<u>DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE</u>	49
ITEM 11.	<u>EXECUTIVE COMPENSATION</u>	50
ITEM 12.	<u>SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS</u>	50
ITEM 13.	<u>CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE</u>	50
ITEM 14.	<u>PRINCIPAL ACCOUNTING FEES AND SERVICES</u>	50
	<b><u>PART IV</u></b>	
ITEM 15.	<u>EXHIBITS, FINANCIAL STATEMENT SCHEDULES</u>	50
	<u>FORM 10-K SUMMARY</u>	52

ITEM  
16.

---

Table of Contents

**CAUTIONARY LANGUAGE ABOUT FORWARD-LOOKING STATEMENTS**

This Annual Report on Form 10-K includes “forward-looking statements” within the meaning and protections of Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. All statements other than statements of historical fact are statements that could be forward-looking statements. You can identify these forward-looking statements through our use of words such as “may,” “will,” “anticipate,” “assume,” “should,” “indicate,” “would,” “believe,” “contemplate,” “expect,” “estimate,” “project,” “could,” “intend,” “target” and other similar words and expressions of the future. These forward-looking statements include, but are not limited to: (i) statements of our goals, intentions and expectations; (ii) statements regarding our business plans, prospects, growth and operating strategies; (iii) statements regarding the asset quality of our loan and investment portfolios; and (iv) estimates of our risks and future costs and benefits.

These forward-looking statements are based on current beliefs and expectations of our management and are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control. In addition, these forward-looking statements are subject to assumptions with respect to future business strategies and decisions that are subject to change. The following factors, among others, could cause actual results to differ materially from the anticipated results or other expectations expressed in the forward-looking statements:

- changes in laws or government regulations or policies affecting financial institutions, including changes in regulatory fees and capital requirements;
- local, regional, national and international economic and market conditions and events and the impact they may have on us, our customers and our assets and liabilities;
- competition among depository and other financial institutions;
- changes in the prices, values and sales volume of residential and commercial real estate in Montana;
- inflation and changes in the interest rate environment that reduce our margins or reduce the fair value of financial instruments;
- our ability to attract deposits and other sources of funding or liquidity;
- changes or volatility in the securities markets;
- political developments, uncertainties or instability;
- our ability to enter new markets successfully and capitalize on growth opportunities;
- our ability to successfully perform due diligence and integrate acquired businesses including our recent acquisition of Big Muddy Bancorp, Inc.;
- changes in consumer spending, borrowing and savings habits;
- our ability to continue to increase and manage our commercial and residential real estate, multi-family and commercial business loans;
- possible impairments of securities held by us, including those issued by government entities and government sponsored enterprises;
- the level of future deposit insurance premium assessments;
- the costs or effects of mergers, acquisitions or dispositions we may make, whether we are able to obtain any required governmental approvals in connection with any such mergers, acquisitions or dispositions, and/or our ability to realize the contemplated financial or business benefits, including any anticipated cost savings or synergies, associated with any such mergers, acquisitions or dispositions, including the recent merger of The State Bank of Townsend with

and into Opportunity Bank of Montana;  
our ability to develop and maintain secure and reliable information technology systems, effectively defend ourselves against cyberattacks, or recover from breaches to our cybersecurity infrastructure;  
the failure of assumptions underlying the establishment of allowance for possible loan losses and other estimates;  
the possibility of goodwill impairment charges in the future;  
changes in the financial performance and/or condition of our borrowers and their ability to repay their loans when due; and  
the effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Securities and Exchange Commission, the Public Company Accounting Oversight Board, the Financial Accounting Standards Board and other accounting standard setters.

Because of these and other uncertainties, our actual future results may be materially different from the results indicated by these forward-looking statements. For a further list and description of various risks, relevant factors and uncertainties that could cause future results or events to differ materially from those expressed or implied in our forward-looking statements, see the Item 1A, "Risk Factors" and Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" sections contained elsewhere in this report, as well as other reports that we file with the SEC.



Table of Contents

**PART I**

**ITEM 1. DESCRIPTION OF BUSINESS.**

**Overview**

Eagle Bancorp Montana, Inc. (“Eagle” or “the Company”), is a Delaware corporation that holds 100.0% of the capital stock of Opportunity Bank of Montana (“the Bank”), formerly American Federal Savings Bank (“AFSB”). The Bank was founded in 1922 as a Montana-chartered building and loan association and has conducted operations and maintained its administrative office in Helena, Montana since that time. In 1975, the Bank adopted a federal thrift charter and in October 2014 converted to a Montana chartered commercial bank and became a member bank in the Federal Reserve System. The Bank currently has 22 branch offices and 19 automated teller machines located in our market areas and we participate in the Money Pass® ATM network. The Bank also operates certain branches under the brand names Dutton State Bank, Farmers State Bank of Denton and The State Bank of Townsend.

On September 5, 2017, the Company entered into an Agreement and Plan of Merger with TwinCo, a Montana corporation, and TwinCo’s wholly-owned subsidiary, Ruby Valley Bank, a Montana chartered commercial bank to acquire 100% of TwinCo’s equity voting interests. The merger agreement provided that Ruby Valley Bank would merge with and into Opportunity Bank of Montana and that TwinCo would merge with and into the Company. Ruby Valley Bank operated two branches in Madison County, Montana. The transaction provided an opportunity to expand market presence and lending activities, particularly in agricultural lending. The acquisition closed January 31, 2018, after receipt of approvals from regulatory authorities, approval of TwinCo shareholders and the satisfaction of other closing conditions. The total consideration paid was \$18.93 million and included cash consideration of \$9.90 million and common stock issued of \$9.03 million.

We provide loan and deposit services to customers who are predominantly small businesses and individuals throughout Montana. We are a diversified lender with a focus on residential mortgage loans, commercial real estate mortgage loans, commercial business loans and second mortgage/home equity loan products. In addition, we offer wealth management products and services through our wealth management division and financial consultants located in several of our markets.

The Bank is headquartered at 1400 Prospect Avenue, Helena, Montana, 59601. Investor information for the Company may be found at [www.opportunitybank.com](http://www.opportunitybank.com). The contents on or accessible through our website are not incorporated into this report.

The Bank has equity investments in Certified Development Entities which have received allocations of New Markets Tax Credits (“NMTC”). Administered by the Community Development Financial Institutions Fund of the U.S. Department of the Treasury, the NMTC program is aimed at stimulating economic and community development and job creation in low-income communities.

### **Recent Developments**

On August 21, 2018, Eagle entered into an Agreement and Plan of Merger with Big Muddy Bancorp, Inc. (“BMB”), a Montana corporation and BMB’s wholly-owned subsidiary, The State Bank of Townsend (“SBOT”), a Montana chartered commercial bank to acquire 100% of BMB’s equity voting interests. On January 1, 2019, BMB merged with and into Eagle, with Eagle continuing as the surviving corporation. SBOT operated four branches in Townsend, Dutton, Denton and Choteau, Montana. The total consideration paid was \$16.4 million, all of which was paid in Eagle common stock.

## Table of Contents

### **Business Strategy**

Our principal strategy is to continue our profitability through building a diversified loan portfolio and operating the Bank as a full-service community bank that offers both retail and commercial loan and deposit products in all of its markets. We believe that this focus will enable us to continue to grow our franchise, while maintaining our commitment to customer service, high asset quality and sustained net earnings.

The following are the key elements of our business strategy:

Continue to diversify our portfolio by emphasizing our recent growth in commercial real estate and commercial business loans as a complement to our traditional single family residential real estate lending. As of December 31, 2018, such loans constituted approximately 65.56% of total loans;

Continue to emphasize the attraction and retention of lower cost core deposits;

Seek opportunities where presented to acquire other institutions or expand our branch network through opening new branches and/or loan production offices;

Maintain our strong asset quality; and

Operate as a community-oriented independent financial institution that offers a broad array of financial services with high levels of customer service.

Our results of operations may be significantly affected by our ability to effectively implement our business strategy including our plans for expansion through strategic acquisitions. If we are unable to effectively integrate and manage acquired or merged businesses or attract significant new business through our branching efforts, our financial performance may be negatively affected.

### **Market Areas**

From our headquarters in Helena, Montana, we operate 22 full service retail banking offices, including our main office. Our other full service branches are located in Helena – Neill (opened 1987), Helena – Skyway (opened 2009), Bozeman – Oak (opened 1980, relocated 2009), Butte (opened 1979), Townsend (opened 1979), Montana. The Sterling

Montana branch acquisition that was completed in 2012 included retail banking offices in: Bozeman, Big Timber, Livingston, Billings, Missoula and Hamilton. The Bozeman Mendenhall location was sold in June 2015, reconstructed by the new owners and we lease a portion of the new building. We opened a loan production office in Great Falls, Montana in 2015 and it transitioned to a full service branch in 2017. Our Great Falls branch moved to a new location in 2018. A branch in Billings Heights opened in 2017. The TwinCo acquisition in January 2018 included retail banking offices in Twin Bridges and Sheridan, Montana. The BMB merger in January 2019 included retail banking offices in Choteau, Denton, Dutton and Townsend, Montana.

Montana is one of the largest states in terms of land mass but ranks as one of the least populated states. According to U.S. Census Bureau data for 2010, it had a population of 989,415 (1.06 million estimated for 2018). Helena, where we are headquartered, is Montana's state capital. It is also the county seat of Lewis and Clark County, which has a population of approximately 67,773 and is located within 120 miles of four of Montana's other five largest cities: Missoula, Great Falls, Bozeman and Butte. Helena is approximately midway between Yellowstone and Glacier National Parks. Its economy has shown moderate growth, in terms of both employment and income. State government and the numerous offices of the federal government comprise the largest employment sector. Helena also has significant employment in the service industries. Specifically, it has evolved into a central health care center with employment in the medical and the supporting professions as well as the medical insurance industry. The local economy is also dependent to a lesser extent upon ranching and agriculture. These have been more cyclical in nature and remain vulnerable to severe weather conditions, increased competition, both domestic and international, as well as commodity prices.

Butte, Montana is approximately 64 miles southwest of Helena. Butte and the surrounding Silver Bow County have a population of approximately 34,602. Butte's economy was historically reliant on the mining industry and fluctuations in metal and mineral commodity prices have had a corresponding impact on the local economy.

Table of Contents

Bozeman is approximately 95 miles southeast of Helena. It is located in Gallatin County, which has a population of approximately 107,810. Bozeman is home to Montana State University and has experienced significant growth, in part due to the growth of the University as well as the increased tourism for resort areas in and near Bozeman. Agriculture, however, remains an important part of Bozeman's economy. Bozeman has also become an attractive location for retirees, primarily from the West Coast, owing to its many winter and summer recreational opportunities and the presence of the University.

Townsend, Montana is approximately 34 miles southeast of Helena. Townsend is located in Broadwater County which has a population of approximately 5,936. Many of its residents commute to other Montana locations for work, particularly Helena. Other employment in Townsend is primarily in agriculture and services.

Livingston, Montana is approximately 124 miles southeast of Helena. Livingston and the surrounding Park County have a population of approximately 16,353. Livingston's economy is somewhat reliant on wood products and tourism.

Big Timber, Montana is approximately 158 miles southeast of Helena. Big Timber and the surrounding Sweet Grass County have a population of approximately 3,691. Big Timber's economy is somewhat reliant on the wood products, agriculture and tourism industries.

Billings, Montana is approximately 239 miles southeast of Helena. Billings and the surrounding Yellowstone County have a population of approximately 158,980. Billings is a significant trade center for eastern Montana. Select manufacturing is also a significant contributing portion of its economy.

Missoula, Montana is approximately 116 miles west of Helena. Missoula and the surrounding Missoula County have a population of approximately 117,441. The University of Montana is located in Missoula and the local economy is reliant on the University and the corresponding trade and services resulting from the University's presence.

Hamilton, Montana is approximately 161 miles southwest of Helena in Ravalli County. Ravalli County has a population of approximately 42,563. Hamilton is a relatively short distance from Missoula with a number of persons working in Missoula, residing in Hamilton. Medical research and the wood products industry are significant contributors to Ravalli County's economy.

Great Falls, Montana is approximately 91 miles northeast of Helena in Cascade County. Cascade County has a population of approximately 81,654. Health care, education services, and accommodation and food services are large contributors to Cascade County's economy.

Twin Bridges, Montana is approximately 94 miles south of Helena in Madison County. Sheridan, Montana is approximately 103 miles south of Helena and is also in Madison County. Madison County has a population of approximately 8,175. Construction, health care and social assistance are significant contributors to the economy of Madison County.

Choteau, Montana is approximately 103 miles north of Helena in Teton County. Dutton, Montana is approximately 114 miles north of Helena and is also in Teton County. Teton County has a population of approximately 6,085. Agriculture, forestry, fishing and hunting along with health care and social assistance are significant contributors to Teton County's economy.

Denton, Montana is approximately 179 miles northeast of Helena in Fergus County. Fergus County has a population of approximately 11,291. Agriculture, retail trade and construction are significant contributors to Fergus County's economy.

### **Competition**

We face strong competition in our primary market areas for retail deposits and the origination of loans. Historically, Montana was a unit banking state. This means that the ability of Montana state banks to create branches was either prohibited or significantly restricted. As a result of unit banking, Montana has a significant number of independent financial institutions serving a single community in a single location. While the state's population is approximately 1.06 million people, there are 51 credit unions in Montana as well as 1 national thrift institution and 46 commercial banks as of December 31, 2018. Our most direct competition for depositors has historically come from locally owned and out-of-state commercial banks, thrift institutions and credit unions operating in our primary market areas. Competition in our primary market areas has increased in recent years. Our competition for loans also comes from banks, thrifts and credit unions, in addition to mortgage bankers and brokers. Our principal market areas can be characterized as markets with moderately increasing incomes, relatively low unemployment, increasing wealth (particularly in the growing resort areas such as Bozeman) and moderate population growth.

Table of Contents

**Lending Activities**

**General**

The Bank originates residential 1-4 family, commercial real estate, home equity, consumer and commercial loans. Residential 1-4 family loans include residential mortgages and construction of residential properties. Commercial real estate loans include loans on multi-family dwellings, nonresidential property, commercial construction and development and farmland loans. Home equity loans include loans secured by the borrower's primary residence. Typically, the property securing such loans is subject to a prior lien. Consumer loans consist of loans secured by collateral other than real estate, such as automobiles, recreational vehicles and boats. Personal loans and lines of credit are made on deposits held by the Bank and on an unsecured basis. Commercial business loans consist of business loans and lines of credit on a secured and unsecured basis and include agriculture production loans.

**Fee Income**

The Bank receives lending related fee income from a variety of sources. Its principal source of this income is from the origination and servicing of sold mortgage loans. Fees generated from mortgage loan servicing, which generally consists of collecting mortgage payments, maintaining escrow accounts, disbursing payments to investors and foreclosure processing for loans held by others, were \$2.30 million and \$2.13 million for the years ended December 31, 2018 and 2017, respectively. Other loan related fee income for late charges and other ancillary fees were \$172,000 and \$174,000 for the years ended December 31, 2018 and 2017, respectively.

**Residential 1-4 Family Loans**

The Bank originates residential 1-4 family mortgage loans secured by property located in the Bank's market areas. At December 31, 2018, \$116.94 million or 18.92% of the Bank's total loans were such loans. The Bank generally originates residential 1-4 family mortgage loans in amounts of up to 80.0% of the lesser of the appraised value or the selling price of the mortgaged property without requiring private mortgage insurance. A mortgage loan originated by the Bank, whether fixed rate or adjustable rate, can have a term of up to 30 years. The Bank holds substantially all of its adjustable rate and its 8, 10 and 12-year fixed rate loans in portfolio. Adjustable rate loans limit the periodic interest rate adjustment and the minimum and maximum rates that may be charged over the term of the loan. The Bank's fixed rate 15-year and 20-year loans are held in portfolio or sold in the secondary market depending on market conditions. Generally, all 30-year fixed rate loans are sold in the secondary market. The volume of loan sales is dependent on the volume, type and term of loan originations.

The Bank derives a significant portion of its noninterest income from servicing of loans that it has sold. The Bank offers many of the fixed rate loans it originates for sale in the secondary market on a servicing retained basis. This means that we process the borrower's payments and send them to the purchaser of the loan. This retention of servicing enables the Bank to increase fee income and maintain a relationship with the borrower. At December 31, 2018, the Bank had \$964.97 million in residential 1-4 family mortgage loans and \$33.41 million in other loan categories sold with servicing retained. The Bank does not ordinarily purchase home mortgage loans from other financial institutions.

Property appraisals on real estate securing the Bank's single-family residential loans are made by state certified and licensed independent appraisers who are approved annually by the Board. Appraisals are performed in accordance with applicable regulations and policies. The Bank generally obtains title insurance policies on all first mortgage real estate loans originated. On occasion, refinancing of mortgage loans are approved using title reports instead of title insurance. Title reports are also allowed on home equity loans. Borrowers generally remit funds with each monthly payment of principal and interest, to a loan escrow account from which the Bank makes disbursements for such items as real estate taxes and hazard and mortgage insurance premiums as they become due.

The Bank also lends funds for the residential 1-4 family construction. Residential 1-4 family construction loans are made both to individual homeowners for the construction of their primary residence and, to a lesser extent, to local builders for the construction of pre-sold houses or houses that are being built for sale in the future. Residential 1-4 family construction loans accounted for \$27.17 million or 4.40% of the Bank's total loan portfolio at December 31, 2018.



## Table of Contents

### **Commercial Real Estate Loans**

The Bank originates commercial real estate loans including loans on multi-family dwellings. Commercial real estate loans made up 41.54% of the Bank's total loan portfolio, or \$256.78 million at December 31, 2018. The Bank's commercial real estate loans are primarily permanent loans secured by improved property such as office buildings, retail stores, commercial warehouses and apartment buildings. The terms and conditions of each loan are tailored to the needs of the borrower and based on the financial strength of the project and any guarantors. Generally, commercial real estate loans originated by the Bank will not exceed 75.0% of the appraised value or the selling price of the property, whichever is less. Commercial real estate loans are typically made with fixed rates of interest and 5 to 15-year maturities. Upon maturity, the loan is repaid or the terms and conditions are renegotiated. Generally, all commercial real estate loans that we originate are secured by property located in the state of Montana and within the market areas of the Bank. The Bank's largest single commercial real estate loan at December 31, 2018 was a 50% participation loan originated by another bank in northwestern Montana. The Company's share of the total outstanding loan at December 31, 2018 was \$9.58 million and it is collateralized by commercial real estate located in Missoula, Montana. At December 31, 2018 this loan is performing in accordance with its repayment terms.

The Bank also lends funds for commercial construction and development. Commercial construction and development loans accounted for \$41.74 million or 6.75% of the Bank's total loan portfolio at December 31, 2018. In addition, the bank originates loans secured by farm and ranch real estate. Farmland loans accounted for \$29.92 million or 4.84% of the Bank's total loan portfolio at December 31, 2018.

### **Home Equity Loans**

The Bank also originates home equity loans. These loans are secured by the borrowers' primary residence, but are typically subject to a prior lien, which may or may not be held by the Bank. At December 31, 2018, \$52.16 million or 8.44% of our total loans were home equity loans. Borrowers may use the proceeds from the Bank's home equity loans for many purposes, including home improvement, debt consolidation or other purchasing needs. The Bank offers fixed rate, fixed payment home equity loans as well as variable and fixed rate home equity lines of credit. Fixed rate home equity loans typically have terms of no longer than 15 years.

Home equity loans are secured by real estate but they have historically carried a greater risk than first lien residential mortgages because of the existence of a prior lien on the property securing the loan, as well as the flexibility the borrower has with respect to the loan proceeds. The Bank attempts to minimize this risk by maintaining conservative underwriting policies on such loans. We generally make home equity loans for not more than 85.0% of appraised value of the underlying real estate collateral, less the amount of any existing prior liens on the property securing the loan.

## Consumer Loans

As part of its strategy to invest in higher yielding shorter term loans, the Bank emphasized growth of its consumer lending portfolio in recent years. This portfolio includes personal loans secured by collateral other than real estate, unsecured personal loans and lines of credit and loans secured by deposits held by the Bank. As of December 31, 2018, consumer loans totaled \$16.57 million or 2.68% of the Bank's total loan portfolio. These loans consist primarily of auto loans, RV loans, boat loans, personal loans and credit lines and deposit account loans. Consumer loans are originated in the Bank's market areas and generally have maturities of up to 7 years. For loans secured by savings accounts, the Bank will lend up to 90.0% of the account balance on single payment loans and up to 100.0% for monthly payment loans.

Consumer loans have a shorter term and generally provide higher interest rates than residential loans. Consumer loans can be helpful in improving the spread between average loan yield and cost of funds and at the same time improve the matching of the maturities of rate sensitive assets and liabilities.

The underwriting standards employed by the Bank for consumer loans include a determination of the applicant's credit history and an assessment of the applicant's ability to meet existing obligations and payments on the proposed loan. The stability of the applicant's monthly income may be determined by verification of gross monthly income from primary employment, and additionally from any verifiable secondary income. Creditworthiness of the applicant is of primary consideration; however, the underwriting process also includes a comparison of the value of the collateral in relation to the proposed loan amount.

## Table of Contents

### **Commercial Loans**

Commercial business loans amounted to \$59.05 million, or 9.56% of the Bank's total loan portfolio at December 31, 2018. Agricultural production loans amounted to \$17.71 million, or 2.87% of the Bank's total loan portfolio at December 31, 2018. The Bank's commercial business loans are traditional business loans and are not secured by real estate. Such loans may be structured as unsecured lines of credit or may be secured by inventory, accounts receivable or other business assets. Agricultural operating loans are generally secured with equipment, cattle, crops or other non-real property and at times the underlying real property.

Commercial business loans of this nature usually involve greater credit risk than residential 1-4 family loans. The collateral we receive is typically related directly to the performance of the borrower's business which means that repayment of commercial business loans is dependent on the successful operations and income stream of the borrower's business. Such risks can be significantly affected by economic conditions. In addition, commercial lending generally requires substantially greater oversight efforts compared to residential real estate lending.

### **Loans to One Borrower**

Under Montana law, commercial banks such as the Bank, are subject to certain exemptions and are allowed to select the Office of the Comptroller of the Currency ("OCC") formula used to determine limits on credit concentrations to single borrowers to an amount equal to 15.0% of the institution's total capital. As of December 31, 2018, the Bank's limit to a single borrower was \$15.02 million. Our largest aggregation of loans to one borrower was approximately \$17.13 million at December 31, 2018. This consisted of four loans: two commercial real estate loans secured by two separate detention facilities, a commercial real estate loan secured by a chemical dependency treatment facility and a commercial loan. The first commercial real estate loan had a principal balance of \$4.63 million at December 31, 2018. However, 80.0% of that amount, or \$3.70 million at December 31, 2018 was sold to Montana Board of Investments, leaving a net principal balance payable to the Bank of \$926,000. As of December 31, 2018, the principal balance on the second commercial real estate loan was \$8.86 million. However, 90.0% of this loan is guaranteed by the USDA Rural Development. Thus, 90.0% of the loan, or \$7.98 million at December 31, 2018, is not required to be included in the Bank's limitations to a single borrower under applicable banking regulations. This leaves approximately \$886,000 subject to the lending limit described above. The third commercial real estate loan had a principal balance of \$3.62 million as of December 31, 2018. The commercial loan had a principal balance of \$24,000 at December 31, 2018. As a result, the total amount subject to the lending limit at December 31, 2018 was \$5.45 million. At December 31, 2018, these loans were performing in accordance with their terms. The Bank maintains the servicing for these loans.

### **Loan Solicitation and Processing**

Our customary sources of mortgage loan applications include repeat customers, walk-ins and referrals from home builders and real estate brokers. We also advertise in local newspapers and on local radio and television. We currently have the ability to accept online mortgage loan applications and provide pre-approvals through our website. Our branch managers and loan officers located at our headquarters and in branches, have authority to approve certain types of loans when presented with a completed application. Other loans must be approved at our main offices as disclosed below. No loan consultants or loan brokers are currently utilized for either residential or commercial lending activities.

After receiving a loan application from a prospective borrower, a credit report and verifications are obtained to confirm specific information relating to the loan applicant's employment, income and credit standing. When required by our policies, an appraisal of the real estate intended to secure the proposed loan is undertaken by an independent fee appraiser. In connection with the loan approval process, our staff analyzes the loan applications and the property involved. Officers and branch managers are granted lending authority based on the nature of the loan and the managers' level of experience. We have established a series of loan committees to approve any loans which may exceed the lending authority of particular officers or branch managers. Three Directors of the Board are required for approval of any loan, or aggregation of loans to a single borrower, that exceeds \$2.50 million.

Loan applicants are promptly notified of the decision by a letter setting forth the terms and conditions of the decision. If approved, these terms and conditions include the amount of the loan, interest rate basis, amortization term, a brief description of real estate to be mortgaged, tax escrow and the notice of requirement of insurance coverage to be maintained. We generally require title insurance on first mortgage loans and fire and casualty insurance on all properties securing loans, which insurance must be maintained during the entire term of the loan.

## Table of Contents

### **Loan Commitments**

We generally provide commitments to fund fixed and adjustable-rate single-family mortgage loans for periods up to 60 days at a specified term and interest rate, and other loan categories for shorter time periods. The total amount of our commitments to extend credit as of December 31, 2018, was approximately \$18.75 million, all of which was for residential mortgage loans.

### **Investment Activities**

#### **General**

State-chartered commercial banks such as the Bank have the authority to invest in various types of investment securities, including United States Treasury obligations, securities of various Federal agencies (including securities collateralized by mortgages), certificates of deposits of insured banks and savings institutions, municipal securities, corporate debt securities and loans to other banking institutions.

Eagle maintains liquid assets that may be invested in specified short-term securities and other investments. Liquidity levels may be increased or decreased depending on the yields on investment alternatives. They may also be increased based on management's judgment as to the attractiveness of yields available in relation to other opportunities. Liquidity levels can also change based on management's expectation of future yield levels, as well as management's projections as to the short-term demand for funds to be used in the Bank's loan origination and other activities. Eagle maintains an investment securities portfolio and a mortgage-backed securities ("MBSs") portfolio as part of its investment portfolio.

#### **Investment Policies**

The investment policy of Eagle, which is established by the Board, is designed to foster earnings and liquidity within prudent interest rate risk guidelines, while complementing the Bank's lending activities. The policy provides for available-for-sale (including those accounted for under ASC Topic 825), held-to-maturity and trading classifications. However, Eagle currently does not hold any securities for purposes of trading or held-to-maturity. The policy permits investments in high credit quality instruments with diversified cash flows while permitting us to maximize total return within the guidelines set forth in our interest rate risk and liquidity management policies. Permitted investments include but are not limited to U.S. government obligations, government agency or government-sponsored agency obligations, state, county and municipal obligations, asset-backed securities and mortgage-backed securities.

Collateralized mortgage obligations (“CMOs”), investment grade corporate debt securities and commercial paper are also included. We also invest in Federal Home Loan Bank (“FHLB”) overnight deposits and federal funds, but these instruments are not considered part of the investment portfolio.

Our investment policy also includes several specific guidelines and restrictions to ensure adherence with safe and sound activities. The policy prohibits investments in high-risk mortgage derivative products (as defined within the policy) without prior approval from the Board. To secure such approval, management must demonstrate the business advantage of such investments.

We do not participate in the use of off-balance sheet derivative financial instruments, except interest rate caps and certain financial instruments designated as cash flow hedges related to loans committed to be sold in the secondary market. Further, Eagle does not invest in securities which are not rated investment grade at time of purchase.

The Board, through its asset/liability committee, has charged the President and CEO with implementation of the investment policy. All transactions are reported to the Board monthly, as well as the current composition of the portfolio, including market values and unrealized gains and losses.

### **Sources of Funds**

#### **General**

Deposits are the major source of our funds for lending and other investment purposes. Borrowings are also used to compensate for reductions in the availability of funds from other sources. In addition to deposits and borrowings, we derive funds from loans and investment securities principal payments. Funds are also derived from proceeds for the maturity, call and sale of investment securities and from the sale of loans. Loan and investment securities principal payments are a relatively stable source of funds, while loan prepayments and deposit inflows are significantly influenced by general interest rates and financial market conditions.

## Table of Contents

### **Deposits**

We offer a variety of deposit accounts. Deposit account terms vary, primarily as to the required minimum balance amount, the amount of time that the funds must remain on deposit and the applicable interest rate.

Our current deposit products include certificates of deposit accounts ranging in terms from 90 days to five years, as well as, checking, savings and money market accounts. Individual retirement accounts (“IRAs”) are included in certificates of deposit.

Deposits are obtained primarily from residents of Helena, Bozeman, Butte, Townsend, Billings, Missoula, Livingston, Big Timber and Hamilton, and since the merger with Ruby Valley Bank, Twin Bridges and Sheridan. We believe we are able to attract deposit accounts by offering outstanding service, competitive interest rates, convenient locations and service hours. We use traditional methods of advertising to attract new customers and deposits, including radio, television, print media advertising and sales training and incentive programs for employees. Management believes that non-residents of Montana hold an insignificant number and amount of deposit accounts.

We pay interest rates on deposits which are competitive in our market. Interest rates on deposits are set by senior management, based on a number of factors, including: projected cash flow; a current survey of a selected group of competitors’ rates for similar products; external data which may influence interest rates; investment opportunities and loan demand; and scheduled certificate maturities and loan and investment repayments.

### **Borrowings**

Deposits are the primary source of funds for our lending and investment activities and for general business purposes. However, as the need arises, or in order to take advantage of funding opportunities, we also borrow funds in the form of advances to supplement our supply of lendable funds and to meet deposit withdrawal requirements. We have Federal funds line of credits with FHLB of Des Moines, Pacific Coast Bankers Bank (“PCBB”), PNC Financial Services Group, Inc. (“PNC”), United Bankers’ Bank (“UBB”) and Zions Bank. Our Federal funds line of credit with Stockman Bank was terminated during 2018.

In February 2017, the Company completed the issuance, through a private placement, of \$10.00 million aggregate principal amount of 5.75% fixed senior unsecured notes due in 2022. The interest will be paid semi-annually through maturity date. The notes are not subject to redemption at the option of the Company.

In June 2015, the Company completed the issuance of \$10.00 million in aggregate principal amount of subordinated notes due in 2025 in a private placement transaction to an institutional accredited investor. The notes will bear interest at an annual fixed rate of 6.75% and interest will be paid quarterly through maturity date or earlier redemption. The notes qualify as Tier 2 capital for regulatory purposes, subject to applicable limitations. The notes are recorded as long term debt for accounting purposes.

In September 2005, our predecessor entity formed a special purpose subsidiary, Eagle Bancorp Statutory Trust I (the "Trust"), for the purpose of issuing trust preferred securities in the amount of \$5.16 million. Our predecessor entity has issued subordinated debentures to the Trust, and the coupon on the debentures matches the dividend payment on the trust preferred securities. Upon the closing of the second-step conversion and reorganization, we assumed the obligations of our predecessor in connection with the subordinated debentures and trust preferred securities. For regulatory purposes, the securities qualify as Tier 1 Capital, while for accounting purposes they are recorded as long term debt. The securities have a 30-year maturity and carried a fixed coupon of 6.02% for the first five years, at which time the coupon became variable, at a spread of 142 basis points over 3 month LIBOR. At December 31, 2018 the rate was 4.228%.

### **Other Activities**

The Company offers wealth management services at its locations through financial advisors employed by the Bank. Income from wealth management services was \$536,000 and \$624,000 for the years ended December 31, 2018 and 2017, respectively.

### **Subsidiary Activity**

We are permitted to invest in the capital stock of, or originate secured or unsecured loans to, subsidiary corporations. The following are subsidiaries of the Company: Opportunity Bank of Montana, Eagle Bancorp Statutory Trust I, and AFSB NMTC Investment Fund, LLC, which is a subsidiary of the Bank.



## Table of Contents

### **Personnel**

As of December 31, 2018, we had 235 full-time employees and 14 part-time employees. The employees are not represented by a collective bargaining unit. We believe our relationship with our employees to be good.

### **Regulation**

Set forth below is a brief description of certain laws and regulations applicable to Eagle and the Bank. These descriptions of laws and regulations as well as those contained elsewhere do not purport to be complete and are qualified in their entirety by reference to applicable laws and regulations. Legislative or regulatory changes in the future could adversely affect our operations or financial condition.

### **General**

As a state-chartered commercial bank, the Bank is subject to extensive regulation, examination and supervision by the Montana Division of Banking and Financial Institutions and the Federal Deposit Insurance Corporation (“FDIC”), as the insurer of its deposits. The Bank is a member of the Federal Reserve Bank (“FRB”) System and its deposit accounts are insured up to applicable limits by the Deposit Insurance Fund, which is administered by the FDIC. There are periodic examinations to evaluate the Bank’s safety and soundness and compliance with various regulatory requirements. Under certain circumstances, the FDIC may also examine the Bank. This regulatory structure is intended primarily for the protection of the insurance fund and depositors. The regulatory structure also gives the regulatory authorities extensive discretion in connection with their supervisory and enforcement activities and examination policies, including policies with respect to the classification of assets and the establishment of adequate allowance for loan losses for regulatory purposes. Eagle, as a bank holding company, is required to file certain reports with, and is subject to examination by, and must otherwise comply with the rules and regulations of the FRB. Eagle is also subject to the rules and regulations of the Securities and Exchange Commission (“SEC”) under the federal securities laws. See “—Holding Company Regulation.”

### **Dodd-Frank Act**

In July 2010, the President signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”). The Dodd-Frank Act has significantly changed the bank regulatory structure and affected the lending, investment, trading and operating activities of financial institutions and their holding companies. Many of the provisions of the Dodd-Frank Act are subject to delayed effective dates and/or require the issuance of implementing

regulations, some of which have not yet been issued in final form. The Dodd-Frank Act and implementing regulations have increased the regulatory burden, compliance cost and interest expense for Eagle and the Bank.

The Dodd-Frank Act will require the FRB to set minimum capital levels for depository institution holding companies that are as stringent as those required for the insured depository subsidiaries, and the components of Tier 1 capital would be restricted to capital instruments that are currently considered to be Tier 1 capital for insured depository institutions. Under the Dodd-Frank Act, the proceeds of trust preferred securities are excluded from Tier 1 capital unless such securities were issued prior to May 19, 2010 by bank or savings and loan holding companies with less than \$15 billion of assets.

The Dodd-Frank Act also created a new Consumer Financial Protection Bureau with broad powers to supervise and enforce consumer protection laws. The Consumer Financial Protection Bureau has broad rule-making authority for a wide range of consumer protection laws that apply to all banks such as the Bank, including the authority to prohibit “unfair, deceptive or abusive” acts and practices. The Consumer Financial Protection Bureau has examination and enforcement authority over all banks with more than \$10 billion in assets. Banks with \$10 billion or less in assets will continue to be examined by their applicable bank regulators.

The legislation also broadened the base for FDIC insurance assessments. Assessments will now be based on the average consolidated total assets less tangible equity capital of a financial institution. The Dodd-Frank Act also permanently increases the maximum amount of deposit insurance for banks, savings institutions and credit unions to \$250,000 per depositor, retroactive to January 1, 2009, and non-interest bearing transaction accounts had unlimited deposit insurance through December 31, 2012. Lastly, the Dodd-Frank Act directs the FRB to promulgate rules prohibiting excessive compensation paid to bank holding company executives, regardless of whether the company is publicly traded or not.

Table of Contents

**Federal Regulation of Commercial Banks**

*General*

Deposits in the Bank, a Montana state-chartered commercial bank are insured by the FDIC. The bank has no branches in any other state. The Bank is subject to regulation and supervision by the Montana Department of Administration's Banking and Financial Institutions Division and the FRB. The federal laws that apply to the Bank regulate, among other things, the scope of its business, its investments, its reserves against deposits, the timing of the availability of deposited funds, and the nature, amount of, and collateral for loans. Federal laws also regulate community reinvestment and insider credit transactions and impose safety and soundness standards.

The Bank's general permissible lending limit for loans-to-one-borrower is 15.0% of unimpaired capital and surplus. An additional amount may be lent, equal to 10.0% of total capital, if the loan is fully secured by certain readily marketable collateral, which is defined to include certain financial instruments and bullion, but generally does not include real estate.

The federal banking agencies, have adopted guidelines establishing safety and soundness standards on such matters as loan underwriting and documentation, asset quality, earnings standards, internal controls and audit systems, interest rate risk exposure and compensation and other employee benefits. If the appropriate federal banking agency determines that an institution fails to meet any standard prescribed by the guidelines, the agency may require the institution to submit to the agency an acceptable plan to achieve compliance with the standard. If an institution fails to submit or implement an acceptable plan, the appropriate federal banking agency may issue an enforceable order requiring correction of the deficiencies.

*Federal Home Loan Bank System*

The Bank is a member of the FHLB of Des Moines. FHLB Des Moines is one of 11 regional FHLBs that administer the home financing credit function of banks, credit unions and savings institutions. Each FHLB serves as a reserve or central bank for its members within its assigned region. It is funded primarily from proceeds derived from the sale of consolidated obligations of the FHLB System. It makes loans or advances to members in accordance with policies and procedures, established by the Board of Directors of the FHLB, which are subject to the oversight of the Federal Housing Finance Board. All advances from the FHLB are required to be fully secured by sufficient collateral as determined by the FHLB. In addition, all long-term advances are required to provide funds for residential home financing. As a member, the Bank is required to purchase and maintain a specified amount of shares of capital stock in the FHLB of Des Moines.

The FHLBs continue to contribute to low- and moderately-priced housing programs through direct loans or interest subsidies on advances targeted for community investment and low- and moderate-income housing projects. These contributions have affected adversely the level of FHLB dividends paid and could continue to do so in the future. These contributions could also have an adverse effect on the value of FHLB stock in the future. A reduction in value of the Bank's FHLB stock may result in a corresponding reduction in the Bank's capital.

### ***Federal Reserve System***

The Federal Reserve System requires all depository institutions to maintain noninterest-bearing reserves at specified levels against their checking and non-personal time deposits. The balances maintained to meet the reserve requirements imposed by the Federal Reserve System may be used to satisfy liquidity requirements.

The Bank has authority to borrow from the Federal Reserve System "discount window". The Bank maintains a "primary credit" facility at the Federal Reserve's discount window.

As a new member of the Federal Reserve System, the Company is required to maintain a minimum level of investment in FRB stock based on a specific percentage of its capital and surplus. A reduction in value of the Bank's FRB stock may result in a corresponding reduction in the Bank's capital.

### ***Insurance of Deposit Accounts***

Deposit accounts at the Bank are insured by the FDIC, generally up to a maximum of \$250,000 per separately insured depositor and up to a maximum of \$250,000 for self-directed retirement accounts. The Bank's deposits, therefore, are subject to FDIC deposit insurance assessments. Assessments paid to the FDIC by the Bank and other banking institutions are used to fund the FDIC's Federal Deposit Insurance Fund.

Table of Contents

***Insurance of Accounts and Regulation by the FDIC***

As insurer of deposits in banks, the FDIC imposes deposit insurance premiums and is authorized to conduct examinations of and to require reporting by FDIC-insured institutions. It also may prohibit any FDIC-insured institution from engaging in any activity the FDIC determines by regulation or order to pose a serious risk to the fund. The FDIC also has the authority to initiate enforcement actions against savings institutions, after giving FRB an opportunity to take such action. Insurance of deposits may be terminated by the FDIC upon a finding that the institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC or written agreement with the FDIC. We are not aware of any practice, condition or violation that might lead to the termination of the Bank's deposit insurance.

***New Assessments Under Dodd-Frank***

The FDIC assesses deposit insurance premiums on each insured institution quarterly based on annualized rates for one of four risk categories. The assessment base for calculating deposit insurance assessments is an institution's average total assets minus its average tangible equity (defined as Tier I capital). Under the FDIC's risk-based assessment system, insured institutions are assigned to one of four risk categories based on supervisory evaluations, regulatory capital levels and certain other risk factors. Rates are based on each institution's risk category and certain specified risk adjustments. Stronger institutions pay lower rates while riskier institutions pay higher rates. The assessment rate schedule establishes assessments ranging from 2.5 to 45 basis points. The FDIC may increase or decrease its rates for each quarter by 2 basis points without further rulemaking. In an emergency, the FDIC may also impose a special assessment.

***Minimum Reserve Ratios***

The Dodd-Frank Act establishes 1.35% as the minimum reserve ratio for the Deposit Insurance Fund ("DIF"). The FDIC had adopted a plan under which it would meet this ratio by September 30, 2020, the deadline imposed by the Dodd-Frank Act. The Dodd-Frank Act required the FDIC to offset the effect on institutions, with assets less than \$10 billion, of the increase in the statutory minimum reserve ratio to 1.35% from the former statutory minimum of 1.15%. During 2018 the DIF ratio reached 1.36%. Once the ratio hits 1.38%, the FDIC indicated it will automatically apply a small Bank's credits to reduce its regular insurance assessment up to the entire amount of the assessment. In addition to the statutory minimum ratio, the FDIC must designate a reserve ratio, known as the designated reserve ratio, or DRR, which may exceed the statutory minimum. The FDIC has established 2.0% as the DRR.

The FDIC has authority to increase insurance assessments. A significant increase in insurance premiums would likely have an adverse effect on the operating expenses and results of operations of the Bank. There can be no prediction as to what insurance assessment rates will be in the future. In addition to the assessment for deposit insurance, through 2019, institutions are required to make payments on bonds issued in the late 1980s by the Financing Corporation to recapitalize a predecessor deposit insurance fund.

### ***Capital Requirements***

State chartered commercial banks, such as the Bank, are required by the FRB to maintain minimum levels of regulatory capital. These minimum capital standards include: a ratio of total capital to risk-weighted assets of 9.875%, a ratio of Tier 1 capital to risk-weighted assets of 7.875%, a ratio of common equity Tier 1 capital to risk-weighted assets of 6.375%, or a ratio of Tier 1 capital to total assets of 4.00%. All of these ratios except for the ratio of Tier 1 capital to total assets include the capital conservation buffer of 1.875% phased-in beginning January 1, 2018. The regulations require that, in meeting the capital standards, institutions must generally deduct investments in and loans to subsidiaries engaged in activities as principal that are not permissible for a national bank.

The risk-based capital standard requires state chartered commercial banks to maintain Tier 1 and total capital (which is defined as core capital and supplementary capital) to risk-weighted assets of at least 7.875% and 9.875%, respectively. In determining the amount of risk-weighted assets, all assets, including certain off-balance sheet assets, recourse obligations, residual interests and direct credit substitutes, are multiplied by a risk-weight factor of 0.0% to 100.0%, assigned by the FRB capital regulation based on the risks believed inherent in the type of asset. Tier 1 capital is defined as common stockholders' equity (including retained earnings), certain noncumulative perpetual preferred stock and related surplus and minority interests in equity accounts of consolidated subsidiaries, less intangibles other than certain mortgage servicing rights and credit card relationships. The components of supplementary capital currently include cumulative preferred stock, long-term perpetual preferred stock, mandatory convertible securities, subordinated debt and intermediate preferred stock. Also included is the allowance for loan and lease losses limited to a maximum of 1.25% of risk-weighted assets. Overall, the amount of supplementary capital included as part of total capital cannot exceed 100.0% of core capital. The FRB also has authority to establish individual minimum capital requirements for financial institutions.

## Table of Contents

*Basel III – New Capital and Prompt Corrective Action Regulations.* In July 2013, the federal bank regulatory agencies issued interim final rules that revise and replace the current risk-based capital requirements in order to implement the “Basel III” regulatory capital reforms released by the Basel Committee on Banking Supervision and changes required by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. The Basel III reforms reflected in the final rules include an increase in the risk-based capital requirements and certain changes to capital components and the calculation of risk-weighted assets.

Effective January 1, 2015, bank holding companies with consolidated assets of \$1 billion or more and banks like Opportunity Bank must comply with new minimum capital ratio requirements to be phased-in between January 1, 2015 and January 1, 2019, which would consist of the following: (i) a new common equity Tier 1 capital to total risk weighted assets ratio of 4.5% which increased to 6.375% during 2018 with the capital conservation buffer of 1.875%; (ii) a Tier 1 capital to total risk weighted assets ratio of 6.0% which increased to 7.875% during 2018 with the capital conservation buffer of 1.875%; (iii) a total capital to total risk weighted assets ratio of 8.0% which increased to 9.875% during 2018 with the capital conservation buffer of 1.875%; and (iv) a Tier 1 capital to adjusted average total assets (“leverage”) ratio of 4.0%.

The capital conservation buffer, when fully phased-in will require maintenance of a minimum of 2.5% of common equity Tier 1 capital to total risk weighted assets in excess of the regulatory minimum capital ratio requirements described above. The 2.5% buffer will increase the minimum capital ratios to (i) a common equity Tier 1 capital ratio of 7.0%, (ii) a Tier 1 capital ratio of 8.5%, and (iii) a total capital ratio of 10.5%. The new buffer requirement will be phased-in between January 1, 2016 and January 1, 2019. If the capital ratio levels of a banking organization fall below the capital conservation buffer amount, the organization will be subject to limitations on (i) the payment of dividends; (ii) discretionary bonus payments; (iii) discretionary payments under Tier 1 instruments; and (iv) engaging in share repurchases.

The federal bank regulatory agencies also implemented changes to the prompt corrective action framework, which is designed to place restrictions on insured depository institutions if their capital ratios begin to show signs of weakness. These changes will take effect beginning January 1, 2015 and will require insured depository institutions to meet the following increased capital ratio requirements in order to qualify as “well capitalized:” (i) a new common equity Tier 1 capital ratio of 6.5%; (ii) a Tier 1 capital ratio of 8.0%; (iii) a total capital ratio of 10.0%; and (iv) a Tier 1 leverage ratio of 5.0%. See also the additional discussion below under “Prompt Corrective Action.”

Management believes that, as of December 31, 2018, the Company and the Bank would meet all capital adequacy requirements under the Basel III Capital rules on a fully phased-in basis as if such requirements were currently in effect; however, final rules are subject to regulatory discretion and could result in the need for additional capital levels in the future.

## *Prompt Corrective Action*

Federal bank regulatory agencies are required to take certain supervisory actions against undercapitalized institutions, the severity of which depends upon the institution's degree of undercapitalization. Generally, an institution that has a ratio of total capital to risk-weighted assets of less than 8.0%, a ratio of Tier 1 capital to risk-weighted assets of less than 6.0%, a ratio of common equity Tier 1 capital to risk-weighted assets of less than 4.5%, or a ratio of Tier 1 capital to total assets of less than 4.0% is considered to be "undercapitalized." An institution that has a total risk-based capital ratio less than 6.0%, a Tier 1 capital ratio of less than 4.0%, a common equity Tier 1 capital ratio of less than 3.0% or a Tier 1 leverage ratio that is less than 3.0% is considered to be "significantly undercapitalized." An institution that has a tangible capital to assets ratio equal to or less than 2.0% is deemed to be "critically undercapitalized." Subject to a narrow exception, the FRB is required to appoint a receiver or conservator for a bank that is "critically undercapitalized." Regulations also require that a capital restoration plan be filed with the FRB within 45 days of the date a bank receives notice that it is "undercapitalized," "significantly undercapitalized" or "critically undercapitalized." In addition, numerous mandatory supervisory actions become immediately applicable to an undercapitalized institution, including, but not limited to, increased monitoring by regulators and restrictions on growth, capital distributions and expansion. "Significantly undercapitalized" and "critically undercapitalized" institutions are subject to more extensive mandatory regulatory actions. The FRB also could take any one of a number of discretionary supervisory actions, including the issuance of a capital directive and the replacement of senior executive officers and directors. At December 31, 2018, the Bank's capital ratios met the "well capitalized" standards.



Table of Contents

***Limitations on Capital Distributions***

A principal source of the parent holding company's cash is from dividends received from the Bank, which are subject to government regulation and limitation. Regulatory authorities may prohibit banks and bank holding companies from paying dividends in a manner that would constitute an unsafe or unsound banking practice. In addition, a bank may not pay cash dividends if that payment could reduce the amount of its capital below that necessary to meet minimum applicable regulatory capital requirements. The Bank is subject to Montana state law and cannot declare a dividend greater than the previous two years' net earnings without providing notice to the state. Additionally, current guidance from the FRB provides, among other things, that dividends per share on the Company's common stock generally should not exceed earnings per share, measured over the previous four fiscal quarters. Basel III also introduces additional limitations on banks' ability to issue dividends by imposing a capital conservation buffer requirement.

***Transactions with Affiliates***

The Bank's authority to engage in transactions with "affiliates" is limited by regulations and by Sections 23A and 23B of the Federal Reserve Act as implemented by the FRB's Regulation W. The term "affiliates" for these purposes generally means any company that controls or is under common control with an institution. Eagle is an affiliate of the Bank. In general, transactions with affiliates must be on terms that are as favorable to the institution as comparable transactions with non-affiliates. In addition, certain types of transactions, *i.e.* "covered transactions," are restricted to an aggregate percentage of the institution's capital. Collateral in specified amounts must be provided by affiliates in order to receive loans from an institution. In addition, banks are prohibited from lending to any affiliate that is engaged in activities that are not permissible for bank holding companies and no bank may purchase the securities of any affiliate other than a subsidiary.

Our authority to extend credit to executive officers, directors and 10.0% or greater shareholders ("insiders"), as well as entities controlled by these persons, is governed by Sections 22(g) and 22(h) of the Federal Reserve Act and its implementing regulation, FRB Regulation O. Among other things, loans to insiders must be made on terms substantially the same as those offered to unaffiliated individuals and not involve more than the normal risk of repayment. There is an exception for bank-wide lending programs that do not discriminate in favor of insiders. Regulation O also places individual and aggregate limits on the amount of loans that may be made to insiders based, in part, on the institution's capital position, and requires that certain prior board approval procedures be followed. Extensions of credit to executive officers are subject to additional restrictions on the types and amounts of loans that may be made. At December 31, 2018, we were in compliance with these regulations.

**Holding Company Regulation**

*General*

Eagle is a bank holding company subject to regulatory oversight of the FRB. Eagle is required to register and file reports with the FRB and is subject to regulation and examination by the FRB. In addition, the FRB has enforcement authority over Eagle and its non-bank institution subsidiaries which also permits the FRB to restrict or prohibit activities that are determined to present a serious risk to the Bank.

*Mergers and Acquisitions*

Eagle must obtain approval from the FRB before acquiring more than 5.0% of the voting stock of another bank or bank holding company or acquiring such an institution or holding company by merger, consolidation or purchase of its assets. In evaluating an application for Eagle to acquire control of a bank, the FRB would consider the financial and managerial resources and future prospects of Eagle and the target institution, the effect of the acquisition on the risk to the Deposit Insurance Fund, the convenience and the needs of the community and competitive factors.

Eagle obtained the necessary approvals from the FRB and the Montana Division of Banking and Financial Institutions before acquiring TwinCo on January 31, 2018 and BMB on January 1, 2019.

Table of Contents

*Acquisition of Eagle*

Under the Bank Holding Company Act and the Change in Bank Control Act, a notice or application must be submitted to the FRB if any person (including a company), or a group acting in concert, seeks to acquire 10.0% or more of Eagle's outstanding voting stock, unless the FRB has found that the acquisition will not result in a change in control of Eagle. In acting on such a notice or application, the FRB must take into consideration certain factors, including the financial and managerial resources of the acquirer and the anti-trust effect of the acquisition. Any company that acquires control will be subject to regulation as a bank holding company.

**Federal Securities Laws**

Eagle's common stock is registered with the SEC under the Exchange Act. We are subject to the information, proxy solicitation, insider trading restrictions and other requirements under the Exchange Act. Our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and all amendments to those reports, filed with or furnished to the SEC, are available free of charge through our Internet website, [www.opportunitybank.com](http://www.opportunitybank.com), as soon as reasonably practical after we have electronically filed such material with, or furnished it to, the SEC. The SEC maintains an Internet site that contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC at [www.sec.gov](http://www.sec.gov). The contents on or accessible through, these websites are not incorporated into this filing. Further, our references to the URLs for these websites are intended to be inactive textual references only.

**Sarbanes-Oxley Act of 2002**

The Sarbanes-Oxley Act addresses, among other issues, corporate governance, auditing and accounting, executive compensation and enhanced and timely disclosure of corporate information. As directed by the Sarbanes-Oxley Act, our Chief Executive Officer and Chief Financial Officer are required to certify that our quarterly and annual reports do not contain any untrue statement of a material fact. The rules adopted by the Securities and Exchange Commission under the Sarbanes-Oxley Act have several requirements, including having these officers certify that: they are responsible for establishing, maintaining and regularly evaluating the effectiveness of our internal control over financial reporting; they have made certain disclosures to our auditors and the audit committee of the board of directors about our internal control over financial reporting; and they have included information in our quarterly and annual reports about their evaluation and whether there have been changes in our internal control over financial reporting or in other factors that could materially affect internal control over financial reporting.

Table of Contents

**ITEM 1A. RISK FACTORS**

**We hold certain intangible assets that could be classified as impaired in the future. If these assets are considered to be either partially or fully impaired in the future, our earnings and the book values of these assets would decrease.**

As a result of the branch acquisition from Sterling in 2012, the final goodwill recorded related to the acquisition was \$7.03 million. In addition, we recorded goodwill related to the TwinCo acquisition of \$5.09 million during the first quarter of 2018. We are required to test our goodwill for impairment on a periodic basis. The impairment testing process considers a variety of factors, including the current market price of our common shares, the estimated net present value of our assets and liabilities and information concerning the terminal valuation of similarly situated insured depository institutions. It is possible that future impairment testing could result in a partial or full impairment of the value of our goodwill. If an impairment determination is made in a future reporting period, our earnings and the book value of goodwill will be reduced by the amount of the impairment.

**Risks associated with system failures, interruptions, or breaches of security could negatively affect our earnings.**

Information technology systems are critical to our business. We use various technology systems to manage our customer relationships, general ledger, securities, deposits, and loans. We have established policies and procedures to prevent or limit the impact of system failures, interruptions, and security breaches, but such events may still occur or may not be adequately addressed if they do occur. In addition, any compromise of our systems could deter customers from using our products and services. Although we rely on security systems to provide security and authentication necessary to effect the secure transmission of data, these precautions may not protect our systems from compromises or breaches of security.

In addition, we outsource a majority of our data processing to certain third-party providers. If these third-party providers encounter difficulties, or if we have difficulty communicating with them, our ability to adequately process and account for transactions could be affected, and our business operations could be adversely affected. Threats to information security also exist in the processing of customer information through various other vendors and their personnel.

The occurrence of any system failures, interruption, or breach of security could damage our reputation and result in a loss of customers and business thereby subjecting us to additional regulatory scrutiny, or could expose us to litigation and possible financial liability. Any of these events could have a material adverse effect on our financial condition and results of operations.

**Changes in the structure of Fannie Mae and Freddie Mac (“GSEs”) and the relationship among the GSEs, the federal government and the private markets, or the conversion of the current conservatorship of the GSEs into receivership, could result in significant changes to our securities portfolio.**

The GSEs are currently in conservatorship, with their primary regulator, the Federal Housing Finance Agency, acting as conservator. We cannot predict if, when or how the conservatorships will end, or any associated changes to the GSEs’ business structure that could result. There are several proposed approaches, including possible legislative changes in discussion in both the House Financial Services Committee and the Senate Banking Committee which, if enacted, could change the nature of government participation in the private mortgage market or alternatively the structure of the GSEs, the relationship among the GSEs, the government and the private markets, including the trading markets for agency conforming mortgage loans and markets for mortgage-related securities in which we participate. We cannot predict the prospects for the enactment, timing or content of legislative or rulemaking proposals regarding the future status of any of these approaches. Accordingly, there continues to be uncertainty regarding the future of the GSEs, including whether they will continue to exist in their current form. GSE reform, if enacted, could result in a significant change and adversely impact our business operations, particularly as to our residential mortgage lending activities.

**Our business may be adversely affected by conditions in the financial markets and economic conditions generally and in our market areas in particular.**

Our financial performance generally, and in particular the ability of our borrowers to pay interest on and repay principal of outstanding loans and the value of collateral securing those loans, as well as demand for loans and other products and services we offer and whose success we rely on to drive our future growth, is highly dependent upon the business environment in the markets in which we operate, principally in Montana, and in the United States as a whole. Unlike larger banks that are more geographically diversified, we provide banking and financial services to customers primarily in Montana. The economic conditions in our local markets may be different from, and in some instances worse than, the economic conditions in the United States as a whole. Some elements of the business environment that affect our financial performance include short-term and long-term interest rates, the prevailing yield curve, inflation and price levels, monetary policy, unemployment and strength of the domestic economy and local economy in the markets in which we operate. Unfavorable market conditions can result in deterioration in the credit quality of our borrowers and the demand for our products and services, an increase in the number of loan delinquencies, defaults and charge-offs, additional provisions for loan and lease losses, adverse asset values and an overall material adverse effect on the quality of our loan portfolio.

Unfavorable or uncertain economic and market conditions can be caused by declines in economic growth, business activity or investor or business confidence; limitations on the availability or increases in the cost of credit and capital; increases in inflation or interest rates; high unemployment; natural disasters; state or local government insolvency; or a combination of these or other factors.



Table of Contents

In recent years, economic growth and business activity across a wide range of industries and regions in the U.S. has been slow and uneven. There are continuing concerns related to the level of U.S. government debt and fiscal actions that may be taken to address that debt, further declining oil prices and ongoing federal budget negotiations that may have a destabilizing effect on financial markets. There can be no assurance that economic conditions will continue to improve, and these conditions could worsen. Economic pressure on consumers and uncertainty regarding continuing economic improvement may result in changes in consumer and business spending, borrowing and saving habits. Such conditions could have a material adverse effect on the credit quality of our loans or our business, financial condition or results of operations.

**If the allowance for credit losses is not sufficient to cover actual loan losses, our earnings could decrease.**

Our customers may not repay their loans according to the original terms, and the collateral, if any, securing the payment of these loans may be insufficient to pay any remaining loan balance. We may experience significant loan losses, which may have a material adverse effect on operating results. We make various assumptions and judgments about the collectability of the loan portfolio, including the creditworthiness of borrowers and the value of the real estate and other assets serving as collateral for the repayment of loans. If the assumptions prove to be incorrect, the allowance for credit losses may not be sufficient to cover losses inherent in our loan portfolio, resulting in additions to the allowance. Material additions to the allowance would materially decrease net income.

Our emphasis on the origination of consumer, commercial real estate and commercial business loans is one of the more significant factors in evaluating the allowance for loan losses. As we continue to increase the amount of such loans, additional or increased provisions for loan losses may be necessary and would decrease earnings.

Bank regulators periodically review our allowance for loan losses and may require an increase to the provision for loan losses or further loan charge-offs. Any increase in our allowance for loan losses or loan charge-offs as required by these regulatory authorities may have a material adverse effect on our results of operations or financial condition.

**We could record future losses on our securities portfolio.**

A number of factors or combinations of factors could require us to conclude in one or more future reporting periods that an unrealized loss exists with respect to our investment securities portfolio that constitutes an impairment that is other than temporary, which could result in material losses to us. These factors include, but are not limited to, continued failure by the issuer to make scheduled interest payments, an increase in the severity of the unrealized loss on a particular security, an increase in the continuous duration of the unrealized loss without an improvement in value or changes in market conditions and/or industry or issuer specific factors that would render us unable to forecast a full recovery in value. In addition, the fair values of securities could decline if the overall economy and the financial

condition of some of the issuers deteriorates and there is limited liquidity for these securities.

**Changes in our accounting policies or in accounting standards could materially affect how we report our financial condition and results of operations.**

Our accounting policies are essential to understanding our financial results and condition. Some of these policies require the use of estimates and assumptions that may affect the value of our assets or liabilities and financial results. Some of our accounting policies are critical because they require management to make difficult, subjective, and complex judgments about matters that are inherently uncertain and because it is likely that materially different amounts would be reported under different conditions or using different assumptions. If such estimates or assumptions underlying our financial statements are incorrect, we may experience material losses.

From time to time, the Financial Accounting Standards Board and the Securities and Exchange Commission change the financial accounting and reporting standards or the interpretation of those standards that govern the preparation of our financial statements. These changes are beyond our control, can be hard to predict and could materially impact how we report our results of operations and financial condition. We could also be required to apply a new or revised standard retroactively, resulting in our restating prior period financial statements in material amounts.



Table of Contents

**Because we have increased our commercial real estate and commercial business loan originations, our credit risk has increased and continued downturns in the local real estate market or economy could adversely affect our earnings.**

We intend to continue our recent emphasis on originating commercial real estate and commercial business loans. Commercial real estate and commercial business loans generally have more risk than the residential real estate (1-4 family) loans we originate. Because the repayment of commercial real estate and commercial business loans depends on the successful management and operation of the borrower's properties or related businesses, repayment of such loans can be affected by adverse conditions in the local real estate market or economy. Commercial real estate and commercial business loans may also involve relatively large loan balances to individual borrowers or groups of related borrowers. A downturn in the real estate market or the local economy could adversely affect the value of properties securing the loan or the revenues from the borrower's business, thereby increasing the risk of nonperforming loans. As our commercial real estate and commercial business loan portfolios increase, the corresponding risks and potential for losses from these loans may also increase.

**Declines in home values could decrease our loan originations and increase delinquencies and defaults.**

Declines in home values in our markets could adversely impact results from operations. Like all financial institutions, we are subject to the effects of any economic downturn, and in particular, a significant decline in home values would likely lead to a decrease in new home equity loan originations and increased delinquencies and defaults in both the consumer home equity loan and residential real estate loan portfolios and result in increased losses in these portfolios. Declines in the average sale prices of homes in our primary markets could lead to higher loan losses.

**We continually encounter technological change.**

The financial services industry is continually undergoing rapid technological change with frequent introductions of new, technology-driven products and services. The effective use of technology increases efficiency and enables financial institutions to better serve customers and to reduce costs. Our future success depends, in part, upon our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands, as well as to create additional efficiencies in our operations. Many of our competitors have substantially greater resources to invest in technological improvements than we do. We may not be able to effectively implement new, technology-driven products and services or be successful in marketing these products and services to our customers. In addition, the implementation of technological changes and upgrades to maintain current systems and integrate new ones may also cause service interruptions, transaction processing errors and system conversion delays and may cause us to fail to comply with applicable laws. Failure to successfully keep pace with technological change affecting the financial services industry and avoid interruptions, errors and delays could have a material adverse effect on our business, financial condition or results of operations.

We expect that new technologies and business processes applicable to the consumer credit industry will continue to emerge, and these new technologies and business processes may be better than those we currently use. Because the pace of technological change is high and our industry is intensely competitive, we may not be able to sustain our investment in new technology as critical systems and applications become obsolete or as better ones become available. A failure to maintain current technology and business processes could cause disruptions in our operations or cause our products and services to be less competitive, all of which could have a material adverse effect on our business, financial condition or results of operations.

**We depend on the services of our executive officers and other key employees.**

Our success depends upon the continued employment of certain members of our senior management team. We also depend upon the continued employment of the individuals that manage several of our key functional areas. The departure of any member of our senior management team may adversely affect our operations.

**Changes in interest rates could adversely affect our results of operations and financial condition.**

Our results of operations and financial condition are significantly affected by changes in interest rates. Our results of operations depend substantially on our net interest income, which is the difference between the interest income we earn on our interest-earning assets, such as loans and securities, and the interest expense we pay on our interest-bearing liabilities, such as deposits, borrowings and trust preferred securities.

Table of Contents

Changes in interest rates may also affect the average life of loans and mortgage-related securities. Decreases in interest rates can result in increased prepayments of loans and mortgage-related securities, as borrowers refinance to reduce their borrowing costs. Under these circumstances, we are subject to reinvestment risk to the extent that we are unable to reinvest the cash received from such prepayments at rates that are comparable to the rates on existing loans and securities. Additionally, increases in interest rates may decrease loan demand and make it more difficult for borrowers to repay adjustable rate loans. Also, increases in interest rates may extend the life of fixed rate assets, which would restrict our ability to reinvest in higher yielding alternatives, and may result in customers withdrawing certificates of deposit early so long as the early withdrawal penalty is less than the interest they could receive as a result of the higher interest rates.

Changes in interest rates also affect the current fair value of our interest-earning securities portfolio. Generally, the value of securities moves inversely with changes in interest rates.

**We earn a significant portion of our noninterest income through sales of residential mortgages in the secondary market. We rely on the mortgage secondary market for some of our liquidity.**

Our noninterest income attributable to mortgage banking activities has grown significantly in recent years. We originate and sell mortgage loans, including \$279.74 million of mortgage loans sold during 2018. We rely on Federal National Mortgage Association (“FNMA”), Federal Home Loan Mortgage Corporation (“FHLMC”) and other purchasers to purchase loans in order to reduce our credit risk and provide funding for additional loans we desire to originate. We cannot provide assurance that these purchasers will not materially limit their purchases from us due to capital constraints or other factors, including, with respect to FNMA and FHLMC, a change in the criteria for conforming loans. In addition, various proposals have been made to reform the U.S. residential mortgage finance market, including the role of FNMA and FHLMC. The exact effects of any such reforms are not yet known, but may limit our ability to sell conforming loans to FNMA and FHLMC. In addition, mortgage lending is highly regulated, and our inability to comply with all federal and state regulations and investor guidelines regarding the origination, underwriting documentation and servicing of mortgage loans may also impact our ability to continue selling mortgage loans. If we are unable to continue to sell loans in the secondary market or we experience a period of low mortgage activity, our noninterest income as well as our ability to fund, and thus originate, additional mortgage loans may be adversely affected, which could have a material adverse effect on our business, financial condition or results of operations.

**There can be no assurance we will be able to continue paying dividends on our common stock at recent levels.**

We may not be able to continue paying quarterly dividends commensurate with recent levels given that the ability to pay dividends on our common stock depends on a variety of factors. The payment of dividends is subject to government regulation in that the regulatory authorities may prohibit banks and bank holding companies from paying dividends that would constitute an unsafe or unsound banking practice. Our ability to pay dividends is subject to

certain regulatory requirements. The Federal Reserve generally prohibits a bank holding company from declaring or paying a cash dividend which would impose undue pressure on the capital of a subsidiary bank or would be funded only through borrowing or other arrangements that might adversely affect a bank holding company's financial position. The Federal Reserve Board policy is that a bank holding company should not continue its existing rate of cash dividends on its common stock unless its net income is sufficient to fully fund each dividend and its prospective rate of earnings retention appears consistent with its capital needs, asset quality and overall financial condition. The power of the board of directors of an insured depository institution to declare a cash dividend or other distribution with respect to capital is subject to statutory and regulatory restrictions which limit the amount available for such distribution depending upon the earnings, financial condition and cash needs of the institution, as well as general business conditions.

As a result, future dividends will generally depend on the level of earnings at the Bank. The Bank is subject to Montana law and cannot declare a dividend greater than the previous two year's earnings without providing notice to the state. Also, in the event there shall occur an event of default on any of our debt instruments, we would be unable to pay any dividends on our common stock.

**Our business strategy includes significant growth plans, and our financial condition and results of operations could be negatively affected if we fail to grow or fail to manage our growth effectively.**

We intend to pursue an organic growth strategy for our business; however, we regularly evaluate potential acquisitions and expansion opportunities. If appropriate opportunities present themselves, we expect to engage in selected acquisitions of financial institutions, branch acquisitions and other business growth initiatives or undertakings. There can be no assurance that we will successfully identify appropriate opportunities, that we will be able to negotiate or finance such activities or that such activities, if undertaken, will be successful. There are risks associated with our growth strategy. To the extent that we grow through acquisitions, we cannot ensure that we will be able to adequately or profitably manage this growth.

Table of Contents

Acquiring other banks, branches or other assets, as well as other expansion activities, involves various risks including the risks of incorrectly assessing the credit quality of acquired assets, encountering greater than expected costs of integrating acquired banks or branches, the risk of loss of customers and/or employees of the acquired institution or branch, executing cost savings measures, not achieving revenue enhancements and otherwise not realizing the transaction's anticipated benefits. Our ability to address these matters successfully cannot be assured. In addition, our strategic efforts may divert resources or management's attention from ongoing business operations, may require investment in integration and in development and enhancement of additional operational and reporting processes and controls and may subject us to additional regulatory scrutiny.

Our growth initiatives may also require us to recruit and retain experienced personnel to assist in such initiatives. Accordingly, the failure to identify and retain such personnel would place significant limitations on our ability to successfully execute our growth strategy. In addition, to the extent we expand our lending beyond our current market areas, we could incur additional risks related to those new market areas. We may not be able to expand our market presence in our existing market areas or successfully enter new markets.

If we do not successfully execute our acquisition growth plan, it could adversely affect our business, financial condition, results of operations, reputation and growth prospects. In addition, if we were to conclude that the value of an acquired business had decreased and that the related goodwill had been impaired, that conclusion would result in an impairment of goodwill charge, which would adversely affect our results of operations. While we believe we will have the executive management resources and internal systems in place to successfully manage our future growth, there can be no assurance growth opportunities will be available or that we will successfully manage our growth.

**Strong competition may limit growth and profitability.**

Competition in the banking and financial services industry is intense. We compete with commercial banks, savings institutions, mortgage brokerage firms, credit unions, finance companies, mutual funds, insurance companies, and brokerage and investment banking firms operating locally and elsewhere. Many of these competitors (whether regional or national institutions) have substantially greater resources and lending limits than we have and may offer certain services that we do not or cannot provide. Our profitability depends upon our ability to successfully compete in our market areas.

**We operate in a highly regulated environment and may be adversely affected by changes in laws and regulations.**

We are subject to extensive regulation, supervision and examination by the Board of Governors of the Federal Reserve Board and the Montana Division of Banking and Financial Institutions. The federal banking laws and

regulations govern the activities in which we may engage, and are primarily for the protection of depositors and the Deposit Insurance Fund at the FDIC. These regulatory authorities have extensive discretion in connection with their supervisory and enforcement activities, including the ability to impose restrictions on a bank's operations, reclassify assets, determine the adequacy of a bank's allowance for loan losses and determine the level of deposit insurance premiums assessed. Any change in such regulation and oversight, whether in the form of regulatory policy, new regulations or legislation or additional deposit insurance premiums could have a material impact on our operations. Because our business is highly regulated, the laws and applicable regulations are subject to frequent change. Any new laws, rules and regulations could make compliance more difficult or expensive or otherwise adversely affect our business, financial condition or prospects.

**Financial reform legislation enacted by Congress has, among other things, tightened capital standards, created a new Consumer Financial Protection Bureau and resulted in new laws and regulations that are expected to increase our costs of operations.**

Since the recent financial crisis, federal and state banking laws and regulations, as well as interpretations and implementations of these laws and regulations, have undergone substantial review and change. In particular, the Dodd-Frank Act drastically revised the laws and regulations under which we operate. Financial institutions generally have also been subjected to increased scrutiny from regulatory authorities.

The Dodd-Frank Act created the Consumer Financial Protection Bureau with broad powers to supervise and enforce consumer protection laws. The Consumer Financial Protection Bureau has broad rule-making authority for a wide range of consumer protection laws that apply to all banks and savings institutions, including the authority to prohibit "unfair, deceptive or abusive" acts and practices. The Consumer Financial Protection Bureau has examination and enforcement authority over all banks and savings institutions with more than \$10 billion in assets. Banks with \$10 billion or less in assets will continue to be examined for compliance with the consumer laws by their primary bank regulators, which in the case of the Bank is the FRB.

Table of Contents

It is difficult to predict at this time what impact the Dodd-Frank Act and its implementing rules will have on community banks like the Bank. However, it is expected that at a minimum they will increase our operating and compliance costs and could increase our interest expense.

**If our investment in the Federal Home Loan Bank of Des Moines becomes impaired, our earnings and shareholders' equity could decrease.**

We are required to own common stock of the Federal Home Loan Bank of Des Moines ("FHLB") to qualify for membership in the FHLB System and to be eligible to borrow funds under the FHLB's advance program. The aggregate cost of our FHLB common stock as of December 31, 2018 was \$5.01 million. FHLB common stock is not a marketable security and can only be redeemed by the FHLB.

FHLB's may be subject to accounting rules and asset quality risks that could materially lower their regulatory capital. In an extreme situation, it is possible that the capitalization of a FHLB, including the FHLB of Des Moines, could be substantially diminished or reduced to zero. Consequently, we believe that there is a risk that our investment in FHLB of Des Moines common stock could be deemed impaired at some time in the future, and if this occurs, it would cause our earnings and shareholders' equity to decrease by the amount of the impairment charge.

**ITEM 1B. UNRESOLVED STAFF COMMENTS.**

None.

Table of Contents**ITEM 2. PROPERTIES.**

Eagle's and the Bank's executive office is located at 1400 Prospect Avenue in Helena, Montana. As of December 31, 2018, the Bank conducted its business through 19 offices. These offices are located in Helena, Butte, Bozeman, Townsend, Livingston, Big Timber, Billings, Missoula, Hamilton, Great Falls, Sheridan, and Twin Bridges, Montana. The Sheridan and Twin Bridges branches were acquired in 2018 as part of the TwinCo acquisition. In December 2018, the Great Falls office moved to a new location on River Drive South. The principal banking office in Helena also serves as the executive headquarters. This headquarters houses approximately 31.0% of the Bank's full-time employees. In addition, an operations center is located in Helena. The following table includes the location of each of the Bank's offices, the year the office was opened and the net book value including land, buildings and furniture and equipment. The square footage at each location is also presented.

Location	Address	Opened	Value At December 31, 2018 (In Thousands)	Square Footage
Helena - Prospect Office	1400 Prospect Avenue Helena, MT 59601	1997	\$ 6,417	32,304
Helena - Neill Office	28 Neill Ave. Helena, MT 59601	1987	791	1,391
Helena - Skyway Office	2090 Cromwell Dixon Helena, MT 59602	2009	1,881	4,643
Butte Office	3401 Harrison Avenue Butte, MT 59701	1979	392	3,890
Bozeman - Oak Office	1455 Oak Street Bozeman, MT 59715	1980 (Relocated 2009)	6,628	19,818
Townsend Office	416 Broadway Townsend, MT 59644	1979	110	1,973
Bozeman - Mendenhall Office	5 W. Mendenhall, Ste. 101 Bozeman, MT 59715	2012	*	977
Livingston Office	123 S. Main Street Livingston, MT 59047	2012 (Leased until building was purchased in 2016)	2,339	11,072
Big Timber Office	101 McLeod Street Big Timber, MT 59011	2012	750	2,004
Billings - S. 24th Street W. Office	455 S. 24 <sup>th</sup> Street West Billings, MT 59102	2012	*	107



Edgar Filing: Eagle Bancorp Montana, Inc. - Form 10-K

Missoula - Higgins Office	200 N. Higgins Missoula, MT 59802	2012	*	139	3,079
Missoula - Reserve Office	1510 S Reserve Street Missoula, MT 59801	2012	*	43	4,320
Hamilton Office	711 S. First Street Hamilton, MT 59840	2012		1,576	4,870
Missoula - Home Loan Office	2800 S. Reserve Street Missoula, MT 59801	2012	*	38	2,965
Helena - Operations Center	3210 Euclid Avenue Helena, MT 59601	2012		809	6,758
Great Falls Office	501 River Dr. S., Ste. 100 Great Falls, MT 59405	2015	*	938	5,144
Billings - Main Office	895 Main Street, Ste. 1 Billings, MT 59105	2017	*	62	1,300
Billings - N. 27th Street Office	1025 N. 27th Street Billings, MT 59101	N/A	**	3,644	N/A
Sheridan Office	103 N. Main Sheridan, MT 59749	2018		1,114	8,080
Twin Bridges Office	107 N. Main Twin Bridges, MT 59754	2018		588	7,668

\* Leased location

\*\*Property under construction. Not an operational branch as of December 31, 2018

As of December 31, 2018, the net book value of land, buildings and furniture and equipment owned by the Bank, less accumulated depreciation, totaled \$29.34 million. This includes construction in progress of \$1.79 million, primarily relating to the construction of new branch locations. The Company is in the process of building a future branch in Billings on North 27<sup>th</sup> Street.

### ITEM 3. LEGAL PROCEEDINGS.

The Bank, from time to time, is a party to routine litigation, which arises in the normal course of business, such as claims to enforce liens, condemnation proceedings on properties in which the Bank holds security interests, claims involving the making and servicing of real property loans, and other issues incident to the business of the Bank. There were no lawsuits pending or known by the Company to be contemplated against Eagle or the Bank as of December 31, 2018.

### ITEM 4. MINE SAFETY DISCLOSURES.

Not applicable.



Table of Contents**PART II****ITEM MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS  
5. AND ISSUER PURCHASES OF EQUITY SECURITIES.**

Our common stock is traded on the Nasdaq Global Market under the symbol "EBMT." At the close of business on December 31, 2018, there were 5,477,652 shares of common stock outstanding, held by approximately 802 shareholders of record. The closing price of the common stock on December 31, 2018, was \$16.50 per share. The following table includes the high and low prices for our common stock for each quarter presented, as well as, dividends paid during each quarter:

Quarter Ended	High	Low	Dividends Paid
<b>Calendar Year 2018:</b>			
December 31, 2018	\$18.45	\$14.20	\$ 0.0925
September 30, 2018	19.35	16.85	0.0925
June 30, 2018	21.25	18.95	0.0900
March 31, 2018	21.75	19.50	0.0900
<b>Calendar Year 2017:</b>			
December 31, 2017	\$21.95	\$18.30	\$ 0.0900
September 30, 2017	19.31	17.35	0.0900
June 30, 2017	20.45	17.40	0.0800
March 31, 2017	22.32	17.80	0.0800

Payment of dividends on our shares of common stock is subject to determination and declaration by the Board of Directors (the "Board") and will depend upon a number of factors, including capital requirements, regulatory limitations on the payment of dividends, our results of operations and financial condition, tax considerations and general economic conditions. No assurance can be given that dividends will be declared or, if declared, what the amount of dividends will be, or whether such dividends, once declared, will continue.

On July 19, 2018, the Board authorized the repurchase of up to 100,000 shares of its common stock. Under the plan, shares may be purchased by the Company on the open market or in privately negotiated transactions. The extent to which the company repurchases its shares and the timing of such repurchase will depend upon market conditions and other corporate considerations. No shares were purchased under this plan during the three months ended December 31, 2018 or September 30, 2018. However, during 2019, 36,000 shares were purchased at an average price of \$17.49 per share. The plan expires on July 19, 2019.

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

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

**ITEM 6. SELECTED FINANCIAL DATA.**

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

Table of Contents

**ITEM MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS  
7. OF OPERATIONS.**

The following discussion and analysis of the financial condition and results of operations of Eagle is intended to help investors understand our company and our operations. The financial review is provided as a supplement to, and should be read in conjunction with the Consolidated Financial Statements and the related Notes included elsewhere in this report.

**Overview**

Historically, our principal business has consisted of attracting deposits from the general public and the business community and making loans secured by various types of collateral, including real estate and other consumer assets. We are significantly affected by prevailing economic conditions, particularly interest rates, as well as government policies concerning, among other things, monetary and fiscal affairs, housing and financial institutions and regulations regarding lending and other operations, privacy and consumer disclosure. Attracting and maintaining deposits is influenced by a number of factors, including interest rates paid on competing investments offered by other financial and non-financial institutions, account maturities, fee structures and levels of personal income and savings. Lending activities are affected by the demand for funds and thus are influenced by interest rates, the number and quality of lenders and regional economic conditions. Sources of funds for lending activities include deposits, borrowings, repayments on loans, cash flows from maturities of investment securities and income provided from operations.

Our earnings depend primarily on our level of net interest income, which is the difference between interest earned on our interest-earning assets, consisting primarily of loans and investment securities, and the interest paid on interest-bearing liabilities, consisting primarily of deposits, borrowed funds, and trust-preferred securities. Net interest income is a function of our interest rate spread, which is the difference between the average yield earned on our interest-earning assets and the average rate paid on our interest-bearing liabilities, as well as a function of the average balance of interest-earning assets compared to interest-bearing liabilities. Also contributing to our earnings is noninterest income, which consists primarily of service charges and fees on loan and deposit products and services, net gains and losses on sale of assets, and mortgage loan service fees. Net interest income and noninterest income are offset by provisions for loan losses, general administrative and other expenses, including salaries and employee benefits and occupancy and equipment costs, as well as by state and federal income tax expense.

The Bank has a strong mortgage lending focus, with loan originations in single-family residential mortgages, which has enabled it to successfully market home equity loans, as well as a wide range of shorter term consumer loans for various personal needs (automobiles, recreational vehicles, etc.). In recent years we have also focused on adding commercial loans to our portfolio, both real estate and non-real estate. We have made significant progress in this initiative. As of December 31, 2018, commercial real estate and commercial business loans represented 53.13% and 12.43% of the total loan portfolio, respectively. The purpose of this diversification is to mitigate our dependence on the mortgage market, as well as to improve our ability to manage our interest rate spread. The Bank's management

recognizes that fee income will also enable it to be less dependent on specialized lending and it maintains a significant loan serviced portfolio, which provides a steady source of fee income. As of December 31, 2018, we had mortgage servicing rights, net of \$7.10 million compared to \$6.58 million as of December 31, 2017. Gain on sale of loans also provides significant fee income or noninterest income in periods of high mortgage loan origination volumes. Such income will be adversely affected in periods of lower mortgage activity.

Fee income is also supplemented with fees generated from our deposit accounts. The Bank has a high percentage of non-maturity deposits, such as checking accounts and savings accounts, which allows management flexibility in managing its spread. Non-maturity deposits and certificates of deposit do not automatically reprice as interest rates rise.

In recent years, management's focus has been on improving our core earnings. Core earnings can be described as income before taxes, with the exclusion of gain on sale of loans and adjustments to the market value of our loans serviced portfolio. Management believes that we will need to continue to focus on increasing net interest margin, other areas of fee income, and control operating expenses to achieve earnings growth going forward. Management's strategy of growing the loan portfolio and deposit base is expected to help achieve these goals: loans typically earn higher rates of return than investments; a larger deposit base will yield higher fee income; increasing the asset base will reduce the relative impact of fixed operating costs. The biggest challenge to management's strategy is funding the growth of our balance sheet in an efficient manner. Though deposit growth this last year was steady, it may become more difficult to maintain due to significant competition and possible reduced customer demand for deposits as customers may shift into other asset classes.

## Table of Contents

Other than in limited circumstances for certain high-credit-quality customers, we do not offer “interest only” mortgage loans on residential 1-4 family properties (where the borrower pays interest but no principal for an initial period, after which the loan converts to a fully amortizing loan). We also do not offer loans that provide for negative amortization of principal, such as “Option ARM” loans, where the borrower can pay less than the interest owed on their loan, resulting in an increased principal balance during the life of the loan. We do not offer “subprime loans” (loans that generally target borrowers with weakened credit histories typically characterized by payment delinquencies, previous charge-offs, judgments, bankruptcies, or borrowers with questionable repayment capacity as evidenced by low credit scores or high debt-burden ratios) or Alt-A loans (traditionally defined as loans having less than full documentation).

The level and movement of interest rates impacts the Bank’s earnings as well. The Federal Open Market Committee (“FOMC”) increased the federal funds target rate during the year ended December 31, 2018 from 1.50% to 2.50%.

From time to time the Bank has considered growth through mergers or acquisition as an alternative to its strategy of organic growth. On September 5, 2017, the Company entered into an Agreement and Plan of Merger with TwinCo, a Montana corporation, and TwinCo’s wholly-owned subsidiary, Ruby Valley Bank, a Montana chartered commercial bank to acquire 100% of TwinCo’s equity voting interests. The merger agreement provided that Ruby Valley Bank would merge with and into Opportunity Bank of Montana and that TwinCo would merge with and into the Company. Ruby Valley Bank operated 2 branches in Madison County, Montana. The transaction provided an opportunity to expand market presence and lending activities, particularly in agricultural lending. The acquisition closed January 31, 2018, after receipt of approvals from regulatory authorities, approval of TwinCo shareholders and the satisfaction of other closing conditions. The total consideration paid was \$18.93 million and included cash consideration of \$9.90 million and common stock issued of \$9.03 million.

Effective January 1, 2019, Eagle completed its previously announced merger (the “Merger”) with Big Muddy Bancorp, Inc. (“BMB”), pursuant to an Agreement and Plan of Merger, dated as of August 21, 2018, by and among Eagle, Opportunity Bank of Montana, BMB and BMB’s wholly-owned subsidiary, The State Bank of Townsend, a Montana chartered commercial bank (“SBOT”). At the effective time of the Merger, BMB merged with and into Eagle, with Eagle continuing as the surviving corporation. SBOT operates four branches in Townsend, Dutton, Denton and Choteau, Montana. Eagle acquired approximately \$108.00 million in assets, \$92.00 million in deposits and \$92.00 million in gross loans based on BMB’s September 30, 2018 financial statements.

## Recent Accounting Pronouncements

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606). This guidance is a comprehensive new revenue recognition standard that supersedes substantially all existing revenue recognition guidance. The new standard’s core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. In doing so, companies will need to use more judgment and make

more estimates than under existing guidance. These may include identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. In July 2015, the FASB agreed to delay the effective date of the standard by one year. Therefore, the new standard was effective in the first quarter of 2018 and was adopted by the Company.

Our revenue is comprised of net interest income on financial assets and financial liabilities, which is explicitly excluded from the scope of ASU 2014-09, and non-interest income. The largest percentage of our non-interest income is derived from the gain on sale of mortgage loans. The gains are recognized at the time of the sale of the loan, when proceeds are sent to us by the investor purchasing the loan.

No change in the recognition of revenue on that portion of our noninterest income was recognized. We also evaluated the impact of this standard on our revenue from our wealth management division and it did not have a significant impact on our consolidated financial statements.

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



Table of Contents

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842) intended to improve financial reporting regarding leasing transactions. The new standard affects all companies and organizations that lease assets. The standard will require organizations to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases if the lease terms are more than 12 months. The guidance also will require qualitative and quantitative disclosures providing additional information about the amounts recorded in the financial statements. The amendments in this update are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company is evaluating the potential impact of the amendment on the Company's consolidated financial statements. We currently lease seven locations that serve as full-service branches, with the longest running lease expiring in 2028. We are using a third party vendor to assist with the implementation of this standard.

In September 2016, the FASB issued ASU No. 2016-13, Financial Instruments – Credit Losses (Topic 326) intended to improve financial reporting by requiring timelier recording of credit losses on loans and other financial instruments held by financial institutions and other organizations. The standard requires an organization to measure all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. The standard also requires enhanced disclosures to help investors and other financial statement users better understand significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization's portfolio. These disclosures include qualitative and quantitative requirements that provide additional information about the amounts recorded in the financial statements. Additionally, the standard amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration.

The amendments in this update are effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. All entities may adopt the amendments in this update earlier as of the fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. An entity will apply the amendments in this update through a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective (that is, a modified-retrospective approach).

The Company believes the amendments in this update will have an impact on the Company's consolidated financial statements and is working to evaluate the significance of that impact. In that regard, we have established a working group under the direction of our Chief Financial Officer and Chief Credit Officer. The group is composed of individuals from the finance and credit administration areas of the Company. We are currently developing an implementation plan, including assessment of processes, segmentation of the loan portfolio and identifying and adding data fields necessary for analysis. The adoption of this standard is likely to result in an increase in the allowance for loan and lease losses as a result of changing from an "incurred loss" model to an "expected loss" model. While we currently cannot reasonably estimate the impact of adopting this standard, we expect the impact will be influenced by the composition, characteristics and quality of our loan and securities portfolios, as well as the general economic conditions and forecasts as of the adoption date.

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

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

Table of Contents

**Critical Accounting Policies**

Certain accounting policies are important to the understanding of our financial condition, since they require management to make difficult, complex or subjective judgments, some of which may relate to matters that are inherently uncertain. Estimates associated with these policies are susceptible to material changes as a result of changes in facts and circumstances, including, but without limitation, changes in interest rates, performance of the economy, financial condition of borrowers and laws and regulations. The following are the accounting policies we believe are critical.

**Allowance for Loan Losses**

We recognize that losses will be experienced on loans and that the risk of loss will vary with, among other things, the type of loan, the creditworthiness of the borrower, general economic conditions and the quality of the collateral for the loan. We maintain an allowance for loan losses to absorb losses inherent in the loan portfolio. The allowance for loan losses represents management's estimate of probable losses based on all available information. The allowance for loan losses is based on management's evaluation of the collectability of the loan portfolio, including past loan loss experience, known and inherent losses, information about specific borrower situations and estimated collateral values, and current economic conditions. The loan portfolio and other credit exposures are regularly reviewed by management in its determination of the allowance for loan losses. The methodology for assessing the appropriateness of the allowance includes a review of historical losses, internal data including delinquencies among others, industry data, and economic conditions.

As an integral part of their examination process, the FRB and the Montana Division of Banking will periodically review our allowance for loan losses and may require us to make additional provisions for estimated losses based upon judgments different from those of management. In establishing the allowance for loan losses, loss factors are applied to various pools of outstanding loans. Loss factors are derived using our historical loss experience and may be adjusted for factors that affect the collectability of the portfolio as of the evaluation date. Commercial business loans that are criticized are evaluated individually to determine the required allowance for loan losses and to evaluate the potential impairment of such loans under FASB ASC Topic 310 *Receivables*. Although management believes that it uses the best information available to establish the allowance for loan losses, future adjustments to the allowance for loan losses may be necessary and results of operations could be adversely affected if circumstances differ substantially from the assumptions used in making the determinations. Because future events affecting borrowers and collateral cannot be predicted with certainty, there can be no assurance that the existing allowance for loan losses is adequate or that increases will not be necessary should the quality of loans deteriorate as a result of the factors discussed previously. Any material increase in the allowance for loan losses may adversely affect our financial condition and results of operations. The allowance is based on information known at the time of the review. Changes in factors underlying the assessment could have a material impact on the amount of the allowance that is necessary and the amount of provision to be charged against earnings. Such changes could impact future results.

## Valuation of Investment Securities

All of our investment securities are classified as available-for-sale and recorded at current fair value. Unrealized gains or losses, net of deferred taxes, are reported in other comprehensive income as a separate component of shareholders' equity. In general, fair value is based upon quoted market prices of identical assets, when available. If quoted market prices are not available, fair value is based upon valuation models that use cash flow, security structure and other observable information. Where sufficient data is not available to produce a fair valuation, fair value is based on broker quotes for similar assets. Broker quotes may be adjusted to ensure that financial instruments are recorded at fair value. Adjustments may include unobservable parameters, among other things. No adjustments were made to any broker quotes received by us.

We conduct a quarterly review and evaluation of our investment securities to determine if any declines in fair value are other than temporary. In making this determination, we consider the period of time the securities were in a loss position, the percentage decline in comparison to the securities' amortized cost, the financial condition of the issuer, if applicable, and the delinquency or default rates of underlying collateral. We consider our intent to sell the investment securities and the likelihood that we will not have to sell the investment securities before recovery of their cost basis. If impairment exists, credit related impairment losses are recorded in earnings while noncredit related impairment losses are recorded in accumulated other comprehensive income.

Table of Contents

**Deferred Income Taxes**

We use the asset and liability method of accounting for income taxes as prescribed in FASB ASC Topic 740 *Income Taxes*. Using this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. If current available information raises doubt as to the realization of the deferred tax assets, a valuation allowance is established. Deferred tax assets and liabilities are measured using enacted tax rates expected to be applied to taxable income in the years in which those temporary differences are expected to be recovered or settled. We exercise significant judgment in evaluating the amount and timing of recognition of the resulting tax liabilities and assets. These judgments require us to make projections of future taxable income. The judgments and estimates we make in determining our deferred tax assets, which are inherently subjective, are reviewed on an ongoing basis as regulatory and business factors change. A reduction in estimated future taxable income could require us to record a valuation allowance. Changes in levels of valuation allowances could result in increased income tax expense, and could negatively affect earnings.

**Financial Condition**

***December 31, 2018 compared to December 31, 2017***

Total assets increased \$137.12 million, or 19.1%, to \$853.90 million at December 31, 2018 from \$716.78 million at December 31, 2017. The largest driver of the increase was the increase in loans receivable, net, partly due to the acquisition of TwinCo. Loans receivable, net increased by \$102.93 million or 20.3%, to \$610.33 million at December 31, 2018 from \$507.40 million at December 31, 2017. Total liabilities increased by \$125.93 million, or 19.9%, to \$759.10 million from \$633.17 million at December 31, 2017. The increase was primarily due to an increase in deposits due in part to the TwinCo acquisition, as well as an increase in FHLB advances and other borrowings. Total deposits increased \$106.05 million or 20.4%, to \$626.61 million at December 31, 2018 from \$520.56 million at December 31, 2017. FHLB advances and other borrowings increased \$19.25 million to \$102.22 million at December 31, 2018 compared to \$82.97 million at December 31, 2017. Total shareholders' equity increased \$11.19 million to \$94.81 million at December 31, 2018 compared to \$83.62 million at December 31, 2017.

**Balance Sheet Details**

***Investment Activities***

We maintain a portfolio of investment securities, classified as either available-for-sale (including those accounted for under FASB ASC Topic 825) or held-to-maturity to enhance total return on investments. Our investment securities include U.S. government and agency obligations, Small Business Administration pools, municipal securities, mortgage-backed securities (“MBSs”), collateralized mortgage obligations (“CMOs”), asset-backed securities (“ABSs”), and corporate obligations, all with varying characteristics as to rate, maturity and call provisions. There were no held-to-maturity investment securities included in the investment portfolio at December 31, 2018 or 2017. All investment securities included in the investment portfolio are available-for-sale. Eagle also has interest-bearing deposits in other banks and stock in FHLB and FRB.

The following table summarizes investment activities:

	December 31, 2018		2017		2016			
	Fair Value	Percentage of Total	Fair Value	Percentage of Total	Fair Value	Percentage of Total		
(Dollars in Thousands)								
Securities available-for-sale:								
U.S. government and agency	\$9,347	6.22	% \$4,857	3.48	% 5,608	4.18	%	
Municipal obligations	68,278	45.44	% 67,886	48.66	% 67,664	50.45	%	
Corporate obligations	11,119	7.40	% 14,644	10.50	% 9,307	6.94	%	
Mortgage-backed securities	19,348	12.88	% 24,869	17.82	% 29,512	22.01	%	
Collateralized mortgage obligations	23,875	15.89	% 19,788	14.18	% 16,345	12.19	%	
Asset-backed securities	10,198	6.79	% -	0.00	% -	0.00	%	
Total securities available-for-sale	142,165	94.62	% 132,044	94.64	% 128,436	95.77	%	
Interest-bearing deposits	1,057	0.70	% 1,920	1.38	% 787	0.59	%	
FHLB capital stock, at cost	5,011	3.33	% 4,086	2.93	% 4,012	2.99	%	
FRB capital stock, at cost	2,033	1.35	% 1,465	1.05	% 871	0.65	%	
Total	\$ 150,266	100.00	% \$ 139,515	100.00	% 134,106	100.00	%	

Table of Contents

Securities available-for-sale increased \$10.13 million or 7.7%, to \$142.17 million at December 31, 2018 compared to \$132.04 million at December 31, 2017. The net increase was due in part to the acquisition of TwinCo. The largest increase in securities available-for-sale was for ABSs, which increased to \$10.20 million at December 31, 2018 primarily due to purchase activity. U.S. government and agency securities increased \$4.49 million, also primarily due to purchase activity. CMOs increased \$4.09 million mainly due to purchase activity. Municipal obligations increased slightly by \$392,000 due to investment purchases largely offset by investment sales. MBSs decreased \$5.52 million primarily due to principal payments. MBSs sales activity was offset by purchases activity. Corporate obligations decreased by \$3.53 million largely due to investment sales and the maturities.

Table of Contents

The following table sets forth information regarding the values, weighted average yields and maturities of investments. The yields on municipal bonds have been computed on a tax equivalent basis.

	December 31, 2018											
	One Year or Less	One to Five Years	Five to Ten Years	After Ten Years	Total Investment Securities							
	Fair Value	Annualized Weighted Average Value	Fair Value	Annualized Weighted Average Value	Fair Value	Annualized Weighted Average Value	Fair Value	Annualized Weighted Average Value	Fair Value	Annualized Weighted Average Value	Approximate Market Value	Annualized Weighted Average Yield
		Yield		Yield		Yield		Yield				Yield
(Dollars in Thousands)												
Securities available-for-sale:												
U.S. government and agency	\$-	-	% \$2,222	2.44%	\$3,892	2.75%	\$3,233	2.75%	\$9,347	\$9,347		2.68%
Municipal obligations	-	-	1,692	2.89	8,147	2.89	58,439	3.03	68,278	68,278		3.00
Corporate obligations	-	-	11,119	2.87	-	-	-	-	11,119	11,119		2.87
Mortgage-backed securities <sup>(1)</sup>	-	-	-	-	461	1.98	18,887	3.75	19,348	19,348		3.71
Collateralized mortgage obligations	-	-	9,890	1.90	6,581	2.90	7,404	2.61	23,875	23,875		2.40
Asset-backed securities	-	-	-	-	-	-	10,198	3.00	10,198	10,198		3.00
Total securities available-for-sale	-	-	24,923	2.45	19,081	2.84	98,161	3.12	142,165	142,165		2.96
Interest-bearing deposits	1,057	1.11	-	-	-	-	-	-	1,057	1,057		1.11
Federal funds sold	-	-	-	-	-	-	-	-	-	-		-
FHLB capital stock (no maturity)	-	-	-	-	-	-	-	-	5,011	5,011		5.26
FRB capital stock (no maturity)	-	-	-	-	-	-	-	-	2,033	2,033		6.00
Total	\$1,057	1.11%	\$24,923	2.45%	\$19,081	2.84%	\$98,161	3.12%	\$150,266	\$150,266		3.07%



(1)  
Mortgage-backed securities are shown at their final maturity date. They provide on-going liquidity for the Company through scheduled and prepaid principal payments on a monthly basis.

30

---

Table of Contents***Lending Activities***

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

	December 31, 2018		2017		2016		2015		2014			
	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total		
	(Dollars in thousands)											
Real estate loans:												
Residential 1-4 family <sup>(1)</sup>	\$116,939	18.92 %	\$109,911	21.37 %	113,262	24.24 %	118,133	28.95 %	103,420	32.40 %		
Residential 1-4 family construction	27,168	4.40 %	25,306	4.92 %	20,540	4.40 %	22,958	5.63 %	10,149	3.18 %		
Total residential 1-4 family	144,107	23.32 %	135,217	26.29 %	133,802	28.64 %	141,091	34.58 %	113,569	35.58 %		
Commercial real estate	256,784	41.54 %	194,805	37.88 %	166,932	35.73 %	141,011	34.55 %	109,126	34.18 %		
Commercial construction and development	41,739	6.75 %	38,351	7.46 %	41,810	8.95 %	23,450	5.75 %	4,275	1.34 %		
Farmland	29,915	4.84 %	11,627	2.26 %	6,185	1.32 %	3,469	0.85 %	2,704	0.85 %		
Total commercial real estate	328,438	53.13 %	244,783	47.60 %	214,927	46.00 %	167,930	41.15 %	116,105	36.37 %		
Total real estate loans	472,545	76.45 %	380,000	73.89 %	348,729	74.64 %	309,021	75.73 %	229,674	71.95 %		
Other loans:												
Home equity	52,159	8.44 %	52,672	10.24 %	49,018	10.49 %	45,345	11.11 %	40,123	12.57 %		
Consumer	16,565	2.68 %	15,712	3.06 %	14,800	3.16 %	14,641	3.59 %	13,827	4.33 %		
Commercial	59,053	9.56 %	63,300	12.31 %	52,795	11.30 %	37,174	9.10 %	35,364	11.08 %		
Agricultural	17,709	2.87 %	2,563	0.50 %	1,911	0.41 %	1,898	0.47 %	218	0.07 %		
Total commercial	76,762	12.43 %	65,863	12.81 %	54,706	11.71 %	39,072	9.57 %	35,582	11.15 %		

Edgar Filing: Eagle Bancorp Montana, Inc. - Form 10-K

loans

Total other loans	145,486	23.55 %	134,247	26.11 %	118,524	25.36 %	99,058	24.27 %	89,532	28.05 %
Total loans	618,031	100.00 %	514,247	100.00 %	467,253	100.00 %	408,079	100.00 %	319,206	100.00 %
Deferred loan fees	(1,098 )		(1,093 )		(1,092 )		(795 )		(486 )	
Allowance for loan losses	(6,600 )		(5,750 )		(4,770 )		(3,550 )		(2,450 )	
Total loans, net	\$610,333		\$507,404		461,391		403,734		316,270	

31

---

Table of Contents*Lending Activities*

Loans receivable increased \$102.93 million to \$610.33 at December 31, 2018 due in part to the TwinCo acquisition. The TwinCo acquisition included \$55.06 million of acquired loans. Excluding acquired loans, loans receivable, net increased by \$47.87 million. Including acquired loans, total commercial real estate loans increased \$83.65 million, total commercial loans increased \$10.90 million, total residential loans increased \$8.89 million, and consumer loans increased \$853,000. These increases were slightly offset by a decrease in home equity loans of \$513,000. Total loan originations were \$517.47 million for the year ended December 31, 2018, with total residential 1-4 family accounting for \$346.44 million of the total. Total commercial real estate originations were \$97.71 million. Total commercial and home equity loan originations totaled \$49.12 million and \$14.94 million, respectively, for the same period. Consumer loan originations totaled \$9.26 million. Loans held-for-sale decreased by \$1.63 million, to \$7.32 million at December 31, 2018 from \$8.95 million at December 31, 2017.

*Loan Maturities.* The following table sets forth the estimated maturity of the loan portfolio of the Bank at December 31, 2018. Balances exclude deferred loan fees and allowance for loan losses. Scheduled principal repayments of loans do not necessarily reflect the actual life of such assets. The average life of a loan is typically substantially less than its contractual terms because of prepayments. In addition, due on sale clauses on loans generally give the Bank the right to declare loans immediately due and payable in the event, among other things, the borrower sells the real property, subject to the mortgage, and the loan is not paid off. All mortgage loans are shown to be maturing based on the date of the last payment required by the loan agreement, except as noted.

Loans having no stated maturity, those without a scheduled payment, demand loans and matured loans, are shown as due within six months.

	One Year  or Less	One to Five Years	After 5 Years	Total
Total residential 1-4 family <sup>(1)</sup>	\$24,848	\$4,108	\$122,469	\$151,425
Total commercial real estate	38,028	15,890	274,520	328,438
Home equity	4,483	10,485	37,191	52,159
Consumer	1,833	10,096	4,636	16,565
Total Commercial	29,123	25,156	22,483	76,762
Total loans <sup>(1)</sup>	\$98,315	\$65,735	\$461,299	\$625,349

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



Table of Contents

The following table includes loans by fixed or adjustable rates at December 31, 2018:

	Fixed	Adjustable	Total
	(Dollars in Thousands)		
Due after December 31, 2019:			
Total residential 1 to 4 family <sup>(1)</sup>	\$71,895	\$54,682	\$126,577
Total commercial real estate	80,710	209,700	290,410
Home equity	7,016	40,660	47,676
Consumer	12,988	1,744	14,732
Total commercial	33,939	13,700	47,639
Total due after December 31, 2019 <sup>(1)</sup>	206,548	320,486	527,034
Due in less than one year	81,027	17,288	98,315
Total loans <sup>(1)</sup>	\$287,575	\$337,774	\$625,349
Percent of total	45.99 %	54.01 %	100.00 %

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

The following table sets forth information with respect to our loan originations, purchases and sales activity:

	Years Ended	
	December 31,	
	2018	2017
	(In Thousands)	
Net loans receivable at beginning of period <sup>(1)</sup>	\$516,353	\$479,621
Loans originated:		
Total residential 1-4 family	346,437	325,979
Total commercial real estate	97,706	80,068
Home equity	14,938	20,714
Consumer	9,261	9,139
Total commercial	49,125	36,869
Total loans originated	517,467	472,769
Loans sold:		
Whole loans	279,740	288,939
Principal repayments and loan refinancings	137,284	148,079

Deferred loan fees increase	5	1
Allowance for losses increase	850	980
Net loan increase	101,298	36,732
Net loans receivable at end of period <sup>(1)</sup>	\$617,651	\$516,353

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

Table of Contents

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

For mortgage loans and home equity loans, if the borrower is unable to cure the delinquency or reach a payment agreement, we will institute foreclosure actions. If a foreclosure action is taken and the loan is not reinstated, paid in full or refinanced, the property is sold at judicial sale at which we may be the buyer if there are no adequate offers to satisfy the debt. Any property acquired as the result of foreclosure, or by deed in lieu of foreclosure, is classified as real estate owned until such time as it is sold or otherwise disposed of. When real estate owned is acquired, it is recorded at its fair market value less estimated selling costs. The initial recording of any loss is charged to the allowance for loan losses. Subsequent write-downs are recorded as a charge to operations. As of December 31, 2018, the Bank had \$107,000 of real estate owned.

Loans are reviewed on a quarterly basis and are placed on non-accrual status when they are 90 days or more delinquent. Loans may be placed on non-accrual status at any time if, in the opinion of management, the collection of additional interest is doubtful. Interest accrued and unpaid at the time a loan is placed on non-accrual status is charged against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured. At December 31, 2018, we had \$2.29 million (there were no specific reserves for loan losses) of loans that were nonperforming and held on non-accrual status.

The following table provides information regarding the Bank's loans that are delinquent 30 to 89 days:

	December 31, 2018			
	Number		Percentage of	
	Amount		Total	
	(Dollars in Thousands)			
Loan type:				
Real estate loans:				
Residential 1-4 family	5	\$ 381	18.75	%
Residential 1-4 family construction	1	118	5.81	%
Commercial real estate	3	975	47.98	%
Commercial construction and development	1	9	0.44	%
Other loans:				
Home equity	2	39	1.92	%



Edgar Filing: Eagle Bancorp Montana, Inc. - Form 10-K

Consumer	26	135	6.64	%
Commercial	5	284	13.98	%
Agricultural	2	91	4.48	%
Total	45	\$ 2,032	100.00	%

34

---

Table of Contents

The following table sets forth information regarding nonperforming assets:

	December 31,				
	2018	2017	2016	2015	2014
	(Dollars in Thousands)				
Non-accrual loans					
Real estate loans:					
Residential 1-4 family	\$253	\$475	\$221	\$730	\$821
Residential 1-4 family construction	634	-	-	-	-
Commercial real estate	432	-	-	667	-
Commercial construction and development	13	-	-	-	-
Other loans:					
Home equity	469	242	297	161	48
Consumer	127	153	96	145	16
Commercial	308	107	-	327	77
Agricultural	32	-	-	-	-
Accruing loans delinquent 90 days or more					
Real estate loans:					
Residential 1-4 family	130	-	456	221	-
Residential 1-4 family construction	-	-	-	247	-
Commercial real estate	1,347	-	4	4	-
Other loans:					
Home equity	-	-	35	-	-
Restructured loans					
Other loans:					
Home equity	22	-	43	46	48
Total nonperforming loans	3,767	977	1,152	2,548	1,010
Real estate owned and other repossessed property, net	107	525	825	595	637
Total nonperforming assets	\$3,874	\$1,502	\$1,977	\$3,143	\$1,647
Total nonperforming loans to total loans	0.61 %	0.19 %	0.25 %	0.63 %	0.32 %
Total nonperforming loans to total assets	0.44 %	0.14 %	0.17 %	0.40 %	