

EnPro Associates, LLC  
Form S-4/A  
May 04, 2015  
Table of Contents

As filed with the Securities and Exchange Commission on May 4, 2015

Registration No. 333-203020

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**  
**AMENDMENT NO. 1**  
**TO**  
**FORM S-4**  
**REGISTRATION STATEMENT UNDER THE**  
**SECURITIES ACT OF 1933**

**ENPRO INDUSTRIES, INC.\***

(Exact name of registrant, as specified in its charter)

<b>North Carolina</b> (State or other jurisdiction of incorporation or organization)	<b>3590</b> (Primary Standard Industrial Code Number)	<b>01-0573945</b> (I.R.S. Employer Identification No.)
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**5605 Carnegie Boulevard, Suite 500**

**Charlotte, North Carolina 28209**

**(704) 731-1500**

(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

**Robert S. McLean**

**Vice President, General Counsel and Secretary**

**EnPro Industries, Inc.**

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**5605 Carnegie Boulevard, Suite 500**

**Charlotte, North Carolina 28209**

**(704) 731-1519**

(Name, address, including zip code, and telephone number, including area code, of agent for service)

*Copies to:*

**Stephen M. Lynch**

**Robinson, Bradshaw & Hinson, P.A.**

**101 North Tryon Street, Suite 1900**

**Charlotte, North Carolina 28246**

**(704) 377-8355**

\* The co-registrants listed on the next page are also included in this Form S-4 Registration Statement as additional registrants.

Approximate date of commencement of proposed sale to the public: As soon as practicable after this Registration Statement becomes effective.

If the securities being registered on this form are being offered in connection with the formation of a holding company and there is compliance with General Instruction G, check the following box "

If this form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. "

If this form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. "

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

If applicable, place an X in the box to designate the appropriate rule provision relied upon in conducting this transaction:

Exchange Act Rule 13e-4(i) (Cross-Border Issuer Tender Offer)

Exchange Act Rule 14d-1(d) (Cross-Border Third-Party Tender Offer) "

**The Registrants hereby amend this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrants shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933, or until this Registration Statement shall become effective on such date as the Securities and Exchange Commission, acting pursuant to said Section 8(a), may determine.**

**Table of Contents****TABLE OF ADDITIONAL REGISTRANTS**

<b>Exact Name of</b>	<b>Primary Standard</b>	<b>Jurisdiction of</b>	<b>I.R.S. Employer</b>
	<b>Industrial</b>		
<b>Additional Registrants*</b>	<b>Number</b>	<b>Formation</b>	<b>Identification No.</b>
Applied Surface Technology, Inc.	2390	California	94-3215818
Advanced Transit Dynamics, Inc.	3714	Delaware	20-5951765
Belfab, Inc.	2390	Delaware	20-4190001
Coltec Industries Inc	3590	Pennsylvania	13-1846375
Coltec International Services Co.	7380	Delaware	13-3895074
Compressor Products International LLC	3590	Delaware	26-0040341
EnPro Associates, LLC	7380	North Carolina	46-3446145
Garlock Pipeline Technologies, Inc.	3050	Colorado	84-1178066
GGB LLC	3562	Delaware	22-3661977
GGB, Inc.	7380	Delaware	56-2258305
SD Friction, LLC	3714	Delaware	46-3701250
Stemco Holdings, Inc.	3714	Delaware	65-1237730
STEMCO Kaiser Incorporated	3714	Michigan	38-1684860
Stemco LP	3714	Texas	20-2064000
Stemco Products, Inc.	3714	Delaware	76-0801919
Technetics Group Daytona, Inc.	2390	Delaware	20-4189961
Technetics Group LLC	2390	North Carolina	45-2824227
Technetics Group Oxford, Inc.	2390	Delaware	30-0001515

\* The address and agent for service of process for each of the additional registrants are the same as for EnPro Industries, Inc. The additional registrants are wholly owned subsidiaries of EnPro Industries, Inc. and are guarantors of the notes being registered hereby. Such guarantees are full and unconditional and joint and several. The guarantee of a subsidiary guarantor will be automatically and unconditionally released and discharged without any action on the part of the trustee or the holders of the notes in the situations set forth in the prospectus.

**Table of Contents**

The information in this prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

**Subject to completion, dated May 4, 2015**

**PROSPECTUS**

**EnPro Industries, Inc.**

**Offer to Exchange All Outstanding \$300,000,000 5.875% Senior Notes due 2022**

**for**

**\$300,000,000 5.875% Senior Notes due 2022**

**which have been registered under the Securities Act**

We are offering to exchange new 5.875% Senior Notes due 2022 (which we refer to as the new notes ) for our currently outstanding 5.875% Senior Notes due 2022 (which we refer to as the old notes ) on the terms and subject to the conditions detailed in this prospectus and the accompanying letter of transmittal.

The exchange offer will expire at 5:00 p.m., New York City time, on \_\_\_\_\_, 2015, unless extended.

All old notes that are validly tendered and not validly withdrawn will be exchanged.

Tenders of old notes may be withdrawn any time prior to 5:00 p.m., New York City time, on the date of expiration of the exchange offer.

The exchange of notes will not be a taxable exchange for U.S. federal income tax purposes.

We will not receive any proceeds from the exchange offer.

The terms of the new notes to be issued are identical in all material respects to the outstanding old notes, except that the new notes have been registered under the Securities Act of 1933, as amended, or the Securities Act, and will not have any of the transfer restrictions and certain additional interest provisions relating to the old notes. The new notes will represent the same debt as the old notes and we will issue the new notes under the same indenture.

We do not intend to apply for listing of the new notes on any securities exchange or to arrange for them to be quoted on any quotation system. A public market for the new notes may not develop, which could make selling the new notes difficult.

Each broker-dealer that receives new notes for its own account pursuant to the exchange offer must acknowledge that it will deliver a prospectus in connection with any resale of such new notes. The letter of transmittal states that by so acknowledging and by delivering a prospectus, a broker-dealer will not be deemed to admit that it is an underwriter within the meaning of the Securities Act. This prospectus, as it may be amended or supplemented from time to time, may be used by a broker-dealer in connection with resales of new notes received in exchange for old notes where such old notes were acquired by such broker-dealer as a result of market-making activities or other trading activities. We have agreed that, for a period of 180 days after consummation of the exchange offer, we will make this prospectus available to any broker-dealer for use in connection with any such resale. See Plan of Distribution.

**See Risk Factors beginning on page 25 for a discussion of matters that participants in the exchange offer should consider.**

**Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon the adequacy or accuracy of this prospectus. Any representation to the contrary is a criminal offense.**

The date of this prospectus is \_\_\_\_\_, 2015

Table of Contents

## TABLE OF CONTENTS

	<b>Page</b>
<u>NON-GAAP FINANCIAL MEASURES</u>	ii
<u>CAUTIONARY DISCLOSURE REGARDING FORWARD-LOOKING STATEMENTS</u>	ii
<u>MARKET DATA</u>	iii
<u>BASIS OF FINANCIAL INFORMATION</u>	iii
<u>WHERE YOU CAN FIND MORE INFORMATION AND INCORPORATION BY REFERENCE</u>	iii
<u>SUMMARY</u>	1
<u>RISK FACTORS</u>	25
<u>USE OF PROCEEDS</u>	42
<u>CAPITALIZATION</u>	43
<u>RATIO OF EARNINGS TO FIXED CHARGES</u>	45
<u>SELECTED HISTORICAL CONSOLIDATED FINANCIAL INFORMATION</u>	46
<u>BUSINESS OVERVIEW</u>	49
<u>BOARD OF DIRECTORS AND MANAGEMENT</u>	62
<u>DESCRIPTION OF OTHER INDEBTEDNESS</u>	67
<u>THE EXCHANGE OFFER</u>	71
<u>DESCRIPTION OF THE NOTES</u>	82
<u>BOOK-ENTRY, DELIVERY AND FORM</u>	147
<u>MATERIAL U.S. FEDERAL INCOME TAX CONSIDERATIONS</u>	149
<u>PLAN OF DISTRIBUTION</u>	150
<u>LEGAL MATTERS</u>	151
<u>EXPERTS</u>	151

Rather than repeat certain information in this prospectus that we have already included in reports filed with the Securities and Exchange Commission (the "SEC"), this prospectus incorporates important business and financial information about us that is not included in or delivered with this prospectus. We will provide this information to you at no charge upon written or oral request directed to: Dan Grgurich, Director, Investor Relations and Corporate Communications, EnPro Industries, Inc., 5605 Carnegie Boulevard, Suite 500, Charlotte, NC 28209-4674, telephone (704) 731-1500. In order to ensure timely delivery of the information, any request should be made no later than five business days before the expiration date of the exchange offer.

You should rely only on the information contained or incorporated by reference in this document or to which we have referred you. We have not authorized anyone to provide you with information that is different. The information contained or incorporated by reference in this prospectus speaks only as of the date of the document containing such information. Our business, financial condition, liquidity, results of operations and prospects may have changed subsequent to any such date.

**WE ARE NOT MAKING THE EXCHANGE OFFER TO, NOR WILL WE ACCEPT SURRENDERS FOR EXCHANGE FROM, HOLDERS OF OLD NOTES IN ANY JURISDICTION IN WHICH THE APPLICABLE EXCHANGE OFFER WOULD NOT BE IN COMPLIANCE WITH THE SECURITIES OR BLUE SKY LAWS OF SUCH JURISDICTION OR WHERE IT IS OTHERWISE UNLAWFUL.**





**Table of Contents**

**NON-GAAP FINANCIAL MEASURES**

We have provided EBITDA, Adjusted EBITDA, Segment EBITDA and a ratio of total net debt to Adjusted EBITDA, all of which are not financial measures under generally accepted accounting principles in the United States ( GAAP ), in this prospectus because we believe they provide investors with additional information to measure our operating performance and evaluate our ability to service our debt. Our method for calculating these non-GAAP financial measures may differ from other companies' methods and may not be comparable to similarly titled measures reported by other companies. These measures are not recognized under GAAP, and we do not intend for this information to be considered in isolation or as a substitute for GAAP measures. For a reconciliation of these non-GAAP financial measures to the most directly comparable GAAP financial measures, see Summary Summary Historical Consolidated Financial Information and Other Data, and related footnotes, included elsewhere in this prospectus.

**CAUTIONARY DISCLOSURE REGARDING FORWARD-LOOKING STATEMENTS**

This prospectus and the information incorporated by reference herein includes statements that reflect projections or expectations of our future financial condition, results of operations and business that are subject to risk and uncertainty. When used in this prospectus, the words may, hope, will, should, expect, plan, anticipate, in estimate, predict, potential, continue, likely, and other expressions generally identify forward-looking statements.

We cannot guarantee actual results or events will not differ materially from those projected, estimated, assigned or anticipated in any of the forward-looking statements contained in this prospectus. Important factors that could result in those differences include those specifically noted in the forward-looking statements and those identified in Risk Factors in prospectus and in risk factors in our annual report on Form 10-K for the year ended December 31, 2014 (the 2014 Form 10-K ), which include:

the value of pending claims and the number and value of future asbestos claims against our subsidiaries;

risks inherent and potential adverse developments that may occur in the Chapter 11 reorganization proceeding involving Garlock Sealing Technologies LLC ( GST LLC ), The Anchor Packing Company ( Anchor ) and Garrison Litigation Management Group, Ltd. ( Garrison ), and together with GST LLC and Anchor, GST ), including risks presented by efforts of asbestos claimant representatives to assert claims against us based on various theories of derivative corporate responsibility, including veil piercing and alter ego;

general economic conditions in the markets served by our businesses, some of which are cyclical and experience periodic downturns;

prices and availability of raw materials; and

the amount of any payments required to satisfy contingent liabilities related to discontinued operations of our predecessors, including liabilities for certain products, environmental matters, employee benefit obligations and other matters.

We caution you not to place undue reliance on these statements, which speak only as of the date on which such statements were made.

Whenever you read or hear any subsequent written or oral forward-looking statements attributed to us or any person acting on our behalf, you should keep in mind the cautionary statements contained or referred to in this section.

**Table of Contents**

**MARKET DATA**

Market data used throughout this prospectus is based on our management's knowledge of the industry and the good faith estimates of our management. This data involves a number of assumptions and limitations, and you are cautioned not to give undue weight to such estimates.

**BASIS OF FINANCIAL INFORMATION**

On June 5, 2010 (the "Petition Date"), three of our subsidiaries, GST LLC, Anchor and Garrison filed voluntary petitions for reorganization under Chapter 11 of the United States Bankruptcy Code in the U.S. Bankruptcy Court for the Western District of North Carolina in Charlotte (the "Bankruptcy Court"). The filings were the initial step in an asbestos claims resolution process. The filings did not include EnPro Industries, Inc., or any other EnPro Industries, Inc. operating subsidiary. GST LLC now operates in the ordinary course under court protection from asbestos claims. All pending litigation against GST is stayed during the process.

The financial results of GST and subsidiaries are included in our consolidated results through June 4, 2010, the day prior to the Petition Date. However, GAAP requires an entity that files for protection under the U.S. Bankruptcy Code, whether solvent or insolvent, whose financial statements were previously consolidated with those of its parent, as GST's and its subsidiaries' were with ours, generally must be prospectively deconsolidated from the parent and the investment accounted for using the cost method. Prior to its deconsolidation effective on the Petition Date, GST LLC and its subsidiaries operated as part of the Garlock group of companies within EnPro's Sealing Products segment. Accordingly, the financial results of GST and its subsidiaries are not included in our consolidated results after June 4, 2010. See Note 18 to the audited consolidated financial statements included in the 2014 Form 10-K, which is incorporated by reference into this prospectus.

**WHERE YOU CAN FIND MORE INFORMATION AND INCORPORATION BY REFERENCE**

We are required to file annual and quarterly reports and other information with the Securities and Exchange Commission ("SEC"). You may read and copy any materials we file with the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Room 1580, Washington, D.C., 20549. Please call 1-800-SEC-0330 for further information on the operation of the Public Reference Room. Our filings are also available to the public from commercial document retrieval services and at the web site maintained by the SEC at <http://www.sec.gov>. In addition, you may obtain these materials on our website. Our Internet website address is [www.enproindustries.com](http://www.enproindustries.com). Information on our website does not constitute part of this prospectus and should not be relied upon in connection with making any decision with respect to the exchange offer.

We incorporate by reference information into this prospectus. This means that we disclose important information to you by referring you to another document filed separately with the SEC. The information in the documents incorporated by reference is considered to be part of this prospectus, and information in documents that we file later with the SEC will automatically update and supersede this information. We incorporate by reference the documents listed below filed by us under Section 13(a), 13(c), 14 or 15(d) of the Exchange Act. These documents contain important information about us and our financial condition.

Our Annual Report on Form 10-K for the fiscal year ended December 31, 2014;

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Our Definitive Proxy Statement filed on Schedule 14A on March 26, 2015;

Our Quarterly Report on Form 10-Q for the period ended March 31, 2015; and

Our Current Report on Form 8-K filed on February 20, 2015, April 8, 2015 and May 1, 2015.

In addition, all documents that we subsequently file pursuant to Section 13(a), 13(c), 14 or 15(d) of the Exchange Act (which does not include information furnished in a Current Report pursuant to Item 2.02 or Item 7.01, and any information relating thereto furnished pursuant to Item 9.01, in each case on Form 8-K),

iii

**Table of Contents**

including after the date of the initial registration statement of which this prospectus is a part and prior to effectiveness of such registration statement, prior to the termination of the exchange offer, including any period during which we have agreed to make this prospectus available to broker-dealers for resales as described herein, shall be deemed to be incorporated by reference and will, from the date of filing such documents, automatically update and supersede information contained in this prospectus as if that information were included in this prospectus. Such documents are considered to be a part of this prospectus, effective as of the date such documents are filed.

You can also obtain from us without charge copies of any document incorporated by reference in this prospectus, excluding exhibits (unless the exhibit is specifically incorporated by reference into the information that this prospectus incorporates) by requesting such materials in writing or by telephone from us at:

Dan Grgurich

Director, Investor Relations and Corporate Communications

EnPro Industries, Inc.

5605 Carnegie Boulevard

Suite 500

Charlotte, NC 28209-4674

(704) 731-1500

**IN ORDER TO OBTAIN TIMELY DELIVERY, YOU MUST REQUEST THE INFORMATION NO LATER THAN , , 2015, WHICH IS FIVE BUSINESS DAYS BEFORE THE INITIAL SCHEDULED EXPIRATION DATE OF THE EXCHANGE OFFER.**

**Table of Contents**

**SUMMARY**

*This summary highlights significant aspects of our business and the exchange offer, but it is not complete and may not contain all of the information that may be important to you. You should read this entire prospectus carefully, including the information incorporated by reference in this prospectus. Investing in the notes involves significant risks, as described in the Risk Factors section. In this prospectus, unless otherwise indicated or the context otherwise requires, references to the terms we, us, our, the Issuer, EnPro or the Company refer to EnPro Industries, Inc. and its subsidiaries. All financial data presented in this prospectus is the financial data of EnPro Industries, Inc. and its consolidated subsidiaries unless otherwise indicated.*

*The old notes consisting of the 5.875% Senior Notes due 2022, \$300,000,000 in aggregate principal amount of which were issued on September 16, 2014 and the new notes consisting of the 5.875% Senior Notes due 2022 offered pursuant to this prospectus are sometimes collectively referred to in this prospectus as the notes. This prospectus and the letter of transmittal that accompanies it collectively constitute the exchange offer.*

**Company Overview**

We are a leader in the design, development, manufacture and marketing of proprietary engineered industrial products that primarily include: sealing products; heavy-duty truck wheel-end component systems; self-lubricating non-rolling bearing products; precision engineered components and lubrication systems for reciprocating compressors; and heavy-duty, medium-speed diesel, natural gas and dual fuel reciprocating engines, including parts and services. We serve a diverse set of end markets and customers with leading brands, including Garlock®, STEMCO®, GGB® and Fairbanks Morse Engine . We believe our products are considered by our customers to be best-in-class due to a history of performance in critical and demanding applications where there is a high cost for failure. We manufacture our products at 63 primary manufacturing facilities in 13 countries. For the year ended December 31, 2014 we generated \$1,219.3 million of consolidated net sales, \$22.0 million of net income and \$155.4 million of Adjusted EBITDA, see Summary Historical Consolidated Financial Information and Other Data.

The charts below highlight our diversity of net sales by end market and geography:

*2014 Consolidated Sales by End Use Market*

*2014 Consolidated Sales by Geography*

**Consolidated Operations**

We manage our business as three segments: Sealing Products, Engineered Products, and Power Systems. Our reportable segments are managed separately based on differences in their products and services and their

**Table of Contents**

end-customers. Segment EBITDA is segment profit (which is the total segment revenue reduced by operating expenses and restructuring and other costs identifiable with the segment) before depreciation and amortization expense, see Summary Historical Consolidated Financial Information and Other Data.

The following charts set forth the sales and Segment EBITDA of each of our segments for the year ended December 31, 2014.

*Segment Sales*

*Segment EBITDA*

*(dollars in millions)*

**Table of Contents****Segment Overview of EnPro Industries**

	<b>Sealing Products</b>			<b>Engineered Products</b>		<b>Power Systems</b>
	<b>Sales(1): \$664 million</b>			<b>Sales(1): \$358 million</b>		<b>Sales(1): \$200 million</b>
	<b>Segment EBITDA(2): \$117 million</b>			<b>Segment EBITDA(2): \$49 million</b>		<b>Segment EBITDA(2): \$32 million</b>
<b>ended December 31, 2014</b>	<b>Segment EBITDA Margin(3): 18% (4)</b>			<b>Segment EBITDA Margin(3): 14%</b>		<b>Segment EBITDA Margin(3):</b>
<b>Products</b>	Gaskets & Packing	High Performance Metal Seals	Wheel End Suspension	Metal-polymer Plain Bearings	Core Compressor Products	Medium-speed Diesel, Natural Gas and Dual Fuel Engines to 24MW
	Oil Seals	Bellows	Brake Products	Bushing Blocks	Sealing Components	Parts & Service
	Bearing Isolators	Brush Seals	Innovative Tire and Mileage Solutions	Solid Polymer Bearings	Lubrication Systems	Integrated Power Systems
	Expansion Joints	Acoustic Media		Bearing Assemblies	Reciprocating Compressor	
	Flange Isolation Seal	Combustion Products		Filament Wound Plain Bearings	Reconditioning and Field Service	
	Pipeline Products	Polymer Products				
<b>Markets</b>	General Industry	Semiconductor Equipment	Medium/Heavy Duty Truck	Auto	Oil & Gas	Marine Power & Propulsion
	Oil & Gas	Aerospace	Other Industries	General Industry	PET Bottle Manufacturing	Power Generation
	Basic Materials	Power Generation		Agriculture Equipment	Chemical Processing	Oil & Gas
	Chemical Processing	General Industry		Fluid Power	Other Industries	Engine and Auxiliary Equipment Engineering
	Power Generation	Oil & Gas		Primary Metals		
	Water/Wastewater	Food & Beverage		Renewable Energy		
				Other Industries		



	Pulp and Paper					
	Other Industries					
Representative Customers	BASF	AREVA	FedEx	Alstom	Air Products	U.S. Navy
	Chevron	Applied Materials	FleetPride	Bosch	Contech	U.S. Coast Guard
	Dow		Great Dane	Caterpillar	ESSO	Naval Shipyards
	Fluor	BAE	Mack	Casappa	Gardner	Ecopetrol
	General Electric	Electricite du France	Swift	Emerson	Graham Packaging	General Dynamics NASSCO
	Saudi Aramco	General Electric	Volvo	John Deere	Maersk	Electricite du France
	ThyssenKrupp	Honeywell	Wal-Mart	Tenneco	Shell	
		Schlumberger				

- (1) Sales for each segment include intersegment sales. Intersegment sales for the year ended December 31, 2014 were \$2.7 million.
- (2) Segment EBITDA is segment profit before depreciation and amortization. Segment profit does not include an allocation of corporate expenses. For a presentation of segment profit and the calculation of segment EBITDA, see Summary Historical Consolidated Financial Information and Other Data.
- (3) Segment EBITDA Margin is Segment EBITDA divided by segment sales.
- (4) The Garlock column, and the discussion of the Sealing Products segment below, includes products, customers, competition, and raw materials for Garlock Sealing Technologies, LLC which is one of the three of our subsidiaries that filed voluntary petitions for reorganization under Chapter 11 of the United States Bankruptcy Code on June 4, 2010. The financial results of GST and subsidiaries are not included in our consolidated results after June 4, 2010 and are not included in the sales, Segment EBITDA, Segment EBITDA Margin or other financial measures of the Sealing Products segment for periods after June 4, 2010 included above or elsewhere in this prospectus.

## **Table of Contents**

### **Sealing Products Segment**

Our Sealing Products segment includes three operating divisions, Garlock, Technetics and Stemco, that serve a wide variety of industries where performance and durability are vital for safety and environmental protection. Our products are used in many demanding environments such as those characterized by high pressure, high temperature and chemical corrosion, and many of our products support critical applications with a low tolerance for failure.

The Garlock family of companies designs, manufactures and sells sealing products including: metallic, non-metallic and composite material gaskets; dynamic seals; compression packing; hydraulic components; expansion joints; flange sealing and isolation products; pipeline casing spacers/isolators; casing end seals; modular sealing systems for sealing pipeline penetrations; and safety-related signage for pipelines. These products are used in a variety of industries, including chemical and petrochemical processing, petroleum extraction and refining, pulp and paper processing, power generation, food and pharmaceutical processing, primary metal manufacturing, mining, and water and waste treatment. Among the well-known brand names are Garlock<sup>®</sup>, Gylon<sup>®</sup>, KLOZURE<sup>®</sup>, GUARDIAN<sup>®</sup>, Pikote<sup>®</sup>, EVSP<sup>®</sup>, and Gar-Seal<sup>®</sup>.

Technetics Group designs, manufactures and sells high performance metal seals; elastomeric seals; bellows and bellows assemblies; pedestals for semiconductor manufacturing; and a wide range of polytetrafluoroethylene ( PTFE ) products. These products are used in a variety of industries, including electronics and semiconductor, aerospace, power generation, oil and gas, food and beverage and other industries. Brands include Helicoflex<sup>®</sup>, Belfab<sup>®</sup>, Feltmetal<sup>®</sup>, Plastomer<sup>®</sup>, and Bio-Guardian<sup>®</sup> and Origaf<sup>®</sup>.

Stemco designs, manufactures and sells heavy-duty truck wheel-end component systems including: seals; hubcaps; mileage counters; bearings; locking nuts; brake products; suspension components; and RF-based tire pressure monitoring and inflation systems and automated mileage collection devices, as well as trailer end fairings designed to increase fuel efficiency. Its products primarily serve the medium and heavy-duty truck market. Product brands include STEMCO<sup>®</sup>, STEMCO Kaiser<sup>®</sup>, STEMCO Duroline<sup>®</sup>, STEMCO Crewson<sup>®</sup>, STEMCO Motor Wheel<sup>®</sup>, Grit Guard<sup>®</sup>, Guardian HP<sup>®</sup>, Voyager<sup>®</sup>, Discover<sup>®</sup>, Endeavor<sup>®</sup>, Pro-Torq<sup>®</sup>, Sentinel<sup>®</sup>, Data Trac<sup>®</sup>, DataTrac<sup>®</sup>, QwikKit<sup>®</sup>, Centrifuse<sup>®</sup>, Aeris<sup>™</sup> and TrailerTail<sup>®</sup>.

### ***Customers***

Our Sealing Products segment sells products to industrial agents and distributors, original equipment manufacturers ( OEMs ), engineering and construction firms and end users worldwide. Sealing products are offered to global customers, with approximately 37% of sales delivered to customers outside the United States in 2014. Representative customers are shown in the segment overview table above. In 2014, the largest customer accounted for approximately 7% of segment revenues.

### ***Raw Materials and Components***

Our Sealing Products segment uses PTFE resins, aramid fibers, specialty elastomers, elastomeric compounds, graphite and carbon, common and exotic metals, cold-rolled steel, leather, aluminum die castings, nitrile rubber, powdered metal components, and various fibers and resins. We believe all of these raw materials and components are readily available from various suppliers.

### **Engineered Products Segment**

Our Engineered Products segment includes two high performance industrial products businesses: GGB and Compressor Products International (CPI).

## **Table of Contents**

GGB designs, manufactures and sells self-lubricating, non-rolling, metal polymer, solid polymer, and filament wound bearing products, as well as aluminum bushing blocks for hydraulic applications. The bearing surfaces are made of PTFE or a mixture that includes PTFE to provide maintenance-free performance and reduced friction. GGB's bearing products typically perform as sleeve bearings or thrust washers under conditions of no lubrication, minimal lubrication or pre-lubrication and are used in a wide variety of markets such as the automotive, pump and compressor, construction, power generation and general industrial markets. GGB has approximately 20,000 bearing part numbers of different designs and physical dimensions. GGB® is a leading and well recognized brand name and sells products under the DU®, DP®, DX®, DS, HX, EP, SY and GAR-MAX names.

CPI designs, manufactures sells and services components for reciprocating compressors and engines. These components, which include, packing and wiper rings, piston and rider rings, compressor valve assemblies, divider block valves, compressor monitoring systems, lubrication systems and related components, are utilized primarily in the refining, petrochemical, natural gas gathering, storage and transmission, and general industrial markets. Brand names for our products include Hi-Flo, Valvealert, Mentor, Triple Circle, CPI Special Polymer Alloys, Twin Ring, Liard, Pro Flo, Neomag, CVP, XDC, POPR and Protecting Compressor World Wide.

## ***Customers***

The Engineered Products segment sells its products to a diverse customer base using a combination of direct sales and independent distribution networks worldwide, with approximately 73% of sales delivered to customers outside the United States in 2014. GGB has customers worldwide in all major industrial sectors, and supplies products directly to customers through GGB's own local distribution system and indirectly to the market through independent agents and distributors with their own local networks. CPI sells its products and services globally through its internal salesforce, independent sales representatives, distributors and service centers. Representative customers are shown in the segment overview table above. In 2014, the largest customer accounted for approximately 2% of segment revenues.

## ***Raw Materials***

GGB's major raw material purchases include steel coil, bronze powder, bronze coil, PTFE and aluminum. GGB sources components from a number of external suppliers. CPI's major raw material purchases include PTFE, polyetheretherketone (PEEK), compound additives, bronze, steel, and stainless steel bar stock. We believe all of these raw materials and components are readily available from various suppliers.

## **Power Systems Segment**

Our Power Systems segment designs, manufactures, sells and services heavy-duty, medium-speed diesel, natural gas and dual-fuel reciprocating engines. We market these products and services under the Fairbanks Morse Engine brand name. Products in this segment include licensed heavy-duty, medium-speed diesel, natural gas and dual fuel reciprocating engines, in addition to our own designs. The reciprocating engines range in size from 700 to 31,970 horsepower and from five to 20 cylinders. The government and the general industrial market for marine propulsion, power generation, and pump and compressor applications use these products. We have been building engines for over 115 years under the Fairbanks Morse Engine brand name and we have a large installed base of engines for which we supply aftermarket parts and service. Fairbanks Morse Engine has been a key supplier to the U.S. Navy for medium-speed diesel engines and has supplied engines to the U.S. Navy for over 70 years.



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**Table of Contents*****Customers***

Our Power Systems segment sells its products and services to customers worldwide, including major shipyards, municipal utilities, institutional and industrial organizations, sewage treatment plants, nuclear power plants and offshore oil and gas platforms, with approximately 12% of sales delivered to customers outside the United States in 2014. We market our products through a direct sales force of engineers in North America and through independent agents worldwide. Representative customers are shown in the segment overview table above. In 2014, the largest customer accounted for approximately 13% of segment revenues.

***Raw Materials and Components***

The Power Systems segment purchases multiple ferrous and non-ferrous castings, forgings, plate stock and bar stock for fabrication and machining into engines. In addition, we buy a considerable amount of precision-machined engine components. We believe all of these raw materials and components are readily available from various suppliers, but may be subject to long and variable lead times.

***Garlock Sealing Technologies***

On June 5, 2010 (the Petition Date), three of our subsidiaries, GST LLC, Anchor and Garrison, filed voluntary petitions for reorganization under Chapter 11 of the United States Bankruptcy Code in the Bankruptcy Court. The filings were the initial step in an asbestos claims resolution process. The filings did not include EnPro Industries, Inc., or any other EnPro Industries, Inc. operating subsidiary. GST LLC now operates in the ordinary course under court protection from asbestos claims. All pending litigation against GST is stayed during the bankruptcy process. For the year ended December 31, 2014, GST generated \$240.6 million in net sales, \$113.8 million in net income and \$52.2 million in Adjusted EBITDA, and at March 31, 2015 its aggregate cash and cash equivalents and investments in marketable securities were \$237.2 million.

The financial results of GST and subsidiaries are included in our consolidated results through June 4, 2010, the day prior to the Petition Date. However, GAAP requires an entity that files for protection under the U.S. Bankruptcy Code, whether solvent or insolvent, whose financial statements were previously consolidated with those of its parent, as GST's and its subsidiaries' were with ours, generally must be prospectively deconsolidated from the parent and the resulting investment to be accounted for using the cost method. Prior to its deconsolidation effective on the Petition Date, GST LLC and its subsidiaries operated as part of the Garlock group of companies within EnPro's Sealing Products segment. GST LLC designs, manufactures and sells sealing products, including metallic, non-metallic and composite material gaskets, rotary seals, compression packing, resilient metal seals, elastomeric seals, hydraulic components, and expansion joints. GST LLC and its subsidiaries operate five primary manufacturing facilities, including GST LLC's operations in Palmyra, New York and Houston, Texas.

On May 29, 2014, GST filed its first amended proposed plan of reorganization. In January 2015, we announced that GST and we had reached agreement with the court-appointed legal representative of future asbestos claimants (the Future Claimants Representative) that includes a second amended proposed plan of reorganization. The Future Claimants Representative has agreed to support, recommend and vote in favor of the second amended plan. On January 14, 2015, GST filed the second amended plan of reorganization which provides for (a) the treatment of present and future asbestos claims against GST that have not been resolved by settlement or verdict prior to the Petition Date, and (b) administrative and litigation costs. This revised plan of reorganization provides for the establishment of two facilities—a settlement facility (which would receive \$220 million from GST and \$30 million from our consolidated subsidiary, Coltec Industries Inc (Coltec), upon consummation of the plan and additional contributions by GST aggregating \$77.5 million over the seven years following consummation of the plan) and a

litigation fund (which would receive \$30 million from GST upon consummation of the plan) to fund the defense and payment of claims of claimants who elect to pursue litigation

## **Table of Contents**

under the plan rather than accept the settlement option under the plan. Funds contained in the settlement facility and the litigation fund would provide the exclusive remedies for current and future GST asbestos claimants other than claimants whose claims had been resolved by settlement or verdict prior to the Petition Date and were not paid prior to the Petition Date. The plan provides that GST will pay in full claims that had been resolved by settlement or verdict prior to the Petition Date that were not paid prior to the Petition Date (with respect to claims resolved by verdict, such payment will be made only to the extent the verdict becomes final). The amount of such claims resolved by verdict is \$2.5 million. GST estimates the range of its aggregate liability for the unpaid settled asbestos claims to be from \$3.1 million to \$16.4 million, and the revised plan provides that if the actual amount is less than \$10.0 million GST will contribute the difference to the settlement facility. In addition, the revised plan provides that, during the 40-year period following confirmation of the plan, GST would, if necessary, make supplementary annual contributions, subject to specified maximum annual amounts that decline over the period, to maintain a specified balance at specified dates of the litigation fund. The maximum aggregate amount of all such contingent supplementary contributions over that period is \$132 million. Under the plan, EnPro would guarantee GST's payment of the \$77.5 million of deferred contributions plus accrued interest to the settlement facility and, to the extent they are required, the supplementary contributions to the litigation fund.

If the plan is confirmed by the Bankruptcy Court and is consummated, GST will be re-consolidated with our results for financial reporting purposes. The plan is subject to confirmation by the Bankruptcy Court and we cannot assure you that GST will be able to obtain necessary Bankruptcy Court approval of the plan, including the settlement of asbestos claims and related releases of claims against us included therein, and that the plan will become effective. See **Risk Factors**. We cannot assure you that GST will be able to obtain Bankruptcy Court approval of its revised plan of reorganization and the settlement and resolution of claims and related releases of liability embodied therein or what the final terms of such plan will be at consummation, and the time period for the resolution of the bankruptcy proceedings is not presently determinable.

## **Competition**

We compete with a number of competitors in each of our segments. Although it varies by products, competition is based primarily on performance of the product for specific applications, product reliability, availability and price. Our leading brand names, including Garlock® and STEMCO®, have been built upon long-standing reputations for reliability and durability. In addition, we believe the breadth, performance and quality of our product offerings allow us to achieve premium pricing and have made us a preferred supplier among our agents and distributors in many of our businesses. Key competitors for the Sealing Products segment include Federal-Mogul Corporation, A.W. Chesterton Company and SKF USA Inc. Key competitors for the Engineered Products segment include Federal-Mogul Corporation and Saint-Gobain's Norglide division. Key competitors for the Power Systems segment include MTU, Caterpillar Inc., and Wartsila Corporation.

## **Competitive Strengths**

We believe the following strengths provide us with significant competitive advantages as we execute our business strategy:

### **Our Brands Set Industry Standards and Drive a Portfolio of Highly Repeatable, Stable Businesses**

Our leading brands, including Garlock®, STEMCO®, GGB® and Fairbanks Morse Engine, have legacies ranging from 60 to 125 years. We believe that the products sold under these leading brands are well established and highly recognized in their respective markets, and, in our flagship product lines, we hold leading market positions. In many cases, we expect our products are the products of choice for our customers given our long-standing histories of



reliable performance in demanding and critical applications. We believe many of our products set industry standards around safety, emissions control, reliability, and performance. And we were among the first to market with a number of products, including opposed piston engines, non-asbestos sealing

## **Table of Contents**

products, high-performance PTFE gaskets, metal-polymer bearings, and zero-PFOA (perfluorooctanoic acid) bearings. A meaningful percentage of our sales is generated by products that are either sole-sourced or customer-specified. The focus of our brand and business model has been, and continues to be, developing premium quality products that meet demanding performance standards, providing customers with focused service and support, and developing and nurturing enduring customer relationships.

### **Many of Our Products Perform in Demanding Environments and Serve Critical Applications**

Many of our products support critical applications in demanding environments such as those characterized by high pressure, high temperature, chemical corrosion and demand for zero failure. Notable examples include sealing products for nuclear reactor pressure vessels; seals, bearings and related products for aircraft engines and landing gear; wheel-end and brake products for Class 8 trucks; and engines that provide propulsion or auxiliary power for U.S. Navy vessels. We believe many of our products' long-standing histories of performance reliability in demanding environments and for critical applications provide significant commercial advantages, leading to value-based pricing opportunities that drive premium margins and capital returns. In addition, some applications in which our products serve are characterized by high customer switching costs, due to both the critical nature of the application and the specification process.

### **Our Highly Diversified Business Portfolio Leads to Stable Cash Flows**

Our sales are generated across a broad range of industries and geographies. We serve more than 30 end markets, and approximately 45% of our 2014 net sales were derived from sales of our products outside of the United States. A slowdown in a specific industry or economy can be offset by an uptick in other markets, providing confidence in our ability to sustain profitability and stable cash flows over time. We also have a strong mix of aftermarket and OEM customers. In 2014, approximately 50% of our net sales were to aftermarket customers and 50% to OEM customers. Much of our OEM business is platform-based and sole-sourced, resulting in very low product displacement. Additionally, our large installed base of products generates a steady recurring aftermarket revenue stream.

### **We Have Positioned Our Company for Growth and Continuous Improvement**

Since our spin-off from Goodrich Corporation ( Goodrich ) in 2002, we have systematically refined our business mix and model, and we are well positioned for future growth and continuous operational improvement. Initiatives undertaken include the following:

We have streamlined our mix of businesses, divesting a large division (Quincy Compressor) and several small, non-strategic business units. We have reinvested fully the proceeds of those divestitures into businesses that fit strategically with our operating divisions and that provide new products, new technologies and new or expanded geographic reach. In the process, we have refined our acquisition processes and developed a formal playbook for a strategy-driven conservative approach to managing our portfolio. We have expanded globally through both acquisitions and organic initiatives, particularly in Asia, South America and the Middle East.

We have developed a comprehensive supply chain management process and currently have 40 category teams managing 85% of our total spend, targeting annual savings of 3.6% through the business cycle.

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We have developed a world-class safety program and culture and are one of only three companies to be recognized on two separate occasions by EHS Today as America's Safest Company.

**Table of Contents**

We have invested heavily in our infrastructure with major facility upgrades and ERP implementations in all of our operating divisions. And we have developed an EnPro global manufacturing and commercial business model through cross-division collaboration and external benchmarking.

On the commercial front, we recently added the roles of Chief Innovation Officer and Chief Customer Officer to the responsibilities of two of our senior executives.

**Net income**

\$235 \$218 \$514 \$435

**Basic and diluted earnings per share**

\$0.15 \$0.13 \$0.32 \$0.27

See Notes to Consolidated Financial Statements.

**Table of Contents****SP Bancorp, Inc.****Consolidated Statements of Comprehensive Income (Unaudited)****(Dollars in thousands)**

	Six Months Ended June 30,	
	2012	2011
	<i>(Unaudited)</i>	
Other comprehensive income, before tax:		
Net change in unrealized gains on available for sale securities	\$ 391	\$ 274
Reclassification adjustment for gain on sale of securities available for sale	(500)	(202)
Other comprehensive (loss) income before tax	(109)	72
Income tax benefit (expense)	36	(26)
Other comprehensive (loss) income, net of tax	(73)	46
Net income	514	435
Comprehensive income	\$ 441	\$ 481

See Notes to Consolidated Financial Statements.

**Table of Contents****SP Bancorp, Inc.****Consolidated Statements of Stockholders Equity (Unaudited)**

(Dollars in thousands)

	Common Stock	Additional Paid-In Capital	Unallocated ESOP Shares	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance, December 31, 2010	\$ 17	\$ 15,290	\$ (817)	\$ 17,701	\$ (87)	\$ 32,104
Additional stock issuance costs		(15)				(15)
ESOP shares purchased in open market			(102)			(102)
ESOP shares allocated		3	21			24
Net income				435		435
Unrealized gain on securities available for sale, net of tax of \$99					175	175
Reclassification adjustment for gain on securities available for sale included in net income, net of tax of (\$73)					(129)	(129)
<b>Balance, June 30, 2011</b>	<b>\$ 17</b>	<b>\$ 15,278</b>	<b>\$ (898)</b>	<b>\$ 18,136</b>	<b>\$ (41)</b>	<b>\$ 32,492</b>
Balance, December 31, 2011	\$ 17	\$ 15,278	\$ (1,018)	\$ 18,636	\$ 214	\$ 33,127
ESOP shares purchased in the open market			(373)			(373)
ESOP shares allocated		5	38			43
Net income				514		514
Unrealized gain on securities available for sale, net of tax of \$129					262	262
Reclassification adjustment for gain on securities available for sale included in net income, net of tax of (\$165)					(335)	(335)
Repurchase of common stock		(251)		(61)		(312)
<b>Balance, June 30, 2012</b>	<b>\$ 17</b>	<b>\$ 15,032</b>	<b>\$ (1,353)</b>	<b>\$ 19,089</b>	<b>\$ 141</b>	<b>\$ 32,926</b>

See Notes to Consolidated Financial Statements.

**Table of Contents****SP Bancorp, Inc.****Consolidated Statements of Cash Flows (Unaudited)****(Dollars in thousands)**

	Six Months Ended June 30,	
	2012	2011
<b>Cash flows from operating activities:</b>		
Net income	\$ 514	\$ 435
<b>Adjustments to reconcile net income to net cash provided by operating activities:</b>		
Depreciation and amortization	143	179
Amortization of premiums on securities	243	244
ESOP expense	43	24
Provision for loan losses	702	411
Provision for losses on OREO	244	
Gain on sale of securities available for sale	(500)	(202)
Gain on sale of mortgage loans	(879)	(529)
Proceeds from sale of mortgage loans	31,516	22,697
Loans originated for sale	(35,691)	(21,089)
Increase in cash surrender value of BOLI	(113)	(76)
Decrease (increase) in accrued interest receivable	214	(46)
Decrease (increase) in other assets and deferred tax assets	1,424	(381)
(Increase) in fixed annuity investment	(23)	(22)
Increase in accrued interest payable and other liabilities	441	34
<b>Net cash (used in) provided by operating activities</b>	<b>(1,722)</b>	<b>1,679</b>
<b>Cash flows from investing activities:</b>		
Purchase of securities available for sale	(7,332)	(20,147)
Maturities, calls and principal pay downs on securities available for sale	1,015	3,842
Proceeds from sale of securities available for sale	15,266	16,027
Redemptions (purchases) of FHLB stock	705	(2)
Originations, net of loan repayments	(6,499)	(6,934)
Additions to other real estate owned	(176)	
Purchases of premises and equipment	(97)	(52)
Purchase of BOLI	(1,000)	(6,000)
<b>Net cash provided by (used in) investing activities</b>	<b>1,882</b>	<b>(13,266)</b>
<b>Cash flows from financing activities:</b>		
Net increase in deposit accounts	14,463	26,769
Repayment of FHLB advances, net	(16,933)	(4)
ESOP shares purchased	(373)	(102)
Conversion costs		(15)
Repurchase of common stock	(312)	
<b>Net cash (used in) provided by financing activities</b>	<b>(3,155)</b>	<b>26,648</b>
Net (decrease) increase in cash and cash equivalents	(2,995)	15,061
Cash and cash equivalents at beginning of period	9,928	11,814
Cash and cash equivalents at end of period	\$ 6,933	\$ 26,875



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Supplemental cash flow information:

Cash transactions:

Income taxes paid	\$	31	\$	377
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Interest expense paid	\$	746	\$	917
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Noncash transactions:

Transfers of loans to other real estate owned	\$		\$	1,783
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Transfers of loans held for portfolio to loans held for sale	\$		\$	1,459
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See Notes to Consolidated Financial Statements.

## Table of Contents

### **SP Bancorp, Inc.**

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

**(Dollars in thousands)**

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

##### General

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

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

##### Consolidation

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

##### Interim Financial Statements

The financial statements of the Company at June 30, 2012 and for the three and six months ended June 30, 2012 and 2011 have been prepared in conformity with U.S. generally accepted accounting principles for interim financial information and predominant practices followed by the financial services industry; and are unaudited. However, in management's opinion, the interim data at June 30, 2012 and for the three and six months ended June 30, 2012 and 2011 include all adjustments, consisting of only normal recurring adjustments, necessary for a fair statement of the results of the interim periods. The results of operations for the interim periods are not necessarily indicative of the results of operations to be expected for the full year.

##### Use of Estimates

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

##### Subsequent Events

Companies are required to evaluate events and transactions that occur after the balance sheet date but before the date the financial statements are issued. They must recognize in the financial statements the effect of all events or transactions that provide additional evidence of conditions that existed at the balance sheet date, including the estimates inherent in the financial preparation process. Entities shall not recognize the impact of events or transactions that provide evidence about conditions that did not exist at the balance sheet date but arose after that date. The Company has evaluated subsequent events through the time of filing these financial statements with the SEC and noted no subsequent events requiring financial statement recognition or disclosure, except as discussed in Note 11 to Consolidated Financial Statements.



**Table of Contents****SP Bancorp, Inc.****Notes to Consolidated Financial Statements (Unaudited)****(Dollars in thousands)****Basic and Diluted Earnings Per Share**

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Net income	\$ 235	\$ 218	\$ 514	\$ 435
Weighted-average shares outstanding (in 000s)	1,565	1,640	1,597	1,640
Basic and diluted earnings per share	\$ 0.15	\$ 0.13	\$ 0.32	\$ 0.27

**Recent Authoritative Accounting Guidance**

In May 2011, the FASB issued ASU 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. The amendments improve consistency for measuring fair value and for disclosing information about fair value measurements in accordance with U.S. generally accepted accounting principles and International Financial Reporting Standards. The ASU was adopted for the three and six months ended June 30, 2012. The adoption of this guidance did not materially impact the Company.

In June 2011, the FASB issued ASU 2011-05, Comprehensive Income (Topic 220). The amendments require that all nonowner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. On October 21, 2011, the FASB deferred the effective date of presentation requirements for classification adjustments. The adoption of this ASU resulted in adding separate Consolidated Statements of Comprehensive Income.

**Note 2. Stock Conversion**

On October 29, 2010, Share Plus Federal Bank completed its conversion from a federal mutual savings bank to a capital stock savings bank. A new holding company, SP Bancorp, Inc., was established as part of the conversion. The public offering was consummated through the sale and issuance by SP Bancorp, Inc. of 1,725,000 shares of common stock at \$10 per share. Net proceeds of \$14.5 million were raised in the stock offering, after deduction of conversion costs of \$2.0 million and excluding \$0.8 million which was loaned by the Company to a trust for the ESOP. The ESOP purchased 67,750 shares in the offering and 70,250 shares in the open market. Shares of the Company's common stock purchased by the ESOP are held in a suspense account until released for allocation to participants. Shares released are allocated to each eligible participant based on the ratio of each such participant's compensation, as defined in the ESOP, to the total compensation of all eligible plan participants. As the unearned shares are released from suspense, the Bank recognizes compensation expense equal to the fair value of the ESOP shares committed to be released during the year. To the extent that the fair value of the ESOP shares differs from the cost of such shares, the difference is charged or credited to equity as additional paid-in capital.

SP Bancorp, Inc.'s common stock is traded on the NASDAQ Capital Market under the symbol SPBC. Voting rights are held and exercised exclusively by the stockholders of SP Bancorp, Inc. Deposit account holders of the Bank continue to be insured by the FDIC. A liquidation account was established in the amount of \$17.0 million, which represented the Bank's total equity capital as of



**Table of Contents**

**SP Bancorp, Inc.**

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

**(Dollars in thousands)**

March 31, 2010, the latest balance sheet date in the final prospectus used in the conversion. The liquidation account is maintained for the benefit of eligible holders who continue to maintain their accounts at the Bank. The liquidation account is reduced annually to the extent that eligible account holders have reduced their qualifying deposits. Subsequent increases will not restore an eligible account holder's interest in the liquidation account. In the event of a complete liquidation of the Bank, and only in such event, each eligible account holder will be entitled to receive a distribution from the liquidation account in an amount proportionate to the adjusted qualifying account balances then held.

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

On February 27, 2012, SP Bancorp, Inc. announced that its Board of Directors has authorized a stock repurchase program pursuant to which SP Bancorp, Inc. intends to repurchase up to 5% of its issued and outstanding shares, or up to approximately 86,250 shares.

Open market purchases will be conducted in accordance with the limitations set forth in Rule 10b-18 of the Securities and Exchange Commission and other applicable legal requirements. The repurchase program may be suspended, terminated or modified at any time for any reason, including market conditions, the cost of repurchasing shares, the availability of alternative investment opportunities, liquidity, and other factors deemed appropriate. These factors may also affect the timing and amount of share repurchases. The repurchase program does not obligate SP Bancorp, Inc. to purchase any particular number of shares, and there is no guarantee as to the exact number of shares to be repurchased by SP Bancorp, Inc.

SP Bancorp, Inc. had repurchased 25,200 shares under the stock repurchase program through June 30, 2012.

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

Securities have been classified in the consolidated balance sheets according to management's intent. At June 30, 2012 and December 31, 2011, all of the Company's securities were classified as available for sale. The amortized cost of securities and their approximate fair values at June 30, 2012 and December 31, 2011 are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b><u>Securities Available for Sale</u></b>				
June 30, 2012:				
Municipal securities	\$ 2,136	\$ 97	\$	\$ 2,233
Collateralized mortgage obligations guaranteed by FNMA and FHLMC	6,611	9		6,620
Mortgage-backed securities guaranteed by SBA, FNMA, GNMA and FHLMC	7,335	108		7,443
	\$ 16,082	\$ 214	\$	\$ 16,296
December 31, 2011:				
Municipal securities	\$ 8,737	\$ 385	\$	\$ 9,122
Collateralized mortgage obligations guaranteed by FNMA and FHLMC	12,809	26	(90)	12,745
Mortgage-backed securities guaranteed by SBA, FNMA, GNMA and FHLMC	3,228	5	(3)	3,230
	\$ 24,774	\$ 416	\$ (93)	\$ 25,097

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

For the six months ended June 30, 2012, proceeds from sale of securities available for sale, gross gains and gross losses were \$15,266, \$581 and \$81, respectively.

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

There were no gross unrealized losses at June 30, 2012.

**Table of Contents**

SP Bancorp, Inc.

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

(Dollars in thousands)

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

	Number of Security Positions with Unrealized losses	Continuous Unrealized Losses Existing for Less than 12 Months		Continuous Unrealized Losses Existing for 12 Months or Longer		Total	
		Market Value	Unrealized Losses	Market Value	Unrealized Losses	Market Value	Unrealized Losses
December 31, 2011:							
Collateralized mortgage obligations	7	\$ 10,019	\$ (90)	\$	\$	\$ 10,019	\$ (90)
Mortgage-backed securities	1	970	(3)			970	(3)
	8	\$ 10,989	\$ (93)	\$	\$	\$ 10,989	\$ (93)

For all of the above securities available for sale, the gross unrealized losses are generally due to changes in interest rates. The Company does not intend to sell these securities and it is more-likely-than-not that the Company will not be required to sell prior to anticipated recovery. Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent of the Company to sell or whether it would be more-likely-than-not required to sell its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

The scheduled maturities of securities at June 30, 2012 and December 31, 2011 are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	June 30, 2012 Available for Sale		December 31, 2011 Available for Sale	
	Amortized Cost	Market Value	Amortized Cost	Market Value
After 5 years through 10 years	\$	\$	\$	\$
Due after 10 years	2,136	2,233	8,737	9,122
	2,136	2,233	8,737	9,122
Mortgage-backed securities and collateralized mortgage obligations	13,946	14,063	16,037	15,975
	\$ 16,082	\$ 16,296	\$ 24,774	\$ 25,097



**Table of Contents**

SP Bancorp, Inc.

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

(Dollars in thousands)

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

Loans at June 30, 2012 and December 31, 2011 consisted of the following:

	June 30, 2012	December 31, 2011
Commercial business	\$ 8,147	\$ 6,986
Commercial real estate	42,061	38,348
One-to-four family	153,731	150,613
Home equity	9,305	9,612
Consumer	6,825	8,318
	220,069	213,877
Premiums, net	72	71
Deferred loan costs, net	530	494
Allowance for loan losses	(2,186)	(1,754)
	\$ 218,485	\$ 212,688

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

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

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

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

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

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



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

Following is an age analysis of past due loans by loan class as of June 30, 2012 and December 31, 2011:

	Commercial Business	Commercial Real Estate	One-to-Four Family	Home Equity	Consumer	Total
<b>At June 30, 2012:</b>						
Past Due:						
30-59 days	\$	\$ 296	\$ 1,364	\$	\$ 10	\$ 1,670
60-89 days			148		1	149
90 days or more						
Total past due		296	1,512		11	1,819
Current	8,147	41,765	152,219	9,305	6,814	218,250
Total loans	\$ 8,147	\$ 42,061	\$ 153,731	\$ 9,305	\$ 6,825	\$ 220,069
<b>At December 31, 2011</b>						
Past Due:						
30-59 days	\$	\$	\$ 2,457	\$ 27	\$ 16	\$ 2,500
60-89 days			161		1	162
90 days or more			207			207
Total past due			2,825	27	17	2,869
Current	6,986	38,348	147,788	9,585	8,301	211,008
Total loans	\$ 6,986	\$ 38,348	\$ 150,613	\$ 9,612	\$ 8,318	\$ 213,877

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

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

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

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

Following is a summary of loans by grade or classification as of June 30, 2012 and December 31, 2011:

	Commercial Business	Commercial Real Estate	One-to-Four Family	Home Equity	Consumer	Total
<b>At June 30, 2012:</b>						
Credit Quality Indicator:						
Credit Risk Profile by Grade or Classification:						
Pass	\$ 8,147	\$ 34,943	\$ 150,584	\$ 9,296	\$ 6,796	\$ 209,766
Special Mention			558	9	28	595
Substandard		7,118	2,589		1	9,708
Doubtful						
Loss						
<b>Total</b>	<b>\$ 8,147</b>	<b>\$ 42,061</b>	<b>\$ 153,731</b>	<b>\$ 9,305</b>	<b>\$ 6,825</b>	<b>\$ 220,069</b>
<b>At December 31, 2011</b>						
Credit Quality Indicator:						
Credit Risk Profile by Grade or Classification:						
Pass	\$ 6,986	\$ 31,170	\$ 148,433	\$ 9,600	\$ 8,281	\$ 204,470
Special Mention			687	12	37	736
Substandard		7,178	1,493			8,671
Doubtful						
Loss						
<b>Total</b>	<b>\$ 6,986</b>	<b>\$ 38,348</b>	<b>\$ 150,613</b>	<b>\$ 9,612</b>	<b>\$ 8,318</b>	<b>\$ 213,877</b>

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

Impaired loans and nonperforming loans by loan class at June 30, 2012 and December 31, 2011 were summarized as follows:

	Commercial Business	Commercial Real Estate	One-to-Four Family	Home Equity	Consumer	Total
<b>At June 30, 2012:</b>						
Impaired loans:						
Impaired loans with an allowance for loan losses	\$	\$ 1,463	\$ 392	\$	\$ 13	\$ 1,868
Impaired loans with no allowance for loan losses		3,734	1,540		10	5,284
<b>Total impaired loans</b>	<b>\$</b>	<b>\$ 5,197</b>	<b>\$ 1,932</b>	<b>\$</b>	<b>\$ 23</b>	<b>\$ 7,152</b>
Unpaid principal balance of impaired loans	\$	\$ 5,197	\$ 1,932	\$	\$ 23	\$ 7,152
Allowance for loan losses on impaired loans	\$	\$ 130	\$ 98	\$	\$ 4	\$ 232
Average recorded investment in impaired loans	\$	\$ 5,237	\$ 1,914	\$ 8	\$ 26	\$ 7,185
Nonperforming loans:						
Nonaccrual loans	\$	\$ 5,197	\$ 1,715	\$	\$ 13	\$ 6,925
Loans past due 90 days and still accruing						
Troubled debt restructurings (not included in nonaccrual loans)			208		21	229
	\$	\$ 5,197	\$ 1,923	\$	\$ 34	\$ 7,154
<b>At December 31, 2011</b>						
Impaired loans:						
Impaired loans with an allowance for loan losses	\$	\$	\$ 16	\$	\$ 15	\$ 31
Impaired loans with no allowance for loan losses		5,258	1,741	12	15	7,026
<b>Total impaired loans</b>	<b>\$</b>	<b>\$ 5,258</b>	<b>\$ 1,757</b>	<b>\$ 12</b>	<b>\$ 30</b>	<b>\$ 7,057</b>
Unpaid principal balance of impaired loans	\$	\$ 5,258	\$ 1,757	\$ 12	\$ 30	\$ 7,057
Allowance for loan losses on impaired loans	\$	\$	\$ 14	\$	\$ 5	\$ 19
Average recorded investment in impaired loans	\$ 177	\$ 5,319	\$ 2,203	\$ 101	\$ 34	\$ 7,834
Nonperforming loans:						
Nonaccrual loans	\$	\$	\$ 207	\$	\$	\$ 207
Loans past due 90 days and still accruing						
Troubled debt restructurings (not included in nonaccrual loans)		5,258	1,497		64	6,819
	\$	\$ 5,258	\$ 1,704	\$	\$ 64	\$ 7,026

For the six months ended June 30, 2012 and 2011, gross interest income that would have been recorded had our non-accruing loans been current in accordance with their original terms was \$207 and \$149, respectively. Interest income recognized on such loans for the six months ended June 30, 2012 and 2011 was \$148 and \$30, respectively. Interest income recognized on impaired loans for the six months ended June 30, 2012 and 2011 was \$145 and \$30, respectively.



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

Following is a summary of the activity in the allowance for loan losses by loan class for the six months ended June 30, 2012 and 2011 and total investment in loans at June 30, 2012, December 31, 2011 and June 30, 2011:

	Commercial Business	Commercial Real Estate	One-to-Four Family	Home Equity	Consumer	Total
<b>Six Months Ended June 30, 2012</b>						
Allowance for Loan Losses:						
Balance, beginning of period	\$ 130	\$ 624	\$ 778	\$ 133	\$ 89	\$ 1,754
Provision for loan losses	63	350	329	(15)	(25)	702
Loans charged to the allowance			(240)	(28)	(11)	(279)
Recoveries of loans previously charged off			1	1	7	9
<b>Balance, end of period</b>	<b>\$ 193</b>	<b>\$ 974</b>	<b>\$ 868</b>	<b>\$ 91</b>	<b>\$ 60</b>	<b>\$ 2,186</b>
Ending balance: individually evaluated for impairment	\$	\$ 130	\$ 98	\$	\$ 4	\$ 232
Ending balance: collectively evaluated for impairment	\$ 193	\$ 844	\$ 770	\$ 91	\$ 56	\$ 1,954
<b>At June 30, 2012:</b>						
Loans:						
Ending balance	\$ 8,147	\$ 42,061	\$ 153,731	\$ 9,305	\$ 6,825	\$ 220,069
Ending balance individually evaluated for impairment	\$	\$ 5,197	\$ 1,932	\$	\$ 23	\$ 7,152
Ending balance collectively evaluated for impairment	\$ 8,147	\$ 36,864	\$ 151,799	\$ 9,305	\$ 6,802	\$ 212,917
<b>At December 31, 2011:</b>						
Loans:						
Ending balance	\$ 6,986	\$ 38,348	\$ 150,613	\$ 9,612	\$ 8,318	\$ 213,877
Ending balance individually evaluated for impairment	\$	\$ 5,258	\$ 1,757	\$ 12	\$ 30	\$ 7,057
Ending balance collectively evaluated for impairment	\$ 6,986	\$ 33,090	\$ 148,856	\$ 9,600	\$ 8,288	\$ 206,820
<b>Six Months Ended June 30, 2011:</b>						
Allowance for Loan Losses:						
Balance, beginning of period	\$ 131	\$ 1,081	\$ 736	\$ 60	\$ 128	\$ 2,136
Provision for loan losses	51	112	254	10	(16)	411
Loans charged to the allowance	(125)	(467)	(73)		(31)	(696)
Recoveries of loans previously charged off					8	8
<b>Balance, end of period</b>	<b>\$ 57</b>	<b>\$ 726</b>	<b>\$ 917</b>	<b>\$ 70</b>	<b>\$ 89</b>	<b>\$ 1,859</b>
Ending balance: individually evaluated for impairment	\$	\$ 218	\$ 260	\$ 16	\$	\$ 494

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Ending balance: collectively evaluated for impairment	\$	57	\$	508	\$	657	\$	54	\$	89	\$	1,365
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### At June 30, 2011:

Loans:

Ending balance	\$	3,594	\$	31,522	\$	141,029	\$	10,117	\$	9,319	\$	195,581
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Ending balance individually evaluated for impairment	\$	319	\$	5,789	\$	3,010	\$	112	\$	23	\$	9,253
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Ending balance collectively evaluated for impairment	\$	3,275	\$	25,733	\$	138,019	\$	10,005	\$	9,296	\$	186,328
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The \$291 increase in the provision for loan losses for the six months ended June 30, 2012 versus June 30, 2011 was primarily attributable to an increase in the loss experience factors used to determine the general allowance for loan losses.

We establish an allocated allowance when loans are determined to be impaired, including troubled debt restructurings. The allowance is measured by determining the present value of expected future cash flows or, for collateral-dependent loans, the fair value of the collateral adjusted for market conditions and selling expenses. The Company has allocated allowance for loan losses of \$232 and \$5 to customers whose loan terms have been modified in troubled debt restructurings as of June 30, 2012 and December 31, 2011. The Company has not committed to lend additional amounts to customers with outstanding loans that are classified as troubled debt restructurings at June 30, 2012 and December 31, 2011.

During the periods ended June 30, 2012 and 2011, the terms of certain loans were modified as troubled debt restructurings. The modification of the terms of such loans included one or a combination of the following: a reduction of the stated interest rate of the loan; an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk; or a permanent reduction of the recorded investment in the loan.



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

Modifications involving a reduction of the stated interest rate of the loan were for periods ranging from nine months to five years. Modifications involving an extension of the maturity date were for periods ranging from three months to five years.

Following is a summary of troubled debt restructurings during the six months ended June 30, 2012 and 2011 and loans that have been restructured during the previous twelve months that subsequently defaulted during the six months ended June 30, 2012 and 2011:

	Commercial Business	Commercial Real Estate	One-to-Four Family	Home Equity	Consumer	Total
<b>Troubled debt restructurings during the six months ended June 30, 2012:</b>						
Number of contracts			1			1
Pre-restructuring outstanding recorded investment	\$	\$	\$ 392	\$	\$	\$ 392
Post-restructuring outstanding recorded investment	\$	\$	\$ 392	\$	\$	\$ 392
<b>Troubled debt restructurings during the previous twelve months that subsequently defaulted during the six months ended June 30, 2012</b>						
Number of contracts			3			3
Recorded investment	\$	\$	\$ 1,264	\$	\$	\$ 1,264
<b>Troubled debt restructurings during the six months ended June 30, 2011:</b>						
Number of contracts		3			1	4
Pre-restructuring outstanding recorded investment	\$	\$ 5,581	\$	\$	\$ 9	\$ 5,590
Post-restructuring outstanding recorded investment	\$	\$ 5,251	\$	\$	\$ 9	\$ 5,260
<b>Troubled debt restructurings during the previous twelve months that subsequently defaulted during the six months ended June 30, 2011</b>						
Number of contracts			1		1	2
Recorded investment	\$	\$	\$ 71	\$	\$ 5	\$ 76

The Bank originated \$35,691 and \$21,089 in loans during the six months ended June 30, 2012 and 2011, respectively, which were placed with various correspondent lending institutions. Proceeds on sales of these loans were \$31,516 and \$22,697 for the six months ended June 30, 2012 and 2011, respectively. Gains on sales of these loans were \$879 and \$529 for the six months ended June 30, 2012 and 2011, respectively. These loans were sold with servicing rights released.

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Loans serviced for the benefit of others amounted to \$3,229, \$3,257 and \$2,578 at June 30, 2012, December 31, 2011 and June 30, 2011, respectively.

### **Note 5. Borrowings**

The Bank periodically borrows from the FHLB of Dallas. At June 30, 2012, the Bank had a total of nine such advances which totaled \$9,045. These advances have various maturities ranging from November 19, 2012 through November 17, 2014 at interest rates from 1.96% to 3.09%. At December 31, 2011, the Bank had a total of eleven such advances which totaled \$25,978. These advances have various maturities ranging from January 27, 2012 through November 17, 2014 at interest rates from 0.14% to 3.09%.

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

These advances are secured by FHLB of Dallas stock, real estate loans and securities of \$124,211 and \$121,640, at June 30, 2012 and December 31, 2011, respectively. The Bank had remaining credit available under the FHLB advance program of \$115,063 and \$95,529 at June 30, 2012 and December 31, 2011, respectively.

**Note 6. Income Taxes**

The difference between the statutory rate of 34% and the effective tax rates of 22.5% and 25.4% for the six months ended June 30, 2012 and 2011, respectively, was primarily attributable to permanent differences related to tax exempt income consisting of interest on municipal obligations and BOLI income.

There were no significant changes in deferred tax items during the six months ended June 30, 2012.

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

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

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

At June 30, 2012 and December 31, 2011, the approximate amounts of these financial instruments were as follows:

	<b>June 30, 2012</b>	<b>December 31, 2011</b>
Commitments to extend credit	\$ 16,591	\$ 21,568

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained if deemed necessary by the Bank upon extension of credit is based on management's credit evaluation of the counterparty. Collateral held varies but may include cattle, accounts receivable, inventory, property, single and multi-family residences, plant and equipment and income-producing commercial properties. At June 30, 2012 and December 31, 2011, commitments to fund fixed rate loans of \$4,442 and \$9,239, respectively, were included in the commitments to extend credit. Interest rates on these commitments to fund fixed rate loans, including unsecured loans, ranged from 3.00% to 17.00% at June 30, 2012 and from 3.49% to 17.90% at December 31, 2011.

The Bank has not incurred any significant losses on its commitments in the six months ended June 30, 2012 or 2011. Although the maximum exposure to loss is the amount of such commitments, management anticipates no material losses from such activities.

**Table of Contents**

SP Bancorp, Inc.

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

(Dollars in thousands)

**Note 8. Regulatory Capital**

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

Quantitative measures established by regulation to ensure capital adequacy requires the Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), of core capital (as defined) to adjusted tangible assets (as defined) and of tangible capital (as defined) to tangible assets. Management believes, as of June 30, 2012 and December 31, 2011, that the Bank meets all capital adequacy requirements to which it is subject.

At June 30, 2012 and December 31, 2011, the most recent regulatory notification categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the institution's category.

The following table sets forth the Bank's capital ratios as of June 30, 2012 and December 31, 2011:

	Actual		Minimum for Capital Adequacy Purposes		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>As of June 30, 2012:</b>						
Total capital to risk weighted assets	\$ 31,846	16.35%	\$ 15,579	8.00%	\$ 19,474	10.00%
Tier 1 capital to risk weighted assets	29,660	15.23%	7,790	4.00%	11,684	6.00%
Tier 1 capital to assets	29,660	10.96%	10,821	4.00%	13,526	5.00%
<b>As of December 31, 2011:</b>						
Tangible capital to tangible assets	\$ 29,319	10.75%	\$ 4,090	1.50%	N/A	N/A
Total capital to risk weighted assets	31,073	16.48%	15,081	8.00%	\$ 18,852	10.00%
Tier 1 capital to risk weighted assets	29,319	15.55%	7,541	4.00%	11,311	6.00%
Tier 1 capital to assets	29,319	10.75%	10,905	4.00%	13,632	5.00%

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

The following is a reconciliation of the Bank's equity capital under U.S. generally accepted accounting principles to Tangible and Tier 1 capital and Total capital (as defined by the OCC) at June 30, 2012 and December 31, 2011:

	June 30, 2012	December 31, 2011
Equity capital	\$ 29,801	\$ 29,533
Unrealized gains on securities, net	(141)	(214)
<b>Tangible and Tier 1 capital</b>	<b>29,660</b>	<b>29,319</b>
Allowance for loan losses	2,186	1,754
<b>Total capital</b>	<b>\$ 31,846</b>	<b>\$ 31,073</b>

**Note 9. Fair Value Measurements**

Accounting standards define fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall not be adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets and liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal market that are (1) independent, (2) knowledgeable, (3) able to transact and (4) willing to transact.

The guidance requires the use of valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets and liabilities. The income approach uses valuation techniques to convert future amounts, such as cash flows or earnings, to a single present amount on a discounted basis. The cost approach is based on the amount that currently would be required to replace the service capacity of an asset (replacement cost). Valuation techniques should be consistently applied. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. In that regard, the guidance establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs.

The fair value hierarchy is as follows:

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

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



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

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

The following table represents assets and liabilities reported on the consolidated balance sheet at their fair value as of June 30, 2012 and December 31, 2011 by level within the ASC 820 fair value measurement hierarchy:

		Fair Value Measurements at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	Assets/ Liabilities Measured At Fair Value			
<b>June 30, 2012:</b>				
Measured on a recurring basis:				
Assets:				
Securities available for sale:				
Municipal securities	\$ 2,233	\$	\$ 2,233	\$
Collateralized mortgage obligations	6,620		6,620	
Mortgage-backed securities	7,443		7,443	
Measured on a nonrecurring basis:				
Assets:				
Impaired loans	1,627			1,627
Other real estate owned	280			280
<b>December 31, 2011:</b>				
Measured on a recurring basis:				
Assets:				
Securities available for sale:				
Municipal securities	\$ 9,122	\$	\$ 9,122	\$
Collateralized mortgage obligations	12,745		12,745	
Mortgage-backed securities	3,230		3,230	
Measured on a nonrecurring basis:				
Assets:				
Impaired loans	12			12
Other real estate owned	1,300			1,300

There were no transfers between Level 1 and Level 2 categorizations for the periods presented.

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

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

Securities available for sale are classified within Level 2 of the valuation hierarchy. The Company obtains fair value measurements for securities from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S Treasury yield curve, live trading levels, trade execution data, market consensus prepayment spreads, credit information and the bond's terms and conditions, among other things.

Certain financial assets and financial liabilities are measured at fair value on a nonrecurring basis. The instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). Certain impaired loans are reported at the fair value of underlying collateral if repayment is expected solely from the collateral. Other real estate owned is initially recorded at fair value less estimated costs of disposal, which establishes a new cost basis. For the six months ended June 30, 2012 and for the year ended December 31, 2011, adjustments of \$244 and \$200, respectively, were recorded to write-down commercial properties included in other real estate owned to its fair value less estimated selling costs. Collateral values are estimated using Level 2 inputs based on observable market data such as independent appraisals or Level 3 inputs based on customized discounting.

For the six months ended June 30, 2012 and for the year ended December 31, 2011, impaired loans (with allocated allowance for losses) with principal balances of \$1,855 and \$31, respectively, had additional provisions for losses of \$228 and \$19, respectively.

There were no transfers into or out of Level 3 categorization for the periods presented.

For Level 3 financial and nonfinancial assets measured at fair value on a non-recurring basis at June 30, 2012, the significant unobservable inputs used in the fair value measurements are follows:

<b>Assets</b>	<b>Fair Value</b>	<b>Valuation Technique</b>	<b>Unobservable Input(s)</b>	<b>Range (Weighted Average)</b>
Impaired loans	\$ 1,627	Collateral method	Adjustments for selling costs	N/A
Foreclosed and repossessed assets	\$ 280	Collateral method	Adjustments for selling costs	N/A



**Table of Contents**

SP Bancorp, Inc.

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

(Dollars in thousands)

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

The carrying amount, estimated fair value and the financial hierarchy of the Company's financial instruments at June 30, 2012 and December 31, 2011 were as follows:

	Fair Value Measurements at Reporting Date Using				
	June 30, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
	Carrying Amount	Estimated Fair Value			
<b>Financial assets:</b>					
Cash and cash equivalents	\$ 6,933	\$ 6,933	6,933		
Securities available for sale	16,296	16,296		16,296	
Fixed annuity investment	1,199	1,199		1,199	
Restricted stock	1,315	1,315		1,315	
Loans and loans held for sale	228,423	227,794		226,158	1,636
Accrued interest receivable	747	747		747	
<b>Financial liabilities:</b>					
Deposit accounts	226,397	223,288		223,288	
Accrued interest payable	27	27		27	
Borrowings	9,045	9,299		9,299	
<b>Off-balance sheet assets (liabilities):</b>					
Commitments to extend credit					

	Fair Value Measurements at Reporting Date Using				
	December 31, 2011	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
	Carrying Amount	Estimated Fair Value			
<b>Financial assets:</b>					
Cash and cash equivalents	\$ 9,928	\$ 9,928	9,928		
Securities available for sale	25,097	25,097		25,097	
Fixed annuity investment	1,176	1,176		1,176	
Restricted stock	2,020	2,020		2,020	
Loans and loans held for sale	217,572	217,829		217,817	12
Accrued interest receivable	961	961		961	
<b>Financial liabilities:</b>					
Deposit accounts	211,934	208,744		208,744	
Accrued interest payable	29	29		29	

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Borrowings	25,978	26,299	26,299
Off-balance sheet assets (liabilities):			
Commitments to extend credit			

## **Table of Contents**

### **SP Bancorp, Inc.**

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

**(Dollars in thousands)**

#### **Fair Values of Financial Instruments**

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

##### *Cash and short-term instruments*

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

##### *Securities*

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

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

##### *Fixed annuity investment*

The carrying amount approximates fair value.

##### *Loans and loans held for sale*

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

##### *Deposits*

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

##### *Advances from Federal Home Loan Bank*

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

*Accrued interest*

The carrying amounts of accrued interest approximate their fair values.

**Table of Contents**

**SP Bancorp, Inc.**

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

**(Dollars in thousands)**

*Off-balance sheet instruments*

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

**Note 11. Subsequent Event**

During the three months ended March 31, 2012, the Bank experienced a fraudulent wire transfer from a customer's account. The Company accrued and expensed the \$50 deductible under its insurance policy during the same period. In August, 2012, the Company was notified by its insurance carrier that its claim for reimbursement of loss was denied. The Company has provided for an additional loss of \$228 in connection with this incident during the three months ended June 30, 2012. Although the Company has provided for a total loss of \$278, the Company strongly disagrees with the position taken by its insurance carrier and is challenging this decision.

**Table of Contents**

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

Management's discussion and analysis of financial condition and results of operations at June 30, 2012 and for the three and six months ended June 30, 2012 and 2011 is intended to assist in understanding the financial condition and results of operations of the Company. The information contained in this section should be read in conjunction with the Unaudited Consolidated Financial Statements and the notes thereto, appearing in Part 1, Item 1 of this report.

**CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS**

This Form 10-Q contains forward-looking statements, which can be identified by the use of words such as estimate, project, believe, intend, anticipate, plan, seek, expect, will, may and words of similar meaning. These forward-looking statements include, but are not limited to:

statements of our goals, intentions and expectations;

statements regarding our business plans, prospects, growth and operating strategies;

statements regarding the asset quality of our loan and investment portfolios; and

estimates of our risks and future costs and benefits.

These forward-looking statements are based on our current beliefs and expectations and are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control. In addition, these forward-looking statements are subject to assumptions with respect to future business strategies and decisions that are subject to change. We are under no duty to and do not take any obligation to update any forward-looking statements after the date of this Form 10-Q.

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

general economic conditions, either nationally or in our market areas, that are worse than expected;

competition among depository and other financial institutions;

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

adverse changes in the securities markets;

changes in laws or government regulations or policies affecting financial institutions, including changes in regulatory fees and capital requirements;

our ability to enter new markets successfully and capitalize on growth opportunities;

our ability to successfully integrate acquired entities, if any;

changes in consumer spending, borrowing and savings habits;

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**Table of Contents**

changes in accounting policies and practices, as may be adopted by the bank regulatory agencies, the Financial Accounting Standards Board, the Securities and Exchange Commission and the Public Company Accounting Oversight Board;

changes in our organization, compensation and benefit plans;

changes in our financial condition or results of operations that reduce capital; and

changes in the financial condition or future prospects of issuers of securities that we own.

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

**Overview**

On October 29, 2010, SharePlus Federal Bank completed its conversion from a federal mutual savings bank to a capital stock savings bank. A new holding company, SP Bancorp, Inc., was established as part of the conversion. The public offering was consummated through the sale and issuance by SP Bancorp, Inc. of 1,725,000 shares of common stock at \$10 per share. Net proceeds of \$14.5 million were raised in the stock offering, after deduction of conversion costs of \$2.0 million and excluding \$0.8 million which was loaned by the Company to a trust for the Employee Stock Ownership Plan (the ESOP). The ESOP purchased 67,750 shares in the offering and 70,250 in the open market.

At June 30, 2012, we had total assets of \$270.7 million, compared to \$273.0 million at December 31, 2011. This slight decrease was primarily the result of a decrease in securities and cash and cash equivalents, substantially offset by an increase in loans.

During the three months ended June 30, 2012, we had net income of \$235,000, compared to a net income of \$218,000 for the three months ended June 30, 2011. Higher net income resulted from higher net interest income and noninterest income, partially offset by higher noninterest expense.

During the six months ended June 30, 2012, we had net income of \$514,000, compared to a net income of \$435,000 for the six months ended June 30, 2011. Higher net income resulted from higher net interest income and noninterest income, partially offset by higher noninterest expense and provision for loan losses.

Our results of operations depend mainly on our net interest income, which is the difference between the interest income we earn on our loan and investment portfolios and the interest expense we incur on our deposits and, to a lesser extent, our borrowings. Results of operations are also affected by service charges and other fees, provision for loan losses, commissions, gain on sales of securities and loans and other income. Our noninterest expense consists primarily of compensation and benefits, occupancy costs, equipment expense, data processing, ATM expense, professional and outside services, FDIC insurance assessments, marketing and income tax expense.

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

**Critical Accounting Policies.** There are no material changes to the critical accounting policies disclosed in SP Bancorp, Inc.'s Form 10-K dated December 31, 2011, as filed on March 30, 2012 with the Securities and Exchange Commission.

**Economy.** Like the national economy, the Texas economy has been weak, but the Texas unemployment rate has been below the national rate for several months. The Dallas-Fort Worth Metroplex unemployment rate was 6.8% in May 2012, compared to 7.9% in



**Table of Contents**

May 2011. The state's seasonally adjusted unemployment rate decreased from 8.2% in June 2011 to 7.0% in June 2012, and the corresponding U.S. rate decreased from 9.2% to 8.2% during the same period.

**Comparison of Financial Condition at June 30, 2012 and December 31, 2011*****Summary of Selected Balance Sheet Data.***

(Dollars in thousands)	June 30, 2012	December 31, 2011	Increase (Decrease)	% Change
Total assets	\$ 270,729	\$ 272,959	\$ (2,230)	(0.82)%
Total cash and cash equivalents	6,933	9,928	(2,995)	(30.17)
Securities available for sale, at fair value	16,296	25,097	(8,801)	(35.07)
Loans held for sale	9,938	4,884	5,054	103.48
Loans, net	218,485	212,688	5,797	2.73
Other real estate owned	1,756	1,824	(68)	(3.73)
Premises and equipment, net	4,300	4,346	(46)	(1.06)
Federal Home Loan Bank of Dallas stock and other restricted stock, at cost	1,315	2,020	(705)	(34.90)
Bank-owned life insurance	7,307	6,193	1,114	17.99
Other assets <sup>(1)</sup>	4,399	5,979	(1,580)	(26.43)
Deposits	226,397	211,934	14,463	6.82
Borrowings	9,045	25,978	(16,933)	(65.18)
Stockholders' equity	32,926	33,127	(201)	(0.61)

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

Total assets decreased slightly by \$2.2 million to \$270.7 million at June 30, 2012. Proceeds from sale of securities and cash equivalents were reinvested in loans, including loans held for sale. Customer deposits were used to repay maturing FHLB advances.

Net loans increased to \$218.5 million at June 30, 2012, as loan originations were marginally higher than loan collections. Loans held for sale increased as a result of the low interest rate environment.

Deposits increased by \$14.5 million, or 6.8%, to \$226.4 million at June 30, 2012 from \$211.9 million at December 31, 2011. Deposits, in particular noninterest-bearing deposits, increased primarily from deposit inflows from existing customers.

Federal Home Loan Bank advances decreased \$16.9 million to \$9.0 million at June 30, 2012.

Stockholders' equity remained virtually unchanged primarily as a result of repurchases of common stock of \$312,000 and ESOP shares purchased in the open market of \$373,000, substantially offset by net income of \$514,000 for the six months ended June 30, 2012.

**Comparison of Operating Results for the Three Months Ended June 30, 2012 and 2011**

**General.** We recorded net income of \$235,000 for the three months ended June 30, 2012, compared to net income of \$218,000 for the same period last year. Net interest income increased by \$271,000 to \$2.6 million for the three months ended June 30, 2012 from

**Table of Contents**

\$2.3 million for the three months ended June 30, 2011, the provision for loan losses decreased by \$76,000 and noninterest income increased by \$239,000, which was substantially offset by a higher noninterest expense of \$567,000.

**Summary of Net Interest Income.**

(Dollars in thousands)	Three Months Ended June 30,		Increase	% Change
	2012	2011	(Decrease)	
<b>Interest income:</b>				
Interest and fees on loans	\$ 2,817	\$ 2,571	\$ 246	9.57%
Securities - taxable	45	119	\$ (74)	(62.18)
Securities - nontaxable	26	36	\$ (10)	(27.78)
Other interest - earning assets	35	32	\$ 3	9.38
<b>Total interest income</b>	<b>2,923</b>	<b>2,758</b>	<b>165</b>	<b>5.98</b>
<b>Interest expense:</b>				
Savings deposits	14	22	\$ (8)	(36.36)
Money market	21	43	\$ (22)	(51.16)
Demand deposit account	18	30	\$ (12)	(40.00)
Certificates of deposit	236	270	\$ (34)	(12.59)
<b>Total deposits</b>	<b>289</b>	<b>365</b>	<b>(76)</b>	<b>(20.82)</b>
Borrowings	83	113	\$ (30)	(26.55)
<b>Total interest expense</b>	<b>372</b>	<b>478</b>	<b>(106)</b>	<b>(22.18)</b>
<b>Net interest income</b>	<b>\$ 2,551</b>	<b>\$ 2,280</b>	<b>\$ 271</b>	<b>11.89%</b>

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

	Three Months Ended June 30,		Increase (decrease)
	2012	2011	
Loans	5.05%	5.27%	(0.22)%
Securities - taxable	1.27%	2.51%	(1.24)
Securities - nontaxable	3.40%	3.59%	(0.19)
Other interest - earning assets	0.56%	0.45%	0.11
Total interest-earning assets	4.40%	4.48%	(0.08)
Savings deposits	0.15%	0.25%	(0.10)
Money market	0.22%	0.40%	(0.18)
Demand deposit account	0.13%	0.21%	(0.08)
Certificates of deposit	1.27%	1.59%	(0.32)
Total deposits	0.56%	0.71%	(0.15)
Borrowings	1.54%	2.83%	(1.29)
Total interest-bearing liabilities	0.65%	0.87%	(0.22)
Net interest rate spread	3.75%	3.61%	0.14
Net interest margin	3.84%	3.70%	0.14%

**Average Balances**

(Dollars in thousands)	Three Months Ended June 30,		Increase (Decrease)	% Change
	2012	2011		
Loans	\$ 223,070	\$ 195,069	\$ 28,001	14.35%
Securities - taxable	14,125	18,968	(4,843)	(25.53)
Securities - nontaxable	3,063	4,009	(946)	(23.60)
Other interest - earning assets	25,580	28,388	(2,808)	(9.89)
Total interest-earning assets	265,838	246,434	19,404	7.87
Savings deposits	37,381	34,860	2,521	7.23
Money market	38,828	42,948	(4,120)	(9.59)
Demand deposit account	55,658	58,526	(2,868)	(4.90)
Certificates of deposit	74,443	67,926	6,517	9.59
Total deposits	206,310	204,260	2,050	1.00
Borrowings	21,584	15,979	5,605	35.08
Total interest-bearing liabilities	227,894	220,239	7,655	3.48
Net interest-earning assets	\$ 37,944	\$ 26,195	\$ 11,749	44.85%

**Table of Contents**

**Interest Income.** Interest income increased primarily due to our growth in loans, our highest earning asset.

Interest income and fees on loans increased as the increase in the average balance of loans more than offset a decrease in the average yield on our loans. The average yield on our loan portfolio decreased, reflecting a lower market interest rate environment.

Interest income on taxable securities decreased from a decline in the average balance and average yield of our taxable securities. The decline in the average yield on our taxable securities portfolio resulted from lower market interest rates.

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

During the June 2012 quarter, we utilized deposits and overnight and short-term advances to fund loans.

**Net Interest Income.** Net interest income increased as our net interest-earning assets increased. In addition, our net interest rate spread increased to 3.75% from 3.61%, and we experienced a 14 basis point increase in our net interest margin to 3.84% from 3.70%.

**Provision for Loan Losses.** We recorded a provision for loan losses of \$215,000 for the three months ended June 30, 2012, compared to \$291,000 for the same period in 2011. The decrease in the provision for loan losses was primarily attributable to a higher degree of loss exposures in the second quarter of 2011.

**Summary of Noninterest Income.**

(Dollars in thousands)	Three Months Ended June 30,		Increase	%
	2012	2011	(Decrease)	Change
<b>Noninterest income:</b>				
Service charges	\$ 274	\$ 314	\$ (40)	(12.74)%
Gain on sale of securities available for sale	180	174	\$ 6	3.45
Gain on sale of mortgage loans	512	306	\$ 206	67.32
Increase in cash surrender value of BOLI	57	59	\$ (2)	(3.39)
Other	101	32	\$ 69	215.63
<b>Total noninterest income</b>	<b>\$ 1,124</b>	<b>\$ 885</b>	<b>\$ 239</b>	<b>27.01%</b>

**Noninterest Income.** Noninterest income increased primarily due to gains on sale of mortgage loans. Our origination, sale and resulting gains on one-to-four family residential loans in the secondary market is dependent upon relative customer demand, which is affected by current and anticipated market interest rates.

Service charges decreased as a result of lower NSF charges and other deposit fees driven by new regulations related to overdraft protection programs. Other noninterest income increased due primarily to transaction-based fee income generated from the Bank's mortgage warehouse business.

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

(Dollars in thousands)	Three Months Ended June 30,		Increase (Decrease)	% Change
	2012	2011		
Noninterest expense:				
Compensation and benefits	\$ 1,512	\$ 1,317	\$ 195	14.81%
Occupancy costs	241	257	\$ (16)	(6.23)
Equipment expense	59	62	\$ (3)	(4.84)
Data processing expense	136	123	\$ 13	10.57
ATM expense	60	97	\$ (37)	(38.14)
Professional and outside services	341	291	\$ 50	17.18
Stationery and supplies	21	28	\$ (7)	(25.00)
Marketing	56	44	\$ 12	27.27
FDIC insurance assessments	53	78	\$ (25)	(32.05)
Operations from OREO	35	29	\$ 6	20.69
Provision for losses on OREO	244		\$ 244	NM
Other	401	266	\$ 135	50.75
Total noninterest expense	\$ 3,159	\$ 2,592	\$ 567	21.88%

NM Not meaningful.

**Noninterest Expense.** Noninterest expense increased due primarily to a provision for losses on OREO, an increase in other noninterest expense and an increase in compensation and benefits and professional and outside services, partially offset by a decrease in ATM expense and FDIC insurance assessments.

Compensation and benefits increased due to higher salary levels and mortgage commission expense, and additional personnel associated with the mortgage warehouse business. ATM expense decreased due to contract renegotiation efforts in June 2012 to reduce costs, retroactive to February 2012. Professional and outside services reflects higher outside information technology ( IT ) costs and expenses associated with the Company's public filing requirements with the SEC, partially offset by lower outside consultant fees incurred for general corporate purposes. During the three months ended June 30, 2011, the IT services were performed internally by one employee. FDIC insurance assessments decreased due to a lower insurance assessment rate. The provision for losses on OREO represents a write-down on a commercial real estate property. Other noninterest expense increased as a result of a provision for loss on a fraudulent wire transfer transaction, partially offset by lower legal expenses related to loan matters, travel costs and mortgage servicing costs.

During the three months ended March 31, 2012, the Bank experienced a fraudulent wire transfer from a customer's account. The Company accrued and expensed the \$50,000 deductible under its insurance policy during the same period. In August, 2012, the Company was notified by its insurance carrier that its claim for reimbursement of loss was denied. The Company has provided for an additional loss of \$228,000 in connection with this incident during the three months ended June 30, 2012. Although the Company has provided for a total loss of \$278,000, the Company strongly disagrees with the position taken by its insurance carrier and is challenging this decision.

**Income Tax Expense.** We recorded income tax expense of \$66,000 for the three months ended June 30, 2012, compared to income tax expense of \$64,000 for the same period in 2011. Our effective tax rate was 21.9% for the three months ended June 30, 2012, compared to 22.7% for the three months ended June 30, 2011.

**Table of Contents****Comparison of Operating Results for the Six Months Ended June 30, 2012 and 2011**

**General.** We recorded net income of \$514,000 for the six months ended June 30, 2012, compared to net income of \$435,000 for the same period last year. Net interest income increased by \$488,000 to \$5.1 million for the six months ended June 30, 2012 from \$4.6 million for the six months ended June 30, 2011 and noninterest income increased by \$648,000, which was partially offset by a higher provision for loan losses of \$291,000 and noninterest expense of \$765,000.

*Summary of Net Interest Income.*

(Dollars in thousands)	Six Months Ended June 30,		Increase (Decrease)	% Change
	2012	2011		
<b>Interest income:</b>				
Interest and fees on loans	\$ 5,589	\$ 5,189	\$ 400	7.71%
Securities - taxable	83	199	(116)	(58.29)
Securities - nontaxable	76	70	6	8.57
Other interest - earning assets	67	54	13	24.07
<b>Total interest income</b>	<b>5,815</b>	<b>5,512</b>	<b>303</b>	<b>5.50</b>
<b>Interest expense:</b>				
Savings deposits	27	41	(14)	(34.15)
Money market	42	85	(43)	(50.59)
Demand deposit account	35	57	(22)	(38.60)
Certificates of deposit	470	521	(51)	(9.79)
<b>Total deposits</b>	<b>574</b>	<b>704</b>	<b>(130)</b>	<b>(18.47)</b>
<b>Borrowings</b>	<b>170</b>	<b>225</b>	<b>(55)</b>	<b>(24.44)</b>
<b>Total interest expense</b>	<b>744</b>	<b>929</b>	<b>(185)</b>	<b>(19.91)</b>
<b>Net interest income</b>	<b>\$ 5,071</b>	<b>\$ 4,583</b>	<b>\$ 488</b>	<b>10.65%</b>

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

## Average Yields and Rates

	Six Months Ended June 30,		Increase (decrease)
	2012	2011	
Loans	5.09%	5.32%	(0.23)%
Securities - taxable	1.18%	2.07%	(0.89)
Securities - nontaxable	3.37%	3.61%	(0.24)
Other interest - earning assets	0.55%	0.49%	0.06
Total interest - earning assets	4.42%	4.59%	(0.17)
Savings deposits	0.15%	0.25%	(0.10)
Money market	0.22%	0.41%	(0.19)
Demand deposit account	0.13%	0.21%	(0.08)
Certificates of deposit	1.28%	1.61%	(0.33)
Total deposits	0.57%	0.72%	(0.15)
Borrowings	1.33%	2.82%	(1.49)
Total interest-bearing liabilities	0.66%	0.88%	(0.22)
Net interest rate spread	3.76%	3.71%	0.05
Net interest margin	3.85%	3.82%	0.03%
Average Balances			

(Dollars in thousands)	Six Months Ended June 30,		Increase (Decrease)	% Change
	2012	2011		
Loans	\$ 219,792	\$ 195,076	\$ 24,716	12.67%
Securities - taxable	14,043	19,219	(5,176)	(26.93)
Securities - nontaxable	4,510	3,878	632	16.30
Other interest - earning assets	24,761	22,071	2,690	12.19
Total interest - earning assets	263,106	240,244	22,862	9.52
Savings deposits	35,770	33,211	2,559	7.71
Money market	38,386	41,212	(2,826)	(6.86)
Demand deposit account	52,374	55,223	(2,849)	(5.16)
Certificates of deposit	73,291	64,618	8,673	13.42
Total deposits	199,821	194,264	5,557	2.86
Borrowings	25,519	15,980	9,539	59.69
Total interest-bearing liabilities	225,340	210,244	15,096	7.18
Net interest-earning assets	\$ 37,766	\$ 30,000	\$ 7,766	25.89%

**Interest Income.** Interest income increased primarily due to our growth in loans, our highest earning asset.

**Table of Contents**

Interest income and fees on loans increased as the increase in the average balance of loans more than offset a decrease in the average yield on our loans. The average yield on our loan portfolio decreased, reflecting a lower market interest rate environment.

Interest income on taxable securities decreased from a decline in the average balance and average yield of our taxable securities. The decline in the average yield on our taxable securities portfolio resulted from lower market interest rates.

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

During the six months ended June 2012, we utilized deposits and overnight and short-term advances to fund loans.

**Net Interest Income.** Net interest income increased as our net interest-earning assets increased. In addition, our net interest rate spread increased to 3.76% from 3.71%, and we experienced a 3 basis point increase in our net interest margin to 3.85% from 3.82% due to an increase in our net interest-earning assets.

**Provision for Loan Losses.** We recorded a provision for loan losses of \$702,000 for the six months ended June 30, 2012, compared to \$411,000 for the same period in 2011. The increase in the provision for loan losses was primarily attributable to an increase in the loss experience factors used to determine the general allowance for loan losses.

**Summary of Noninterest Income.**

(Dollars in thousands)	Six Months Ended June 30,		Increase	
	2012	2011	(Decrease)	% Change
Noninterest income:				
Service charges	\$ 568	\$ 634	\$ (66)	(10.41)%
Gain on sale of securities available for sale	500	202	298	147.52
Gain on sale of mortgage loans	879	529	350	66.16
Increase in cash surrender value of BOLI	113	76	37	48.68
Other	166	137	29	21.17
<b>Total noninterest income</b>	<b>\$ 2,226</b>	<b>\$ 1,578</b>	<b>\$ 648</b>	<b>41.06%</b>

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

Service charges decreased as a result of lower NSF charges and other deposit fees driven by new regulations related to overdraft protection programs. Other noninterest income increased due primarily to transaction-based fee income generated from the Bank's mortgage warehouse business.



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

(Dollars in thousands)	Six Months Ended June 30,		Increase (Decrease)	% Change
	2012	2011		
Noninterest expense:				
Compensation and benefits	\$ 2,960	\$ 2,603	\$ 357	13.71%
Occupancy costs	496	526	(30)	(5.70)
Equipment expense	124	131	(7)	(5.34)
Data processing expense	270	238	32	13.45
ATM expense	156	188	(32)	(17.02)
Professional and outside services	678	523	155	29.64
Stationery and supplies	51	66	(15)	(22.73)
Marketing	110	88	22	25.00
FDIC insurance assessments	99	170	(71)	(41.76)
Operations from OREO	66	131	(65)	(49.62)
Provision for losses on OREO	244		244	NM
Other	678	503	175	34.79
Total noninterest expense	\$ 5,932	\$ 5,167	\$ 765	14.81%

NM Not meaningful.

**Noninterest Expense.** Noninterest expense increased due primarily to a provision for losses on OREO, an increase in other noninterest expense and an increase in compensation and benefits and professional and outside services, partially offset by lower costs from operations from OREO and a decrease in FDIC insurance assessments.

Compensation and benefits increased due to higher salary levels and mortgage commission expense, and additional personnel associated with the mortgage warehouse business. Professional and outside services reflects higher outside information technology (IT) costs and expenses associated with the Company's public filing requirements with the SEC, partially offset by lower outside consultant fees incurred for general corporate purposes. During the six months ended June 30, 2011, the IT services were performed internally by one employee. FDIC insurance assessments decreased due to a lower insurance assessment rate. Operations from OREO decreased due to a higher degree of various holding costs related to other real estate owned in 2011. The provision for losses on OREO represents a write-down on a commercial real estate property. Other noninterest expense increased due to a provision for loss on a fraudulent wire transfer transaction, partially offset by lower legal expenses related to loan matters and mortgage servicing costs.

During the three months ended March 31, 2012, the Bank experienced a fraudulent wire transfer from a customer's account. The Company accrued and expensed the \$50,000 deductible under its insurance policy during the same period. In August, 2012, the Company was notified by its insurance carrier that its claim for reimbursement of loss was denied. The Company has provided for an additional loss of \$228,000 in connection with this incident during the three months ended June 30, 2012. Although the Company has provided for a total loss of \$278,000, the Company strongly disagrees with the position taken by its insurance carrier and is challenging this decision.

**Income Tax Expense.** We recorded income tax expense of \$149,000 for the six months ended June 30, 2012, compared to income tax expense of \$148,000 for the same period in 2011. Our effective tax rate was 22.5% for the six months ended June 30, 2012, compared to 25.4% for the six months ended June 30, 2011.

**Average Balances and Yields**

The following tables set forth average balance sheets, average yields and costs, and certain other information for the periods indicated. Tax-equivalent yield adjustments have not been made for tax-exempt securities. All average balances are daily average balances.



**Table of Contents**

Nonaccrual loans were included in the computation of average balances, but have been reflected in the table as loans carrying a zero yield. The yields set forth below include the effect of deferred fees, discounts and premiums that are amortized or accreted to interest income or expense.

	For the Three Months Ended June 30,					
	2012			2011		
	Average Outstanding Balance	Interest	Yield/Rate (1)	Average Outstanding Balance	Interest	Yield/Rate (1)
<b>Interest-earning assets:</b>						
Loans, net	\$ 223,070	\$ 2,817	5.05%	\$ 195,069	\$ 2,571	5.27%
Taxable investment securities	14,125	45	1.27%	18,968	119	2.51%
Nontaxable investment securities	3,063	26	3.40%	4,009	36	3.59%
Total other interest earning assets	24,280	34	0.56%	27,434	31	0.45%
FHLB of Dallas stock	1,300	1	0.31%	954	1	0.42%
<b>Total interest-earning assets</b>	<b>265,838</b>	<b>2,923</b>	<b>4.40%</b>	<b>246,434</b>	<b>2,758</b>	<b>4.48%</b>
Non-interest-earning assets	16,849			18,073		
<b>Total assets</b>	<b>\$ 282,687</b>			<b>\$ 264,507</b>		
<b>Interest-bearing liabilities:</b>						
Savings deposits	\$ 37,381	\$ 14	0.15%	\$ 34,860	\$ 22	0.25%
Money market	38,828	21	0.22%	42,948	43	0.40%
Demand deposit accounts	55,658	18	0.13%	58,526	30	0.21%
Certificates of deposit	74,443	236	1.27%	67,926	270	1.59%
<b>Total deposits</b>	<b>206,310</b>	<b>289</b>	<b>0.56%</b>	<b>204,260</b>	<b>365</b>	<b>0.71%</b>
Borrowings	21,584	83	1.54%	15,979	113	2.83%
<b>Total interest-bearing liabilities</b>	<b>227,894</b>	<b>372</b>	<b>0.65%</b>	<b>220,239</b>	<b>478</b>	<b>0.87%</b>
Non-interest-bearing liabilities	21,820			11,832		
<b>Total liabilities</b>	<b>249,714</b>			<b>232,071</b>		
Equity	32,973			32,436		
<b>Total liabilities and equity</b>	<b>\$ 282,687</b>			<b>\$ 264,507</b>		
Net interest income		\$ 2,551			\$ 2,280	
Net interest rate spread <sup>(2)</sup>			3.75%			3.61%
Net interest-earning assets <sup>(3)</sup>	\$ 37,944			\$ 26,195		
Net interest margin <sup>(4)</sup>			3.84%			3.70%
Average interest-earning assets to interest-bearing liabilities			116.65%			111.89%

(1) Yields and rates for the three months ended June 30, 2012 and 2011 are annualized.

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

(3) Net interest-earning assets represent total interest-earning assets less total interest-bearing liabilities.

- (4) Net interest margin represents net interest income divided by average total interest-earning assets.

**Table of Contents**

	For the Six Months Ended June 30,					
	2012			2011		
	Average Outstanding Balance	Interest	Yield/Rate (1)	Average Outstanding Balance	Interest	Yield/Rate (1)
<b>Interest-earning assets:</b>						
Loans, net	\$ 219,792	\$ 5,589	5.09%	\$ 195,076	\$ 5,189	5.32%
Taxable investment securities	14,043	83	1.18%	19,219	199	2.07%
Nontaxable investment securities	4,510	76	3.37%	3,878	70	3.61%
Total other interest earning assets	23,246	64	0.55%	21,118	52	0.49%
FHLB of Dallas stock	1,515	3	0.40%	953	2	0.42%
<b>Total interest-earning assets</b>	<b>263,106</b>	<b>5,815</b>	<b>4.42%</b>	<b>240,244</b>	<b>5,512</b>	<b>4.59%</b>
Non-interest-earning assets	17,063			14,338		
<b>Total assets</b>	<b>\$ 280,169</b>			<b>\$ 254,582</b>		
<b>Interest-bearing liabilities:</b>						
Savings deposits	\$ 35,770	\$ 27	0.15%	\$ 33,211	\$ 41	0.25%
Money market	38,386	42	0.22%	41,212	85	0.41%
Demand deposit accounts	52,374	35	0.13%	55,223	57	0.21%
Certificates of deposit	73,291	470	1.28%	64,618	521	1.61%
<b>Total deposits</b>	<b>199,821</b>	<b>574</b>	<b>0.57%</b>	<b>194,264</b>	<b>704</b>	<b>0.72%</b>
Borrowings	25,519	170	1.33%	15,980	225	2.82%
<b>Total interest-bearing liabilities</b>	<b>225,340</b>	<b>744</b>	<b>0.66%</b>	<b>210,244</b>	<b>929</b>	<b>0.88%</b>
Non-interest-bearing liabilities	19,777			11,955		
<b>Total liabilities</b>	<b>245,117</b>			<b>222,199</b>		
Equity	35,052			32,383		
<b>Total liabilities and equity</b>	<b>\$ 280,169</b>			<b>\$ 254,582</b>		
Net interest income		\$ 5,071			\$ 4,583	
Net interest rate spread <sup>(2)</sup>			3.76%			3.71%
Net interest-earning assets <sup>(3)</sup>	\$ 37,766			\$ 30,000		
Net interest margin <sup>(4)</sup>			3.85%			3.82%
Average interest-earning assets to interest-bearing liabilities			116.76%			114.27%

(1) Yields and rates for the six months ended June 30, 2012 and 2011 are annualized.

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

(3) Net interest-earning assets represent total interest-earning assets less total interest-bearing liabilities.

(4) Net interest margin represents net interest income divided by average total interest-earning assets.

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**Table of Contents**

**Liquidity and Capital Resources**

Liquidity is the ability to meet current and future financial obligations of a short-term nature. Our primary sources of funds consist of deposit inflows, loan sales and repayments, advances from the Federal Home Loan Bank of Dallas, and maturities and sales of securities. While maturities and scheduled amortization of loans and securities are predictable sources of funds, deposit flows and mortgage prepayments are greatly influenced by general interest rates, economic conditions and competition. Our Asset/Liability Management Committee is responsible for establishing and monitoring our liquidity targets and strategies in order to ensure that sufficient liquidity exists for meeting the borrowing needs and deposit withdrawals of our customers as well as unanticipated contingencies. For the six months ended June 30, 2012, our liquidity ratio averaged 17.27%. We believe that we have enough sources of liquidity to satisfy our short- and long-term liquidity needs as of June 30, 2012.

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

Our most liquid assets are cash and cash equivalents. The levels of these assets are affected by our operating, financing, lending and investing activities during any given period. At June 30, 2012, cash and cash equivalents totaled \$6.9 million. Securities classified as available-for-sale, which provide additional sources of liquidity, totaled \$16.3 million at June 30, 2012.

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

At June 30, 2012, we had \$16.6 million in loan commitments outstanding, including \$13.5 million in unused lines of credit to borrowers. Certificates of deposit due within one year of June 30, 2012 totaled \$39.1 million, or 17.3% of total deposits. If these deposits do not remain with us, we will be required to seek other sources of funds, including loan sales and Federal Home Loan Bank advances. Depending on market conditions, we may be required to pay higher rates on such deposits or other borrowings than we currently pay on the certificates of deposit due on or before June 30, 2013. We believe, however, that based on past experience, a significant portion of such deposits will remain with us. We have the ability to attract and retain deposits by adjusting the interest rates offered.

Our primary investing activity is originating loans. During the six months ended June 30, 2012 and 2011 we originated \$92.5 million and \$78.4 million of loans, including unfunded commitments, respectively. We purchased \$7.3 million and \$20.1 million of securities during the six months ended June 30, 2012 and 2011, respectively.

Financing activities consist primarily of activity in deposit accounts and Federal Home Loan Bank advances. We had a net increase in total deposits of \$14.5 million and \$26.8 million for the six months ended June 30, 2012 and 2011, respectively. Deposit flows are affected by the overall level of interest rates, the interest rates and products offered by us and our local competitors, and by other factors. Borrowings decreased by \$16.9 million and \$4,000 for the six months ended June 30, 2012 and 2011, respectively.

Liquidity management is both a daily and long-term function of business management. If we require funds beyond our ability to generate them internally, borrowing agreements exist with the Federal Home Loan Bank of Dallas, which provides an additional source of funds. Federal Home Loan Bank advances decreased \$16.9 million to \$9.0 million at June 30, 2012. At June 30, 2012, we had remaining credit available under the FHLB of Dallas program of \$115.1 million.

SharePlus Federal Bank is subject to various regulatory capital requirements, including a risk-based capital measure. The risk-based capital guidelines include both a definition of capital and a framework for calculating risk-weighted assets by assigning balance sheet assets and off-balance sheet items to broad risk categories. At June 30, 2012, SharePlus Federal Bank exceeded all regulatory capital requirements. SharePlus Federal Bank is considered well capitalized under regulatory guidelines. See Note 8 - Regulatory Capital of the notes to the consolidated financial statements.

## Table of Contents

### **Nonperforming Assets**

**Nonperforming Loans.** At June 30, 2012, our nonaccrual loans totaled \$6.9 million. The non-accrual loans consisted of five single-family residential loans totaling \$1.7 million with \$98,000 in allocated allowances, one consumer loan totaling \$13,000 with \$4,000 in allocated allowances, and three commercial real estate loans totaling \$5.2 million with \$130,000 in allocated allowances. These commercial real estate loans remained current at June 30, 2012.

For the six months ended June 30, 2012, gross interest income that would have been recorded had our non-accruing loans been current in accordance with their original terms was \$207,000. Interest income recognized on such loans for the six months ended June 30, 2012 was \$148,000.

At June 30, 2012, we had a total of 15 loans that were not currently classified as non-accrual, 90 days past due or troubled debt restructurings, but where known information about possible credit problems of borrowers caused management to have serious concerns as to the ability of the borrowers to comply with present loan repayment terms and that could result in disclosure as non-accrual, 90 days past due or troubled debt restructurings. Three of these loans are automobile loans with an aggregate principal balance of \$6,000 and were made to individuals who either declared personal bankruptcy or have been slow to pay. Ten of these loans, with an aggregate balance of \$1.2 million are collateralized by one- to four-family residential mortgages of borrowers who have, on occasion, been late with scheduled payments. One of these loans is a commercial real estate loan totaling \$1.6 million impacted by slow leasing activity and rental rates below original projections at the time of origination. This loan is current, recently made a principal reduction of \$265,000, and continues to maintain significant interest reserves at the Bank. One of these loans is a land loan totaling \$296,000 and, while having fallen past due recently, is believed to have guarantor support.

**Troubled Debt Restructurings.** Troubled debt restructurings include loans for which either a portion of interest or principal has been forgiven, or for loans modified at interest rates or on terms materially less favorable than current market rates. We periodically modify loans to extend the term or make other concessions to help a borrower stay current on their loan and to avoid foreclosure. We generally do not forgive principal or interest on loans or modify the interest rates on loans to rates that are below market rates. At June 30, 2012, we had \$229,000 of troubled debt restructurings (not included in nonaccrual loans) related to 7 consumer loans totaling \$21,000 and two residential loans totaling \$208,000. Of this \$229,000 in troubled debt restructurings (not included in nonaccrual loans), two loans totaling \$208,000 were past due between 30-89 days.

**Other Real Estate Owned.** At June 30, 2012, we had \$1.8 million in other real estate owned, consisting of two commercial real estate properties. One of these properties is currently under contract for sale and scheduled to close in August, 2012.

**Classification of Assets.** Assets that do not expose us to risk sufficient to warrant classification, but which possess potential weaknesses that deserve our close attention, are required to be designated as special mention. As of June 30, 2012, we had \$595,000 of assets designated as special mention with an allocated allowance of \$4,000.

When we classify assets as either substandard or doubtful, we allocate a portion of the related general loss allowances to such assets as we deem prudent. The allowance for loan losses is the amount estimated by management as necessary to absorb credit losses incurred in the loan portfolio that are both probable and reasonably estimable at the balance sheet date. When we classify a problem asset as doubtful, we charge the asset off. For other classified assets, we provide an allocated allowance for that portion of the asset that is considered uncollectible. Our determination as to the classification of our assets and the amount of our loss allowances are subject to review by our principal federal regulator, the Office of the Comptroller of the Currency, which can require that we establish additional loss allowances. We regularly review our asset portfolio to determine whether any assets require classification in accordance with applicable regulations. On the basis of our review of our assets at June 30, 2012, substandard assets consisted of loans of \$9.7 million with an allocated allowance of \$228,000 and other real estate owned of \$1.8 million. There were no doubtful or loss assets at June 30, 2012.

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## **Table of Contents**

As of June 30, 2012, our largest substandard asset was a \$2.0 million commercial real estate loan collateralized by 119 acres of raw land located in Celina, Texas. The loan was originated in February 2008 to a developer who purchased the property for residential development. The land was appraised at \$4.4 million in early 2008 and the loan to value was 47% at the time the loan was originated. We identified the loan as special mention in December 2009, recognizing the source of repayment through timely sale of the land had been significantly extended. The loan was further classified to substandard in March 2010 as market conditions, in management's opinion, had not significantly improved. In February 2011, the loan maturity was extended from February 2013 to February 2015. In exchange the borrower made a principal reduction of \$105,000. The Bank subsequently reduced the interest rate to 6% fixed with interest payable quarterly. The Bank's strategy for the extended maturity was to reduce the principal balance, reduce exposure and allow for additional time to either sell or refinance the property. The Bank had the property appraised again in December 2011. The appraised value was \$2.3 million resulting in a loan to value of 87%. In February 2012, the borrower missed his quarterly payment and this loan was placed on non-accrual. The borrower has since brought the loan current and the loan now has interest reserves in place.

### **Allowance for Loan Losses**

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

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

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

**General Valuation Allowance on Non-impaired Loans.** We establish a general allowance for non-impaired loans to recognize the inherent and probable losses associated with lending activities. This general valuation allowance is determined by segregating the loans by loan category and assigning allowance percentages based on our historical loss experience for the last three years, adjusted for qualitative factors that could impact the allowance for loan losses. These qualitative factors may include changes in lending policies and procedures, existing general economic and business conditions affecting our primary market area, credit quality trends, collateral value, loan volumes and concentrations, seasoning of the loan portfolio, recent loss experience in particular segments of the portfolio, duration of the current business cycle and bank regulatory examination results. The applied loss factors are re-evaluated quarterly to ensure their relevance in the current real estate environment.

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

The allowance for loan losses increased \$432,000, or 24.6%, to \$2.2 million at June 30, 2012 from \$1.8 million at December 31, 2011. In addition, the allowance for loan losses to total loans receivable, including loans held for sale, increased to 0.95% at June 30,



## **Table of Contents**

2012 as compared to 0.80% at December 31, 2011. The allowance for loan losses as a percentage of nonperforming loans increased to 30.56% at June 30, 2012 from 24.96% at December 31, 2011. The increase was attributable primarily to an increase in the loss experience factors used to determine the general allowance for loan losses and allowances allocated to one single-family loan and one commercial real estate loan, which are both classified as troubled debt restructurings.

Substandard loans increased to \$9.7 million at June 30, 2012 from \$8.7 million at December 31, 2011. Nonperforming loans, including troubled debt restructurings not included in nonaccrual loans, increased slightly to \$7.2 million at June 30, 2012 from \$7.0 million at December 31, 2011. Nonperforming loans are evaluated to determine impairment.

Impaired loans with valuation allowances were \$1.9 million at June 30, 2012, and the related valuation allowance for loan losses was \$232,000. Impaired loans without specific valuation allowances were \$5.3 million at June 30, 2012.

To the best of our knowledge, we have provided for all losses that are both probable and reasonable to estimate at June 30, 2012 and December 31, 2011.

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

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

There were no changes in our nonaccrual or charge-off policies during the six months ended June 30, 2012 or 2011. The accrual of interest on loans is discontinued at the time future payments are not reasonably assured or the loan is 90 days delinquent, unless the credit is well secured and in the process of collection. Loans are placed on nonaccrual status or charged-off at an earlier date if collection of principal or interest is considered doubtful.

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

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

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

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

## **Impact of Inflation and Changing Prices**

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

**Table of Contents**

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

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

**Item 4. Controls and Procedures**

An evaluation was performed under the supervision and with the participation of the Company's management, including the Chief Executive Officer and the Senior Vice President and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) promulgated under the Securities and Exchange Act of 1934, as amended) as of June 30, 2012. Based on that evaluation, the Company's management, including the Chief Executive Officer and the Senior Vice President and Chief Financial Officer, concluded that the Company's disclosure controls and procedures were effective.

During the quarter ended June 30, 2012, there have been no changes in the Company's internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**Part II - Other Information**

**Item 1. Legal Proceedings**

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

**Item 1A. Risk Factors**

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

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

Period	(a) Total Number of Shares (or Units) Purchased	(b) Average Price Paid per Share (or Unit)	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) That May Yet Be Purchased Under the Plans or Programs
April 1, 2012 through April 30, 2012	200	\$ 12.05	200	77,850
May 1, 2012 through May 31, 2012	9,500	\$ 12.30	9,500	68,350
June 1, 2012 through June 30, 2012	7,300	\$ 12.99	7,300	61,050
Total	17,000	\$ 12.60	17,000	

On February 27, 2012, the Board of Directors authorized the Company's first stock repurchase program of 86,250 shares.

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. Mine Safety Disclosures**

Not applicable.

**Item 5. Other Information**

None.

**Item 6. Exhibits**

3.1	Articles of Incorporation of SP Bancorp Inc. <sup>(1)</sup>
3.2	Bylaws of SP Bancorp, Inc. <sup>(1)</sup>
4.0	Form of Common Stock Certificate of SP Bancorp, Inc. <sup>(1)</sup>
10.1	2010 Incentive Compensation Plan <sup>(1)</sup>
10.2	2008 Nonqualified Deferred Compensation Plan <sup>(1)</sup>
10.3	Phantom Stock Plan <sup>(1)</sup>
10.4	SP Bancorp, Inc. 2012 Equity Incentive plan <sup>(2)</sup>
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document

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101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

- (1) Incorporated by reference into this document from the Exhibits filed with the Securities Exchange Commission in the Registration Statement on Form S-1, and any amendments thereto, Registration No. 333-167967.
- (2) Incorporated by reference to the Company's definitive proxy statement filed on April 12, 2012.

**Table of Contents**

**SIGNATURES**

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

**SP BANCORP, INC.**

Date: August 13, 2012

*/s/ Jeffrey Weaver*  
Jeffrey Weaver

President and Chief Executive Officer

Date: August 13, 2012

*/s/ Suzanne C. Salls*  
Suzanne C. Salls

Senior Vice President and Chief Financial Officer