

SP Bancorp, Inc.  
Form 10-Q  
August 13, 2012  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

x **Quarterly Report Pursuant To Section 13 or 15(d) of the Securities Exchange Act of 1934**  
For the quarterly period ended June 30, 2012

OR

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

Commission File No. 001-34933

**SP Bancorp, Inc.**

(Exact name of registrant as specified in its charter)

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<b>Maryland</b> (State or other jurisdiction of incorporation or organization)	<b>27-3347359</b> (I.R.S. Employer Identification Number)
<b>5224 W. Plano Parkway,</b> <b>Plano, Texas</b> (Address of Principal Executive Offices)	<b>75093</b> Zip Code
<b>(972) 931-5311</b> (Registrant's telephone number)	
<b>N/A</b> (Former name or former address, if changed since last report)	

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

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

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

Large accelerated filer <input type="checkbox"/>	Accelerated filer <input type="checkbox"/>
Non-accelerated filer <input type="checkbox"/>	Smaller reporting company <input checked="" type="checkbox"/>

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

Shares of the Registrant's common stock, par value \$0.01 per share, issued and outstanding as of August 3, 2012 were 1,694,050.

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**SP Bancorp, Inc.**

**FORM 10-Q**

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**Table of Contents****SP Bancorp, Inc.****Consolidated Balance Sheets (Unaudited)**

(Dollars in thousands, except per share amounts)

	June 30, 2012	December 31, 2011
<b>ASSETS</b>		
Cash and due from banks	\$ 3,208	\$ 2,978
Federal funds sold	3,725	6,950
<b>Total cash and cash equivalents</b>	<b>6,933</b>	<b>9,928</b>
Securities available for sale (amortized cost of \$16,082 at June 30, 2012 and \$24,774 at December 31, 2011)	16,296	25,097
Fixed annuity investment	1,199	1,176
Loans held for sale	9,938	4,884
Loans, net of allowance for losses of \$2,186 at June 30, 2012 and \$1,754 at December 31, 2011	218,485	212,688
Accrued interest receivable	747	961
Other real estate owned ( OREO )	1,756	1,824
Premises and equipment, net	4,300	4,346
Federal Home Loan Bank ( FHLB ) stock and other restricted stock, at cost	1,315	2,020
Bank-owned life insurance ( BOLI )	7,307	6,193
Deferred tax assets	547	509
Other assets	1,906	3,333
<b>Total assets</b>	<b>\$ 270,729</b>	<b>\$ 272,959</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Deposits:		
Noninterest-bearing	\$ 21,566	\$ 8,898
Interest-bearing	204,831	203,036
<b>Total deposits</b>	<b>226,397</b>	<b>211,934</b>
Borrowings	9,045	25,978
Accrued interest payable	27	29
Other liabilities	2,334	1,891
<b>Total liabilities</b>	<b>237,803</b>	<b>239,832</b>
Commitments and contingencies		
Stockholders equity :		
Preferred stock, \$0.01 par value, 50,000,000 shares authorized; none issued or outstanding		
Common stock, \$0.01 par value; 100,000,000 shares authorized; 1,699,800 and 1,725,000 shares issued and outstanding, respectively	17	17
Additional paid-in capital	15,032	15,278
Unallocated Employee Stock Ownership Plan ( ESOP ) shares	(1,353)	(1,018)
Retained earnings - substantially restricted	19,089	18,636
Accumulated other comprehensive income	141	214
<b>Total stockholders equity</b>	<b>32,926</b>	<b>33,127</b>
<b>Total liabilities and stockholders equity</b>	<b>\$ 270,729</b>	<b>\$ 272,959</b>

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See Notes to Consolidated Financial Statements.

**Table of Contents****SP Bancorp, Inc.****Consolidated Statements of Income (Unaudited)****(Dollars in thousands, except per share amounts)**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
<b>Interest income:</b>				
Interest and fees on loans	\$ 2,817	\$ 2,571	\$ 5,589	\$ 5,189
Securities - taxable	45	119	83	199
Securities - nontaxable	26	36	76	70
Other interest - earning assets	35	32	67	54
<b>Total interest income</b>	<b>2,923</b>	<b>2,758</b>	<b>5,815</b>	<b>5,512</b>
<b>Interest expense:</b>				
Deposit accounts	289	365	574	704
Borrowings	83	113	170	225
<b>Total interest expense</b>	<b>372</b>	<b>478</b>	<b>744</b>	<b>929</b>
<b>Net interest income</b>	<b>2,551</b>	<b>2,280</b>	<b>5,071</b>	<b>4,583</b>
Provision for loan losses	215	291	702	411
<b>Net interest income after provision for loan loss</b>	<b>2,336</b>	<b>1,989</b>	<b>4,369</b>	<b>4,172</b>
<b>Noninterest income:</b>				
Service charges	274	314	568	634
Gain on sale of securities available for sale	180	174	500	202
Gain on sale of mortgage loans	512	306	879	529
Increase in cash surrender value of BOLI	57	59	113	76
Other	101	32	166	137
<b>Total noninterest income</b>	<b>1,124</b>	<b>885</b>	<b>2,226</b>	<b>1,578</b>
<b>Noninterest expense:</b>				
Compensation and benefits	1,512	1,317	2,960	2,603
Occupancy costs	241	257	496	526
Equipment expense	59	62	124	131
Data processing expense	136	123	270	238
ATM expense	60	97	156	188
Professional and outside services	341	291	678	523
Stationery and supplies	21	28	51	66
Marketing	56	44	110	88
FDIC insurance assessments	53	78	99	170
Provision for losses on OREO	244		244	
Operations from OREO	35	29	66	131
Other	401	266	678	503
<b>Total noninterest expense</b>	<b>3,159</b>	<b>2,592</b>	<b>5,932</b>	<b>5,167</b>
<b>Income before income tax expense</b>	<b>301</b>	<b>282</b>	<b>663</b>	<b>583</b>

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Income tax expense	66	64	149	148
<b>Net income</b>	<b>\$ 235</b>	<b>\$ 218</b>	<b>\$ 514</b>	<b>\$ 435</b>
<b>Basic and diluted earnings per share</b>	<b>\$ 0.15</b>	<b>\$ 0.13</b>	<b>\$ 0.32</b>	<b>\$ 0.27</b>

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.

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**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



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**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
<b>December 31, 2011:</b>							
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						
Total	\$ 8,147	\$ 42,061	\$ 153,731	\$ 9,305	\$ 6,825	\$ 220,069
<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						
Total	\$ 6,986	\$ 38,348	\$ 150,613	\$ 9,612	\$ 8,318	\$ 213,877

**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.





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Following is a summary of the activity in the allowance for loan losses by loan class for the six months ended June 30, 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.

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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%.

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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.

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(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.





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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			

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### **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.

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**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.

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

Management's discussion and analysis of financial condition and results of operations at June 30, 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;



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our ability to successfully integrate acquired entities, if any;

changes in consumer spending, borrowing and savings habits;

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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