PALATIN TECHNOLOGIES INC
Form 10-Q
February 13, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended December 31, 2012

or

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

For the transition period from ___________ to __________

Commission file number: 001-15543

PALATIN TECHNOLOGIES, INC.
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	95-4078884 (I.R.S. Employer Identification No.)
4B Cedar Brook Drive Cranbury, New Jersey (Address of principal executive offices)	08512 (Zip Code)

(609) 495-2200
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x 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.

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company x

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

As of February 12, 2013, 38,947,912 shares of the registrant's common stock, par value $.01 per share, were outstanding.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

PALATIN TECHNOLOGIES, INC.
and Subsidiary
Consolidated Balance Sheets
(unaudited)

	December 31, 2012	June 30, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	$ 32,850,676	$ 3,827,198
Accounts receivable	37,991	27,631
Restricted cash	—	350,000
Prepaid expenses and other current assets	343,912	532,010
Total current assets	33,232,579	4,736,839
Property and equipment, net	285,649	318,653
Other assets	58,542	324,992
Total assets	$ 33,576,770	$ 5,380,484
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Capital lease obligations	$ 23,144	$ 22,277
Accounts payable	484,815	294,894
Accrued expenses	1,541,729	2,706,496
Accrued compensation	—	433,333
Total current liabilities	2,049,688	3,457,000
Capital lease obligations	8,116	19,909
Deferred rent	54,068	72,677
Total liabilities	2,111,872	3,549,586
Stockholders' equity:		
Preferred stock of $0.01 par value – authorized 10,000,000 shares;		
Series A Convertible; issued and outstanding 4,697 shares as of December 31, 2012 and 4,997 as of June 30, 2012	47	50
Common stock of $0.01 par value – authorized 200,000,000 shares;		
issued and outstanding 38,947,912 shares as of December 31, 2012 and 34,900,591 as of June 30, 2012, respectively	389,479	349,006
Additional paid-in capital	282,447,525	240,725,127
Accumulated deficit	(251,372,153)	(239,243,285)
Total stockholders' equity	31,464,898	1,830,898
Total liabilities and stockholders' equity	$ 33,576,770	$ 5,380,484

The accompanying notes are an integral part of these consolidated financial statements.

PALATIN TECHNOLOGIES, INC.
and Subsidiary
Consolidated Statements of Operations
(unaudited)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2012	2011	2012	2011
REVENUES:	$ 6,555	$ 11,492	$ 10,361	$ 38,709
OPERATING EXPENSES:				
Research and development	2,445,770	2,693,067	4,789,083	4,977,450
General and administrative	1,001,538	1,019,747	2,062,554	2,129,129
Total operating expenses	3,447,308	3,712,814	6,851,637	7,106,579
Loss from operations	(3,440,753)	(3,701,322)	(6,841,276)	(7,067,870)
OTHER INCOME (EXPENSE):				
Investment income	13,016	7,234	27,387	22,274
Interest expense	(1,360)	(1,847)	(3,642)	(4,820)
Increase in fair value of warrants	—	—	(7,069,165)	—
Gain on disposition of supplies and equipment	—	3,000	4,620	3,000
Total other income (expense), net	11,656	8,387	(7,040,800)	20,454
Loss before income taxes	(3,429,097)	(3,692,935)	(13,882,076)	(7,047,416)
Income tax benefit	1,753,208	1,068,233	1,753,208	1,068,233
NET LOSS	$ (1,675,889)	$ (2,624,702)	$ (12,128,868)	$ (5,979,183)
Basic and diluted net loss per common share	$ (0.02)	$ (0.08)	$ (0.14)	$ (0.17)
Weighted average number of common shares outstanding used in computing basic and diluted net loss per common share	106,424,443	34,900,591	89,046,806	34,900,591

The accompanying notes are an integral part of these consolidated financial statements.

PALATIN TECHNOLOGIES, INC.
and Subsidiary
Consolidated Statements of Cash Flows
(unaudited)

	Six Months Ended December 31, 2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$(12,128,868)	$(5,979,183)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	54,778	501,087
Gain on sale of supplies and equipment	(4,620)	(3,000)
Stock-based compensation	325,720	452,320
Increase in fair value of warrants	7,069,165	—
Changes in operating assets and liabilities:		
Accounts receivable	(10,360)	(937,084)
Prepaid expenses, restricted cash and other assets	804,548	(357,451)
Accounts payable	189,921	83,661
Accrued expenses, compensation and deferred rent	(1,616,709)	(675,134)
Unearned revenue	—	(38,709)
Net cash used in operating activities	(5,316,425)	(6,953,493)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sale of supplies and equipment	4,620	3,000
Purchases of property and equipment	(21,774)	—
Net cash (used in) provided by investing activities	(17,154)	3,000
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payments on capital lease obligations	(10,926)	(20,743)
Payment of withholding taxes related to restricted stock units	(34,785)	—
Proceeds from sale of common stock units	34,402,768	—
Net cash provided by (used in) financing activities	34,357,057	(20,743)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	29,023,478	(6,971,236)
CASH AND CASH EQUIVALENTS, beginning of year	3,827,198	18,869,639
CASH AND CASH EQUIVALENTS, end of year	$32,850,676	$11,898,403
SUPPLEMENTAL CASH FLOW INFORMATION:		
Cash paid for interest	$3,534	$4,820

The accompanying notes are an integral part of these consolidated financial statements.

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PALATIN TECHNOLOGIES, INC.
and Subsidiary

Notes to Consolidated Financial Statements
(unaudited)

(1) ORGANIZATION:

Nature of Business – Palatin Technologies, Inc. (Palatin or the Company) is a biopharmaceutical company developing targeted, receptor-specific peptide therapeutics for the treatment of diseases with significant unmet medical need and commercial potential. Palatin's programs are based on molecules that modulate the activity of the melanocortin and natriuretic peptide receptor systems. The melanocortin system is involved in a large and diverse number of physiologic functions, and therapeutic agents modulating this system may have the potential to treat a variety of conditions and diseases, including sexual dysfunction, obesity and related disorders, pigmentation disorders and inflammation-related diseases. The natriuretic peptide receptor system has numerous cardiovascular functions, and therapeutic agents modulating this system may be useful in treatment of acute asthma, heart failure, hypertension and other cardiovascular diseases.

The Company's primary product in development is bremelanotide for the treatment of female sexual dysfunction (FSD). The Company also has drug candidates or development programs for obesity, erectile dysfunction, pulmonary diseases, cardiovascular diseases and inflammatory diseases. The Company has an exclusive global research collaboration and license agreement with AstraZeneca AB (AstraZeneca) to commercialize compounds that target melanocortin receptors for the treatment of obesity, diabetes and related metabolic syndrome, with drug candidates in preclinical evaluation.

Key elements of the Company's business strategy include using its technology and expertise to develop and commercialize therapeutic products; entering into alliances and partnerships with pharmaceutical companies to facilitate the development, manufacture, marketing, sale and distribution of product candidates that the Company is developing; and partially funding its product candidate development programs with the cash flow generated from the Company's license agreements with AstraZeneca and any other companies.

Business Risk and Liquidity – The Company has incurred negative cash flows from operations since its inception, and has expended, and expects to continue to expend in the future, substantial funds to complete its planned product development efforts. As shown in the accompanying consolidated financial statements, the Company has an accumulated deficit as of December 31, 2012 and incurred a net loss for the three and six months ended December 31, 2012. The Company anticipates incurring additional losses in the future as a result of spending on its development programs. To achieve profitability, the Company, alone or with others, must successfully develop and commercialize its technologies and proposed products, conduct successful preclinical studies and clinical trials, obtain required regulatory approvals and successfully manufacture and market such technologies and proposed products. The time required to reach profitability is highly uncertain, and there can be no assurance that the Company will be able to achieve profitability on a sustained basis, if at all.

As of December 31, 2012, the Company's cash and cash equivalents were $32.9 million. The Company intends to utilize existing capital resources for general corporate purposes and working capital, including its clinical trial program with bremelanotide for FSD, preclinical and clinical development of its peptide melanocortin receptor-1 program, preclinical and clinical development of its PL-3994 program and preclinical and clinical development of other portfolio products.

Management believes that the Company's existing capital resources will be adequate to fund its currently planned operations, including completing analysis of results of the Company's Phase 2B clinical trial with bremelanotide for

FSD and holding an end-of-Phase 2 meeting with the U.S. Food and Drug Administration (FDA), through at least calendar year 2013. Phase 3 clinical trials of bremelanotide for FSD will require significant additional resources and capital.

Concentrations – Concentrations in the Company’s assets and operations subject it to certain related risks. Financial instruments that subject the Company to concentrations of credit risk primarily consist of cash and cash equivalents. The Company’s cash and cash equivalents are primarily invested in one money market fund sponsored by a large financial institution. For the three and six months ended December 31, 2012 and 2011, 100% of revenues were from AstraZeneca.

(2) BASIS OF PRESENTATION:

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q. Accordingly, they do not include all of the information and footnote disclosures required to be presented for complete financial statements. In the opinion of management, these consolidated financial statements contain all adjustments (consisting of normal recurring adjustments) considered necessary to present fairly the Company’s financial position as of December 31, 2012, and its results of operations and its cash flows for the three and six months ended December 31, 2012 and 2011. The results of operations for the three and six months ended December 31, 2012 may not necessarily be indicative of the results of operations expected for the full year, except that the Company expects to incur a significant loss for the fiscal year ending June 30, 2013.

PALATIN TECHNOLOGIES, INC.
and Subsidiary

Notes to Consolidated Financial Statements
(unaudited)

The accompanying consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company's annual report on Form 10-K for the year ended June 30, 2012, filed with the Securities and Exchange Commission (SEC), which includes consolidated financial statements as of June 30, 2012 and 2011 and for each of the fiscal years in the three-year period ended June 30, 2012.

(3) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Principles of Consolidation – The consolidated financial statements include the accounts of Palatin and its wholly-owned inactive subsidiary. All significant intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates – The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents – Cash and cash equivalents include cash on hand, cash in banks and all highly liquid investments with a purchased maturity of less than three months. Cash equivalents consist of $32,344,788 and $3,344,146 in a money market fund at December 31, 2012 and June 30, 2012, respectively.

Fair Value of Financial Instruments – The Company's financial instruments consist primarily of cash equivalents, accounts receivable, accounts payable, and capital lease obligations. Management believes that the carrying value of these assets and liabilities are representative of their respective fair values based on the short-term nature of these instruments.

Property and Equipment – Property and equipment consists of office and laboratory equipment, office furniture and leasehold improvements and includes assets acquired under capital leases. Property and equipment are recorded at cost. Depreciation is recognized using the straight-line method over the estimated useful lives of the related assets, generally five years for laboratory and computer equipment, seven years for office furniture and equipment and the lesser of the term of the lease or the useful life for leasehold improvements. Amortization of assets acquired under capital leases is included in depreciation expense. Maintenance and repairs are expensed as incurred while expenditures that extend the useful life of an asset are capitalized.

Impairment of Long-Lived Assets – The Company reviews its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be fully recoverable. To determine recoverability of a long-lived asset, management evaluates whether the estimated future undiscounted net cash flows from the asset are less than its carrying amount. If impairment is indicated, the long-lived asset would be written down to fair value. Fair value is determined by an evaluation of available price information at which assets could be bought or sold, including quoted market prices if available, or the present value of the estimated future cash flows based on reasonable and supportable assumptions.

Deferred Rent – The Company's operating leases provide for rent increases over the terms of the leases. Deferred rent consists of the difference between periodic rent payments and the amount recognized as rent expense on a straight-line basis, as well as tenant allowances for leasehold improvements. Rent expenses are being recognized ratably over the terms of the leases.

Revenue Recognition – Revenue from corporate collaborations and licensing agreements consists of up-front fees, research and development funding, and milestone payments. Non-refundable up-front fees are deferred and amortized to revenue over the related performance period. The Company estimates the performance period as the period in which it performs certain development activities under the applicable agreement. Reimbursements for research and development activities are recorded in the period that the Company performs the related activities under the terms of the applicable agreements. Revenue resulting from the achievement of milestone events stipulated in the applicable agreements is recognized when the milestone is achieved, provided that such milestone is substantive in nature. Revenue from grants is recognized as the Company provides the services stipulated in the underlying grants based on the time and materials incurred.

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Research and Development Costs – The costs of research and development activities are charged to expense as incurred, including the cost of equipment for which there is no alternative future use.

Stock-Based Compensation – The Company charges to expense the fair value of stock options and other equity awards granted. The Company determines the value of stock options utilizing the Black-Scholes option pricing model. Compensation costs for share-based awards with pro rata vesting are allocated to periods on a straight-line basis.

Income Taxes – The Company and its subsidiary file consolidated federal and separate-company state income tax returns. Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of assets and liabilities and their respective tax basis and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences or operating loss and tax credit carryforwards are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the period that includes the enactment date. The Company has recorded a valuation allowance against its deferred tax assets based on the history of losses incurred.

During the three months ended December 31, 2012 and 2011, the Company sold New Jersey state net operating loss (NJ NOL) carryforwards, which resulted in the recognition of $1,753,208 and $1,068,233, respectively, in tax benefits.

Net Loss per Common Share – Basic and diluted earnings per common share (EPS) are calculated in accordance with the provisions of Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 260, "Earnings per Share," which includes guidance pertaining to the warrants, issued in connection with the July 3, 2012 private placement offering, that are exercisable for nominal consideration and, therefore, are to be considered in the computation of basic and diluted net loss per common share. The Series A 2012 warrants to purchase up to 31,988,151 shares of common stock are exercisable starting at July 3, 2012 and, therefore, are included in the weighted average number of common shares outstanding used in computing basic and diluted net loss per common share starting on July 3, 2012.

The Series B 2012 warrants to purchase up to 35,488,380 shares of common stock were considered contingently issuable shares and were not included in computing basic net loss per common share until the Company received stockholder approval for the increase in authorized underlying common stock on September 27, 2012 (see note 6). For diluted EPS, contingently issuable shares are to be included in the calculation as of the beginning of the period in which the conditions were satisfied, unless the effect would be anti-dilutive. The Series B 2012 warrants have been excluded from the calculation of diluted net loss per common share during the period from July 3, 2012 until September 27, 2012 as the impact would be anti-dilutive.

As of December 31, 2012 and 2011, common shares issuable upon conversion of Series A Convertible Preferred Stock, the exercise of outstanding options and warrants (excluding the warrants issued in connection with the July 3, 2013 private placement offering), and the vesting of restricted stock units amounted to an aggregate of 27,685,837 and 27,296,955 shares, respectively. These share amounts have been excluded from the calculation of net loss per share as the impact would be anti-dilutive.

(4) AGREEMENT WITH ASTRAZENECA:

In January 2007, the Company entered into an exclusive global research collaboration and license agreement with AstraZeneca to discover, develop and commercialize compounds that target melanocortin receptors for the treatment of obesity, diabetes and related metabolic syndrome. In June 2008, the license agreement was amended to include additional compounds and associated intellectual property developed by the Company. In December 2008, the license agreement was further amended to include additional compounds and associated intellectual property developed by the Company and extended the research collaboration for an additional year through January 2010. In September 2009, the license agreement was further amended to modify royalty rates and milestone payments. The collaboration is based on the Company's melanocortin receptor obesity program and includes access to compound libraries, core technologies and expertise in melanocortin receptor drug discovery and development. As part of the September 2009 amendment to the research collaboration and license agreement, the Company agreed to conduct additional studies on the effects of melanocortin receptor specific compounds on food intake, obesity and other metabolic parameters.

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In December 2009 and 2008, the Company also entered into clinical trial sponsored research agreements with AstraZeneca, under which the Company agreed to conduct studies of the effects of melanocortin receptor specific compounds on food intake, obesity and other metabolic parameters. Under the terms of these clinical trial agreements, AstraZeneca paid $5,000,000 as of March 31, 2009 upon achieving certain objectives and paid all costs associated with these studies. The Company recognized $6,555 and $10,361, respectively, as revenue in the three and six months ended December 31, 2012 and $11,492 and $38,709, respectively, as revenue in the three and six months ended December 31, 2011 under these clinical trial sponsored research agreements.

The Company received an up-front payment of $10,000,000 from AstraZeneca on execution of the research collaboration and license agreement. Under the September 2009 amendment the Company was paid an additional $5,000,000 in consideration of reduction of future milestones and royalties and providing specific materials to AstraZeneca. The Company is now eligible for milestone payments totaling up to $145,250,000, with up to $85,250,000 contingent on development and regulatory milestones and the balance contingent on achievement of sales targets. In addition, the Company is eligible to receive mid to high single digit royalties on sales of any approved products. AstraZeneca assumed responsibility for product commercialization, product discovery and development costs, with both companies contributing scientific expertise in the research collaboration. The Company provided research services to AstraZeneca through January 2010, the expiration of the research collaboration portion of the research collaboration and license agreement, at a contractual rate per full-time-equivalent employee.

(5) FAIR VALUE MEASUREMENTS:

The fair value of cash equivalents are classified using a hierarchy prioritized based on inputs. Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities. Level 2 inputs are quoted prices for similar assets and liabilities in active markets or inputs that are observable for the asset or liability, either directly or indirectly through market corroboration, for substantially the full term of the financial instrument. Level 3 inputs are unobservable inputs based on management’s own assumptions used to measure assets and liabilities at fair value. A financial asset or liability’s classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement.

The following table provides the assets carried at fair value:

	Fair Value	Quoted prices in active markets (Level 1)	Other quoted/observable inputs (Level 2)	Significant unobservable inputs (Level 3)
December 31, 2012:				
Money Market Fund	$ 32,344,788	$ 32,344,788	$ —	$ —
June 30, 2012:				
Money Market Fund	$ 3,344,146	$ 3,344,146	$ —	$ —

(6) STOCKHOLDERS’ EQUITY:

Common Stock Transactions – On July 3, 2012, the Company closed on a private placement offering in which the Company sold, for aggregate proceeds of $35.0 million, 3,873,000 shares of its common stock, Series A 2012 warrants to purchase up to 31,988,151 shares of common stock, and Series B 2012 warrants to purchase up to

35,488,380 shares of common stock. These warrants are exercisable at an exercise price of $0.01 per share, and expire ten years from the date of issuance. The holders may exercise the warrants on a cashless basis. The warrants are subject to a blocker provision prohibiting exercise of the warrants if the holder and its affiliates would beneficially own in excess of 9.99% of the total number of shares of common stock of the Company following such exercise (as may be adjusted to the extent set forth in the warrant). The warrants also provide that in the event of a Company Controlled Fundamental Transaction (as defined in the warrants), the Company may, at the election of the warrant holder, be required to redeem all or a portion of the warrants at an amount tied to the greater of the then market price of the Company's common stock or the amount per share paid to any other person.

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Because there were not sufficient authorized shares to cover all the outstanding Series B 2012 warrants in the private placement offering as of closing, under ASC 815, “Derivatives and Hedging,” the portion of the warrants above the then authorized level of common stock was required to be classified as a liability and carried at fair value on the Company’s balance sheet. The fair value was calculated by multiplying the number of shares underlying the Series B 2012 warrants above the then authorized level of the Company’s common stock by the closing price of its common stock less the exercise price of $0.01 per share. The warrants were liability classified through September 27, 2012, at which time the then fair value of the warrant liability was reclassified into stockholders’ equity upon stockholder approval of the increase in authorized common stock. The increase in fair value, as a result of the Company’s common stock increasing from $0.50 per share at date of issuance to $0.71 per share upon shareholder approval, of $7,069,165 has been recorded as a non-operating expense.

The purchase agreement for the private placement provides that the purchasers, funds under the management of QVT Financial LP, have certain rights until July 3, 2018, including rights of first refusal and participation in any subsequent equity or debt financing, provided that the funds own at least 20% of the outstanding common stock of the Company calculated as if warrants held by the funds were exercised. The purchase agreement also contains certain restrictive covenants so long as the funds continue to hold specified amounts of warrants or beneficially own specified amounts of the outstanding shares of common stock.

The net proceeds to the Company were $34.4 million, after deducting offering expenses payable by the Company and excluding the proceeds to the Company, if any, from the exercise of the warrants issued in the offering.

Stock Options – In July 2012, the Company granted 285,000 options to its executive officers, 182,500 options to its employees and 112,500 options to its non-employee directors under the Company’s 2011 Stock Incentive Plan. The Company is amortizing the fair value of these options of $182,000, $108,000 and $72,000, respectively, over the 48 months ending July 2016. The Company recognized $35,444 and $70,887, respectively, of stock-based compensation expense related to these options during the three and six months ended December 31, 2012.

Restricted Stock Units – In July 2012, the Company granted 222,500 restricted stock units to its executive officers under the Company’s 2011 Stock Incentive Plan. The Company is amortizing the fair value of these restricted stock units of $160,000 over the 24 months ending July 2014. The Company recognized $30,037 and $54,584, respectively, of stock-based compensation expense related to these restricted stock units during the three and six months ended December 31, 2012.

In June 2011, the Company granted 500,000 restricted stock units to its executive management under the Company’s 2011 Stock Incentive Plan. Half of these restricted stock units vested on June 22, 2012 and the remainder vests 24 months from the date of grant. The grant date fair value of these restricted stock units of $430,000 is being amortized over the 24 month vesting period of the award. The Company recognized $26,875 and $53,750, respectively, of stock-based compensation expense related to these restricted stock units during the three and six months ended December 31, 2012 and $80,625 and $161,250, respectively, for the three and six months ended December 31, 2011.

Stock-based compensation cost for the three and six months ended December 31, 2012 for stock options and equity-based instruments issued other than the stock options and restricted stock units described above was $57,261 and $146,499, respectively, and $161,422 and $291,070, respectively, for the three and six months ended December 31, 2011.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion and analysis should be read in conjunction with the consolidated financial statements and notes to the consolidated financial statements filed as part of this report and the audited consolidated financial statements and notes thereto included in our annual report on Form 10-K for the year ended June 30, 2012.

Statements in this quarterly report on Form 10-Q, as well as oral statements that may be made by us or by our officers, directors, or employees acting on our behalf, that are not historical facts constitute "forward-looking statements", which are made pursuant to the safe harbor provisions of Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). The forward-looking statements in this quarterly report on Form 10-Q do not constitute guarantees of future performance. Investors are cautioned that statements that are not strictly historical statements contained in this quarterly report on Form 10-Q, including, without limitation, current or future financial performance, management's plans and objectives for future operations, ability to raise capital or repay debt, if required, clinical trials and results, uncertainties associated with product research and development, product plans and performance, management's assessment of market factors, as well as statements regarding our strategy and plans and those of our strategic partners, constitute forward-looking statements. Such forward-looking statements involve known and unknown risks, uncertainties and other factors that could cause our actual results to be materially different from historical results or from any results expressed or implied by such forward-looking statements. Our future operating results are subject to risks and uncertainties and are dependent upon many factors, including, without limitation, the risks identified in this report, in our annual report on Form 10-K for the year ended June 30, 2012, as amended by our quarterly report on Form 10-Q for the quarter ended September 30, 2012, and in our other Securities and Exchange Commission (SEC) filings.

We expect to incur losses in the future as a result of spending on our planned development programs and losses may fluctuate significantly from quarter to quarter.

In this quarterly report on Form 10-Q, references to "we", "our", "us" or "Palatin" means Palatin Technologies, Inc. and its subsidiary.

Critical Accounting Policies and Estimates

Our significant accounting policies, which are described in the notes to our consolidated financial statements included in this report and in our annual report on Form 10-K for the year ended June 30, 2012, have not changed as of December 31, 2012. We believe that our accounting policies and estimates relating to revenue recognition, accrued expenses and stock-based compensation are the most critical.

Overview

We are a biopharmaceutical company developing targeted, receptor-specific peptide therapeutics for the treatment of diseases with significant unmet medical need and commercial potential. Our programs are based on molecules that modulate the activity of the melanocortin and natriuretic peptide receptor systems. Our primary product in clinical development is bremelanotide for the treatment of female sexual dysfunction (FSD). In addition, we have drug candidates or development programs for obesity, erectile dysfunction, pulmonary diseases, cardiovascular diseases and inflammatory diseases.

The following drug development programs are actively under development:

- Bremelanotide, a peptide melanocortin receptor agonist, for treatment of FSD. This drug candidate has completed a Phase 2B clinical trial, and we have announced top-line results.

- Melanocortin receptor-based compounds for treatment of obesity, under development by AstraZeneca AB (AstraZeneca) pursuant to our research collaboration and license agreement.

- PL-3994, a peptide mimetic natriuretic peptide receptor A (NPR-A) agonist, for treatment of cardiovascular and pulmonary indications.

The following chart shows the status of our drug development programs.

On November 8, 2012, we reported positive top-line results, including the successful achievement of statistical significance for the primary endpoint and key secondary endpoints in our Phase 2B clinical trial evaluating the efficacy and safety of bremelanotide for treatment of FSD. The primary endpoint data analysis of 327 pre-menopausal women with female sexual arousal disorder, hypoactive sexual desire disorder, or a combination of both disorders, the most common types of FSD, demonstrate that women taking bremelanotide showed statistically significant increases in the number of Satisfying Sexual Events and also showed statistically significant improved measures of overall sexual functioning and distress related to sexual dysfunction, compared to placebo. Bremelanotide was well-tolerated during the trial. The most common types of treatment-emergent adverse events reported more frequently in the bremelanotide arms were facial flushing, nausea and emesis, which were mainly mild-to-moderate in severity. Adverse events that most commonly led to discontinuation were nausea and emesis. No serious adverse events were attributable to bremelanotide during the trial. We have requested an end-of-Phase 2 meeting with the FDA. Based on the results of discussions with the FDA and external advisors regarding the results of this trial and further development steps, Phase 3 activities are anticipated to start in the second-half of calendar year 2013.

We have initiated preclinical studies with new peptide drug candidates for a number of indications, primarily inflammatory disease related, and are continuing preclinical development with a next generation peptide for FSD and erectile dysfunction.

Key elements of our business strategy include: using our technology and expertise to develop and commercialize innovative therapeutic products; entering into alliances and partnerships with pharmaceutical companies to facilitate the development, manufacture, marketing, sale and distribution of product candidates that we are developing; and, partially funding our product development programs with the cash flow generated from our license agreement with AstraZeneca and any other companies.

We incorporated in Delaware in 1986 and commenced operations in the biopharmaceutical area in 1996. Our corporate offices are located at 4B Cedar Brook Drive, Cranbury, New Jersey 08512 and our telephone number is (609) 495-2200. We maintain an Internet site at http://www.palatin.com, where among other things, we make available free of charge on and through this website our Forms 3, 4 and 5, proxy statements, annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d), Section 14A and Section 16 of the Exchange Act as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. Our website and the information contained in it or connected to it are not incorporated into this quarterly report on Form 10-Q.

Results of Operations

Three and Six Months Ended December 31, 2012 Compared to the Three and Six Months Ended December 31, 2011

Revenue – For the three and six months ended December 31, 2012, we recognized \$6,555 and \$10,361, respectively, in revenue compared to \$11,492 and \$38,709, respectively, for the three and six months ended December 31, 2011 pursuant to our license agreement with AstraZeneca. Revenue for the three and six months ended December 31, 2012 and 2011 consisted entirely of reimbursement of development costs and per-employee compensation, earned at the contractual rate.

Research and Development – Research and development expenses were \$2.4 million and \$4.8 million, respectively, for the three and six months ended December 31, 2012 compared to \$2.7 million and \$5.0 million, respectively, for the three and six months ended December 31, 2011. These expenses were primarily costs relating to our Phase 2B clinical trial evaluating the efficacy and safety of bremelanotide for the treatment of FSD. We are currently compiling and analyzing data from this Phase 2B clinical trial, which commenced in June 2011 and had the last patient complete treatment in September 2012.

Research and development expenses related to our bremelanotide, PL-3994, peptide melanocortin agonist, obesity and other preclinical programs were $1.9 million and $3.6 million, respectively, for the three and six months ended December 31, 2012 compared to $1.8 million and $3.1 million, respectively, for the three and six months ended December 31, 2011. Spending to date has been primarily related to our Phase 2B clinical trial evaluating the efficacy and safety of bremelanotide for the treatment of FSD. The amount of such spending and the nature of future development activities are dependent on a number of factors, including primarily the availability of funds to support future development activities, success of our clinical trials and preclinical and discovery programs, and our ability to progress compounds in addition to bremelanotide and PL-3994 into human clinical trials.

The amounts of project spending above exclude general research and development spending, which decreased to $0.5 million and $1.2 million, respectively, for the three and six months ended December 31, 2012 compared to $0.9 million and $1.9 million, respectively, for the three and six months ended December 31, 2011. The decrease is the result of reducing staffing levels and closing our research laboratory operations in connection with the lease expiration of our laboratory facilities in July 2012.

Cumulative spending from inception to December 31, 2012 on our bremelanotide, NeutroSpec (a previously marketed imaging product on which all work is suspended) and other programs (which include PL-3994, other peptide melanocortin agonists, obesity and other discovery programs) amounts to approximately $158.8 million, $55.6 million and $60.0 million, respectively. Due to various risk factors described in our periodic filings with the SEC, including the difficulty in currently estimating the costs and timing of future Phase 1 clinical trials and larger-scale Phase 2 and Phase 3 clinical trials for any product under development, we cannot predict with reasonable certainty when, if ever, a program will advance to the next stage of development or be successfully completed, or when, if ever, net cash inflows will be generated.

General and Administrative – General and administrative expenses, which consists mainly of compensation and related costs, were $1.0 million and $2.1 million, respectively, for both the three and six months ended December 31, 2012 and December 31, 2011.

Liquidity and Capital Resources

Since inception, we have incurred net operating losses, primarily related to spending on our research and development programs. We have financed our net operating losses primarily through equity financings and amounts received under collaborative agreements.

Our product candidates are at various stages of development and will require significant further research, development and testing and some may never be successfully developed or commercialized. We may experience uncertainties, delays, difficulties and expenses commonly experienced by early stage biopharmaceutical companies, which may include unanticipated problems and additional costs relating to:

- the development and testing of products in animals and humans;
- product approval or clearance;
- regulatory compliance;
- good manufacturing practices (GMPs);
- intellectual property rights;
- product introduction;
- marketing, sales and competition; and
- obtaining sufficient capital.

Failure to enter into collaboration agreements and obtain timely regulatory approval for our product candidates and indications would impact our ability to increase revenues and could make it more difficult to attract investment capital for funding our operations. Any of these possibilities could materially and adversely affect our operations and require us to curtail or cease certain programs.

During the six months ended December 31, 2012, we used $5.3 million of cash for our operating activities, compared to $7.0 million used in the six months ended December 31, 2011. Lower net cash outflows from operations in the six months ended December 31, 2012 were primarily the result of an increase in proceeds received from the sale of our New Jersey NOLs and secondarily of lower costs relating to our Phase 2B clinical trial evaluating the efficacy and safety of bremelanotide for the treatment of FSD, in which the last patient completed treatment in September 2012.

During the six months ended December 31, 2012, net cash used in investing activities was $17,154, consisting of $21,774 used for capital expenditures offset by $4,620 in proceeds from the sale of equipment. Cash provided by investing activities for the six months ended December 31, 2011 of $3,000 consisted of proceeds from the sale of equipment.

During the six months ended December 31, 2012, cash provided by financing activities of $34.4 million consisted primarily of the net proceeds from the completion on July 3, 2012 of our private placement of 3,873,000 shares of our common stock, Series A 2012 warrants to purchase up to 31,988,151 shares of our common stock, and Series B 2012 warrants to purchase up to 35,488,380 shares of our common stock. Aggregate gross proceeds to us were $35.0 million, with net proceeds, after deducting offering expenses, of $34.4 million. During the six months ended December 31, 2011, cash used in financing activities consisted of payments of $20,743 on capital lease obligations during the quarter.

As of December 31, 2012, our cash and cash equivalents were $32.9 million and our current liabilities were $2.0 million. We believe that our cash and cash equivalents are adequate to fund our planned operations, including completing analysis of results of our Phase 2B clinical trial with bremelanotide for FSD and holding an end-of-Phase 2 meeting with the U.S. Food and Drug Administration (FDA), through at least calendar year 2013. Over the next twelve months we intend to focus efforts on preparing for our Phase 3 clinical trial with bremelanotide for FSD, assuming that results of the end-of-Phase 2 meeting with FDA support advancing the program, conducting preclinical research on one or more peptide melanocortin agonists for sexual dysfunction and other indications, conducting preclinical research on peptide melanocortin agonists for inflammatory disease related indications, and development and testing of an inhaled formulation of PL-3994.

Our current cash and cash equivalents are not sufficient to complete all of the clinical trials required for product approval for any of our products. We expect that the Phase 3 bremelanotide clinical trial program for FSD will require significant additional resources and capital. We intend to seek additional capital through public or private equity or debt financings, collaborative arrangements on our product candidates, including bremelanotide for FSD, or other sources. However, sufficient additional funding to support operations past calendar year 2013, including Phase 3 clinical trials with bremelanotide, may not be available on acceptable terms or at all. If additional funding is not available, we will be required to seek collaborators for our product candidates at an earlier stage than otherwise would be desirable and on terms that are less favorable than might otherwise be available, and relinquish, license or otherwise dispose of rights on unfavorable terms to technologies and product candidates that we would otherwise seek to develop or commercialize ourselves. The nature and timing of our development activities are highly dependent on our financing activities.

We anticipate incurring additional losses over at least the next few years. To achieve profitability, if ever, we, alone or with others, must successfully develop and commercialize our technologies and proposed products, conduct preclinical studies and clinical trials, obtain required regulatory approvals and successfully manufacture and market such technologies and proposed products. The time required to reach profitability is highly uncertain, and we do not know whether we will be able to achieve profitability on a sustained basis, if at all.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Not required to be provided by smaller reporting companies.

Item 4. Controls and Procedures.

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures, as defined in Exchange Act Rules 13a-15(e) and 15d-15(e), as of the end of the period covered by this report. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of December 31, 2012. There were no changes in our internal control over financial reporting that occurred during our most recent fiscal quarter that materially affected, or that are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings.

We may be involved, from time to time, in various claims and legal proceedings arising in the ordinary course of our business. We are not currently a party to any claim or legal proceeding.

Item 1A. Risk Factors.

There have been no material changes to our risk factors disclosed in Part I, Item 1A of our annual report on Form 10-K for the fiscal year ended June 30, 2012, other than as set forth in our quarterly report on Form 10-Q for the fiscal quarter ended September 30, 2012.

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

None.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

Not applicable.

Item 5. Other Information.

None.

Item 6. Exhibits.

Exhibits filed or furnished with this report:

31.1	Certification of Chief Executive Officer.
31.2	Certification of Chief Financial Officer.
32.1	Certification by Chief Executive Officer pursuant to 18 U.S.C. Section 1350.
32.2	Certification by Chief Financial Officer pursuant to 18 U.S.C. Section 1350.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document

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.

	Palatin Technologies, Inc. (Registrant)
Date: February 13, 2013	/s/ Carl Spana Carl Spana, Ph.D. President and Chief Executive Officer (Principal Executive Officer)
Date: February 13, 2013	/s/ Stephen T. Wills Stephen T. Wills, CPA, MST Executive Vice President, Chief Financial Officer and Chief Operating Officer

EXHIBIT INDEX

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101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document

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5.23

1,463,054

18,236

4.99

Mortgage-backed securities

99,089

649

2.62

78,485

426

2.17

Investment securities (2)

100,796

738

2.93

78,616

558

2.84

Other interest earning assets

4,020

35

3.57

3,028

11

1.45

Total interest earning assets (1)

1,948,058

24,207

4.97

1,623,183

19,231

4.74

Other noninterest earning assets (3)

164,815

-

141,665

-

Total assets

$
2,112,873

$
24,207

$

1,764,848

$
19,231

Interest bearing liabilities:

Savings accounts

$
158,983

282

0.71

$
144,880

174

0.48

NOW accounts

567,328

1,383

0.98

513,202

1,025

0.80

Money market deposit accounts

150,078

476

1.27

111,642

170

0.61

Certificates of deposit

616,944

2,784

1.81

523,441

1,656

1.27

Total interest bearing deposits

1,493,333

4,925

1.32

1,293,165

3,025

0.94

Borrowings:

Securities sold under agreements
to repurchase

3,573

8

0.87

4,585

8

0.70

FHLB advances

146,010

932

2.55

70,797

284

1.60

Note Payable

3,957

48

4.85

3,000

29

3.87

Subordinated debt

14,982

226

6.03

14,884

182

4.89

Total interest bearing liabilities

1,661,855

6,139

1.48

1,386,431

3,528

1.02

Noninterest bearing demand deposits

226,559

-

193,028

-

Other noninterest bearing liabilities

9,816

-

6,657

-

Total liabilities

1,898,230

6,139

1,586,116

3,528

Stockholders’ equity

214,643

-

178,732

-

Total liabilities and
stockholders' equity

$
2,112,873

$
6,139

$
1,764,848

$
3,528

Net interest income

$
18,068

$
15,703

Interest rate spread (4)

3.49
%

3.72
%
Net interest margin (5)

3.71
%

3.87
%

Ratio of average interest-earning assets
to average interest-bearing liabilities

117.22
%

117.08
%

(1) Calculated net of deferred loan fees, loan discounts and loans-in-process. Non-accrual loans are not included in average loans.
(2) Includes FHLB and Federal Reserve Bank of St. Louis membership stock and related cash dividends.
(3) Includes average balances for fixed assets and BOLI of $60.7 million and $37.7 million, respectively, for the three-month period ended December 31, 2018, as compared to $53.9 million and $34.6 million, respectively, for the same period of the prior fiscal year.
(4) Interest rate spread represents the difference between the average rate on interest-earning assets and the average cost of interest-bearing liabilities.
(5) Net interest margin represents annualized net interest income divided by average interest-earning assets.

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(dollars in thousands)	Six-month period ended December 31, 2018 Average Balance	Interest and Dividends	Yield/ Cost (%)	Six-month period ended December 31, 2017 Average Balance	Interest and Dividends	Yield/ Cost (%)
Interest earning assets:						
Mortgage loans (1)	$1,290,995	$ 33,089	5.13	$1,148,842	$ 27,692	4.82
Other loans (1)	373,952	10,612	5.68	300,764	8,000	5.32
Total net loans	1,664,947	43,701	5.25	1,449,606	35,692	4.92
Mortgage-backed securities	96,699	1,232	2.55	78,558	843	2.15
Investment securities (2)	84,020	1,255	2.99	76,928	1,087	2.83
Other interest earning assets	3,608	61	3.38	2,648	20	1.52
Total interest earning assets (1)	1,849,274	46,249	5.00	1,607,740	37,642	4.68
Other noninterest earning assets (3)	157,426	-		141,162	-	
Total assets	$2,006,700	$ 46,249		$1,748,902	$ 37,642	
Interest bearing liabilities:						
Savings accounts	$156,144	525	0.67	$145,376	344	0.47
NOW accounts	557,676	2,644	0.95	498,891	1,974	0.79
Money market deposit accounts	135,194	820	1.21	110,477	320	0.58
Certificates of deposit	579,438	4,945	1.71	532,260	3,249	1.22
Total interest bearing deposits	1,428,452	8,934	1.25	1,287,004	5,887	0.91
Borrowings:						
Securities sold under agreements to repurchase	3,611	16	0.88	7,038	22	0.61
FHLB advances	125,546	1,531	2.44	62,930	510	1.62
Note Payable	3,478	83	4.78	3,000	57	-
Subordinated debt	14,969	450	6.01	14,872	360	4.84
Total interest bearing liabilities	1,576,056	11,014	1.40	1,374,844	6,836	0.99
Noninterest bearing demand deposits	211,621	-		190,179	-	
Other noninterest bearing liabilities	9,985	-		7,012	-	
Total liabilities	1,797,662	11,014		1,572,035	6,836	
Stockholders' equity	209,038	-		176,867	-	
Total liabilities and stockholders' equity	$2,006,700	$ 11,014		$1,748,902	$ 6,836	
Net interest income		$ 35,235			$ 30,806	
Interest rate spread (4)			3.60 %			3.69 %
Net interest margin (5)			3.81 %			3.83 %
Ratio of average interest-earning assets to average interest-bearing liabilities	117.34 %			116.94 %		

(1)

Calculated net of deferred loan fees, loan discounts and loans-in-process. Non-accrual loans are not included in average loans.

(2) Includes FHLB and Federal Reserve Bank of St. Louis membership stock and related cash dividends.

(3) Includes average balances for fixed assets and BOLI of $57.7 million and $37.7 million, respectively, for the six-month period ended December 31, 2018, as compared to $54.0 million and $34.5 million, respectively, for the same period of the prior fiscal year.

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

(5) Net interest margin represents annualized net interest income divided by average interest-earning assets.

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Rate/Volume Analysis

The following table sets forth the effects of changing rates and volumes on the Company's net interest income for the three-and six- month periods ended December 31, 2018, compared to the three- and six- month periods ended December 31, 2017. Information is provided with respect to (i) effects on interest income and expense attributable to changes in volume (changes in volume multiplied by the prior rate), (ii) effects on interest income and expense attributable to change in rate (changes in rate multiplied by prior volume), and (iii) changes in rate/volume (change in rate multiplied by change in volume).

	Three-month period ended December 31, 2018 Compared to three-month period ended December 31, 2017 Increase (Decrease) Due to			
(dollars in thousands)	Rate	Volume	Rate/ Volume	Net
Interest-earnings assets:				
Loans receivable (1)	$876	$3,504	$ 169	$4,549
Mortgage-backed securities	88	112	23	223
Investment securities (2)	17	157	6	180
Other interest-earning deposits	17	3	4	24
Total net change in income on interest-earning assets	998	3,776	202	4,976
Interest-bearing liabilities:				
Deposits	1,200	479	221	1,900
Securities sold under agreements to repurchase	2	(2)	-	-
Subordinated debt	42	1	1	44
Note Payable	8	9	2	19
FHLB advances	168	302	178	648
Total net change in expense on interest-bearing liabilities	1,420	789	402	2,611
Net change in net interest income	$(422)	$2,987	$ (200)	$2,365

	Six-month period ended December 31, 2018 Compared to six-month period ended December 31, 2017 Increase (Decrease) Due to			
(dollars in thousands)	Rate	Volume	Rate/ Volume	Net
Interest-earnings assets:				
Loans receivable (1)	$2,289	$ 5,373	$ 347	$8,009
Mortgage-backed securities	158	195	36	389

Investment securities (2)	60	100	8	168
Other interest-earning deposits	25	7	9	41
Total net change in income on interest-earning assets	2,532	5,675	400	8,607
Interest-bearing liabilities:				
Deposits	2,182	618	247	3,047
Securities sold under agreements to repurchase	9	(10)	(5)	(6)
FHLB advances	258	507	256	1,021
Note payable	15	9	2	26
Subordinated debt	87	2	1	90
Total net change in expense on interest-bearing liabilities	2,551	1,126	501	4,178
Net change in net interest income	$(19)	$ 4,549	$ (101)	$4,429

(1) Does not include interest on loans placed on nonaccrual status.
(2) Does not include dividends earned on equity securities.

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Results of Operations – Comparison of the three-month periods ended December 31, 2018 and 2017

General. Net income for the three-month period ended December 31, 2018, was $7.5 million, an increase of $2.3 million, or 44.2%, as compared to the same period of the prior fiscal year. The increase was attributable to an increase in net interest income and noninterest income and decreases in provision for income taxes and provision for loan losses, partially offset by an increase in noninterest expense.

For the three-month period ended December 31, 2018, basic and fully-diluted net income per share available to common shareholders were $0.82 and $0.81, respectively, as compared to $0.60 under both measures for the same period of the prior fiscal year, which represented increases of $0.22, or 36.7%, and $0.21, or 35.0%, respectively. Our annualized return on average assets for the three-month period ended December 31, 2018, was 1.41%, as compared to 1.17% for the same period of the prior fiscal year. Our return on average common stockholders' equity for the three-month period ended December 31, 2018, was 13.9%, as compared to 11.6% in the same period of the prior fiscal year.

Net Interest Income. Net interest income for the three-month period ended December 31, 2018, was $18.1 million, an increase of $2.4 million, or 15.1%, as compared to the same period of the prior fiscal year. The increase was attributable to a 20.0% increase in the average balance of interest-earning assets, partially offset by a decrease in net interest margin to 3.71% in the current three-month period, from 3.87% in the three-month period a year ago. Our net interest margin is determined by dividing annualized net interest income by total average interest-earning assets.

Loan discount accretion and deposit premium amortization related to the August 2014 Peoples Acquisition, the June 2017 Capaha Acquisition, the February 2018 SMB-Marshfield Acquisition, and the November 2018 Gideon Acquisition resulted in an additional $467,000 in net interest income for the three-month period ended December 31, 2018, as compared to $860,000 in net interest income for the same period a year ago. In the current three-month period, this component of net interest income contributed 10 basis points to the net interest margin, a decrease from a contribution of 21 basis points in the year-ago period. Over the longer term, the Company generally expects this component of net interest income to decline, and the dollar impact of this component of net interest income has generally been declining each sequential quarter as assets from the Peoples Acquisition and the Capaha Acquisition mature or prepay. However, discount accretion resulting from the SMB-Marshfield Acquisition and the Gideon Acquisition has partially offset that decline, as there was no comparable item in the same period a year ago, and full quarter impact of the Gideon Acquisition going forward will contribute further in the second half of fiscal 2019. Also, to the extent we have periodic resolution of specific credit impaired loans, this may create volatility in this component of net interest income. Resolution of particular acquired impaired credits from the Peoples Acquisition and the Capaha acquisition resulted in notably higher levels of discount accretion in the first quarter of fiscal 2019, as well as in the second and third quarters of fiscal 2018.

For the three-month period ended December 31, 2018, our net interest rate spread was 3.49%, as compared to 3.72% in the year-ago period. The decrease in net interest rate spread, compared to the same period a year ago, resulted from a 46 basis point increase in the average cost of interest-bearing liabilities, partially offset by a 23 basis point increase in the average yield on interest-earning assets.

Interest Income. Total interest income for the three-month period ended December 31, 2018, was $24.2 million, an increase of $5.0 million, or 25.9%, as compared to the same period of the prior fiscal year. The increase was attributed to a 20.0% increase in the average balance of interest-earning assets, combined with a 23 basis point increase in the average yield earned on interest-earning assets, as compared to the same period of the prior fiscal year. Increased average interest-earning balances were attributable primarily to growth in the loan portfolio, including organic growth and growth through acquisitions, though investment balances increased at a faster rate, due to growth through acquisitions. The increase in the average yield on interest-earning assets was attributable to origination and renewals of loans at higher market rates and reinvestment in investment securities at higher market rates, partially offset by the decrease in loan discount accretion, discussed above, as well as a shift in the earning asset mix towards the securities portfolio.

Interest Expense. Total interest expense for the three-month period ended December 31, 2018, was $6.1 million, an increase of $2.6 million, or 74.0%, as compared to the same period of the prior fiscal year. The increase was attributable to a 46 basis point increase in the average cost of interest-bearing liabilities, combined with a 19.9% increase in the average balance of interest-bearing liabilities, as compared to the same period of the prior fiscal year. The increase in the average cost of interest-bearing liabilities was attributable primarily to higher market rates for certificates of deposit, short-term FHLB borrowings, money market deposit accounts, and interest-bearing transaction accounts, as well as a shift in the composition of interest-bearing liabilities towards FHLB borrowings. Increased average interest-bearing balances were attributable primarily to increases in certificates of deposit, FHLB borrowings, interest-bearing transaction accounts, money market deposit accounts, and savings accounts, partially offset by lower repurchase agreement balances.

Provision for Loan Losses. The provision for loan losses for the three-month period ended December 31, 2018, was $314,000, as compared to $642,000 in the same period of the prior fiscal year. Decreased provisioning was attributed primarily to continued low levels of net charge offs and a stable outlook regarding the credit quality of the Company's legacy loan portfolio. As a percentage of average loans outstanding, the provision for loan losses in the current three-month period represented a charge of 0.07% (annualized), while the Company recorded net charge offs during the period of 0.02% (annualized). During the same period of the prior fiscal year, the provision for loan losses as a percentage of average loans outstanding represented a charge of 0.18% (annualized), while the Company recorded net charge offs of 0.04% (annualized). (See "Critical Accounting Policies", "Allowance for Loan Loss Activity" and "Nonperforming Assets").

Noninterest Income. The Company's noninterest income for the three-month period ended December 31, 2018, was $4.1 million, an increase of $880,000, or 27.7%, as compared to the same period of the prior fiscal year. The increase was attributable in part to a nonrecurring benefit in the current period of $346,000 related to bank-owned life insurance, and a $60,000 gain related to the Company's sale of stock in a banker's bank, which had been acquired in a recent acquisition. In addition, the Company realized increased bank card interchange income, deposit account service charges, and loan fees, partially offset by a reduction in gains realized on the sale of residential loans originated for sale into the secondary market and inclusion in the year-ago period's results of gains on sales of AFS securities, with no comparable income in the current period. Bank card interchange income and deposit account service charges increased as a result of higher levels of depositor activity, attributable in part to the SMB-Marshfield Acquisition and the Gideon Acquisition. Gains realized on the sale of residential real estate loans originated for sale into the secondary market decreased as volume remained relatively unchanged, but pricing available decreased due to competitive factors and a small shift in the loan mix to less profitable products.

Noninterest Expense. Noninterest expense for the three-month period ended December 31, 2018, was $12.6 million, an increase of $2.0 million, or 19.3%, as compared to the same period of the prior fiscal year. The increase was attributable in part to $420,000 in charges directly attributable to the Gideon Acquisition, including primarily data processing charges, retention bonuses, and legal fees. In the year ago period, comparable charges totaled $111,000. Additionally, the Company realized increases in compensation and benefits, occupancy expenses, bank card network expense, expenses related to and losses on disposition of foreclosed real estate, higher expenses related to providing electronic banking services, and provision for off-balance sheet credit exposure, partially offset by a decrease in advertising expenses and legal and professional fees. Provisioning for off-balance sheet credit exposure increased to $162,000 in the current quarter, as compared to a recovery of $72,000 in the year ago period, as seasonal increases in available credit on agricultural and commercial loans required additional provisioning in the current quarter, while in the year ago quarter similar increases in available credit were more than offset by a decline in available credit on construction lines. Compensation and benefits, occupancy expenses, and expenses related to electronic banking increased as a result of continued growth in our organization's operations, and bank card network expenses have increased as a result of higher levels of depositor activity, all of which are attributable in part to the SMB-Marshfield Acquisition and Gideon Acquisition. The efficiency ratio for the three-month period ended December 31, 2018, was 56.7%, as compared to 55.8% in the same period of the prior fiscal year.

Income Taxes. The income tax provision for the three-month period ended December 31, 2018, was $1.8 million, a decrease of $744,000, or 29.2%, as compared to the same period of the prior fiscal year, attributable to a decrease in the effective tax rate, to 19.5%, as compared to 33.0% in the year-ago period, partially offset by an increase in pre-tax income. The lower effective tax rate was attributed to the December 2017 enactment of a reduction in the federal corporate income tax rate, which also increased the effective tax rate during the quarter ended December 31, 2017, as the enactment of the tax rate reduction required a revaluation of the Company’s deferred tax asset.

Results of Operations – Comparison of the six-month periods ended December 31, 2018 and 2017

General. Net income for the six-month period ended December 31, 2018, was $14.3 million, an increase of $4.2 million, or 42.1%, as compared to the same period of the prior fiscal year. The increase was attributable to increases in net interest income and noninterest income and decreases in provision for income taxes and provision for loan losses, partially offset by an increase in noninterest expense.

For the six-month period ended December 31, 2018, basic and fully-diluted net income per share were $1.57 under both measures, as compared to $1.17 and $1.16, respectively, for the same period of the prior fiscal year, which represented increases of $0.40, or 34.2%, and $0.41, or 35.3%, respectively. Our annualized return on average assets for the six-month period ended December 31, 2018, was 1.42%, as compared to 1.15% for the same period of the prior fiscal year. Our return on average common stockholders' equity for the six-month period ended December 31, 2018, was 13.6%, as compared to 11.3% in the same period of the prior fiscal year.

Net Interest Income. Net interest income for the six-month period ended December 31, 2018, was $35.2 million, an increase of $4.4 million, or 14.4%, as compared to the same period of the prior fiscal year. The increase was attributable to a 15.0% increase in the average balance of interest-earning assets, partially offset by a decrease in net interest margin to 3.81% in the current six-month period, from 3.83% in the six-month period a year ago. Our net interest margin is determined by dividing annualized net interest income by total average interest-earning assets.

Loan discount accretion and deposit premium amortization related to the August 2014 Peoples Acquisition, the June 2017 Capaha Acquisition, the February 2018 SMB-Marshfield Acquisition, and the November 2018 Gideon Acquisition resulted in an additional $1.7 million in net interest income for the six-month period ended December 31, 2018, as compared to $1.3 million in net interest income for the same period a year ago. In the current six-month period, this component of net interest income contributed 18 basis points to the net interest margin, an increase from a contribution of 16 basis points in the year-ago period. Over the longer term, the Company generally expects this component of net interest income to decline, and the dollar impact of this component of net interest income has generally been declining each sequential quarter as assets from the Peoples Acquisition and the Capaha Acquisition mature or prepay. However, discount accretion resulting from the SMB-Marshfield Acquisition and the Gideon Acquisition has partially offset that decline, as there was no comparable item in the same period a year ago, and full quarter impact of the Gideon Acquisition going forward will contribute further in the second half of fiscal 2019. Also, to the extent we have periodic resolution of specific credit impaired loans, this may create volatility in this component of net interest income. Resolution of particular acquired impaired credits from the Peoples Acquisition and the Capaha acquisition resulted in notably higher levels of discount accretion in the first quarter of fiscal 2019, as well as in the second and third quarters of fiscal 2018.

For the six-month period ended December 31, 2018, our net interest spread was 3.60%, as compared to 3.69% in the six-month period a year ago. The decrease in net interest rate spread, compared to the same period a year ago, resulted from a 41 basis point increase in the average cost of interest-bearing liabilities, partially offset by a 32 basis point increase in the average yield on interest-earning assets.

Interest Income. Total interest income for the six-month period ended December 31, 2018, was $46.2 million, an increase of $8.6 million, or 22.9%, as compared to the same period of the prior fiscal year. The increase was attributed to a 15.0% increase in the average balance of interest-earning assets, combined with a 32 basis point increase in the average yield earned on interest-earning assets, as compared to the same period of the prior fiscal year. Increased average interest-earning balances were attributable primarily to growth in the loan portfolio, including organic growth and growth through acquisitions, while investment balances increased at a slower rate, and that growth was due largely to acquisitions. The increase in the average yield on interest-earning assets was attributable primarily to originations and renewals of loans at higher market rates, as well as the increase in loan discount accretion, discussed above.

Interest Expense. Total interest expense for the six-month period ended December 31, 2018, was $11.0 million, an increase of $4.2 million, or 61.1%, as compared to the same period of the prior fiscal year. The increase was attributable to a 41 basis point increase in the average cost of interest-bearing liabilities, combined with a 14.6% increase in the average balance of interest-bearing liabilities, as compared to the same period of the prior fiscal year. The increase in the average cost of interest-bearing liabilities was attributable primarily to higher market rates for certificates of deposit, short-term FHLB borrowings, interest-bearing transaction accounts, and money market deposit accounts, as well as a shift in the composition of interest-bearing liabilities towards FHLB borrowings.

Provision for Loan Losses. The provision for loan losses for the six-month period ended December 31, 2018, was $1.0 million, as compared to $1.5 million in the same period of the prior fiscal year. Decreased provisioning was attributed primarily to continued low levels of net charge offs and a stable outlook regarding the credit quality of the Company's legacy loan portfolio. As a percentage of average loans outstanding, the provision for loan losses in the current six-month period represented a charge of 0.12% (annualized), while the Company recorded net charge offs during the period of 0.02% (annualized). During the same period of the prior fiscal year, provision for loan losses as a percentage of average loans outstanding represented a charge of 0.21% (annualized), while the Company recorded net charge offs of 0.03% (annualized). (See "Critical Accounting Policies", "Allowance for Loan Loss Activity" and "Nonperforming Assets").

Noninterest Income. The Company's noninterest income for the six-month period ended December 31, 2018, was $7.5 million, an increase of $1.0 million, or 16.1%, as compared to the same period of the prior fiscal year. The increase was attributable in part to a nonrecurring benefit in the current period of $346,000 related to bank-owned life insurance, and a $60,000 gain related to the Company's sale of stock in a banker's bank, which had been acquired in a recent acquisition. In addition, the Company realized increased bank card interchange income, earnings on bank-owned life insurance, and deposit account service charges, partially offset by a reduction in gains realized on the sale of residential loans originated for sale into the secondary market and inclusion in the year-ago period's results of gains on sales of AFS securities, with no comparable income in the current period. Bank card interchange income and deposit account service charges increased as a result of higher levels of depositor activity, attributable in part to the SMB-Marshfield Acquisition and the Gideon Acquisition. Gains realized on the sale of residential real estate loans originated for sale into the secondary market decreased as volume remained relatively unchanged, but pricing available decreased due to competitive factors and a small shift in the loan mix to less profitable products.

Noninterest Expense. Noninterest expense for the six-month period ended December 31, 2018, was $24.0 million, an increase of $2.7 million, or 12.8%, as compared to the same period of the prior fiscal year. The increase was attributable primarily to increases in compensation and benefits, occupancy expenses, bank card network expense, and other expenses, including expenses related to and losses on the disposition of foreclosed real estate, provision for off-balance sheet credit exposure, and expenses to provide electronic banking services. Bank card network expenses have increased as a result of higher levels of depositor activity, attributable in part to the SMB-Marshfield Acquisition and the Gideon Acquisition. Compensation and benefits, occupancy expenses, and expenses to provide electronic banking services increased as a result of continued growth in our organization's operations, and were attributable in part to the SMB-Marshfield Acquisition and the Gideon Acquisition. Expenses and losses related to foreclosed real estate are attributable to higher turnover of these assets during the current fiscal year, and provision for off-balance sheet credit exposure was a charge in the current six-month period, as compared to a recovery in the same period a year ago, as seasonal increases in available credit on agricultural and commercial loans required additional provisioning in the current quarter, while in the year ago quarter similar increases in available credit were more than offset by a decline in available credit on construction lines. Charges related to merger and acquisition activity totaled $595,000 in the current fiscal year to date, as compared to $333,000 in the same period of the prior fiscal year. The efficiency ratio for the six-month period ended December 31, 2018, was 56.2%, as compared to 57.2% in the same period of the prior fiscal year.

Income Taxes. The income tax provision for the six-month period ended December 31, 2018, was $3.5 million, a decrease of $1.0 million, or 21.8%, as compared to the same period of the prior fiscal year, attributable to a decrease in the effective tax rate, to 19.6%, as compared to 30.7% in the year-ago period, partially offset by an increase in pre-tax income. The lower effective tax rate was attributed to the December 2017 enactment of a reduction in the federal corporate income tax rate, which also increased the effective tax rate during the six-month period ended December 31, 2017, as the enactment of the tax rate reduction required a revaluation of the Company's deferred tax asset.

Allowance for Loan Loss Activity

The Company regularly reviews its allowance for loan losses and makes adjustments to its balance based on management's analysis of the loan portfolio, the amount of non-performing and classified loans, as well as general economic conditions. Although the Company maintains its allowance for loan losses at a level that it considers sufficient to provide for losses, there can be no assurance that future losses will not exceed internal estimates. In addition, the amount of the allowance for loan losses is subject to review by regulatory agencies, which can order the establishment of additional loss provision. The following table summarizes changes in the allowance for loan losses over the three- and six-month periods ended December 31, 2018 and 2017:

(dollars in thousands)	For the three months ended December 31, 2018	2017	For the six months ended December 31, 2018	2017
Balance, beginning of period	$18,790	$16,357	$18,214	$15,538
Loans charged off:				
Residential real estate	(9)	(55)	(9)	(78)
Construction	-	-	-	-
Commercial business	(47)	(21)	(47)	(21)
Commercial real estate	(25)	(36)	(120)	(36)
Consumer	(3)	(28)	(20)	(58)
Gross charged off loans	(84)	(140)	(196)	(193)
Recoveries of loans previously charged off:				
Residential real estate	-	1	1	1
Construction	-	-	-	-
Commercial business	-	6	1	6
Commercial real estate	3	-	3	-
Consumer	-	1	5	4
Gross recoveries of charged off loans	3	8	10	11
Net (charge offs) recoveries	(81)	(132)	(186)	(182)
Provision charged to expense	314	642	995	1,511
Balance, end of period	$19,023	$16,867	$19,023	$16,867

The allowance for loan losses has been calculated based upon an evaluation of pertinent factors underlying the various types and quality of the Company's loans. Management considers such factors as the repayment status of a loan, the estimated net fair value of the underlying collateral, the borrower's intent and ability to repay the loan, local economic conditions, and the Company's historical loss ratios. We maintain the allowance for loan losses through the provision for loan losses that we charge to income. We charge losses on loans against the allowance for loan losses when we believe the collection of loan principal is unlikely. The allowance for loan losses increased $809,000 to $19.0 million at December 31, 2018, from $18.2 million at June 30, 2018. The increase was deemed appropriate in order to bring the allowance for loan losses to a level that reflects management's estimate of the incurred loss in the Company's loan portfolio at December 31, 2018.

At December 31, 2018, the Company had loans of $29.1 million, or 1.60% of total loans, adversely classified ($28.4 million classified "substandard"; $648,000 classified "doubtful"), as compared to loans of $14.2 million, or 0.90% of total loans, adversely classified ($12.4 million classified "substandard"; $1.8 million classified "doubtful") at June 30, 2018, and $11.1 million, or 0.75% of total loans, adversely classified ($10.5 million classified "substandard"; $602,000 classified "doubtful") at December 31, 2017. Classified loans were generally comprised of loans secured by commercial real estate loans, commercial operating loans and residential real estate loans, and included $14.9 million, at fair value, added as a result of the Gideon Acquisition. All loans considered classified were the result of concerns as to the borrowers' ability to continue to generate sufficient cash flows to service the debt. Of our classified loans, the Company had ceased recognition of interest on loans with a carrying value of $10.3 million at December 31, 2018. As noted in Note 4 to the condensed consolidated financial statements, the Company's total past due loans increased from $9.4 million at June 30, 2018, to $21.0 million at December 31, 2018.

In its quarterly evaluation of the adequacy of its allowance for loan losses, the Company employs historical data including past due percentages, charge offs, and recoveries for the previous five years for each loan category. The Company’s allowance methodology considers the most recent twelve-month period’s average net charge offs and uses this information as one of the primary factors for evaluation of allowance adequacy. Average net charge offs are calculated as net charge offs by portfolio type for the period as a percentage of the average balance of respective portfolio type over the same period.

The following table sets forth the Company’s historical net charge offs as of December 31 and June 30, 2018:

Portfolio segment	December 31, 2018 Net charge offs – 12-month historical	June 30, 2018 Net charge offs – 12-month historical
Real estate loans:		
Residential	0.02%	0.04%
Construction	0.01%	0.01%
Commercial	0.02%	0.01%
Consumer loans	0.16%	0.23%
Commercial loans	0.01%	0.01%

Additionally, in its quarterly evaluation of the adequacy of the allowance for loan losses, the Company evaluates changes in the financial condition of individual borrowers; changes in local, regional, and national economic conditions; the Company’s historical loss experience; and changes in market conditions for property pledged to the Company as collateral. The Company has identified specific qualitative factors that address these issues and subjectively assigns a percentage to each factor. Qualitative factors are reviewed quarterly and may be adjusted as necessary to reflect improving or declining trends. At December 31, 2018, these qualitative factors included:

· Changes in lending policies
· National, regional, and local economic conditions
· Changes in mix and volume of portfolio
· Experience, ability, and depth of lending management and staff
· Entry to new markets
· Levels and trends of delinquent, nonaccrual, special mention and
· Classified loans
· Concentrations of credit
· Changes in collateral values
· Agricultural economic conditions
· Regulatory risk

The qualitative factors are applied to the allowance for loan losses based upon the following percentages by loan type:

Portfolio segment	Qualitative factor applied at interim period ended December 31, 2018	Qualitative factor applied at fiscal year ended June 30, 2018
Real estate loans:		
Residential	0.64%	0.63%
Construction	1.64%	1.69%
Commercial	1.14%	1.27%
Consumer loans	1.43%	1.41%
Commercial loans	1.29%	1.32%

At December 31, 2018, the amount of our allowance for loan losses attributable to these qualitative factors was approximately $16.0 million, as compared to $15.5 million at June 30, 2018, primarily due to loan growth. The relatively small change in qualitative factors applied was attributable to management’s assessment that risks represented by the qualitative factors continue to lessen. Higher levels of net charge offs requiring additional provision for loan losses could result. Although management uses the best information available, the level of the allowance for loan losses remains an estimate that is subject to significant judgment and short-term change.

Nonperforming Assets

The ratio of nonperforming assets to total assets and nonperforming loans to net loans receivable is another measure of asset quality. Nonperforming assets of the Company include nonaccruing loans, accruing loans delinquent/past maturity 90 days or more, and assets which have been acquired as a result of foreclosure or deed-in-lieu of foreclosure. The table below summarizes changes in the Company's level of nonperforming assets over selected time periods:

(dollars in thousands)	December 31, 2018	June 30, 2018	December 31, 2017
Nonaccruing loans:			
Residential real estate	$ 5,836	$ 5,913	$ 924
Construction	24	25	34
Commercial real estate	10,560	1,962	209
Consumer	353	209	123
Commercial business	3,680	1,063	345
Total	20,453	9,172	1,635
Loans 90 days past due accruing interest:			
Residential real estate	-	-	761
Construction	-	-	-
Commercial real estate	-	-	4,147
Consumer	-	-	136
Commercial business	-	-	637
Total	-	-	5,681
Total nonperforming loans	20,453	9,172	7,316
Foreclosed assets held for sale:			
Real estate owned	3,894	3,874	3,653
Other nonperforming assets	54	50	71
Total nonperforming assets	$ 24,401	$ 13,096	$ 11,040

At December 31, 2018, troubled debt restructurings (TDRs) totaled $13.5 million, of which $318,000 was considered nonperforming and is included in the nonaccrual loan total above. The remaining $13.1 million in TDRs have complied with the modified terms for a reasonable period of time and are therefore considered by the Company to be accrual status loans. In general, these loans were subject to classification as TDRs at December 31, 2018, on the basis of guidance under ASU No. 2011-02, which indicates that the Company may not consider the borrower's effective borrowing rate on the old debt immediately before the restructuring in determining whether a concession has been granted. At June 30, 2018, TDRs totaled $13.0 million, of which $1.3 million was considered nonperforming and is included in the nonaccrual loan total above. The remaining $11.7 million in TDRs at June 30, 2018, had complied with the modified terms for a reasonable period of time and were therefore considered by the Company to be accrual status loans.

At December 31, 2018, nonperforming assets totaled $24.4 million, as compared to $13.1 million at June 30, 2018, and $11.0 million at December 31, 2017. The increase in nonperforming assets from fiscal year end was attributable primarily to the Gideon Acquisition, which included $12.9 million in nonperforming loans and a small balance of foreclosed property, and new foreclosures, partially offset by sales of foreclosed assets with a carrying value of $1.3 million.

Liquidity Resources

The term “liquidity” refers to our ability to generate adequate amounts of cash to fund loan originations, loans purchases, deposit withdrawals and operating expenses. Our primary sources of funds include deposit growth, securities sold under agreements to repurchase, FHLB advances, brokered deposits, amortization and prepayment of loan principal and interest, investment maturities and sales, and funds provided by our operations. While the scheduled loan repayments and maturing investments are relatively predictable, deposit flows, FHLB advance redemptions, and loan and security prepayment rates are significantly influenced by factors outside of the Bank’s control, including interest rates, general and local economic conditions and competition in the marketplace. The Bank relies on FHLB advances and brokered deposits as additional sources for funding cash or liquidity needs.

The Company uses its liquid resources principally to satisfy its ongoing cash requirements, which include funding loan commitments, funding maturing certificates of deposit and deposit withdrawals, maintaining liquidity, funding maturing or called FHLB advances, purchasing investments, and meeting operating expenses.

At December 31, 2018, the Company had outstanding commitments and approvals to extend credit of approximately $330.1 million (including $232.0 million in unused lines of credit) in mortgage and non-mortgage loans. These commitments and approvals are expected to be funded through existing cash balances, cash flow from normal operations and, if needed, advances from the FHLB or the Federal Reserve's discount window. At December 31, 2018, the Bank had pledged $737.4 million of its single-family residential and commercial real estate loan portfolios to the FHLB for available credit of approximately $362.4 million, of which $156.2 million had been advanced. The Bank has the ability to pledge several other loan portfolios, including, for example, its multi-family residential real estate, commercial, and home equity loans, which could provide additional collateral for additional borrowings; in total, FHLB borrowings are generally limited to 45% of bank assets, or $870.6 million, subject to available collateral. Also, at December 31, 2018, the Bank had pledged a total of $219.4 million in loans secured by farmland and agricultural production loans to the Federal Reserve, providing access to $162.6 million in primary credit borrowings from the Federal Reserve's discount window, of which none was drawn. Management believes its liquid resources will be sufficient to meet the Company's liquidity needs.

Regulatory Capital

The Company and Bank are subject to various regulatory capital requirements administered by the Federal banking agencies. Failure to meet minimum capital requirements can result in certain mandatory—and possibly additional discretionary – actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and Bank must meet specific capital guidelines that involve quantitative measures of the Company and the Bank's assets, liabilities, and certain off-balance sheet items as calculated under U.S. GAAP, regulatory reporting requirements and regulatory capital standards. The Company and Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Furthermore, the Company and Bank's regulators could require adjustments to regulatory capital not reflected in the condensed consolidated financial statements.

Quantitative measures established by regulatory capital standards to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the table below) of total capital, Tier 1 capital (as defined), and common equity Tier 1 capital (as defined) to risk-weighted assets (as defined) and of Tier 1 capital (as defined) to average total assets (as defined). Management believes, as of December 31 and June 30, 2018, that the Company and the Bank met all capital adequacy requirements to which they are subject.

In July 2013, the Federal banking agencies announced their approval of the final rule to implement the Basel III regulatory reforms, among other changes required by the Dodd-Frank Wall Street Reform and Consumer Protection Act. The approved rule included a new minimum ratio of common equity Tier 1 (CET1) capital of 4.5%, raised the minimum ratio of Tier 1 capital to risk-weighted assets from 4.0% to 6.0%, and included a minimum leverage ratio of 4.0% for all banking institutions. Additionally, the rule created a capital conservation buffer of 2.5% of risk-weighted assets, and prohibited banking organizations from making distributions or discretionary bonus payments during any quarter if its eligible retained income is negative, if the capital conservation buffer is not maintained. This new capital conservation buffer requirement began phasing in beginning in January 2016 at 0.625% of risk-weighted assets and increases by that amount each year until fully implemented in January 2019. The phase-in of the enhanced capital requirements for banking organizations such as the Company and the Bank began January 1, 2015. Other changes included revised risk-weighting of some assets, stricter limitations on mortgage servicing assets and deferred tax assets, and replacement of the ratings-based approach to risk weight securities.

As of December 31, 2018, the most recent notification from the Federal banking agencies categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized the Bank must maintain minimum total risk-based, Tier 1 risk-based, common equity Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed the Bank’s category.

The tables below summarize the Company and Bank's actual and required regulatory capital:

As of December 31, 2018	Actual Amount	Ratio	For Capital Adequacy Purposes Amount	Ratio	To Be Well Capitalized Under Prompt Corrective Action Provisions Amount	Ratio
(dollars in thousands)						
Total Capital (to Risk-Weighted Assets)						
Consolidated	$242,777	12.53 %	$154,972	8.00 %	n/a	n/a
Southern Bank	233,946	12.16 %	153,942	8.00 %	192,427	10.00 %
Tier I Capital (to Risk-Weighted Assets)						
Consolidated	222,406	11.48 %	116,229	6.00 %	n/a	n/a
Southern Bank	213,575	11.10 %	115,456	6.00 %	153,942	8.00 %
Tier I Capital (to Average Assets)						
Consolidated	222,406	10.64 %	83,628	4.00 %	n/a	n/a
Southern Bank	213,575	10.70 %	79,859	4.00 %	99,824	5.00 %
Common Equity Tier I Capital (to Risk-Weighted Assets)						
Consolidated	207,412	10.71 %	87,172	4.50 %	n/a	n/a
Southern Bank	213,575	11.10 %	86,592	4.50 %	125,078	6.50 %

As of June 30, 2018	Actual Amount	Ratio	For Capital Adequacy Purposes Amount	Ratio	Amount	To Be Well Capitalized Under Prompt Corrective Action Provisions Ratio
(dollars in thousands)						
Total Capital (to Risk-Weighted Assets)						
Consolidated	$222,133	13.53 %	$131,335	8.00 %	n/a	n/a
Southern Bank	214,804	13.18 %	130,337	8.00 %	162,921	10.00 %
Tier I Capital (to Risk-Weighted Assets)						
Consolidated	202,756	12.35 %	98,501	6.00 %	n/a	n/a
Southern Bank	195,427	12.00 %	97,753	6.00 %	130,337	8.00 %
Tier I Capital (to Average Assets)						
Consolidated	202,756	10.97 %	73,932	4.00 %	n/a	n/a
Southern Bank	195,427	10.60 %	73,721	4.00 %	92,152	5.00 %
Common Equity Tier I Capital (to Risk-Weighted Assets)						
Consolidated	188,416	11.48 %	73,876	4.50 %	n/a	n/a
Southern Bank	195,427	12.00 %	73,315	4.50 %	105,899	6.50 %

PART I: Item 3: Quantitative and Qualitative Disclosures About Market Risk
SOUTHERN MISSOURI BANCORP, INC.

Asset and Liability Management and Market Risk

The goal of the Company's asset/liability management strategy is to manage the interest rate sensitivity of both interest-earning assets and interest-bearing liabilities in order to maximize net interest income without exposing the Bank to an excessive level of interest rate risk. The Company employs various strategies intended to manage the potential effect that changing interest rates may have on future operating results. The primary asset/liability management strategy has been to focus on matching the anticipated re-pricing intervals of interest-earning assets and interest-bearing liabilities. At times, however, depending on the level of general interest rates, the relationship between long- and short-term interest rates, market conditions and competitive factors, the Company may determine to increase its interest rate risk position somewhat in order to maintain its net interest margin.

In an effort to manage the interest rate risk resulting from fixed rate lending, the Bank has utilized longer term FHLB advances (with maturities up to ten years), subject to early redemptions and fixed terms. Other elements of the Company's current asset/liability strategy include (i) increasing originations of commercial business, commercial real estate, agricultural operating lines, and agricultural real estate loans, which typically provide higher yields and shorter repricing periods, but inherently increase credit risk; (ii) actively soliciting less rate-sensitive deposits, including aggressive use of the Company's "rewards checking" product, and (iii) offering competitively-priced money market accounts and CDs with maturities of up to five years. The degree to which each segment of the strategy is achieved will affect profitability and exposure to interest rate risk.

The Company continues to originate long-term, fixed-rate residential loans. During the first six months of fiscal year 2019, fixed rate 1- to 4-family residential loan production totaled $35.0 million, as compared to $29.5 million during the same period of the prior fiscal year. At December 31, 2018, the fixed rate residential loan portfolio was $171.5 million with a weighted average maturity of 99 months, as compared to $148.7 million at December 31, 2017, with a weighted average maturity of 104 months. The Company originated $18.2 million in adjustable-rate 1- to 4-family residential loans during the six-month period ended December 31, 2018, as compared to $17.4 million during the same period of the prior fiscal year. At December 31, 2018, fixed rate loans with remaining maturities in excess of 10 years totaled $37.3 million, or 2.1% of net loans receivable, as compared to $36.6 million, or 2.5% of net loans receivable at December 31, 2017. The Company originated $179.2 million in fixed rate commercial and commercial real estate loans during the six-month period ended December 31, 2018, as compared to $115.2 million during the same period of the prior fiscal year. The Company also originated $38.5 million in adjustable rate commercial and commercial real estate loans during the six-month period ended December 31, 2018, as compared to $39.1 million during the same period of the prior fiscal year. At December 31, 2018, adjustable-rate home equity lines of credit increased to $41.0 million, as compared to $36.3 million at December 31, 2017. At December 31, 2018, the Company's investment portfolio had an expected weighted-average life of 3.8 years, compared to 3.9 years at December 31, 2017. Management continues to focus on customer retention, customer satisfaction, and offering new products to customers in order to increase the Company's amount of less rate-sensitive deposit accounts.

Interest Rate Sensitivity Analysis

The following table sets forth as of December 31, 2018, management's estimates of the projected changes in net portfolio value ("NPV") in the event of 100, 200, and 300 basis point ("bp") instantaneous and permanent increases, and 100, 200, and 300 basis point instantaneous and permanent decreases in market interest rates. Dollar amounts are expressed in thousands.

December 31, 2018

				NPV as Percentage of PV of Assets	
Change in Rates	Net Portfolio Value	Change	% Change	NPV Ratio	Change
+300 bp	$ 166,935	$ (43,180)	-21%	8.05%	-1.58%
+200 bp	181,211	(28,904)	-14%	8.59%	-1.04%
+100 bp	195,706	(14,409)	-7%	9.12%	-0.51%
0 bp	210,115	-	-	9.63%	0.00%
-100 bp	225,600	15,485	7%	10.17%	0.55%
-200 bp	255,466	45,351	22%	11.33%	1.70%
-300 bp	284,567	74,452	35%	12.45%	2.82%

June 30, 2018

				NPV as Percentage of PV of Assets	
Change in Rates	Net Portfolio Value	Change	% Change	NPV Ratio	Change
+300 bp	$ 171,151	$ (31,594)	-16%	9.57%	-1.22%
+200 bp	182,263	(20,482)	-10%	10.03%	-0.77%
+100 bp	193,119	(9,626)	-5%	10.45%	-0.35%
0 bp	202,745	-	-	10.80%	0.00%
-100 bp	212,684	9,939	5%	11.16%	0.36%
-200 bp	241,161	38,415	19%	12.43%	1.63%
-300 bp	268,610	65,865	32%	13.64%	2.84%

Computations of prospective effects of hypothetical interest rate changes are based on an internally generated model using actual maturity and repricing schedules for the Bank's loans and deposits, and are based on numerous assumptions, including relative levels of market interest rates, loan repayments and deposit run-offs, and should not be relied upon as indicative of actual results. Further, the computations do not contemplate any actions the Bank may undertake in response to changes in interest rates.

Management cannot predict future interest rates or their effect on the Bank's NPV in the future. Certain shortcomings are inherent in the method of analysis presented in the computation of NPV. For example, although certain assets and liabilities may have similar maturities or periods to repricing, they may react in differing degrees to changes in market interest rates. Additionally, certain assets, such as adjustable-rate loans, have an initial fixed rate period typically from one to seven years and over the remaining life of the asset changes in the interest rate are restricted. In addition, the proportion of adjustable-rate loans in the Bank's portfolios could decrease in future periods due to refinancing activity if market interest rates remain steady in the future. Further, in the event of a change in interest rates, prepayment and early withdrawal levels could deviate significantly from those assumed in the table. Finally, the ability of many borrowers to service their adjustable-rate debt may decrease in the event of an interest rate increase.

The Bank's Board of Directors (the "Board") is responsible for reviewing the Bank's asset and liability policies. The Board's Asset/Liability Committees meets monthly to review interest rate risk and trends, as well as liquidity and capital ratios and requirements. The Bank's management is responsible for administering the policies and determinations of the Boards with respect to the Bank's asset and liability goals and strategies.

PART I: Item 4: Controls and Procedures
SOUTHERN MISSOURI BANCORP, INC.

An evaluation of Southern Missouri Bancorp's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities and Exchange Act of 1934, as amended, (the "Act")) as of December 31, 2018, was carried out under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, and several other members of our senior management. The Chief Executive Officer and Chief Financial Officer concluded that, as of December 31, 2018, the Company's disclosure controls and procedures were effective in ensuring that the information required to be disclosed by the Company in the reports it files or submits under the Act is (i) accumulated and communicated to management (including the Chief Executive and Financial Officer) in a timely manner, and (ii) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. There have been no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Act) that occurred during the quarter ended December 31, 2018, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

The Company does not expect that its disclosures and procedures will prevent all errors and all fraud. A control procedure, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control procedure are met. Because of the inherent limitations in all control procedures, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of a simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any control procedure also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control procedure, misstatements due to error or fraud may occur and not be detected.

PART II: Other Information
SOUTHERN MISSOURI BANCORP, INC.

Item 1: Legal Proceedings

In the opinion of management, the Company is not a party to any pending claims or lawsuits that are expected to have a material effect on the Company's financial condition or operations. Periodically, there have been various claims and lawsuits involving the Company mainly as a defendant, such as claims to enforce liens, condemnation proceedings on properties in which the Company holds security interests, claims involving the making and servicing of real property loans and other issues incident to the Bank's business. Aside from such pending claims and lawsuits, which are incident to the conduct of the Company's ordinary business, the Company is not a party to any material pending legal proceedings that would have a material effect on the financial condition or operations of the Company.

Item 1a: Risk Factors

There have been no material changes to the risk factors set forth in Part I, Item 1A of the Company's Annual Report on Form 10-K for the year ended June 30, 2018.

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

Period	Total Number of Shares (or Units) Purchased	Average Price Paid per Share (or Unit)	Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet be Purchased Under the Plans or Program
10/1/2018 thru 10/31/2018	-	-	-	-
11/1/2018 thru 11/30/2018	-	-	-	-
12/1/2018 thru 12/31/2018	-	-	-	-
Total	-	-	-	-

Item 3: Defaults upon Senior Securities

Not applicable

Item 4: Mine Safety Disclosures

Not applicable

Item 5: Other Information

None

Item 6: Exhibits

Exhibit Number	Document
3.1(i)	Articles of Incorporation of the Registrant (filed as an exhibit to the Registrant's Annual Report on Form 10-KSB for the fiscal year ended June 30, 1999 and incorporated herein by reference)
3.1(ii)	Certificate of Designation for the Registrant's Senior Non-Cumulative Perpetual Preferred Stock, Series A (filed as an exhibit to the Registrant's Current Report on Form 8-K filed on July 26, 2011 and incorporated herein by reference)
3.2	Bylaws of the Registrant (filed as an exhibit to the Registrant's Current Report on Form 8-K filed on December 6, 2007 and incorporated herein by reference)
10	Material Contracts:

1. Registrant's 2017 Omnibus Incentive Plan (attached to the Registrant's definitive proxy statement filed on September 26, 2017, and incorporated herein by reference)
2. 2008 Equity Incentive Plan (attached to the Registrant's definitive proxy statement filed on September 19, 2008 and incorporated herein by reference)
3. 2003 Stock Option and Incentive Plan (attached to the Registrant's definitive proxy statement filed on September 17, 2003 and incorporated herein by reference)
4. 1994 Stock Option and Incentive Plan (attached to the Registrant's definitive proxy statement filed on October 21, 1994 and incorporated herein by reference)(P)
5. Management Recognition and Development Plan (attached to the Registrant's definitive proxy statement filed on October 21, 1994 and incorporated herein by reference)(P)
6. Employment Agreements
   - (i) Employment Agreement with Greg A. Steffens (files as an exhibit to the Registrant's Annual Report on Form 10-KSB for the year ended June 30, 1999)(P)
7. Director's Retirement Agreements
   - (i) Director's Retirement Agreement with Sammy A. Schalk (filed as an exhibit to the Registrant's Quarterly Report on Form 10-QSB for the quarter ended December 31, 2000 and incorporated herein by reference)
   - (ii) Director's Retirement Agreement with Ronnie D. Black (filed as an exhibit to the Registrant's Quarterly Report on Form 10-QSB for the quarter ended December 31, 2000 and incorporated herein by reference)
   - (iii) Director's Retirement Agreement with L. Douglas Bagby (filed as an exhibit to the Registrant's Quarterly Report on Form 10-QSB for the quarter ended December 31, 2000 and incorporated herein by reference)
   - (iv) Director's Retirement Agreement with Rebecca McLane Brooks (filed as an exhibit to the Registrant's Quarterly Report on Form 10-QSB for the quarter ended December 31, 2004 and incorporated herein by reference)
   - (v) Director's Retirement Agreement with Charles R. Love (filed as an exhibit to the Registrant's Quarterly Report on Form 10-QSB for the quarter ended December 31, 2004 and incorporated herein by reference)
   - (vi) Director's Retirement Agreement with Charles R. Moffitt (filed as an exhibit to the Registrant's Quarterly Report on Form 10-QSB for the quarter ended December 31, 2004 and incorporated herein by reference)
   - (vii) Director's Retirement Agreement with Dennis C. Robison (filed as an exhibit to the Registrant's Quarterly Report on Form 10-Q for the quarter ended December 31, 2008 and incorporated herein by reference)

(viii) Director's Retirement Agreement with David J. Tooley (filed as an exhibit to the Registrant's Quarterly Report on Form 10-Q for the quarter ended December 31, 2011 and incorporated herein by reference)

(ix) Director's Retirement Agreement with Todd E. Hensley (filed as an exhibit to the Registrant's Annual Report on Form 10-K for the year ended June 30, 2014 and incorporated herein by reference)

8. Tax Sharing Agreement (filed as an exhibit to the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2015 and incorporated herein by reference)

10.1	Named Executive Officer Salary and Bonus Arrangements (filed as an exhibit to Registrant's Annual Report on Form 10-K for the year ended June 30, 2018)
10.2	Director Fee Arrangements for 2017 (filed as an exhibit to Registrant's Annual Report on Form 10-K for the year ended June 30, 2018)
11	Statement Regarding Computation of Per Share Earnings (filed as an exhibit to Registrant's Annual Report on Form 10-K for the year ended June 30, 2018)
14	Code of Conduct and Ethics (filed as an exhibit to the Registrant's Annual Report on Form 10-K for the year ended June 30, 2011)
14.1	Amended Code of Conduct and Ethics (filed as an exhibit to Registrant's Annual Report on Form 10-K for the year ended June 30, 2016)
21	Subsidiaries of the Registrant (filed as an exhibit to Registrant's Annual Report on Form 10-K for the year ended June 30, 2018)
31.1	Rule 13a-14(a)/15-d14(a) Certification
31.2	Rule 13a-14(a)/15-d14(a) Certification
32	Section 1350 Certifications
101	Attached as Exhibit 101 are the following financial statements from the Southern Missouri Bancorp, Inc. Quarterly Report on Form 10-Q for the quarter ended December 31, 2018, formatted in Extensive Business Reporting Language (XBRL): (i) consolidated balance sheets, (ii) consolidated statements of income, (iii) consolidated statements of cash flows and (iv) the notes to consolidated financial statements.

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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.

		SOUTHERN MISSOURI BANCORP, INC. Registrant
Date:	February 11, 2019	/s/ Greg A. Steffens Greg A. Steffens President & Chief Executive Officer (Principal Executive Officer)
Date:	February 11, 2019	/s/ Matthew T. Funke Matthew T. Funke Executive Vice President & Chief Financial Officer (Principal Financial and Accounting Officer)