DONEGAL GROUP INC
Form 10-K
March 09, 2018
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2017

OR

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

For the transition period from __________ to __________

Commission file number 0-15341

DONEGAL GROUP INC.

(Exact name of registrant as specified in its charter)

Delaware	**23-2424711**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification No.)**
1195 River Road, Marietta, Pennsylvania	**17547**
(Address of principal executive offices)	**(Zip code)**

Registrant s telephone number, including area code: (800) 877-0600

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

Title of Each Class	Name of Each Exchange on Which Registered
Class A Common Stock, $.01 par value	**The NASDAQ Global Select Market**
Class B Common Stock, $.01 par value	**The NASDAQ Global Select Market**

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

Indicate by check mark whether the registrant is a well-known seasoned issuer as defined in Rule 405 of the Securities Act: Yes . No .

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act. Yes . No .

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements we incorporate by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. .

Indicate by check mark whether the registrant is a shell company. Yes . No .

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant s most recently completed second fiscal quarter. $187,725,762.

Indicate the number of shares outstanding of each of the registrant s classes of common stock, as of the latest practicable date: 22,623,231 shares of Class A common stock and 5,576,775 shares of Class B common stock outstanding on March 1, 2018.

Documents Incorporated by Reference

The registrant incorporates by reference portions of the registrant s definitive proxy statement relating to registrant s annual meeting of stockholders to be held April 19, 2018 into Part III of this report.

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DONEGAL GROUP INC.

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PART I

Item 1. Business.
Introduction

Donegal Group Inc., or DGI, is an insurance holding company whose insurance subsidiaries offer personal and commercial lines of property and casualty insurance to businesses and individuals in 22 Mid-Atlantic, Midwestern, New England and Southern states. As used in this Form 10-K Report, the terms we, us and our refer to Donegal Group Inc. and its subsidiaries.

Donegal Mutual Insurance Company, or Donegal Mutual, organized us as an insurance holding company on August 26, 1986. At December 31, 2017, Donegal Mutual held approximately 44% of our outstanding Class A common stock and approximately 83% of our outstanding Class B common stock. Donegal Mutual s ownership provides Donegal Mutual with approximately 72% of the combined voting power of our outstanding shares of Class A common stock and our outstanding shares of Class B common stock. Our insurance subsidiaries and Donegal Mutual have interrelated operations due to an intercompany pooling agreement and other intercompany agreements and transactions we describe in Note 3 of the Notes to Consolidated Financial Statements. While maintaining the separate corporate existence of each company, our insurance subsidiaries and Donegal Mutual conduct business together as the Donegal Insurance Group. As such, Donegal Mutual and our insurance subsidiaries share the same business philosophy, the same management, the same employees and the same facilities and offer the same types of insurance products.

We have four segments: our investment function, our personal lines of insurance, our commercial lines of insurance and our investment in Donegal Financial Services Corporation, or DFSC. We set forth financial information about these segments in Note 19 of the Notes to Consolidated Financial Statements. The personal lines products of our insurance subsidiaries consist primarily of homeowners and private passenger automobile policies. The commercial lines products of our insurance subsidiaries consist primarily of commercial automobile, commercial multi-peril and workers compensation policies.

Our insurance subsidiaries and Donegal Mutual provide their policyholders with a selection of insurance products at competitive rates, while pursuing profitability by adhering to a strict underwriting discipline. Our insurance subsidiaries derive a substantial portion of their insurance business from smaller to mid-sized regional communities. We believe this focus provides our insurance subsidiaries with competitive advantages in terms of local market knowledge, marketing, underwriting, claims servicing and policyholder service. At the same time, we believe our insurance subsidiaries have cost advantages over many smaller regional insurers that result from economies of scale our insurance subsidiaries realize through centralized accounting, administrative, data processing, investment and other services.

We believe we have a substantial opportunity, as a well-capitalized regional insurance holding company with a solid business strategy, to grow profitably and compete effectively with national property and casualty insurers. Our downstream holding company structure, with Donegal Mutual holding approximately 72% of the combined voting power of our common stock, has proven its effectiveness and success over the 31 years of our existence. Over that time period, we have grown significantly in terms of revenue and financial strength, and the Donegal Insurance Group has developed an excellent reputation as a regional group of property and casualty insurers.

We have been an effective consolidator of smaller main street property and casualty insurance companies, and we expect to pursue opportunities to acquire other insurance companies to expand our business in a given region or to commence operations in a new region. Since 1995, we have completed six acquisitions of property and casualty insurance companies or began to participate in their business through Donegal Mutual s entry into quota-share reinsurance agreements with them.

Donegal Mutual completed the merger of Mountain States Mutual Casualty Company, or Mountain States, with and into Donegal Mutual effective May 25, 2017. Donegal Mutual was the surviving company in the merger, and Mountain States insurance subsidiaries, Mountain States Indemnity Company and Mountain States Commercial Insurance Company, became insurance subsidiaries of Donegal Mutual upon completion of the merger. Upon completion of the merger, Donegal Mutual assumed all of the policy obligations of Mountain States and began to market its products together with its insurance subsidiaries as the Mountain States Insurance Group in four Southwestern states. For an indefinite period of time, Donegal Mutual will exclude the business of the Mountain States Insurance Group from the pooling agreement with Atlantic States Insurance Company, or Atlantic States, one of our insurance subsidiaries. As a result, our consolidated financial results will exclude the results of Donegal Mutual s operations in those Southwestern states.

We own 48.2% of DFSC. DFSC is a grandfathered unitary savings and loan holding company that owns all of the outstanding capital stock of Union Community Bank, a state savings bank, or UCB. UCB has 15 banking offices, substantially all of which are located in Lancaster County, Pennsylvania. Donegal Mutual owns the remaining 51.8% of DFSC. For further information regarding DFSC, we refer to Business - Donegal Financial Services Corporation in this Form 10-K Report.

Available Information

You may obtain our Annual Reports on Form 10-K, including this Form 10-K Report, our quarterly reports on Form 10-Q, our current reports on Form 8-K, our proxy statement and our other filings pursuant to the Securities Exchange Act of 1934, or the Exchange Act, without charge by viewing our website at www.donegalgroup.com. You may also view our Code of Business Conduct and Ethics and the charters of the executive committee, the audit committee, the compensation committee and the nominating committee of our board of directors on our website. Upon request to our corporate secretary, we will also provide printed copies of any of these documents to you without charge. We have provided the address of our website solely for the information of investors. We do not intend the reference to our website address to be an active link or to otherwise incorporate the contents of our website into this Form 10-K Report.

History and Organizational Structure

In the mid-1980 s, Donegal Mutual, as a mutual insurance company, recognized the desirability of developing additional sources of capital and surplus so it could remain competitive and have the surplus to expand its business and ensure its long-term viability. Accordingly, Donegal Mutual determined to implement a downstream holding company structure as one of its business strategies. Thus, in 1986, Donegal Mutual formed us as a downstream holding company. After Donegal Mutual formed us, we in turn formed Atlantic States as our wholly owned property and casualty insurance company subsidiary.

In connection with the formation of Atlantic States and the establishment of our downstream insurance holding company system, Donegal Mutual and DGI entered into a proportional reinsurance agreement, or pooling agreement, that became effective October 1, 1986. Under the pooling agreement, Donegal Mutual and Atlantic States pool substantially all of their respective premiums, losses and loss expenses to the reinsurance pool, and the reinsurance pool, acting through Donegal Mutual, then cedes a portion of the pooled business, currently 80%, to Atlantic States. Donegal Mutual and Atlantic States share the underwriting results in proportion to their respective participation in the underwriting pool.

Since we established Atlantic States in 1986, Donegal Mutual and our insurance subsidiaries have conducted business together as the Donegal Insurance Group. As the Donegal Insurance Group, Donegal Mutual and our insurance subsidiaries share a combined business plan to enhance market penetration and underwriting profitability objectives. We believe Donegal Mutual s majority interest in the combined voting power of our Class A common stock and of our Class B common stock fosters our ability to implement our business philosophies, enjoy management continuity, maintain superior employee relations and provide a stable environment within which we can grow our businesses.

The products Donegal Mutual and our insurance subsidiaries offer are generally complementary, which permits the Donegal Insurance Group to offer a broad range of products in a given market and to expand the Donegal Insurance Group s ability to service an entire personal lines or commercial lines account. Distinctions within the products Donegal Mutual and our insurance subsidiaries offer generally relate to specific risk profiles within similar classes of business, such as preferred tier products versus standard tier products. Donegal Mutual and we do not allocate all of the standard risk gradients to one company. As a result, the underwriting profitability of the business the individual companies write directly will vary. However, the underwriting pool homogenizes the risk characteristics of all business Donegal Mutual and Atlantic States write directly. We receive 80% of the results of the underwriting pool because Atlantic States has an 80% participation in the pool. The business Atlantic States derives from the underwriting pool represents a significant percentage of our total consolidated revenues. However, that percentage has gradually decreased over the past few years as we have acquired a number of other property and casualty insurance companies that do not participate in the underwriting pool.

As the capital of Atlantic States and our other insurance subsidiaries has increased, the underwriting capacity of our insurance subsidiaries has increased proportionately. The size of the underwriting pool has also increased substantially. Therefore, as we originally planned in the mid-1980s, Atlantic States has successfully raised the capital necessary to support the growth of its direct business as well as to accept increases in its allocation of business from the underwriting pool. The portion of the underwriting pool allocated to Atlantic States has increased from an initial allocation of 35% in 1986 to an 80% allocation since March 1, 2008. We do not anticipate any further change in the pooling agreement between Atlantic States and Donegal Mutual, including any change in the percentage participation of Atlantic States in the underwriting pool.

In addition to Atlantic States, our insurance subsidiaries are Southern Insurance Company of Virginia, or Southern, Le Mars Insurance Company, or Le Mars, The Peninsula Insurance Company and its wholly owned subsidiary, Peninsula Indemnity Company, or collectively, Peninsula, Sheboygan Falls Insurance Company, or Sheboygan, and Michigan Insurance Company, or MICO. In addition, Donegal Mutual has a 100% quota-share reinsurance agreement with Southern Mutual Insurance Company, or Southern Mutual, and Donegal Mutual places its assumed business from Southern Mutual into the underwriting pool.

The following chart depicts our organizational structure, including all of our property and casualty insurance subsidiaries, Southern Mutual and our interest in DFSC:

(1) Because of the different relative voting power of our Class A common stock and our Class B common stock, our public stockholders hold approximately 28% of the combined voting power of our Class A common stock and our Class B common stock and Donegal Mutual holds approximately 72% of the combined voting power of our Class A common stock and our Class B common stock.

Relationship with Donegal Mutual

Donegal Mutual provides facilities, personnel and other services to us and our insurance subsidiaries. Donegal Mutual allocates certain related expenses to Atlantic States in relation to the relative participation of Donegal Mutual and Atlantic States in the underwriting pool they maintain. Our insurance subsidiaries other than Atlantic States reimburse Donegal Mutual for their respective personnel costs and bear their proportionate share of information services costs based on each subsidiaries respective percentage of the total net premiums written of the Donegal Insurance Group. Charges for these services to Atlantic States and our other insurance subsidiaries totaled $125.0 million, $122.4 million and $108.5 million for 2017, 2016 and 2015, respectively.

Our insurance subsidiaries have various reinsurance arrangements with Donegal Mutual. These agreements include:

- excess of loss reinsurance agreements with Le Mars, MICO, Peninsula, Sheboygan and Southern;
- catastrophe reinsurance agreements with Atlantic States, Le Mars and Southern; and
- quota-share reinsurance agreements with MICO and Peninsula.

The purpose of the excess of loss and catastrophe reinsurance agreements is to lessen the effects of a single large loss, or an accumulation of smaller losses arising from one event, to levels that are appropriate given each subsidiary s size, underwriting profile and amount of surplus.

The purpose of the quota-share reinsurance agreement with Peninsula is to transfer to Donegal Mutual 100% of the premiums and losses related to the workers compensation product line of Peninsula in certain states, which provides the availability of an additional workers compensation tier for Donegal Mutual s commercial accounts. Donegal Mutual places its assumed business from Peninsula into the underwriting pool.

The purpose of the quota-share reinsurance agreement with MICO is to transfer to Donegal Mutual 25% of the premiums and losses related to MICO s business. Donegal Mutual places its assumed business from MICO into the underwriting pool.

We and Donegal Mutual have maintained a coordinating committee since our formation in 1986. The coordinating committee consists of two members of our board of directors, neither of whom is a member of Donegal Mutual s board of directors, and two members of Donegal Mutual s board of directors, neither of whom is a member of our board of directors. The purpose of the coordinating committee is to establish and maintain a process for an annual evaluation of the transactions between Donegal Mutual, our insurance subsidiaries and us. The coordinating committee considers the fairness of each intercompany transaction to Donegal Mutual and its policyholders and to us and our stockholders.

A new agreement or any change to a previously approved agreement must receive coordinating committee approval. The approval process for a new agreement between Donegal Mutual and us or one of our insurance subsidiaries or a change in such an agreement is as follows:

both of our members on the coordinating committee must determine that the new agreement or the change in an existing agreement is fair and equitable to us and in the best interests of our stockholders;

both of Donegal Mutual s members on the coordinating committee must determine that the new agreement or the change in an existing agreement is fair and equitable to Donegal Mutual and in the best interests of its policyholders;

our board of directors must approve the new agreement or the change in an existing agreement; and

Donegal Mutual s board of directors must approve the new agreement or the change in an existing agreement.

The coordinating committee also meets annually to review each existing agreement between Donegal Mutual and us or our insurance subsidiaries, including all reinsurance agreements between Donegal Mutual and our insurance subsidiaries. The purpose of this annual review is to examine the results of the agreements over the past year and, in the case of reinsurance agreements, over several years and to determine if the results of the existing agreements remain fair and equitable to us and our stockholders and fair and equitable to Donegal Mutual and its policyholders or if Donegal Mutual and we should mutually agree to certain adjustments to the terms of the agreements. In the case of these reinsurance agreements, the annual adjustments typically relate to the reinsurance premiums, losses and reinstatement premiums. These agreements are ongoing in nature and will continue in effect throughout 2018 in the ordinary course of our business.

Our members on the coordinating committee, as of the date of this Form 10-K Report, are Robert S. Bolinger and Richard D. Wampler, II. Donegal Mutual s members on the coordinating committee as of such date are Dennis J. Bixenman and John E. Hiestand. We refer to our proxy statement for our annual meeting of stockholders to be held on

April 19, 2018 for further information about the members of the coordinating committee.

We believe our relationships with Donegal Mutual offer us and our insurance subsidiaries a number of competitive advantages, including the following:

- enabling our stable management, the consistent underwriting discipline of our insurance subsidiaries, external growth, long-term profitability and financial strength;

- creating operational and expense synergies from the combination of resources and integrated operations of Donegal Mutual and our insurance subsidiaries;

- enhancing our opportunities to expand by acquisition because of the ability of Donegal Mutual to affiliate with and acquire control of other mutual insurance companies and, thereafter, demutualize them and allow us to acquire all of their outstanding stock;

- producing more stable and uniform underwriting results for our insurance subsidiaries over extended periods of time than we could achieve without our relationship with Donegal Mutual;

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providing opportunities for growth because of the ability of Donegal Mutual to enter into reinsurance agreements with other mutual insurance companies and place the business it assumes into the pooling agreement; and

providing Atlantic States with a significantly larger underwriting capacity because of the underwriting pool Donegal Mutual and Atlantic States have maintained since 1986.

In the first quarter of 2018, our board of directors and the board of directors of Donegal Mutual each undertook a review of the relationships between Donegal Mutual and DGI and determined that continuing the current relationships and the current corporate structure of Donegal Mutual and DGI is in the best interests of DGI and its various constituencies.

Business Strategy

Our strategy is designed to allow our insurance subsidiaries to achieve their longstanding goal of outperforming the United States property and casualty insurance industry in terms of profitability and service, thereby providing value to the policyholders of our insurance subsidiaries and, ultimately, providing value to our stockholders. The annual net premiums earned of our insurance subsidiaries have increased from $301.5 million in 2006 to $702.5 million in 2017, a compound annual growth rate of 8.0%.

The combined ratio of our insurance subsidiaries and that of the United States property and casualty insurance industry as computed using United States generally accepted accounting principles, or GAAP, and statutory accounting principles, or SAP, for the years 2013 through 2017 are shown in the following table:

	2017	**2016**	**2015**	**2014**	**2013**
Our GAAP combined ratio	103.0%	98.1%	99.0%	101.7%	98.8%
Our SAP combined ratio	101.7	96.8	97.4	100.5	97.4
Industry SAP combined ratio (1)	105.1	100.9	98.3	97.4	96.4

(1) As reported (projected for 2017) by A.M. Best Company.

We and Donegal Mutual believe we can continue to expand our insurance operations over time through organic growth and acquisitions of, or affiliations with, other insurance companies. We and Donegal Mutual have enhanced the performance of companies we have acquired, while leveraging the acquired companies core strengths and local market knowledge to expand their operations. Our insurance subsidiaries and Donegal Mutual also seek to increase their premium base by making quality independent agency appointments, enhancing their competitive position within each agency, introducing new and enhanced insurance products and developing and maintaining automated systems to improve service, communications and efficiency.

We translate these initiatives into our book value growth in a number of ways, including the following:

maintaining a conservative underwriting culture and pricing discipline to sustain our record of long-term underwriting profitability;

continuing our investment in technology to achieve operating efficiencies that lower expenses, enhance the service we provide to agencies and policyholders and increase the speed of our communications with agencies and policyholders; and

maintaining a conservative investment approach.

A detailed review of our business strategies follows:

Achieving underwriting profitability.

Our insurance subsidiaries seek to achieve a combined ratio of less than 100%. We remain committed to achieving consistent underwriting profitability. We believe that underwriting profitability is a fundamental component of our long-term financial strength because it allows our insurance subsidiaries to generate profits without relying exclusively on their investment income for profitability. Our insurance subsidiaries seek to enhance their underwriting results by:

carefully selecting the product lines they underwrite;

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- carefully selecting the individual risks they underwrite;
- minimizing their individual exposure to catastrophe-prone areas; and
- evaluating their claims history on a regular basis to ensure the adequacy of their underwriting guidelines and product pricing.

Our insurance subsidiaries have no material exposures to asbestos or environmental liabilities. Our insurance subsidiaries seek to provide more than one policy to a given personal lines or commercial lines customer because this account selling strategy diversifies their risk and has historically improved their underwriting results. Our insurance subsidiaries also use reinsurance to manage their exposure and limit their maximum net loss from large single risks or risks in concentrated areas.

Pursuing profitable growth by organic expansion within the traditional operating territories of our insurance subsidiaries through developing and maintaining quality agency representation.

We believe that continued expansion of our insurance subsidiaries within their existing markets will be a key source of their continued premium growth and that maintaining an effective and growing network of independent agencies is integral to their expansion. Our insurance subsidiaries seek to be among the top three insurers within each of the independent agencies for the lines of business our insurance subsidiaries write by providing a consistent, competitive and stable market for their products. We believe that the consistency of the product offerings of our insurance subsidiaries enables our insurance subsidiaries to compete effectively for independent agents with other insurers whose product offerings may fluctuate based on industry conditions. Our insurance subsidiaries offer a competitive compensation program to their independent agents that rewards them for producing profitable growth for our insurance subsidiaries. Our insurance subsidiaries provide their independent agents with ongoing support to enable them to better attract and service customers, including:

- fully automated underwriting and policy issuance systems for personal, commercial and farm lines of insurance;
- training programs;
- marketing support;
- availability of a service center that provides comprehensive service for our personal lines policyholders; and
- field visitations by marketing and underwriting personnel and senior management of our insurance subsidiaries.

Our insurance subsidiaries appoint independent agencies with a strong underwriting and growth track record. We believe that our insurance subsidiaries, by carefully selecting, motivating and supporting their independent agencies, will drive continued long-term growth.

Acquiring property and casualty insurance companies to augment the organic growth of our insurance subsidiaries in existing markets and to expand into new geographic regions.

We have been an effective consolidator of smaller main street property and casualty insurance companies, and we expect to continue to acquire other insurance companies to expand our business in a given region or to commence operations in a new region.

Since 1995, we have completed six acquisitions of property and casualty insurance companies or participated in their business through Donegal Mutual s entry into quota-share reinsurance agreements with them. We intend to continue our growth by pursuing affiliations and acquisitions that meet our criteria. Our primary criteria are:

- location in regions where our insurance subsidiaries are currently conducting business or that offer an attractive opportunity to conduct profitable business;
- a mix of business similar to the mix of business of our insurance subsidiaries;
- annual premium volume up to $100.0 million; and
- fair and reasonable transaction terms.

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We believe that our relationship with Donegal Mutual assists us in pursuing affiliations with, and subsequent acquisitions of, mutual insurance companies because, through Donegal Mutual, we understand the concerns and issues that mutual insurance companies face. In particular, Donegal Mutual has had success affiliating with underperforming mutual insurance companies, and we have either acquired them following their conversion to a stock company or benefited from their underwriting results as a result of Donegal Mutual s entry into a 100% quota-share reinsurance agreement with them and placement of its assumed business into the pooling agreement. We have utilized our strengths and financial position to improve the operations of those underperforming insurance companies. We evaluate a number of areas for operational synergies when considering acquisitions, including product underwriting, expenses, the cost of reinsurance and technology.

We and Donegal Mutual have the ability to employ a number of acquisition and affiliation methods. Our prior acquisitions and affiliations have taken one of the following forms:

- purchase of all of the outstanding stock of a stock insurance company;
- purchase of a book of business;
- quota-share reinsurance transaction;
- merger of a mutual company into Donegal Mutual; or
- two-step acquisition of a mutual insurance company in which:
  - as the first step, Donegal Mutual purchases a surplus note from the mutual insurance company, Donegal Mutual enters into a services agreement with the mutual insurance company and Donegal Mutual s designees become a majority of the members of the board of directors of the mutual insurance company; and
  - as the second step, the mutual insurance company enters into a quota-share reinsurance agreement with Donegal Mutual or demutualizes, or converts, into a stock insurance company. Upon the demutualization or conversion, we purchase the surplus note from Donegal Mutual and exchange it for all of the stock of the stock insurance company resulting from the demutualization or conversion.

We believe that our ability to make direct acquisitions of stock insurance companies and to make indirect acquisitions of mutual insurance companies through a sponsored conversion or a quota-share reinsurance agreement provides us with flexibility that is a competitive advantage in making acquisitions. We also believe our historic record clearly demonstrates our ability to acquire control of an underperforming insurance company, re-underwrite its book of business, reduce its cost structure and return it to sustained profitability.

While Donegal Mutual and we generally engage in preliminary discussions with potential direct or indirect acquisition candidates on an almost continuous basis and are so engaged at the date of this Form 10-K Report, neither Donegal Mutual nor we make any public disclosure regarding a proposed acquisition until Donegal Mutual or we have entered into a definitive acquisition agreement.

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The following table highlights our history of insurance company acquisitions and affiliations since 1988:

Company Name	State of Domicile	Year Control Acquired	Method of Acquisition/Affiliation
Southern Mutual Insurance Company and now Southern Insurance Company of Virginia	Virginia	1984	Surplus note investment by Donegal Mutual in 1984; demutualization in 1988; acquisition of stock by us in 1988.
Pioneer Mutual Insurance Company and then Pioneer Insurance Company (1)(2)	Ohio	1992	Surplus note investment by Donegal Mutual in 1992; demutualization in 1993; acquisition of stock by us in 1997.
Delaware Mutual Insurance Company and then Delaware Atlantic Insurance Company (1)(2)	Delaware	1993	Surplus note investment by Donegal Mutual in 1993; demutualization in 1994; acquisition of stock by us in 1995.
Pioneer Mutual Insurance Company and then Pioneer Insurance Company (1)(2)	New York	1995	Surplus note investment by Donegal Mutual in 1995; demutualization in 1998; acquisition of stock by us in 2001.
Southern Heritage Insurance Company (2)	Georgia	1998	Purchase of stock by us in 1998.
Le Mars Mutual Insurance Company of Iowa and now Le Mars Insurance Company (1)	Iowa	2002	Surplus note investment by Donegal Mutual in 2002; demutualization in 2004; acquisition of stock by us in 2004.
Peninsula Insurance Group	Maryland	2004	Purchase of stock by us in 2004.
Sheboygan Falls Mutual Insurance Company and now Sheboygan Falls Insurance Company (1)	Wisconsin	2007	Contribution note investment by Donegal Mutual in 2007; demutualization in 2008; acquisition of stock by us in 2008.
Southern Mutual Insurance Company (3)	Georgia	2009	Surplus note investment by Donegal Mutual and quota-share reinsurance in 2009.
Michigan Insurance Company	Michigan	2010	Purchase of stock by us and surplus note investment by Donegal Mutual in 2010.

(1) Each of these acquisitions initially took the form of an affiliation with Donegal Mutual. Donegal Mutual provided surplus note financing to the insurance company, and, in connection with that financing, sufficient designees of Donegal Mutual were appointed so as to constitute a majority of the members of the board of directors of the insurance company. Donegal Mutual and the insurance company simultaneously entered into a services agreement whereby Donegal Mutual provided services to improve the operations of the insurance company. Once the insurance company s results of operations improved to the satisfaction of Donegal Mutual, Donegal Mutual sponsored the demutualization of the insurance company. Upon the consummation of the demutualization, Donegal Mutual converted the surplus note to capital stock of the newly demutualized insurance company. We then purchased all of the capital stock of the insurance company from Donegal Mutual and made an additional capital contribution in cash to provide adequate surplus to support the insurance company s planned premium

growth.

(2) To reduce administrative and compliance costs and expenses, these subsidiaries subsequently merged into one of our existing insurance subsidiaries.

(3) Control acquired by Donegal Mutual.

Providing responsive and friendly customer and agent service to enable our insurance subsidiaries to attract new policyholders and retain existing policyholders.

We believe that excellent policyholder service is important in attracting new policyholders and retaining existing policyholders. Our insurance subsidiaries work closely with their independent agents to provide a consistently responsive level of claims service, underwriting and customer support. Our insurance subsidiaries seek to respond expeditiously and effectively to address customer and independent agent inquiries in a number of ways, including:

availability of a customer call center for claims reporting;

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availability of a secure website for access to policy information and documents, payment processing and other features;

timely replies to information requests and policy submissions; and

prompt responses to, and processing of, claims.

Our insurance subsidiaries periodically conduct policyholder surveys to evaluate the effectiveness of their service to policyholders. The management of our insurance subsidiaries meets on a regular basis with the personnel of the independent insurance agents our insurance subsidiaries appoint to seek service improvement recommendations, react to service issues and better understand local market conditions.

Maintaining premium rate adequacy to enhance the underwriting results of our insurance subsidiaries, while maintaining their existing book of business and preserving their ability to write new business.

Our insurance subsidiaries maintain discipline in their pricing by effecting rate increases to sustain or improve their underwriting results without unduly affecting their customer retention. In addition to appropriate pricing, our insurance subsidiaries seek to ensure that their premium rates are adequate relative to the amount of risk they insure. Our insurance subsidiaries review loss trends on a periodic basis to identify changes in the frequency and severity of their claims and to assess the adequacy of their rates and underwriting standards. Our insurance subsidiaries also carefully monitor and audit the information they use to price their policies for the purpose of enabling them to receive an adequate level of premiums for the risk they assume. For example, our insurance subsidiaries inspect substantially all commercial lines risks and a substantial number of personal lines property risks before they commit to insure them to determine the adequacy of the insured amount to the value of the insured property, assess property conditions and identify any liability exposures. Our insurance subsidiaries audit the payroll data of their workers compensation customers to verify that the assumptions used to price a particular policy were accurate. By implementing appropriate rate increases and understanding the risks our insurance subsidiaries agree to insure, our insurance subsidiaries seek to achieve consistent underwriting profitability.

Focusing on expense controls and utilization of technology to increase the operating efficiency of our insurance subsidiaries.

Our insurance subsidiaries maintain stringent expense controls under direct supervision of their senior management. We centralize many processing and administrative activities of our insurance subsidiaries to realize operating synergies and better expense control. Our insurance subsidiaries utilize technology to automate much of their underwriting and to facilitate agency and policyholder communications on an efficient, timely and cost-effective basis. We operate on a paperless basis. Our insurance subsidiaries have increased their annual premium per employee, a measure of efficiency that our insurance subsidiaries use to evaluate their operations, from approximately $470,000 in 1999 to approximately $1.1 million in 2017.

Our insurance subsidiaries maintain technology comparable to that of their larger competitors. Ease of doing business is an increasingly important component of an insurer s value to an independent agency. Our insurance subsidiaries provide a fully automated personal lines underwriting and policy issuance system called WritePro®. WritePro® is a web-based user interface that substantially eases data entry and facilitates the quoting and issuance of policies for the independent agents of our insurance subsidiaries. Our insurance subsidiaries also provide a similar commercial business system called WriteBiz®. WriteBiz® is a web-based user interface that provides the independent agents of our insurance subsidiaries with an online ability to quote and issue commercial automobile, workers compensation, business owners and tradesman policies automatically. WriteFarm® is a web-based user interface that provides the independent agents of our insurance subsidiaries with an online ability to quote and issue farm policies. As a result, applications of the independent agents for our insurance subsidiaries can result in policy issuance without further re-entry of information. These systems also interface with the policy management systems of the independent agents of our insurance subsidiaries.

Maintaining a conservative investment approach.

Return on invested assets is an important element of the financial results of our insurance subsidiaries. The investment strategy of our insurance subsidiaries is to generate an appropriate amount of after-tax income on invested assets while minimizing credit risk through investments in high-quality securities. As a result, our insurance subsidiaries seek to invest a high percentage of their assets in diversified, highly rated and marketable fixed-maturity instruments. The fixed-maturity portfolios of our insurance subsidiaries consist of both taxable and tax-exempt securities. Our insurance subsidiaries maintain a portion of their portfolios in short-term securities to provide liquidity for the payment of claims and operation of their respective businesses. Our insurance subsidiaries maintain a small percentage (5.0% at December 31, 2017) of their portfolios in equity securities.

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Competition

The property and casualty insurance industry is highly competitive on the basis of both price and service. Numerous companies compete for business in the geographic areas where our insurance subsidiaries operate. Many of these other insurance companies are substantially larger and have greater financial resources than those of our insurance subsidiaries. In addition, because our insurance subsidiaries and Donegal Mutual market their respective insurance products exclusively through independent insurance agencies, most of which represent more than one insurance company, our insurance subsidiaries face competition within agencies, as well as competition to retain qualified independent agents.

Products and Underwriting

We report the results of our insurance operations in two segments: personal lines of insurance and commercial lines of insurance. The personal lines our insurance subsidiaries write consist primarily of private passenger automobile and homeowners insurance. The commercial lines our insurance subsidiaries write consist primarily of commercial automobile, commercial multi-peril and workers compensation insurance. We describe these lines of insurance in greater detail below:

Personal

Private passenger automobile policies that provide protection against liability for bodily injury and property damage arising from automobile accidents and protection against loss from damage to automobiles owned by the insured.

Homeowners policies that provide coverage for damage to residences and their contents from a broad range of perils, including fire, lightning, windstorm and theft. These policies also cover liability of the insured arising from injury to other persons or their property while on the insured s property and under other specified conditions.

Commercial

Commercial automobile policies that provide protection against liability for bodily injury and property damage arising from automobile accidents and protection against loss from damage to automobiles owned by the insured.

Commercial multi-peril policies that provide protection to businesses against many perils, usually combining liability and physical damage coverages.

Workers compensation policies employers purchase to provide benefits to employees for injuries sustained during employment. The workers compensation laws of each state determine the extent of the coverage we provide.

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The following table sets forth the net premiums written of our insurance subsidiaries by line of insurance for the periods indicated:

	Year Ended December 31,					
	2017		2016		2015	
(dollars in thousands)	Amount	%	Amount	%	Amount	%
Personal lines:						
Automobile	$ 255,297	35.0%	$ 229,789	33.7%	$ 214,610	34.1%
Homeowners	125,054	17.2	122,811	18.0	119,541	19.0
Other	19,672	2.7	19,057	2.8	18,176	2.9
Total personal lines	400,023	54.9	371,657	54.5	352,327	56.0
Commercial lines:						
Automobile	99,333	13.6	87,849	12.9	76,729	12.2
Commercial multi-peril	110,313	15.1	104,728	15.4	94,219	15.0
Workers compensation	109,884	15.1	108,349	15.9	98,079	15.6
Other	9,586	1.3	9,451	1.3	7,483	1.2
Total commercial lines	329,116	45.1	310,377	45.5	276,510	44.0
Total business	$ 729,139	100.0%	$ 682,034	100.0%	$ 628,837	100.0%

The personal lines and commercial lines underwriting departments of our insurance subsidiaries evaluate and select those risks that they believe will enable our insurance subsidiaries to achieve an underwriting profit. The underwriting departments have significant interaction with the independent agents regarding the underwriting philosophy and the underwriting guidelines of our insurance subsidiaries. Our underwriting personnel also assist the research and development department in the development of quality products at competitive prices to promote growth and profitability.

In order to achieve underwriting profitability on a consistent basis, our insurance subsidiaries:

- assess and select primarily standard and preferred risks;
- adhere to disciplined underwriting guidelines;
- inspect substantially all commercial lines risks and a substantial number of personal lines property risks; and
- utilize various types of risk management and loss control services.

Our insurance subsidiaries also review their existing policies and accounts to determine whether those risks continue to meet their underwriting guidelines. If a given policy or account no longer meets those underwriting guidelines, our insurance subsidiaries will take appropriate action regarding that policy or account, including raising premium rates or non-renewing the policy to the extent applicable law permits.

As part of the effort of our insurance subsidiaries to maintain acceptable underwriting results, they conduct annual reviews of agencies that have failed to meet their underwriting profitability criteria. The review process includes an analysis of the underwriting and re-underwriting practices of the agency, the completeness and accuracy of the applications the agency submits, the adequacy of the training of the agency s staff and the agency s record of adherence to the underwriting guidelines and service standards of our insurance subsidiaries. Based on the results of this review process, the marketing and underwriting personnel of our insurance subsidiaries develop, together with the agency, a plan to improve its underwriting profitability. Our insurance subsidiaries monitor the agency s compliance with the plan and take other measures as required in the judgment of our insurance subsidiaries, including the termination to the extent applicable law permits of agencies that are unable to achieve acceptable underwriting profitability.

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Distribution

Our insurance subsidiaries market their products primarily in the Mid-Atlantic, Midwestern, New England and Southern regions through approximately 2,400 independent insurance agencies. At December 31, 2017, the Donegal Insurance Group actively wrote business in 22 states (Alabama, Delaware, Georgia, Illinois, Indiana, Iowa, Maine, Maryland, Michigan, Nebraska, New Hampshire, New York, North Carolina, Ohio, Pennsylvania, South Carolina, South Dakota, Tennessee, Vermont, Virginia, West Virginia and Wisconsin). Donegal Mutual and its subsidiaries also write business in four Southwestern states (Colorado, New Mexico, Texas and Utah). Donegal Mutual currently excludes the business written in these four states from the pooling agreement between Donegal Mutual and Atlantic States. As a result, this business has no impact on our results of operations. We believe the relationships of our insurance subsidiaries with their independent agents are valuable in identifying, obtaining and retaining profitable business. Our insurance subsidiaries maintain a stringent agency selection procedure that emphasizes appointing agencies with proven marketing strategies for the development of profitable business, and our insurance subsidiaries only appoint agencies with a strong underwriting history and potential growth capabilities. Our insurance subsidiaries also regularly evaluate the independent agencies that represent them based on their profitability and performance in relation to the objectives of our insurance subsidiaries. Our insurance subsidiaries seek to be among the top three insurers within each of their agencies for the lines of business our insurance subsidiaries write.

The following table sets forth the percentage of direct premiums our insurance subsidiaries write, including 80% of the direct premiums Donegal Mutual and Atlantic States write, in each of the states where they conducted a significant portion of their business in 2017:

Pennsylvania	34.4%
Michigan	14.9
Maryland	8.8
Virginia	8.4
Georgia	7.6
Delaware	5.5
Wisconsin	3.7
Ohio	3.2
Iowa	2.8
Nebraska	2.6
Tennessee	2.4
South Dakota	1.2
Other	4.5
Total	100.0%

Our insurance subsidiaries employ a number of policies and procedures that we believe enable them to attract, retain and motivate their independent agents. We believe that the consistency of the product offerings of our insurance subsidiaries enables our insurance subsidiaries to compete effectively for independent agents with other insurers whose product offerings may fluctuate based upon industry conditions. Our insurance subsidiaries have a competitive profit-sharing plan for their independent agents, consistent with applicable state laws and regulations, under which the independent agents may earn additional commissions based upon the volume of premiums produced and the profitability of the business our insurance subsidiaries receive from that agency.

Our insurance subsidiaries encourage their independent agents to focus on account selling, or serving all of a particular insured s property and casualty insurance needs, which our insurance subsidiaries believe generally results in more favorable loss experience than covering a single risk for an individual insured.

Technology

Donegal Mutual owns the majority of the technology systems our insurance subsidiaries use. The technology systems consist primarily of an integrated central processing computer system, a series of server-based computer networks and various communication systems that allow the home office of our insurance subsidiaries and their branch offices to utilize the same systems for the processing of business. Donegal Mutual maintains backup facilities and systems at the office of one of our insurance subsidiaries and tests these backup facilities and systems on a regular basis. Our insurance subsidiaries bear their proportionate share of information services expenses based on their respective percentage of the total net premiums written of the Donegal Insurance Group during the preceding calendar year.

The business strategy of our insurance subsidiaries depends on the use, development and implementation of integrated technology systems. These systems enable our insurance subsidiaries to provide a high level of service to agents and policyholders by processing business in a timely and efficient manner, communicating and sharing data with agents, providing a variety of methods for the payment of premiums and allowing for the accumulation and analysis of information for the management of our insurance subsidiaries.

We believe the availability and use of these technology systems has resulted in improved service to agents and policyholders, increased efficiencies in processing the business of our insurance subsidiaries and lower operating costs. Key components of these integrated technology systems are the agency interface system, the WritePro®, WriteBiz® and WriteFarm® systems, a claims processing system and an imaging system. The agency interface system provides our insurance subsidiaries with a high level of data sharing both to and from agents systems and also provides agents with an integrated means of processing new business. The WritePro®, WriteBiz® and WriteFarm® systems are fully automated underwriting and policy issuance systems that provide agents with the ability to generate underwritten quotes and automatically issue policies that meet the underwriting guidelines of our insurance subsidiaries with limited or no intervention by their personnel. The claims processing system allows our insurance subsidiaries to process claims efficiently and in an automated environment. The imaging system eliminates the need to handle paper files, while providing greater access to the same information by a variety of personnel. We believe our technology systems compare favorably to those of many national property and casualty insurance carriers in terms of quality and service levels.

Claims

The management of claims is a critical component of the philosophy of our insurance subsidiaries to achieve underwriting profitability on a consistent basis and is fundamental to the successful operations of our insurance subsidiaries and their dedication to excellent service. Our senior claims management oversees the claims processing units of each of our insurance subsidiaries to assure consistency in the claims settlement process. The field office staff of our insurance subsidiaries receives support from home office technical, litigation, material damage, subrogation and medical audit personnel.

The claims departments of our insurance subsidiaries rigorously manage claims to assure that they settle legitimate claims quickly and fairly and that they identify questionable claims for defense. In the majority of cases, the personnel of our insurance subsidiaries, who have significant experience in the property and casualty insurance industry and know the service philosophy of our insurance subsidiaries, adjust claims. Our insurance subsidiaries provide various means of claims reporting on a 24-hours a day, seven-days a week basis, including toll-free numbers and electronic reporting through our website and mobile applications. Our insurance subsidiaries strive to respond to notifications of claims promptly, generally within the day reported. Our insurance subsidiaries believe that, by responding promptly to claims, they provide quality customer service and minimize the ultimate cost of the claims. Our insurance subsidiaries engage independent adjusters as needed to handle claims in areas in which the volume of claims is not sufficient to justify the hiring of internal claims adjusters by our insurance subsidiaries. Our insurance subsidiaries also employ private adjusters and investigators, structural experts and various outside legal counsel to supplement their internal staff and to assist in the investigation of claims. Our insurance subsidiaries have a special investigative unit staffed by former law enforcement officers that attempts to identify and prevent fraud and abuse and to investigate questionable claims.

The management of the claims departments of our insurance subsidiaries develops and implements policies and procedures for the establishment of adequate claim reserves. Our insurance subsidiaries employ an actuarial staff that regularly reviews their reserves for incurred but not reported claims. The management and staff of the claims departments resolve policy coverage issues, manage and process reinsurance recoveries and handle salvage and subrogation matters. The litigation and personal injury sections of our insurance subsidiaries manage all claims litigation. Branch office claims above certain thresholds require home office review and settlement authorization. Our insurance subsidiaries provide their claims adjusters reserving and settlement authority based upon their experience and demonstrated abilities. Larger or more complicated claims require consultation and approval of senior claims department management.

Liabilities for Losses and Loss Expenses

Liabilities for losses and loss expenses are estimates at a given point in time of the amounts an insurer expects to pay with respect to incurred policyholder claims based on facts and circumstances the insurer knows at that point in time. At the time of establishing its estimates, an insurer recognizes that its ultimate liability for losses and loss expenses will exceed or be less than such estimates. Our insurance subsidiaries base their estimates of liabilities for losses and loss expenses on assumptions as to future loss trends, expected claims severity, judicial theories of liability and other factors. However, during the loss adjustment period, our insurance subsidiaries may learn additional facts regarding individual claims, and, consequently, it often becomes necessary for our insurance subsidiaries to refine and adjust their estimates for these liabilities. We reflect any adjustments to the liabilities for losses and loss expenses of our insurance subsidiaries in our consolidated results of operations in the period in which our insurance subsidiaries make adjustments to their estimates.

Our insurance subsidiaries maintain liabilities for the payment of losses and loss expenses with respect to both reported and unreported claims. Our insurance subsidiaries establish these liabilities for the purpose of covering the ultimate costs of settling all losses, including investigation and litigation costs. Our insurance subsidiaries base the amount of their liability for reported losses primarily upon a case-by-case evaluation of the type of risk involved, knowledge of the circumstances surrounding each claim and the insurance policy provisions relating to the type of loss the policyholder incurred. Our insurance subsidiaries determine the amount of their liability for unreported claims and loss expenses on the basis of historical information by line of insurance. Our insurance subsidiaries account for inflation in the reserving function through analysis of costs and trends and reviews of historical reserving results. Our insurance subsidiaries monitor their liabilities closely and recompute them periodically using new information on reported claims and a variety of statistical techniques. Our insurance subsidiaries do not discount their liabilities for losses and loss expenses.

Reserve estimates can change over time because of unexpected changes in assumptions related to our insurance subsidiaries external environment and, to a lesser extent, assumptions related to our insurance subsidiaries internal operations. For example, our insurance subsidiaries have experienced a decrease in claims frequency on workers compensation claims during the past several years while the severity of these claims has gradually increased. These trend changes give rise to greater uncertainty as to the pattern of future loss settlements on workers compensation claims. Related uncertainties regarding future trends include the cost of medical technologies and procedures and changes in the utilization of medical procedures. Assumptions related to our insurance subsidiaries external environment include the absence of significant changes in tort law and the legal environment that increase liability exposure, consistency in judicial interpretations of insurance coverage and policy provisions and the rate of loss cost inflation. Internal assumptions include consistency in the recording of premium and loss statistics, consistency in the recording of claims, payment and case reserving methodology, accurate measurement of the impact of rate changes and changes in policy provisions, consistency in the quality and characteristics of business written within a given line of business and consistency in reinsurance coverage and collectability of reinsured losses, among other items. To the extent our insurance subsidiaries determine that underlying factors impacting their assumptions have changed, our insurance subsidiaries make adjustments in their reserves that they consider appropriate for such changes. Accordingly, our insurance subsidiaries ultimate liability for unpaid losses and loss expenses will likely differ from the amount recorded at December 31, 2017. For every 1% change in our insurance subsidiaries loss and loss expense reserves, net of reinsurance recoverable, the effect on our pre-tax results of operations would be approximately $3.8 million.

The establishment of appropriate liabilities is an inherently uncertain process and we can provide no assurance that our insurance subsidiaries ultimate liability will not exceed our insurance subsidiaries loss and loss expense reserves and have an adverse effect on our results of operations and financial condition. Furthermore, we cannot predict the timing, frequency and extent of adjustments to our insurance subsidiaries estimated future liabilities, because the historical conditions and events that serve as a basis for our insurance subsidiaries estimates of ultimate claim costs may change. As is the case for substantially all property and casualty insurance companies, our insurance subsidiaries have found it necessary in the past to increase their estimated future liabilities for losses and loss expenses in certain periods and, in other periods, their estimated future liabilities for losses and loss expenses have exceeded their actual liabilities for losses and loss expenses. Changes in our insurance subsidiaries estimates of their liability for losses and loss expenses generally reflect actual payments and their evaluation of information received subsequent to the prior reporting period. Our insurance subsidiaries recognized an increase in their liability for losses and loss expenses of prior years of $6.6 million, $3.0 million and $7.2 million in 2017, 2016 and 2015, respectively. Our insurance subsidiaries made no significant changes in their reserving philosophy, key reserving assumptions or claims management personnel, and they have made no significant offsetting changes in estimates that increased or decreased their loss and loss expense reserves in these years. The 2017 development represented 1.9% of the December 31, 2016 net carried reserves and resulted primarily from higher-than-expected severity in the commercial multiple peril, personal automobile and commercial automobile lines of business, offset by lower-than-expected severity in the workers compensation line of business, in accident years prior to 2017. The majority of the 2017 development related to increases in the liability for losses and loss expenses of prior years for Atlantic States and Peninsula. The 2016 development represented 0.9% of the December 31, 2015 net carried reserves and resulted primarily from higher-than-expected severity in the commercial multiple peril and commercial automobile liability lines of business, offset by lower-than-expected severity in the workers compensation line of business, in accident years prior to 2016. The majority of the 2016 development related to increases in the liability for losses and loss expenses of prior years for Atlantic States and Southern. The 2015 development represented 2.5% of the December 31, 2014 net carried reserves and resulted primarily from higher-than-expected severity in the private passenger automobile liability, commercial multiple peril and commercial automobile lines of business in accident years prior to 2015. The majority of the 2015 development related to increases in the liability for losses and loss expenses of prior years for Atlantic States and Southern.

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Excluding the impact of severe weather events, our insurance subsidiaries have noted stable amounts in the number of claims incurred and a slight downward trend in the number of claims outstanding at period ends relative to their premium base in recent years across most of their lines of business. However, the amount of the average claim outstanding has increased gradually over the past several years due to various factors such as rising medical loss costs and increased litigation trends. We have also experienced a general slowing of settlement rates in litigated claims. Our insurance subsidiaries could have to make further adjustments to their estimates in the future. However, on the basis of our insurance subsidiaries internal procedures, which analyze, among other things, their prior assumptions, their experience with similar cases and historical trends such as reserving patterns, loss payments, pending levels of unpaid claims and product mix, as well as court decisions, economic conditions and public attitudes, we believe that our insurance subsidiaries have made adequate provision for their liability for losses and loss expenses.

Atlantic States participation in the pool with Donegal Mutual exposes Atlantic States to adverse loss development on the business of Donegal Mutual that the pool includes. However, pooled business represents the predominant percentage of the net underwriting activity of both companies, and Donegal Mutual and Atlantic States share proportionately any adverse risk development relating to the pooled business. The business in the pool is homogeneous and each company has a pro-rata share of the entire pool. Since the predominant percentage of the business of Atlantic States and Donegal Mutual is pooled and the results shared by each company according to its participation level under the terms of the pooling agreement, the intent of the underwriting pool is to produce a more uniform and stable underwriting result from year to year for each company than either would experience individually and to spread the risk of loss between the companies.

Donegal Mutual and our insurance subsidiaries operate together as the Donegal Insurance Group and share a combined business plan designed to achieve market penetration and underwriting profitability objectives. The products our insurance subsidiaries and Donegal Mutual offer are generally complementary, thereby allowing Donegal Insurance Group to offer a broader range of products to a given market and to expand Donegal Insurance Group s ability to service an entire personal lines or commercial lines account. Distinctions within the products of Donegal Mutual and our insurance subsidiaries generally relate to specific risk profiles targeted within similar classes of business, such as preferred tier products compared to standard tier products, but we do not allocate all of the standard risk gradients to one company. Therefore, the underwriting profitability of the business the individual companies write directly will vary. However, because the pool homogenizes the risk characteristics of the predominant percentage of the business Donegal Mutual and Atlantic States write directly and each company shares the underwriting results according to each company s participation percentage, each company realizes its percentage share of the underwriting results of the pool.

Differences between liabilities reported in our financial statements prepared on a GAAP basis and our insurance subsidiaries financial statements prepared on a SAP basis result from anticipating salvage and subrogation recoveries for GAAP but not for SAP. These differences amounted to $18.0 million, $16.8 million and $15.3 million at December 31, 2017, 2016 and 2015, respectively.

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The following table sets forth a reconciliation of the beginning and ending GAAP net liability of our insurance subsidiaries for unpaid losses and loss expenses for the periods indicated:

	Year Ended December 31,		
(in thousands)	2017	2016	2015
Gross liability for unpaid losses and loss expenses at beginning of year	$ 606,665	$ 578,205	$ 538,258
Less reinsurance recoverable	259,147	256,151	245,957
Net liability for unpaid losses and loss expenses at beginning of year	347,518	322,054	292,301
Provision for net losses and loss expenses for claims incurred in the current year	480,647	420,327	391,167
Change in provision for estimated net losses and loss expenses for claims incurred in prior years	6,621	2,989	7,200
Total incurred	487,268	423,316	398,367
Net losses and loss expense payments for claims incurred during:			
The current year	288,380	248,106	236,835
Prior years	163,005	149,746	131,779
Total paid	451,385	397,852	368,614
Net liability for unpaid losses and loss expenses at end of year	383,401	347,518	322,054
Plus reinsurance recoverable	293,271	259,147	256,151
Gross liability for unpaid losses and loss expenses at end of year	$ 676,672	$ 606,665	$ 578,205

The following table sets forth the development of the liability for net unpaid losses and loss expenses of our insurance subsidiaries from 2007 to 2017. Loss data in the table includes business Atlantic States received from the underwriting pool.

Net liability at end of year for unpaid losses and loss expenses sets forth the estimated liability for net unpaid losses and loss expenses recorded at the balance sheet date for each of the indicated years. This liability represents the estimated amount of net losses and loss expenses for claims arising in the current and all prior years that are unpaid at the balance sheet date, including losses incurred but not reported.

The Net liability re-estimated as of portion of the table shows the re-estimated amount of the previously recorded liability based on experience for each succeeding year. The estimate increases or decreases as payments are made and more information becomes known about the severity of the remaining unpaid claims. For example, the 2007 liability has developed a deficiency after ten years because we expect the re-estimated net losses and loss expenses to be

$2.5 million more than the estimated liability we initially established in 2007 of $150.2 million.

The Cumulative deficiency (excess) shows the cumulative deficiency or excess at December 31, 2017 of the liability estimate shown on the top line of the corresponding column. A deficiency in liability means that the liability established in prior years was less than the amount of actual payments and currently re-estimated remaining unpaid liability. An excess in liability means that the liability established in prior years exceeded the amount of actual payments and currently re-estimated unpaid liability remaining.

The Cumulative amount of liability paid through portion of the table shows the cumulative net losses and loss expense payments made in succeeding years for net losses incurred prior to the balance sheet date. For example, the 2007 column indicates that at December 31, 2017 payments equal to $149.3 million of the currently re-estimated ultimate liability for net losses and loss expenses of $152.7 million had been made.

Amounts shown in the 2008 column of the table include information for Sheboygan for all accident years prior to 2008. Amounts shown in the 2010 column of the table include information for MICO for all accident years prior to 2010.

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	Year Ended December 31,										
housands)	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	201
liability at of year unpaid es and expenses	$ 150,152	$ 161,307	$ 180,262	$ 217,896	$ 243,015	$ 250,936	$ 265,605	$ 292,301	$ 322,054	$ 347,518	$ 383,4
liability stimated f:											
year later	152,836	171,130	177,377	217,728	250,611	261,294	280,074	299,501	325,043	354,139	
years	154,435	167,446	177,741	217,355	255,612	268,877	281,782	299,919	329,115		
ee years	152,315	166,756	178,403	218,449	257,349	270,473	281,666	304,855			
r years	151,120	166,852	179,909	218,514	256,460	270,794	284,429				
years	151,287	166,788	179,961	218,202	255,660	271,954					
years later	151,739	166,964	179,858	217,430	256,388						
en years	151,790	167,425	179,996	217,703							
ht years	152,240	167,732	180,130								
e years	152,760	167,508									
years	152,680										
nulative ciency ess)	2,528	6,201	(132)	(193)	13,373	21,018	18,824	12,554	7,061	6,621	
nulative unt of lity paid ugh:											
year later	$ 71,950	$ 79,592	$ 84,565	$ 96,202	$ 119,074	$ 126,677	$ 131,766	$ 131,779	$ 149,746	$ 163,005	
years	105,576	116,035	123,204	148,140	181,288	191,208	194,169	206,637	228,506		
ee years	124,659	136,837	147,165	178,073	217,138	225,956	233,371	251,654			
r years	135,392	148,243	161,363	195,948	234,392	245,094	255,451				
years	140,280	155,331	169,452	203,633	241,538	254,502					
years later	143,778	160,324	173,153	206,731	245,774						
en years	146,491	162,531	174,376	209,527							

nt years			
-	148,235	163,432	175,662
e years			
-	149,013	163,870	
years			
-	149,341		

	Year Ended December 31,								
housands)	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**
ss liability nd of year	$ 263,599	$ 383,317	$ 442,408	$ 458,827	$ 495,619	$ 538,258	$ 578,205	$ 606,665	$ 676,672
nsurance verable	83,337	165,421	199,393	207,891	230,014	245,957	256,151	259,147	293,271
liability at of year	180,262	217,896	243,015	250,936	265,605	292,301	322,054	347,518	383,401
ss stimated lity	270,771	341,095	470,727	497,106	525,946	564,997	591,748	616,465	
estimated verable	90,641	123,392	214,339	225,152	241,517	260,142	262,633	262,326	
stimated lity	180,130	217,703	256,388	271,954	284,429	304,855	329,115	354,139	
ss ulative ciency ess)	7,172	(42,222)	28,319	38,279	30,327	26,739	13,543	9,800	

Third-Party Reinsurance

Our insurance subsidiaries and Donegal Mutual purchase certain third-party reinsurance on a combined basis. Le Mars, Peninsula, Sheboygan and MICO also have separate reinsurance programs that provide certain coverage that is commensurate with their relative size and exposures. Our insurance subsidiaries use several different reinsurers, all of which, consistent with the requirements of our insurance subsidiaries and Donegal Mutual, have an A.M. Best rating of A- (Excellent) or better or, with respect to foreign reinsurers, have a financial condition that, in the opinion of our management, is equivalent to a company with at least an A- (Excellent) rating from A.M. Best.

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The external reinsurance our insurance subsidiaries and Donegal Mutual purchase includes:

- excess of loss reinsurance, under which the losses of Donegal Mutual and our insurance subsidiaries are automatically reinsured, through a series of contracts, over a set retention (generally $1.0 million); and

- catastrophe reinsurance, under which Donegal Mutual and our insurance subsidiaries recover, through a series of reinsurance agreements, 100% of an accumulation of many losses resulting from a single event, including natural disasters, over a set retention (generally $5.0 million) and after exceeding an annual aggregate deductible ($1.0 million in 2017, $975,000 in 2016 and $1.5 million in 2015) up to aggregate losses of $170.0 million per occurrence.

The amount of coverage each of these types of reinsurance provides depends upon the amount, nature, size and location of the risk being reinsured.

For property insurance, our insurance subsidiaries have excess of loss treaties that provide for coverage of $4.0 million per loss over a set retention of $1.0 million. For liability insurance, our insurance subsidiaries have excess of loss treaties that provide for coverage of $49.0 million per occurrence over a set retention of $1.0 million. For workers compensation insurance, our insurance subsidiaries have excess of loss treaties that provide for coverage of $9.0 million on any one life over a set retention of $1.0 million and after exceeding an annual aggregate deductible ($1.2 million in 2017 and 2016 and $1.0 million in 2015).

Our insurance subsidiaries and Donegal Mutual also purchase facultative reinsurance to cover exposures from property and casualty losses that exceed the limits provided by their respective treaty reinsurance.

For policies effective through December 31, 2014, MICO maintained a quota-share reinsurance agreement with third-party reinsurers to reduce its net exposures. Effective January 1, 2015, MICO no longer maintains a quota-share reinsurance agreement with third-party reinsurers.

Investments

At December 31, 2017, 99.8% of all debt securities our insurance subsidiaries held had an investment-grade rating. The investment portfolios of our insurance subsidiaries did not contain any mortgage loans or any non-performing assets at December 31, 2017.

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The following table shows the composition of the debt securities (at carrying value) in the investment portfolios of our insurance subsidiaries, excluding short-term investments, by rating at December 31, 2017:

(dollars in thousands)	December 31, 2017	
Rating[1]	**Amount**	**Percent**
U.S. Treasury and U.S. agency securities[2]	$ 422,139	46.7%
Aaa or AAA	17,203	1.9
Aa or AA	212,031	23.4
A	155,844	17.2
BBB	96,379	10.6
B	2,005	0.2
Total	$ 905,601	100.0%

(1) Ratings assigned by Moody s Investors Services, Inc. or Standard & Poor s Corporation.

(2) Includes mortgage-backed securities of $306.4 million.

Our insurance subsidiaries invest in both taxable and tax-exempt securities as part of their strategy to maximize after-tax income. Tax-exempt securities made up approximately 24.3%, 32.2% and 40.9% of the fixed-maturity securities in the combined investment portfolios of our insurance subsidiaries at December 31, 2017, 2016 and 2015, respectively.

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The following table shows the classification of our investments and the investments of our insurance subsidiaries at December 31, 2017, 2016 and 2015 (at carrying value):

	December 31,					
	2017		2016		2015	
(dollars in thousands)	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
Fixed maturities(1):						
Held to maturity:						
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$ 71,736	7.1%	$ 61,382	6.5%	$ 51,194	5.7%
Obligations of states and political subdivisions	137,581	13.7	122,793	13.0	119,115	13.2
Corporate securities	108,025	10.7	91,555	9.6	65,307	7.2
Mortgage-backed securities	49,313	4.9	60,371	6.4	74,643	8.3
Total held to maturity	366,655	36.4	336,101	35.5	310,259	34.4
Available for sale:						
U.S. Treasury securities and obligations of U.S. government corporations and agencies	44,049	4.4	38,588	4.1	37,189	4.1
Obligations of states and political subdivisions	132,117	13.1	186,083	19.7	236,556	26.3
Corporate securities	105,740	10.5	87,456	9.2	72,812	8.1
Mortgage-backed securities	257,040	25.6	202,948	21.5	154,836	17.2
Total available for sale	538,946	53.6	515,075	54.5	501,393	55.7
Total fixed maturities	905,601	90.0	851,176	90.0	811,652	90.1
Equity securities(2)	50,445	5.0	47,088	5.0	37,261	4.1
Investment in affiliate(3)	38,774	3.9	37,885	4.0	38,477	4.3
Short-term investments(4)	11,050	1.1	9,371	1.0	13,432	1.5
Total investments	$ 1,005,870	100.0%	$ 945,520	100.0%	$ 900,822	100.0%

(1) We refer to Notes 1 and 4 to our Consolidated Financial Statements. We value those fixed maturities we classify as held to maturity at amortized cost; we value those fixed maturities we classify as available for sale at fair value. The total fair value of fixed maturities we classified as held to maturity was $380.5 million at December 31, 2017, $344.6 million at December 31, 2016 and $322.8 million at December 31, 2015. The amortized cost of fixed maturities we classified as available for sale was $538.4 million at December 31, 2017, $511.6 million at December 31, 2016 and $489.0 million at December 31, 2015.

(2)

We value equity securities at fair value. Total cost of equity securities was $44.2 million at December 31, 2017, $42.4 million at December 31, 2016 and $35.8 million at December 31, 2015.

(3) We value our investment in our affiliate at cost, adjusted for our share of earnings and losses of our affiliate as well as changes in equity of our affiliate due to unrealized gains and losses.

(4) We value short-term investments at cost, which approximates fair value.

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The following table sets forth the maturities (at carrying value) in the fixed maturity portfolio of our insurance subsidiaries at December 31, 2017, 2016 and 2015:

	December 31,					
	2017		2016		2015	
(dollars in thousands)	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
Due in(1):						
One year or less	$ 53,826	6.0%	$ 44,120	5.2%	$ 20,990	2.6%
Over one year through three years	74,140	8.2	90,018	10.6	66,505	8.2
Over three years through five years	82,476	9.1	67,640	7.9	66,410	8.2
Over five years through ten years	221,904	24.5	197,967	23.3	202,122	24.9
Over ten years through fifteen years	131,531	14.5	148,959	17.5	172,429	21.2
Over fifteen years	35,371	3.9	39,153	4.6	53,717	6.6
Mortgage-backed securities	306,353	33.8	263,319	30.9	229,479	28.3
	$ 905,601	100.0%	$ 851,176	100.0%	$ 811,652	100.0%

(1) Based on stated maturity dates with no prepayment assumptions. Actual maturities will differ because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

As shown above, our insurance subsidiaries held investments in mortgage-backed securities having a carrying value of $306.4 million at December 31, 2017. The mortgage-backed securities consist primarily of investments in governmental agency balloon pools with stated maturities between one and 40 years. The stated maturities of these investments limit the exposure of our insurance subsidiaries to extension risk in the event that interest rates rise and prepayments decline. Our insurance subsidiaries perform an analysis of the underlying loans when evaluating a mortgage-backed security for purchase, and they select those securities that they believe will provide a return that properly reflects the prepayment risk associated with the underlying loans.

The following table sets forth the investment results of our insurance subsidiaries for the years ended December 31, 2017, 2016 and 2015:

	Year Ended December 31,		
(dollars in thousands)	2017	2016	2015
Invested assets(1)	$ 975,695	$ 923,171	$ 866,882
Investment income(2)	23,527	22,633	20,950
Average yield	2.4%	2.5%	2.4%
Average tax-equivalent yield	2.8	3.0	3.1

(1) Average of the aggregate invested amounts at the beginning and end of the period.

(2) Investment income is net of investment expenses and does not include realized investment gains or losses or provision for income taxes.

A.M. Best Rating

Donegal Mutual and our insurance subsidiaries have an A.M. Best rating of A (Excellent), based upon the respective current financial condition and historical statutory results of operations of Donegal Mutual and our insurance subsidiaries. We believe that the A.M. Best rating of Donegal Mutual and our insurance subsidiaries is an important factor in their marketing of their products to their agents and customers. A.M. Best s ratings are industry ratings based on a comparative analysis of the financial condition and operating performance of insurance companies. A.M. Best s classifications are A++ and A+ (Superior), A and A- (Excellent), B++ and B+ (Good), B and B- (Fair), C++ and C+ (Marginal), C and C- (Weak), D (Poor) and E (Under Regulatory Supervision), F (Liquidation) and S (Suspended). A.M. Best bases its ratings upon factors relevant to the payment of claims of policyholders and are not directed toward the protection of investors in insurance companies. According to A.M. Best, the Excellent rating that the Donegal Insurance Group maintains is assigned to those companies that, in A.M. Best s opinion, have an excellent ability to meet their ongoing obligations to policyholders.

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Regulation

The supervision and regulation of insurance companies consists primarily of the laws and regulations of the various states in which the insurance companies transact business, with the primary regulatory authority being the insurance regulatory authorities in the state of domicile of the insurance company. Such supervision and regulation relate to numerous aspects of an insurance company s business and financial condition. The primary purpose of such supervision and regulation is the protection of policyholders. The authority of the state insurance departments includes the establishment of standards of solvency that insurers must meet and maintain, the licensing of insurers and insurance agents to do business, the nature of, and limitations on, investments, premium rates for property and casualty insurance, the provisions that insurers must make for current losses and future liabilities, the deposit of securities for the benefit of policyholders, the approval of policy forms, notice requirements for the cancellation of policies and the approval of certain changes in control. State insurance departments also conduct periodic examinations of the affairs of insurance companies and require the filing of annual and other reports relating to the financial condition of insurance companies.

In addition to state-imposed insurance laws and regulations, the National Association of Insurance Commissioners, or the NAIC, maintains a risk-based capital system, or RBC, for assessing the adequacy of the statutory capital and surplus of insurance companies that augments the states current fixed dollar minimum capital requirements for insurance companies. At December 31, 2017, our insurance subsidiaries and Donegal Mutual each exceeded by a substantial margin the minimum levels of statutory capital the RBC rules require.

Generally, every state has guaranty fund laws under which insurers licensed to do business in that state can be assessed on the basis of premiums written by the insurer in that state in order to fund policyholder liabilities of insolvent insurance companies. Under these laws in general, an insurer is subject to assessment, depending upon its market share of a given line of business, to assist in the payment of policyholder claims against insolvent insurers. Our insurance subsidiaries and Donegal Mutual have made accruals for their portion of assessments related to such insolvencies based upon the most current information furnished by the guaranty associations.

We are part of an insurance holding company system of which Donegal Mutual is the ultimate controlling person. All of the states in which our insurance companies and Donegal Mutual maintain a domicile have legislation that regulates insurance holding company systems. Each insurance company in the insurance holding company system must register with the insurance supervisory agency of its state of domicile and furnish information concerning the operations of companies within the insurance holding company system that may materially affect the operations, management or financial condition of the insurers within the system. Pursuant to these laws, the respective insurance departments in which our subsidiaries and Donegal Mutual maintain a domicile may examine our insurance subsidiaries or Donegal Mutual at any time, require disclosure of material transactions by the holding company with another member of the insurance holding company system and require prior notice or prior approval of certain transactions, such as extraordinary dividends from the insurance subsidiaries to the holding company. We have insurance subsidiaries domiciled in Iowa, Maryland, Michigan, Pennsylvania, Virginia and Wisconsin.

The Pennsylvania Insurance Holding Companies Act, which generally applies to Donegal Mutual, us and our insurance subsidiaries, requires that all transactions within an insurance holding company system to which an insurer is a party must be fair and reasonable and that any charges or fees for services performed must be reasonable. Any management agreement, service agreement, cost sharing arrangement and material reinsurance agreement must be filed with the Pennsylvania Insurance Department, or the Department, and is subject to the Department s review. We have filed with the Department the pooling agreement between Donegal Mutual and Atlantic States that established the underwriting pool and all material agreements between Donegal Mutual and our insurance subsidiaries.

Approval of the applicable insurance commissioner is also required prior to consummation of transactions affecting the control of an insurer. In virtually all states, including the states where our insurance subsidiaries are domiciled, the acquisition of 10% or more of the outstanding capital stock of an insurer or its holding company or the intent to acquire such an interest creates a rebuttable presumption of a change in control. Pursuant to an order issued in April 2003, the Department approved Donegal Mutual s ownership of up to 70% of our outstanding Class A common stock and Donegal Mutual s ownership of up to 100% of our outstanding Class B common stock.

Our insurance subsidiaries have the legal obligation under state insurance laws to participate in involuntary insurance programs for automobile insurance, as well as other property and casualty insurance lines, in the states in which they conduct business. These programs include joint underwriting associations, assigned risk plans, fair access to insurance requirements plans, reinsurance facilities, windstorm plans and tornado plans. Legislation establishing these programs requires all companies that write lines covered by these programs to provide coverage, either directly or through reinsurance, for insureds who are unable to obtain insurance in the voluntary market. The legislation creating these programs usually allocates a pro rata portion of risks attributable to such insureds to each company on the basis of the direct premiums it has written in that state or the number of automobiles it insures in that state. Generally, state law requires participation in these programs as a condition to obtaining a certificate of authority. Our loss ratio on insurance we write under these involuntary programs has traditionally been significantly greater than our loss ratio on insurance we voluntarily write in those states.

Regulatory requirements, including RBC requirements, may impact our insurance subsidiaries ability to pay dividends. The amount of statutory capital and surplus necessary for our insurance subsidiaries to satisfy regulatory requirements, including RBC requirements, was not significant in relation to our insurance subsidiaries statutory capital and surplus at December 31, 2017. Generally, the maximum amount that one of our insurance subsidiaries may pay to us as ordinary dividends during any year after notice to, but without prior approval of, the insurance commissioner of its domiciliary state is limited to a stated percentage of that subsidiary s statutory capital and surplus at December 31 of the preceding fiscal year or the net income of that subsidiary for its preceding fiscal year. Our insurance subsidiaries paid dividends to us of $13.0 million, $13.0 million and $3.9 million in 2017, 2016 and 2015, respectively. At December 31, 2017, the amount of ordinary dividends our insurance subsidiaries could pay to us during 2018, without the prior approval of their respective domiciliary insurance commissioners, is shown in the following table.

Name of Insurance Subsidiary	Ordinary Dividend Amount
Atlantic States	$ 22,317,084
Le Mars	2,343,480
MICO	5,279,638
Peninsula	1,653,263
Sheboygan	
Southern	5,450,358
Total	$ 37,043,823

Donegal Mutual Insurance Company

Donegal Mutual organized as a mutual fire insurance company in Pennsylvania in 1889. At December 31, 2017, Donegal Mutual had admitted assets of $614.0 million and policyholders surplus of $298.1 million. At December 31, 2017, Donegal Mutual had total liabilities of $315.9 million, including reserves for net losses and loss expenses of $154.7 million and unearned premiums of $71.1 million. Donegal Mutual s investment portfolio of $383.2 million at December 31, 2017 consisted primarily of investment-grade bonds of $125.7 million, its investment in DFSC s common stock and its investment in our Class A common stock and our Class B common stock. At December 31, 2017, Donegal Mutual owned 9,851,025 shares, or approximately 44%, of our Class A common stock, which Donegal Mutual carried on its books at $134.2 million, and 4,647,338 shares, or approximately 83%, of our Class B common stock, which Donegal Mutual carried on its books at $63.3 million. We present Donegal Mutual s financial information in accordance with SAP as the NAIC Accounting Practices and Procedures Manual requires. Donegal Mutual does not, nor is it required to, prepare financial statements in accordance with GAAP.

Donegal Financial Services Corporation

We and Donegal Mutual own DFSC, a unitary thrift holding company that owns UCB. UCB is a state savings bank with 15 banking offices, substantially all of which are located in Lancaster County, Pennsylvania, and approximately $567.7 million in assets at December 31, 2017.

Because Donegal Mutual and we together own all of the outstanding capital stock of DFSC, the Board of Governors of the Federal Reserve System, or the FRB, regulates Donegal Mutual, DFSC and us as grandfathered savings and loan holding companies. As a result, Donegal Mutual, DFSC and we are subject to regulation by the FRB under the holding company provisions of the federal Home Owners Loan Act, or HOLA. However, if any of Donegal Mutual, DFSC or we were to lose this grandfathered status, they or we would become a bank holding company regulated by the FRB under the Bank Holding Company Act. UCB, as a state-chartered stock savings bank, is subject to regulation and supervision by the Pennsylvania Department of Banking and by the Federal Deposit Insurance Corporation. The primary purpose of the statutory and regulatory supervision of financial institutions is to protect depositors, the financial institutions and the financial system as a whole rather than the stockholders of financial institutions or their holding companies.

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Sections 23A and 23B of the Federal Reserve Act impose quantitative and qualitative restrictions on transactions between a savings association and its affiliates. Affiliates of a savings association include, among other entities, the savings association s holding company and non-banking companies under common control with the savings association such as Donegal Mutual and us and our respective subsidiaries. These restrictions on transactions with affiliates apply to transactions between DFSC and UCB, on the one hand, and Donegal Mutual and us and our insurance subsidiaries, on the other hand. These restrictions also apply to transactions among DFSC, UCB and Donegal Mutual. Because DFSC directly controls UCB and Donegal Mutual and we indirectly control UCB, DFSC, Donegal Mutual and we are subject to the Change in Bank Control Act.

Cautionary Statement Regarding Forward-Looking Statements

This Form 10-K Report and the documents we incorporate by reference in this Form 10-K Report contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include certain discussions relating to underwriting, premium and investment income volumes, business strategies, reserves, profitability and business relationships and our other business activities during 2017 and beyond. In some cases, you can identify forward-looking statements by terms such as may, will, should, could, would, expect, plan, intend, anticipate, believe, estimate, objective, project, predict, po expressions. These forward-looking statements reflect our current views about future events and our current assumptions, and are subject to known and unknown risks and uncertainties that may cause our results, performance or achievements to differ materially from those we anticipate or imply by our forward-looking statements. We cannot control or predict many of the factors that could determine our future financial condition or results of operations. Such factors may include those we describe under Risk Factors. The forward-looking statements contained in this Form 10-K Report reflect our views and assumptions only as of the date of this Form 10-K Report. Except as required by law, we do not intend to update, and we assume no responsibility for updating, any forward-looking statements we have made. We qualify all of our forward-looking statements by these cautionary statements.

Item 1A. Risk Factors.
Risk Factors

Risks Relating to Us and Our Business

Donegal Mutual is our controlling stockholder. Donegal Mutual and its directors and executive officers have potential conflicts of interest between the best interests of our stockholders and the best interests of the policyholders of Donegal Mutual.

Donegal Mutual controls the election of all of the members of our board of directors. Six of the eleven members of our board of directors are also directors of Donegal Mutual. Donegal Mutual and we share the same executive officers. These common directors and executive officers have a fiduciary duty to our stockholders and also have a fiduciary duty to the policyholders of Donegal Mutual. Among the potential conflicts of interest that could arise from these separate fiduciary duties are the following:

- We and Donegal Mutual periodically review the percentage participation of Atlantic States and Donegal Mutual in the underwriting pool that Donegal Mutual and Atlantic States have maintained since 1986;

Our insurance subsidiaries and Donegal Mutual annually review and then establish the terms of certain reinsurance agreements between our insurance subsidiaries and Donegal Mutual. Our objective, over the long-term, is for these agreements to have approximately an equal balance between payments and recoveries;

We and Donegal Mutual periodically allocate certain shared expenses among ourselves and our insurance subsidiaries in accordance with various inter-company expense-sharing agreements; and

We and our insurance subsidiaries may enter into other transactions or contractual relationships with Donegal Mutual, including, for example, our purchases from time to time from Donegal Mutual of the surplus note of a mutual insurance company that will subsequently convert into a stock insurance company and ultimately become one of our wholly owned subsidiaries.

Donegal Mutual has sufficient voting power to determine the outcome of all matters submitted to our stockholders for approval.

Each share of our Class A common stock has one-tenth of a vote per share and generally votes as a single class with our Class B common stock. Each share of our Class B common stock has one vote per share and generally votes as a single class with our Class A common stock. Donegal Mutual has the right to vote approximately 72% of the combined voting power of our Class A common stock and our Class B common stock and has sufficient voting control to:

- elect all of the members of our board of directors, who determine our management and policies; and

- control the outcome of any corporate transaction or other matter submitted to a vote of our stockholders for approval, including mergers or other acquisition proposals and the sale of all or substantially all of our assets, in each case regardless of how all of our stockholders other than Donegal Mutual vote their shares.

The interests of Donegal Mutual in maintaining this greater-than-majority voting control of us may have an adverse effect on the price of our Class A common stock and the price of our Class B common stock because of the absence of any potential takeover premium and may, therefore, be inconsistent with the interests of our stockholders other than Donegal Mutual.

Donegal Mutual s majority voting control of us, certain provisions of our certificate of incorporation and by-laws and certain provisions of Delaware law make it remote that anyone could acquire actual control of us unless Donegal Mutual were in favor of another person s acquisition of control of us.

Donegal Mutual s majority voting control of us, certain anti-takeover provisions in our certificate of incorporation and by-laws and certain provisions of the Delaware General Corporation Law, or the DGCL, could delay or prevent the removal of members of our board of directors and could make a merger, tender offer or proxy contest involving us more expensive as well as unlikely to succeed, even if such events were in the best interests of our stockholders other than Donegal Mutual. These factors could also discourage a third party from attempting to acquire control of us. In particular, our certificate of incorporation and by-laws include the following anti-takeover provisions:

- our board of directors is classified into three classes, so that our stockholders elect only one-third of the members of our board of directors each year;

- our stockholders may remove our directors only for cause;

- our stockholders may not take stockholder action except at an annual or special meeting of our stockholders;

- the request of stockholders holding at least 20% of the combined voting power of our Class A common stock and our Class B common stock is required for a stockholder to call a special meeting of our stockholders;

- our by-laws require that stockholders provide advance notice to us to nominate candidates for election to our board of directors or to propose any other item of stockholder business at a stockholders meeting;

- we do not permit cumulative voting rights in the election of our directors;

- our certificate of incorporation does not provide for preemptive rights in connection with any issuance of securities by us; and

- our board of directors may issue, without stockholder approval unless otherwise required by law, preferred stock with such terms as our board of directors may determine.

We have authorized preferred stock that we could issue without stockholder approval to make it more difficult for a third party to acquire us.

We have 2.0 million authorized shares of preferred stock that we could issue in one or more series without further stockholder approval, unless the DGCL or the rules of the NASDAQ Global Select Market otherwise require, and upon such terms and conditions, and having such rights, privileges and preferences, as our board of directors may determine. Our potential issuance of preferred stock may make it more difficult for a third party to acquire control of us.

Because we are an insurance holding company, no person can acquire or seek to acquire a 10% or greater interest in us without first obtaining approval of the insurance commissioners of the states of domicile of each of our insurance subsidiaries.

We own insurance subsidiaries domiciled in the states of Iowa, Maryland, Michigan, Pennsylvania, Virginia and Wisconsin, and Donegal Mutual owns or controls insurance companies domiciled in Georgia and New Mexico. The insurance laws of each of these states provide that no person can acquire or seek to acquire a 10% or greater interest in us without first filing specified information with the insurance commissioners of those states and obtaining the prior approval of the proposed acquisition of a 10% or greater interest in us by each of the state insurance commissioners based on statutory standards designed to protect the safety and soundness of us and our insurance subsidiaries.

Because we are a grandfathered unitary savings and loan holding company, no person can acquire or seek to acquire more than a 10% interest in either class of our common stock without first obtaining approval of, or an exemption from, the FRB.

We own 48.2% of the outstanding stock of DFSC, which owns all of the outstanding stock of UCB. As a result of our ownership interest in DFSC, we are a grandfathered unitary savings and loan holding company regulated by the FRB under HOLA. No person may lawfully acquire more than 10% of any class of voting security of a unitary savings and loan holding company registered under the Exchange Act, as we are, without first filing specified information with the FRB and obtaining the FRB s prior approval of the proposed acquisition or an exemption from the FRB for such acquisition.

Our insurance subsidiaries currently conduct business in a limited number of states, with a concentration of business in Pennsylvania, Michigan, Maryland and Virginia. Any single catastrophe occurrence or other condition affecting losses in these states could adversely affect the results of operations of our insurance subsidiaries.

Our insurance subsidiaries conduct business in 22 states located primarily in the Mid-Atlantic, Midwestern, New England and Southern states. A substantial portion of their business consists of private passenger and commercial automobile, homeowners and workers compensation insurance in Pennsylvania, Michigan, Maryland and Virginia. While our insurance subsidiaries and Donegal Mutual actively manage their respective exposure to catastrophes through their underwriting processes and the purchase of reinsurance, a single catastrophic occurrence, destructive weather pattern, general economic trend, terrorist attack, regulatory development or other condition affecting one or more of the states in which our insurance subsidiaries conduct substantial business could materially adversely affect their business, financial condition and results of operations. Common catastrophic events include hurricanes, earthquakes, tornadoes, wind and hail storms, fires, explosions and severe winter storms.

If the independent agents who market the products of our insurance subsidiaries do not maintain their current levels of premium writing with us, fail to comply with established underwriting guidelines of our insurance subsidiaries or otherwise inappropriately market the products of our insurance subsidiaries, the business, financial condition and results of operations of our insurance subsidiaries could be adversely affected.

Our insurance subsidiaries market their insurance products solely through a network of approximately 2,400 independent insurance agencies. This agency distribution system is one of the most important components of the competitive profile of our insurance subsidiaries. As a result, our insurance subsidiaries depend to a material extent upon their independent agents, each of whom has the authority to bind one or more of our insurance subsidiaries to insurance coverage. To the extent that such independent agents marketing efforts fail to result in the maintenance of their current levels of volume and quality or they bind our insurance subsidiaries to unacceptable insurance risks, fail to comply with the established underwriting guidelines of our insurance subsidiaries or otherwise inappropriately market the products of our insurance subsidiaries, the business, financial condition and results of operations of our insurance subsidiaries could suffer.

The business of our insurance subsidiaries may not continue to grow and may be materially adversely affected if our insurance subsidiaries cannot retain existing, and attract new, independent agents or if insurance consumers increase their use of insurance marketing systems other than independent agents.

Our insurance subsidiaries ability to retain existing, and to attract new, independent agents is essential to the continued growth of the business of our insurance subsidiaries. If independent agents find it easier to do business with the competitors of our insurance subsidiaries, our insurance subsidiaries could find it difficult to retain their existing business or to attract new business. While our insurance subsidiaries believe they maintain good relationships with the independent agents they have appointed, our insurance subsidiaries cannot be certain that these independent agents will continue to sell the products of our insurance subsidiaries to the consumers these independent agents represent. Some of the factors that could adversely affect the ability of our insurance subsidiaries to retain existing, and attract new, independent agents include:

- the significant competition among insurance companies to attract independent agents;
- the labor-intensive and time-consuming process of selecting new independent agents;
- the insistence of our insurance subsidiaries that independent agents adhere to consistent underwriting standards; and
- the ability of our insurance subsidiaries to pay competitive and attractive commissions, bonuses and other incentives to independent agents.

While our insurance subsidiaries sell insurance to policyholders solely through their network of independent agencies, many competitors of our insurance subsidiaries sell insurance through a variety of delivery methods, including independent agencies, captive agencies, the Internet and direct sales. To the extent that current and potential policyholders change their marketing system preference, the business, financial condition and results of operations of our insurance subsidiaries may be adversely affected.

We are dependent on dividends from our insurance subsidiaries for the payment of our operating expenses, our debt service and dividends to our stockholders; however, there are regulatory restrictions and business considerations that may limit the amount of dividends our insurance subsidiaries may pay to us.

As a holding company, we rely primarily on dividends from our insurance subsidiaries as a source of funds to meet our corporate obligations and to pay dividends to our stockholders. The amount of dividends our insurance subsidiaries can pay to us is subject to regulatory restrictions and depends on the amount of surplus our insurance subsidiaries maintain. From time to time, the NAIC and various state insurance regulators consider modifying the method of determining the amount of dividends that an insurance company may pay without prior regulatory approval. The maximum amount of ordinary dividends that our insurance subsidiaries can pay to us in 2018 without prior regulatory approval is approximately $37.0 million. Other business and regulatory considerations, such as the impact of dividends on surplus that could affect the ratings of our insurance subsidiaries, competitive conditions, RBC requirements, the investment results of our insurance subsidiaries and the amount of premiums that our insurance subsidiaries write could also adversely impact the ability of our insurance subsidiaries to pay dividends to us.

If A.M. Best downgrades the rating it has assigned to Donegal Mutual or any of our insurance subsidiaries, it would adversely affect their competitive position.

Industry ratings are a factor in establishing and maintaining the competitive position of insurance companies. A.M. Best, an industry-accepted source of insurance company financial strength ratings, rates Donegal Mutual and our insurance subsidiaries. A.M. Best ratings provide an independent opinion of an insurance company s financial health and its ability to meet its obligations to its policyholders. We believe that the financial strength rating of A.M. Best is material to the operations of Donegal Mutual and our insurance subsidiaries. Currently, Donegal Mutual and our insurance subsidiaries each have an A (Excellent) rating from A.M. Best. If A.M. Best were to downgrade the rating of Donegal Mutual or any of our insurance subsidiaries, it would adversely affect the competitive position of Donegal

Mutual or that insurance subsidiary and make it more difficult for it to market its products and retain its existing policyholders.

Our strategy to grow in part through acquisitions of smaller insurance companies exposes us to risks that could adversely affect our results of operations and financial condition.

The affiliation with, and acquisition of, smaller, and often undercapitalized, insurance companies involves risks that could adversely affect our results of operations and financial condition. The risks associated with these affiliations and acquisitions include:

- the potential inadequacy of reserves for losses and loss expenses of the other insurer;

- the need to supplement management of the other insurer with additional experienced personnel;

- conditions imposed by regulatory agencies that make the realization of cost-savings through integration of the operations of the other insurer with our operations more difficult;

- the need of the other insurer for additional capital that we did not anticipate at the time of the acquisition or affiliation; and
- the use of more of our management s time in improving the operations of the other insurer than we originally anticipated.

If we cannot obtain sufficient capital to fund the organic growth of our insurance subsidiaries and to make acquisitions, we may not be able to expand our business.

Our strategy is to expand our business through the organic growth of our insurance subsidiaries and through our strategic acquisitions of regional insurance companies. Our insurance subsidiaries will require additional capital in the future to support this strategy. If we cannot obtain sufficient capital on satisfactory terms and conditions, we may not be able to expand the business of our insurance subsidiaries or to make future acquisitions. Our ability to obtain additional financing will depend on a number of factors, many of which are beyond our control. For example, we may not be able to obtain additional debt or equity financing because we or our insurance subsidiaries may already have substantial debt at the time, because we or our insurance subsidiaries do not have sufficient cash flow to service or repay our existing or additional debt or because financial institutions are not making financing available. In addition, any equity capital we obtain in the future could be dilutive to our existing stockholders.

A number of the competitors of our insurance subsidiaries have greater financial strength than our insurance subsidiaries, and these competitors may be able to offer their products at lower prices than our insurance subsidiaries can afford to offer their products.

The property and casualty insurance industry is intensely competitive. Competition can be based on many factors, including:

- the perceived financial strength of the insurer;
- premium rates;
- policy terms and conditions;
- policyholder service;
- reputation; and
- experience.

Our insurance subsidiaries compete with many regional and national property and casualty insurance companies, including direct sellers of insurance products, insurers having their own agency organizations and other insurers represented by independent agents. Many of these insurers have greater capital than our insurance subsidiaries, have substantially greater financial, technical and operating resources and have equal or higher ratings from A.M. Best than our insurance subsidiaries. In addition, our competitors may become increasingly better capitalized in the future as the property and casualty insurance industry continues to consolidate.

The greater capitalization of many of the competitors of our insurance subsidiaries enables them to operate with lower profit margins and, therefore, allows them to market their products more aggressively, to take advantage more quickly of new marketing opportunities and to offer lower premium rates. Our insurance subsidiaries may not be able to maintain their current competitive position in the markets in which they operate if their competitors offer prices for their products that are lower than the prices our insurance subsidiaries are prepared to offer. Moreover, if these competitors lower the price of their products and our insurance subsidiaries meet their pricing, the profit margins and revenues of our insurance subsidiaries may decrease and their ratios of claims and expenses to premiums may increase. All of these factors could materially adversely affect the financial condition and results of operations of our insurance subsidiaries and their A.M. Best ratings.

Because the investment portfolios of our insurance subsidiaries consist primarily of fixed-income securities, their investment income and the fair value of their investment portfolios could decrease as a result of a number of factors.

Our insurance subsidiaries invest the premiums they receive from their policyholders and maintain investment portfolios that consist primarily of fixed-income securities. The management of these investment portfolios is an important component of the profitability of our insurance subsidiaries. Our insurance subsidiaries derive a significant portion of their operating income from the income they receive on their invested assets. A number of factors may affect the quality and/or yield of their investment portfolios, including the general economic and business environment, government monetary policy, changes in the credit quality of the issuers of the fixed-income securities our insurance subsidiaries own, changes in market conditions and regulatory changes. The fixed-income securities our insurance subsidiaries own consist primarily of securities issued by domestic entities that are backed either by the credit or collateral of the underlying issuer. Factors such as an economic downturn, disruption in the credit market or the availability of credit, a regulatory change pertaining to a particular issuer s industry, a significant deterioration in the cash flows of the issuer or a change in the issuer s marketplace may adversely affect the ability of our insurance subsidiaries to collect principal and interest from the issuer in which they invest.

The investments of our insurance subsidiaries are also subject to risk resulting from interest rate fluctuations. Increasing interest rates or a widening in the spread between interest rates available on U.S. Treasury securities and corporate debt or asset-backed securities, for example, will typically have an adverse impact on the market values of fixed-rate securities. If interest rates remain at historically low levels, our insurance subsidiaries will generally have a lower overall rate of return on investments of cash their operations generate. In addition, in the event of the call or maturity of investments in a low interest rate environment, our insurance subsidiaries may not be able to reinvest the proceeds in securities with comparable interest rates. Changes in interest rates may reduce both the profitability and the return on the invested capital of our insurance subsidiaries.

We and our insurance subsidiaries depend on key personnel. The loss of any member of our executive management or the senior management of our insurance subsidiaries could negatively affect the continuation of our business strategies and achievement of our growth objectives.

The loss of, or failure to attract, key personnel could significantly impede our financial plans, growth, marketing and other objectives and those of our insurance subsidiaries. The continued success of our insurance subsidiaries depends to a substantial extent on the ability and experience of their senior management. Our insurance subsidiaries and we believe that our future success is dependent on our ability to attract and retain additional skilled and qualified personnel and to expand, train and manage our employees. We and Donegal Mutual have two to five-year automatically-renewing employment agreements with our senior officers, including all of our named executive officers.

The reinsurance agreements on which our insurance subsidiaries rely do not relieve our insurance subsidiaries from their primary liability to their policyholders, and our insurance subsidiaries face a risk of non-payment from their reinsurers as well as the non-availability of reinsurance in the future.

Our insurance subsidiaries rely on reinsurance agreements to limit their maximum net loss from large single catastrophic risks or excess of loss risks in areas where our insurance subsidiaries may have a concentration of policyholders. Reinsurance also enables our insurance subsidiaries to increase their capacity to write insurance because it has the effect of leveraging the surplus of our insurance subsidiaries. Although the reinsurance our insurance subsidiaries maintain provides that the reinsurer is liable to them for any reinsured losses, the reinsurance agreements do not generally relieve our insurance subsidiaries from their primary liability to their policyholders if the reinsurer fails to pay the reinsurance claims of our insurance subsidiaries. To the extent that a reinsurer is unable to pay losses for which it is liable to our insurance subsidiaries, our insurance subsidiaries remain liable for such losses. At December 31, 2017, our insurance subsidiaries had approximately $119.4 million of reinsurance receivables from third-party reinsurers relating to paid and unpaid losses. Any insolvency or inability of these reinsurers to make timely payments to our insurance subsidiaries under the terms of their reinsurance agreements would adversely affect the results of operations of our insurance subsidiaries.

Michigan law requires MICO to provide unlimited lifetime medical benefits under the personal injury protection, or PIP, coverage of the personal automobile and commercial automobile policies it writes in the State of Michigan. Michigan law also requires MICO to be a member of the Michigan Catastrophic Claims Association, or MCCA, in order to write automobile insurance. The MCCA receives funding through assessments that its members collect from policyholders in the state and provides reinsurance for PIP claims that exceed a set retention. At December 31, 2017, MICO had approximately $54.0 million of reinsurance receivables from MCCA relating to paid and unpaid losses. The MCCA has generated significant operating deficits in recent years. Although we currently consider the risk to be remote, should the MCCA be unable to fulfill its payment obligations to MICO in the future, MICO s financial condition and results of operations could be adversely affected.

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In addition, our insurance subsidiaries face a risk of the non-availability of reinsurance or an increase in reinsurance costs that could adversely affect their ability to write business or their results of operations. Market conditions beyond the control of our insurance subsidiaries, such as the amount of surplus in the reinsurance market and the frequency and severity of natural and man-made catastrophes, affect both the availability and the cost of the reinsurance our insurance subsidiaries purchase. If our insurance subsidiaries cannot maintain their current level of reinsurance or purchase new reinsurance protection in amounts that our insurance subsidiaries consider sufficient, our insurance subsidiaries would either have to accept an increase in their net risk retention or reduce their insurance writings, either of which could adversely affect them.

Our equity investment in DFSC subjects us to certain risks inherent to community banking organizations.

Our equity in the earnings of DFSC primarily reflects the underlying results of operations of UCB. UCB is subject to a number of risks, which include, but are not limited to, the following:

- variations in interest rates that may negatively affect UCB s financial performance;
- inherent risks associated with UCB s lending activities;
- a significant decline in general economic conditions in the specific markets in which UCB operates;
- the potential adverse impact of extensive federal and state regulation and supervision of banking organizations;
- potential declines in the value of UCB s investments that are considered other than temporary;
- competition for loans and deposits with numerous regional and national banks and other financial institutions; and
- UCB s ability to attract and retain qualified key personnel.

The growth and profitability of our insurance subsidiaries depend, in part, on the effective maintenance and ongoing development of Donegal Mutual s information technology systems.

Our insurance subsidiaries utilize Donegal Mutual s information technology systems to conduct their insurance business, including policy quoting and issuance, claims processing, processing of incoming premium payments and other important functions. As a result, the ability of our insurance subsidiaries to grow their business and conduct profitable operations depends on Donegal Mutual s ability to maintain its existing information technology systems and to develop new technology systems that will support the business of Donegal Mutual and our insurance subsidiaries in a cost-efficient manner and provide information technology capabilities equivalent to those of our competitors. The allocation among our insurance subsidiaries and Donegal Mutual of the costs of developing and maintaining Donegal Mutual s information technology systems may impact adversely our insurance subsidiaries expense ratio and underwriting profitability, and such costs may exceed Donegal Mutual s and our expectations. In addition, while Donegal Mutual is committed to developing and maintaining information technology systems that will allow Donegal Mutual and our insurance subsidiaries to compete effectively, Donegal Mutual may encounter difficulties integrating new systems with legacy systems, including plans to modernize certain key infrastructure systems over the next several years. Donegal Mutual s information technology systems may not deliver the benefits Donegal Mutual and we expect and may fail to keep pace with our competitors information technology systems. As a result, Donegal Mutual and our insurance subsidiaries may not have the ability to grow their business and meet their profitability objectives.

Our insurance subsidiaries rely on Donegal Mutual s information technology systems, and the disruption or failure of these systems or the compromise of the security of those systems that results in the theft or misuse of confidential information could materially impact adversely the business of Donegal Mutual and our insurance subsidiaries.

Our insurance subsidiaries business operations depend significantly upon the availability and successful operation of Donegal Mutual s information technology systems in order to process new and renewal business, service their policies, process and settle claims and facilitate processing of premium payments. In addition, in the normal course of their operations, Donegal Mutual and our insurance subsidiaries collect, utilize and maintain confidential information regarding individuals and businesses. While Donegal Mutual has established various security measures to protect its information technology systems and confidential data, unanticipated computer viruses, malware, power outages, unauthorized access or other cyberattacks could disrupt those systems or result in the misappropriation or loss of confidential data. Donegal Mutual could experience technology system failures or other outages that would impact the availability of its information technology systems. Disruption in the availability of Donegal Mutual s information technology systems could impact the ability of Donegal Mutual and our insurance subsidiaries to underwrite and process their policies timely, process and settle claims promptly and provide expected levels of customer service to agents and policyholders.

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While Donegal Mutual has identified threats to the security of its information technology systems, Donegal Mutual and we are unaware of any significant breach of the security measures Donegal Mutual maintains. A significant breach of the security of Donegal Mutual s information technology systems that results in the misappropriation or misuse of confidential information could damage the business reputation of Donegal Mutual and our insurance subsidiaries and could expose Donegal Mutual and our insurance subsidiaries to litigation. The financial impact to Donegal Mutual, us and our insurance subsidiaries of a significant breach could be material.

Risks Relating to the Property and Casualty Insurance Industry

Industry trends, such as increased litigation against the insurance industry and individual insurers, the willingness of courts to expand covered causes of loss, rising jury awards, escalating medical costs, increasing loss frequency due to distracted driving and other factors, increasing loss severity and adverse weather conditions may contribute to increased costs and result in the deterioration of the reserves of our insurance subsidiaries.

Loss severity in the property and casualty insurance industry has increased in recent years, principally driven by larger court judgments and increasing medical and automobile repair costs. The industry has also experienced increases in the frequency of automobile losses due to distracted driving, increases in miles driven due to lower fuel costs and other factors. In addition, many classes of complainants have brought legal actions and proceedings that tend to increase the size of judgments. The propensity of policyholders and third-party claimants to litigate and the willingness of courts to expand causes of loss and the size of awards to eliminate exclusions and to increase coverage limits may make the loss reserves of our insurance subsidiaries inadequate for current and future losses.

Loss or significant restriction of the use of credit scoring in the pricing and underwriting of the personal lines insurance products by our insurance subsidiaries could adversely affect their future profitability.

Our insurance subsidiaries use credit scoring as a factor in making risk selection and pricing decisions for personal lines insurance products where allowed by state law. Recently, some consumer groups and regulators have questioned whether the use of credit scoring unfairly discriminates against people with low incomes, minority groups and the elderly. These consumer groups and regulators often call for the prohibition or restriction on the use of credit scoring in underwriting and pricing. Laws or regulations enacted in a number of states that significantly curtail the use of credit scoring in the underwriting process could reduce the future profitability of our insurance subsidiaries.

Changes in applicable insurance laws or regulations or changes in the way insurance regulators administer those laws or regulations could adversely affect the operating environment of our insurance subsidiaries and increase their exposure to loss or put them at a competitive disadvantage.

Property and casualty insurers are subject to extensive supervision in their domiciliary states and in the states in which they do business. This regulatory oversight includes matters relating to:

- licensing and examination;
- approval of premium rates;
- market conduct;

policy forms;

limitations on the nature and amount of certain investments;

claims practices;

mandated participation in involuntary markets and guaranty funds;

reserve adequacy;

insurer solvency;

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- transactions between affiliates;
- the amount of dividends that insurers may pay; and
- restrictions on underwriting standards.

Such regulation and supervision are primarily for the benefit and protection of policyholders rather than stockholders. For instance, our insurance subsidiaries are subject to involuntary participation in specified markets in various states in which they operate and the premium rates our insurance subsidiaries may charge do not always correspond with the underlying costs of providing that coverage.

The NAIC and state insurance regulators are re-examining existing laws and regulations, specifically focusing on:

- insurance company investments;
- issues relating to the solvency of insurance companies;
- risk-based capital guidelines;
- restrictions on the terms and conditions included in insurance policies;
- certain methods of accounting;
- reserves for unearned premiums, losses and other purposes;
- the values at which insurance companies may carry investment securities and the definition of other-than-temporary impairment of investment securities; and
- interpretations of existing laws and the development of new laws.

Changes in state laws and regulations, as well as changes in the way state regulators view related-party transactions in particular, could change the operating environment of our insurance subsidiaries and have an adverse effect on their business. The state insurance regulatory framework has recently come under increased federal scrutiny. Congress is considering proposals that it should create an optional federal charter for insurers. Federal chartering has the potential to create an uneven playing field for insurers by subjecting federally-chartered and state-chartered insurers to different regulatory requirements. Federal chartering also raises the possibility of duplicative or conflicting federal and state requirements. In addition, if federal legislation repeals the partial exemption for the insurance industry from federal antitrust laws, our ability to collect and share loss cost data with the industry could adversely affect the results of operations of our insurance subsidiaries.

Insurance companies are subject to assessments, based on their market share in a given line of business, to assist in the payment of unpaid claims and related costs of insolvent insurance companies. Such assessments could adversely affect the financial condition of our insurance subsidiaries.

Our insurance subsidiaries are subject to assessments pursuant to the guaranty fund laws of the various states in which they conduct business. Generally, under these laws, our insurance subsidiaries can be assessed, depending upon the market share of our insurance subsidiaries in a given line of insurance business, to assist in the payment of unpaid claims and related costs of insolvent insurance companies in those states. We cannot predict the number and magnitude of future insurance company failures in the states in which our insurance subsidiaries conduct business, but future assessments could adversely affect the business, financial condition and results of operations of our insurance subsidiaries.

Our insurance subsidiaries must establish premium rates and loss and loss expense reserves from forecasts of the ultimate costs they expect will arise from risks underwritten during the policy period, and the profitability of our insurance subsidiaries could be adversely affected if their premium rates or reserves are insufficient to satisfy their ultimate costs.

One of the distinguishing features of the property and casualty insurance industry is that it prices its products before it knows its costs, since insurers generally establish their premium rates before they know the amount of losses they will incur. Accordingly, our insurance subsidiaries establish premium rates from forecasts of the ultimate costs they expect to arise from risks they have underwritten during the policy period. These premium rates may not be sufficient to cover the ultimate losses

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our insurance subsidiaries incur. Further, our insurance subsidiaries must establish reserves for losses and loss expenses as balance sheet liabilities based upon estimates involving actuarial and statistical projections at a given time of what our insurance subsidiaries expect their ultimate liability to be. Significant periods of time often elapse between the occurrence of an insured loss and the reporting of the loss and the payment of that loss. It is possible that our insurance subsidiaries ultimate liability could exceed these estimates because of the future development of known losses, the existence of losses that have occurred but are currently unreported and larger than historical settlements of pending and unreported claims. The process of estimating reserves is inherently judgmental and can be influenced by a number of factors, including the following:

- trends in claim frequency and severity;
- changes in operations;
- emerging economic and social trends;
- inflation; and
- changes in the regulatory and litigation environments.

If our insurance subsidiaries have insufficient premium rates or reserves, insurance regulatory authorities may require increases to these reserves. An increase in reserves results in an increase in losses and a reduction in net income for the period in which our insurance subsidiaries recognize a deficiency in reserves. Accordingly, an increase in reserves may adversely impact the business, liquidity, financial condition and results of operations of our insurance subsidiaries.

The financial results of our insurance subsidiaries depend primarily on their ability to underwrite risks effectively and to charge adequate rates to policyholders.

The financial condition, cash flows and results of operations of our insurance subsidiaries depend on their ability to underwrite and set rates accurately for a full spectrum of risks across a number of lines of insurance. Rate adequacy is necessary to generate sufficient premium to pay losses, loss adjustment expenses and underwriting expenses and to realize a profit.

The ability to underwrite and set rates effectively is subject to a number of risks and uncertainties, including:

- the availability of sufficient, reliable data;
- the ability to conduct a complete and accurate analysis of available data;

the ability to recognize in a timely manner changes in trends and to project both the severity and frequency of losses with reasonable accuracy;

uncertainties generally inherent in estimates and assumptions;

the ability to project changes in certain operating expense levels with reasonable certainty;

the development, selection and application of appropriate rating formulae or other pricing methodologies;

the use of modeling tools to assist with correctly and consistently achieving the intended results in underwriting and pricing;

the ability to innovate with new pricing strategies and the success of those innovations on implementation;

the ability to secure regulatory approval of premium rates on an adequate and timely basis;

the ability to predict policyholder retention accurately;

unanticipated court decisions, legislation or regulatory action;

unanticipated changes in our claim settlement practices;

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- changes in driving patterns for auto exposures;
- changes in weather patterns for property exposures;
- changes in the medical sector of the economy;
- unanticipated changes in auto repair costs, auto parts prices and used car prices;
- the impact of emerging technologies, including the advent of autonomous vehicles, on pricing, insurance coverages and loss costs;
- the impact of inflation and other factors on the cost of construction materials and labor;
- the ability to monitor property concentration in catastrophe-prone areas, such as hurricane, earthquake and wind/hail regions; and
- the general state of the economy in the states in which our insurance subsidiaries operate.

Such risks may result in the premium rates of our insurance subsidiaries being based on inadequate or inaccurate data or inappropriate assumptions or methodologies and may cause our estimates of future changes in the frequency or severity of claims to be incorrect. As a result, our insurance subsidiaries could underprice risks, which would negatively affect our margins, or our insurance subsidiaries could overprice risks, which could reduce their volume and competitiveness. In either event, underpricing or overpricing risks could adversely impact our operating results, financial condition and cash flows.

The cyclical nature of the property and casualty insurance industry may reduce the revenues and profit margins of our insurance subsidiaries.

The property and casualty insurance industry is highly cyclical with respect to both individual lines of business and the overall insurance industry. Premium rate levels relate to the availability of insurance coverage, which varies according to the level of surplus available in the insurance industry. The level of surplus in the industry varies with returns on invested capital and regulatory barriers to withdrawal of surplus. Increases in surplus may result in increased price competition among property and casualty insurers. If our insurance subsidiaries find it necessary to reduce premiums or limit premium increases due to these competitive pressures on pricing, our insurance subsidiaries may experience a reduction in their profit margins and revenues, an increase in their ratios of losses and expenses to premiums and, therefore, lower profitability.

Risks Relating to Our Common Stock

The price of our common stock may be adversely affected by its low trading volume.

Our Class A common stock and our Class B common stock have limited liquidity. Reported average daily trading volume for our Class A common stock and our Class B common stock for the year ended December 31, 2017 was approximately 32,196 shares and approximately 177 shares, respectively. This limited liquidity could subject our shares of Class A common stock and our shares of Class B common stock to greater price volatility.

Donegal Mutual s majority voting control of our stock, anti-takeover provisions of our certificate of incorporation and by-laws and certain state laws make it unlikely anyone could acquire control of us unless Donegal Mutual were in favor of the acquisition of control.

Donegal Mutual s ownership of our Class A common stock and Class B common stock, certain anti-takeover provisions of our certificate of incorporation and by-laws, certain provisions of Delaware law and the insurance laws and regulations of Iowa, Georgia, Maryland, Michigan, New Mexico, Pennsylvania, Virginia and Wisconsin could delay or prevent the removal of members of our board of directors and could make it more difficult for a merger, tender offer or proxy contest involving us to succeed, even if our stockholders other than Donegal Mutual believed any of such events would be beneficial to them. These factors could also discourage a third party from attempting to acquire control of us. The classification of our board of directors could also have the effect of delaying or preventing a change in our control.

In addition, we have 2,000,000 authorized shares of preferred stock that we could issue in one or more series without stockholder approval, to the extent applicable law permits, and upon such terms and conditions, and having such rights, privileges and preferences, as our board of directors may determine. Our ability to issue preferred stock could make it difficult for a third party to acquire us. We have no current plans to issue any preferred stock.

Moreover, the DGCL contains provisions that prohibit certain business combination transactions under certain circumstances. In addition, state insurance laws and regulations generally prohibit any person from acquiring, or seeking to acquire, a 10% or greater interest in an insurance company without the prior approval of the state insurance commissioner of the state of domicile of the insurer. Because of our indirect control of UCB, HOLA also prohibits the acquisition of a 10% or greater interest in either our Class A common stock or our Class B common stock without the prior approval of the FRB or the granting of an exemption by the FRB.

Item 1B. Unresolved Staff Comments.

We have no unresolved written comments from the Securities and Exchange Commission (SEC) staff regarding our filings under the Exchange Act.

Item 2. Properties.

We and our insurance subsidiaries share administrative headquarters with Donegal Mutual in a building in Marietta, Pennsylvania that Donegal Mutual owns. Donegal Mutual charges us and our insurance subsidiaries for an appropriate portion of the building expenses under an inter-company allocation agreement. The Marietta headquarters has approximately 270,000 square feet of office space. Southern owns a facility of approximately 10,000 square feet in Glen Allen, Virginia. Le Mars owns a facility of approximately 25,500 square feet in Le Mars, Iowa, Peninsula owns a facility of approximately 14,600 square feet in Salisbury, Maryland and Sheboygan owns a facility of approximately 8,800 square feet in Sheboygan Falls, Wisconsin.

Item 3. Legal Proceedings.

Our insurance subsidiaries are parties to routine litigation that arises in the ordinary course of their insurance business. We believe that the resolution of these lawsuits will not have a material adverse effect on the financial condition or results of operations of our insurance subsidiaries.

Item 4. Mine Safety Disclosures.

Not applicable.

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Executive Officers of the Registrant

The following table sets forth information regarding the executive officers of Donegal Mutual and the Registrant as of December 31, 2017, each of whom has served with us for more than 10 years:

Name	Age	Position
Kevin G. Burke	52	President and Chief Executive Officer of us since 2015; Executive Vice President and Chief Operating Officer of Donegal Mutual since 2014; Senior Vice President of Human Resources of Donegal Mutual and us from 2005 to 2014; Vice President of Human Resources of Donegal Mutual and us from 2001 to 2005; other positions from 2000 to 2001.
Cyril J. Greenya	73	Senior Vice President and Chief Underwriting Officer of Donegal Mutual and us since 2005; Senior Vice President, Underwriting, of Donegal Mutual from 1997 to 2005; other positions from 1986 to 1997.
Jeffrey D. Miller	53	Executive Vice President and Chief Financial Officer of Donegal Mutual and us since 2014; Senior Vice President and Chief Financial Officer of Donegal Mutual and us from 2005 to 2014; Vice President and Controller of Donegal Mutual and us from 2000 to 2005; other positions from 1995 to 2000.
Donald H. Nikolaus	75	President and Chief Executive Officer of Donegal Mutual since 1981 (currently on medical leave of absence); President and Chief Executive Officer of us from 1986 to 2015. Chairman of our board of directors since April 2012.
Sanjay Pandey	51	Senior Vice President and Chief Information Officer of Donegal Mutual and us since 2013; Vice President and Chief Information Officer of Donegal Mutual and us from 2009 to 2013; other positions from 2000 to 2009.
Robert G. Shenk	64	Senior Vice President, Claims, of Donegal Mutual and us since 1997; other positions from 1986 to 1997.
Daniel J. Wagner	57	Senior Vice President and Treasurer of Donegal Mutual and us since 2005; Vice President and Treasurer of Donegal Mutual and us from 2000 to 2005; other positions from 1993 to 2000.

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PART II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Our Class A common stock and Class B common stock trade on the NASDAQ Global Select Market under the symbols DGICA and DGICB, respectively. The following table shows the dividends declared per share and the stock price range for both classes of stock for each quarter during 2017 and 2016:

Quarter	High	Low	Cash Dividend Declared Per Share
2017 - Class A			
1st	$ 18.20	$ 16.24	$
2nd	17.72	15.36	0.1400
3rd	16.68	14.51	0.1400
4th	18.25	15.85	0.2800
2017 - Class B			
1st	$ 17.94	$ 15.30	$
2nd	16.65	14.30	0.1225
3rd	15.90	13.40	0.1225
4th	15.91	13.35	0.2450
2016 - Class A			
1st	$ 15.00	$ 12.69	$
2nd	16.50	13.30	0.1375
3rd	16.85	15.48	0.1375
4th	18.55	14.49	0.2750
2016 - Class B			
1st	$ 16.15	$ 13.51	$
2nd	15.99	12.56	0.1200
3rd	22.88	14.88	0.1200
4th	20.55	15.30	0.2400

At the close of business on March 1, 2018, we had approximately 1,869 holders of record of our Class A common stock and approximately 286 holders of record of our Class B common stock.

We declared dividends of $0.56 per share on our Class A common stock and $0.49 per share on our Class B common stock in 2017, compared to $0.55 per share on our Class A common stock and $0.48 per share on our Class B common stock in 2016.

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Stock Performance Chart.

The following graph provides an indicator of cumulative total stockholder returns on our Class A common stock and our Class B common stock for the period beginning on December 31, 2012 and ending on December 31, 2017, compared to the Russell 2000 Index and a peer group comprised of seven property and casualty insurance companies over the same period. The peer group consists of Cincinnati Financial Corp., EMC Insurance Group Inc., Hanover Insurance, Horace Mann Educators, Selective Insurance Group Inc., State Auto Financial Corp. and United Fire and Casualty Co. The graph shows the change in value of an initial $100 investment on December 31, 2012, assuming reinvestment of all dividends.

	2012	**2013**	**2014**	**2015**	**2016**	**2017**
Donegal Group Inc. Class A	$ 100.00	$ 117.27	$ 122.00	$ 111.36	$ 143.31	$ 146.74
Donegal Group Inc. Class B	100.00	134.16	124.35	97.80	97.05	95.91
Russell 2000 Index	100.00	137.00	141.84	133.74	159.78	180.79
Peer Group	100.00	142.99	153.25	178.46	228.46	249.12

Value Line Publishing LLC prepared the foregoing performance graph and data. The performance graph and accompanying data shall not be deemed filed as part of this Form 10-K Report for purposes of Section 18 of the Exchange Act or otherwise subject to the liabilities of that section and should not be deemed incorporated by reference into any other filing we make under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent we specifically incorporate the performance graph and accompanying data by reference into such filing.

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Item 6. Selected Financial Data.

Year Ended December 31,	**2017**	**2016**	**2015**	**2014**	**2013**
Income Statement Data					
Premiums earned	$ 702,514,755	$ 656,204,797	$ 605,640,728	$ 556,497,535	$ 515,291,944
Investment income, net	23,527,304	22,632,730	20,949,698	18,344,382	18,795,239
Realized investment gains	5,705,255	2,525,575	1,934,424	3,134,081	2,423,442
Total revenues	739,026,537	688,423,020	636,387,263	586,547,742	547,110,065
Income before income taxes	12,114,462	41,328,407	27,592,268	16,282,817	32,710,265
Income taxes	4,998,362	10,527,270	6,602,235	1,743,799	6,388,273
Net income	7,116,100	30,801,137	20,990,033	14,539,018	26,321,992
Basic earnings per share - Class A	0.27	1.19	0.78	0.56	1.04
Diluted earnings per share - Class A	0.26	1.16	0.77	0.55	1.02
Cash dividends per share - Class A	0.56	0.55	0.54	0.53	0.51
Basic earnings per share - Class B	0.22	1.06	0.69	0.49	0.94
Diluted earnings per share - Class B	0.22	1.06	0.69	0.49	0.94
Cash dividends per share - Class B	0.49	0.48	0.47	0.46	0.46
Balance Sheet Data at Year End					
Total investments	$ 1,005,869,705	$ 945,519,655	$ 900,822,274	$ 832,941,077	$ 791,808,307
Total assets	1,737,919,778	1,623,131,037	1,537,834,415	1,458,654,644	1,385,410,502
Debt obligations	64,000,000	74,000,000	86,000,000	58,500,000	63,000,000
Stockholders equity	448,696,104	438,615,320	408,388,568	416,134,643	396,877,111
Book value per share	15.95	16.21	15.66	15.40	15.02

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Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations
Overview

Donegal Mutual Insurance Company (Donegal Mutual) organized us as an insurance holding company on August 26, 1986. See Business - History and Organizational Structure for more information. Our insurance subsidiaries, Atlantic States Insurance Company (Atlantic States), Southern Insurance Company of Virginia (Southern), Le Mars Insurance Company (Le Mars), The Peninsula Insurance Company and Peninsula Indemnity Company (collectively, Peninsula), Sheboygan Falls Insurance Company (Sheboygan Falls) and Michigan Insurance Company (MICO) write personal and commercial lines of property and casualty coverages exclusively through a network of independent insurance agents in certain Mid-Atlantic, Midwest, New England and Southern states. The personal lines products of our insurance subsidiaries consist primarily of homeowners and private passenger automobile policies. The commercial lines products of our insurance subsidiaries consist primarily of commercial automobile, commercial multi-peril and workers compensation policies. We also own 48.2% of the outstanding stock of Donegal Financial Services Corporation (DFSC), a grandfathered unitary savings and loan holding company. Donegal Mutual owns the remaining 51.8% of the outstanding stock of DFSC.

At December 31, 2017, Donegal Mutual held approximately 44% of our outstanding Class A common stock and approximately 83% of our outstanding Class B common stock. This ownership provides Donegal Mutual with approximately 72% of the combined voting power of our outstanding shares of Class A common stock and our outstanding shares of Class B common stock.

Donegal Mutual and Atlantic States entered into a proportional reinsurance agreement, or pooling agreement, effective October 1, 1986. Under this pooling agreement, Donegal Mutual and Atlantic States pool and then share proportionately substantially all of their respective premiums, losses and expenses. Atlantic States participation in the pool has been 80% since March 1, 2008. The operations of our insurance subsidiaries and Donegal Mutual are interrelated due to the pooling agreement and other factors. While maintaining the separate corporate existence of each company, our insurance subsidiaries and Donegal Mutual conduct business together as the Donegal Insurance Group. As such, Donegal Mutual and our insurance subsidiaries share the same business philosophy, the same management, the same employees and the same facilities and offer the same types of insurance products. See Business - History and Organizational Structure for more information regarding the pooling agreement and other transactions with our affiliates.

On July 18, 2013, our board of directors authorized a share repurchase program pursuant to which we have the authority to purchase up to 500,000 additional shares of our Class A common stock at prices prevailing from time to time in the open market subject to the provisions of the SEC Rule 10b-18 and in privately negotiated transactions. We did not purchase any shares of our Class A common stock under this program during 2017 or 2016. We have purchased a total of 57,658 shares of our Class A common stock under this program from its inception through December 31, 2017.

On December 18, 2015, we and Donegal Mutual entered into a Stock Purchase and Standstill Agreement (the Purchase Agreement) with Gregory M. Shepard (Mr. Shepard). Under the terms of the Purchase Agreement, we purchased 2,000,000 shares of our Class A common stock from Mr. Shepard on December 22, 2015 for a price of $33.0 million, or $16.50 per share, representing a premium of approximately $5.8 million from the market price of our Class A common stock on the date of the Purchase Agreement. We reported this premium in excess of the market price as an expense in our consolidated statements of income and comprehensive income for 2015 that we include in this Form 10-K Report. We borrowed $33.0 million under our existing line of credit with M&T Bank to fund the purchase. The Purchase Agreement contains a number of typical standstill provisions pursuant to which Mr. Shepard and any affiliate of Mr. Shepard shall not take a number of control-seeking actions with respect to us for a period of

25 years from the date of the Purchase Agreement.

Critical Accounting Policies and Estimates

We combine our financial statements with those of our insurance subsidiaries and present them on a consolidated basis in accordance with GAAP.

Our insurance subsidiaries make estimates and assumptions that can have a significant effect on amounts and disclosures we report in our financial statements. The most significant estimates relate to the reserves of our insurance subsidiaries for property and casualty insurance unpaid losses and loss expenses, valuation of investments and determination of other-than-temporary investment impairments and the policy acquisition costs of our insurance subsidiaries. While we believe our estimates and the estimates of our insurance subsidiaries are appropriate, the ultimate amounts may differ from the estimates we provided. We regularly review our methods for making these estimates, and we reflect any adjustment we consider necessary in our results of operations for the period in which we make an adjustment.

Liability for Losses and Loss Expenses

Liabilities for losses and loss expenses are estimates at a given point in time of the amounts an insurer expects to pay with respect to incurred policyholder claims based on facts and circumstances the insurer knows at that point in time. At the time of establishing its estimates, an insurer recognizes that its ultimate liability for losses and loss expenses will exceed or be less than such estimates. Our insurance subsidiaries base their estimates of liabilities for losses and loss expenses on assumptions as to future loss trends, expected claims severity, judicial theories of liability and other factors. However, during the loss adjustment period, our insurance subsidiaries may learn additional facts regarding individual claims, and, consequently, it often becomes necessary for our insurance subsidiaries to refine and adjust their estimates for these liabilities. We reflect any adjustments to the liabilities for losses and loss expenses of our insurance subsidiaries in our consolidated results of operations in the period in which our insurance subsidiaries make adjustments to their estimates.

Our insurance subsidiaries maintain liabilities for the payment of losses and loss expenses with respect to both reported and unreported claims. Our insurance subsidiaries establish these liabilities for the purpose of covering the ultimate costs of settling all losses, including investigation and litigation costs. Our insurance subsidiaries base the amount of their liability for reported losses primarily upon a case-by-case evaluation of the type of risk involved, knowledge of the circumstances surrounding each claim and the insurance policy provisions relating to the type of loss the policyholder incurred. Our insurance subsidiaries determine the amount of their liability for unreported claims and loss expenses on the basis of historical information by line of insurance. Our insurance subsidiaries account for inflation in the reserving function through analysis of costs and trends and reviews of historical reserving results. Our insurance subsidiaries monitor their liabilities closely and recompute them periodically using new information on reported claims and a variety of statistical techniques. Our insurance subsidiaries do not discount their liabilities for losses and loss expenses.

Reserve estimates can change over time because of unexpected changes in assumptions related to our insurance subsidiaries   external environment and, to a lesser extent, assumptions related to our insurance subsidiaries   internal operations. For example, our insurance subsidiaries have experienced a decrease in claims frequency on workers compensation claims during the past several years while the severity of these claims has gradually increased. These trend changes give rise to greater uncertainty as to the pattern of future loss settlements on workers   compensation claims. Related uncertainties regarding future trends include the cost of medical technologies and procedures and changes in the utilization of medical procedures. Assumptions related to our insurance subsidiaries   external environment include the absence of significant changes in tort law and the legal environment that increase liability exposure, consistency in judicial interpretations of insurance coverage and policy provisions and the rate of loss cost inflation. Internal assumptions include consistency in the recording of premium and loss statistics, consistency in the recording of claims, payment and case reserving methodology, accurate measurement of the impact of rate changes and changes in policy provisions, consistency in the quality and characteristics of business written within a given line of business and consistency in reinsurance coverage and collectability of reinsured losses, among other items. To the extent our insurance subsidiaries determine that underlying factors impacting their assumptions have changed, our insurance subsidiaries make adjustments in their reserves that they consider appropriate for such changes. Accordingly, our insurance subsidiaries   ultimate liability for unpaid losses and loss expenses will likely differ from the amount recorded at December 31, 2017. For every 1% change in our insurance subsidiaries   loss and loss expense reserves, net of reinsurance recoverable, the effect on our pre-tax results of operations would be approximately $3.8 million.

The establishment of appropriate liabilities is an inherently uncertain process and we can provide no assurance that our insurance subsidiaries   ultimate liability will not exceed our insurance subsidiaries   loss and loss expense reserves and have an adverse effect on our results of operations and financial condition. Furthermore, we cannot predict the timing, frequency and extent of adjustments to our insurance subsidiaries estimated future liabilities, because the historical conditions and events that serve as a basis for our insurance subsidiaries estimates of ultimate claim costs may change. As is the case for substantially all property and casualty insurance companies, our insurance subsidiaries have found it necessary in the past to increase their estimated future liabilities for losses and loss expenses in certain periods and, in other periods, their estimated future liabilities for losses and loss expenses have exceeded their actual liabilities for losses and loss expenses. Changes in our insurance subsidiaries estimates of their liability for losses and loss expenses generally reflect actual payments and their evaluation of information received subsequent to the prior reporting period. Our insurance subsidiaries recognized an increase in their liability for losses and loss expenses of prior years of $6.6 million, $3.0 million and $7.2 million in 2017, 2016 and 2015, respectively. Our insurance subsidiaries made no significant changes in their reserving philosophy, key reserving assumptions or claims management personnel, and they have made no significant offsetting changes in estimates that increased or decreased their loss and loss expense reserves in these years. The 2017 development represented 1.9% of the December 31, 2016 net carried reserves and resulted primarily from higher-than-expected severity in the commercial multiple peril, personal automobile and commercial automobile lines of business, offset by lower-than-expected severity in the workers compensation line of business, in accident years prior to 2017. The majority of the 2017 development related to increases in the liability for losses and loss expenses of prior years for Atlantic States and Peninsula. The 2016 development represented 0.9% of the December 31, 2015 net carried reserves and resulted primarily from higher-than-expected severity in the commercial multiple peril and commercial automobile liability lines of business, offset by lower-than-expected severity in the workers compensation line of business, in accident years prior to 2016. The majority of the 2016 development related to increases in the liability for losses and loss expenses of prior years for Atlantic States and Southern. The 2015 development represented 2.5% of the December 31, 2014 net carried reserves and resulted primarily from higher-than-expected severity in the private passenger automobile liability, commercial multiple peril and commercial automobile lines of business in accident years prior to 2015. The majority of the 2015 development related to increases in the liability for losses and loss expenses of prior years for Atlantic States and Southern.

Excluding the impact of severe weather events, our insurance subsidiaries have noted stable amounts in the number of claims incurred and a slight downward trend in the number of claims outstanding at period ends relative to their premium base in recent years across most of their lines of business. However, the amount of the average claim outstanding has increased gradually over the past several years due to various factors such as rising medical loss costs and increased litigation trends. We have also experienced a general slowing of settlement rates in litigated claims. Our insurance subsidiaries could have to make further adjustments to their estimates in the future. However, on the basis of our insurance subsidiaries internal procedures, which analyze, among other things, their prior assumptions, their experience with similar cases and historical trends such as reserving patterns, loss payments, pending levels of unpaid claims and product mix, as well as court decisions, economic conditions and public attitudes, we believe that our insurance subsidiaries have made adequate provision for their liability for losses and loss expenses.

Atlantic States participation in the pool with Donegal Mutual exposes Atlantic States to adverse loss development on the business of Donegal Mutual that the pool includes. However, pooled business represents the predominant percentage of the net underwriting activity of both companies, and Donegal Mutual and Atlantic States share proportionately any adverse risk development relating to the pooled business. The business in the pool is homogeneous and each company has a pro-rata share of the entire pool. Since the predominant percentage of the business of Atlantic States and Donegal Mutual is pooled and the results shared by each company according to its participation level under the terms of the pooling agreement, the intent of the underwriting pool is to produce a more uniform and stable underwriting result from year to year for each company than either would experience individually and to spread the risk of loss between the companies.

Donegal Mutual and our insurance subsidiaries operate together as the Donegal Insurance Group and share a combined business plan designed to achieve market penetration and underwriting profitability objectives. The products our insurance subsidiaries and Donegal Mutual offer are generally complementary, thereby allowing Donegal Insurance Group to offer a broader range of products to a given market and to expand Donegal Insurance Group s ability to service an entire personal lines or commercial lines account. Distinctions within the products of Donegal Mutual and our insurance subsidiaries generally relate to specific risk profiles targeted within similar classes of business, such as preferred tier products compared to standard tier products, but we do not allocate all of the standard risk gradients to one company. Therefore, the underwriting profitability of the business the individual companies write directly will vary. However, because the pool homogenizes the risk characteristics of the predominant percentage of the business Donegal Mutual and Atlantic States write directly and each company shares the underwriting results according to each company s participation percentage, each company realizes its percentage share of the underwriting results of the pool.

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Our insurance subsidiaries liability for losses and loss expenses by major line of business at December 31, 2017 and 2016 consisted of the following:

	2017	2016
	(in thousands)	
Commercial lines:		
Automobile	$ 74,299	$ 58,615
Workers compensation	103,318	104,446
Commercial multi-peril	71,011	60,887
Other	4,119	3,868
Total commercial lines	252,747	227,816
Personal lines:		
Automobile	110,512	100,498
Homeowners	18,508	17,286
Other	1,634	1,918
Total personal lines	130,654	119,702
Total commercial and personal lines	383,401	347,518
Plus reinsurance recoverable	293,271	259,147
Total liability for losses and loss expenses	$ 676,672	$ 606,665

We have evaluated the effect on our insurance subsidiaries loss and loss expense reserves and our stockholders equity in the event of reasonably likely changes in the variables we consider in establishing loss and loss expense reserves. We established the range of reasonably likely changes based on a review of changes in accident year development by line of business and applied it to our insurance subsidiaries loss reserves as a whole. The selected range does not necessarily indicate what could be the potential best or worst case or the most-likely scenario. The following table sets forth the effect on our insurance subsidiaries loss and loss expense reserves and our stockholders equity in the event of reasonably likely changes in the variables considered in establishing loss and loss expense reserves:

Change in Loss and Loss Expense Reserves Net of Reinsurance	Adjusted Loss and Loss Expense Reserves Net of Reinsurance at December 31, 2017	Percentage Change in Equity at December 31, 2017(1)	Adjusted Loss and Loss Expense Reserves Net of Reinsurance at December 31, 2016	Percentage Change in Equity at December 31, 2016(1)
	(dollars in thousands)			
-10.0%	$ 345,061	6.8%	$ 312,766	5.1%
-7.5	354,646	5.1	321,454	3.9
-5.0	364,231	3.4	330,142	2.6
-2.5	373,816	1.7	338,830	1.3
Base	383,401		347,518	

2.5	392,986	-1.7	356,206	-1.3
5.0	402,571	-3.4	364,894	-2.6
7.5	412,156	-5.1	373,582	-3.9
10.0	421,741	-6.8	382,270	-5.1

(1) Net of income tax effect (21% at December 31, 2017 and 35% at December 31, 2016).

Our insurance subsidiaries base their reserves for unpaid losses and loss expenses on current trends in loss and loss expense development and reflect their best estimates for future amounts needed to pay losses and loss expenses with respect to incurred events currently known to them plus incurred but not reported (IBNR) claims. Our insurance subsidiaries develop their reserve estimates based on an assessment of known facts and circumstances, review of historical loss settlement patterns, estimates of trends in claims severity, frequency, legal and regulatory changes and other assumptions. Our insurance subsidiaries consistently apply actuarial loss reserving techniques and assumptions, which rely on historical information as adjusted to reflect current conditions, including consideration of recent case reserve activity. Our insurance subsidiaries use the most-likely number their actuaries determine. For the year ended December 31, 2017, the actuaries developed a range from a low of $353.0 million to a high of $416.5 million and with a most-likely number of $383.4 million. The actuaries range of estimates for commercial lines in 2017 was $232.8 million to $274.5 million, and the actuaries selected the most-likely number of $252.7 million. The actuaries range of estimates for personal lines in 2017 was $120.2 million to $142.0 million, and the actuaries selected the most-likely number of $130.7 million. For the year ended December 31, 2016, the actuaries developed a range from a low of $318.6 million to a high of $379.0 million and with a most-likely number of $347.5 million. The actuaries range of estimates for commercial lines in 2016 was $208.9 million to $248.4 million, and the actuaries selected the most-likely number of $227.8 million. The actuaries range of estimates for personal lines in 2016 was $109.7 million to $130.6 million, and the actuaries selected the most-likely number of $119.7 million.

Our insurance subsidiaries seek to enhance their underwriting results by carefully selecting the product lines they underwrite. For personal lines products, our insurance subsidiaries insure standard and preferred risks in private passenger automobile and homeowners lines. For commercial lines products, the commercial risks that our insurance subsidiaries primarily insure are business offices, wholesalers, service providers, contractors, artisans and light manufacturing operations. Our insurance subsidiaries have limited exposure to asbestos and other environmental liabilities. Our insurance subsidiaries write no medical malpractice liability risks. Through the consistent application of this disciplined underwriting philosophy, our insurance subsidiaries have avoided many of the long-tail issues other insurance companies have faced. We consider workers compensation to be a long-tail line of business, in that workers compensation claims tend to be settled over a longer time frame than those in the other lines of business of our insurance subsidiaries.

The following table presents 2017 and 2016 claim count and payment amount information for workers compensation. Workers compensation losses primarily consist of indemnity and medical costs for injured workers.

	For the Year Ended December 31,	
(dollars in thousands)	2017	2016
Number of claims pending, beginning of period	2,710	2,694
Number of claims reported	6,348	6,343
Number of claims settled or dismissed	6,152	6,327
Number of claims pending, end of period	2,906	2,710
Losses paid	$ 41,970	$ 39,718
Loss expenses paid	9,474	9,326

Investments

We make estimates concerning the valuation of our investments and the recognition of other-than-temporary declines in the value of our investments. For equity securities, when we consider a decline in the value of an individual investment to be other than temporary, we write down the investment to its fair value and reflect the amount of the write-down as a realized loss in our results of operations. We individually monitor all investments for other-than-temporary declines in value. Generally, we assume there has been an other-than-temporary decline in value if an individual equity security has depreciated in value by more than 20% of original cost and has been in such an unrealized loss position for more than six months. We held five equity securities that were in an unrealized loss position at December 31, 2017. Based upon our analysis of general market conditions and underlying factors impacting these equity securities, we considered these declines in value to be temporary. With respect to a debt security that is in an unrealized loss position, we first assess if we intend to sell the debt security. If we determine we intend to sell the debt security, we recognize the impairment loss in our results of operations. If we do not intend to sell the debt security, we determine whether it is more likely than not that we will be required to sell the security prior to recovery. If we determine it is more likely than not that we will be required to sell the debt security prior to recovery, we recognize an impairment loss in our results of operations. If we determine it is more likely than not that we will not be required to sell the debt security prior to recovery, we then evaluate whether a credit loss has occurred. We determine whether a credit loss has occurred by comparing the amortized cost of the debt security to the present value of the cash flows we expect to collect. If we expect a cash flow shortfall, we consider that a credit loss has occurred. If we determine that a credit loss has occurred, we consider the impairment to be other than temporary. We then recognize the amount of the impairment loss related to the credit loss in our results of operations, and we recognize the remaining portion of the impairment loss in our other comprehensive

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income, net of applicable taxes. In addition, we may write down securities in an unrealized loss position based on a number of other factors, including when the fair value of an investment is significantly below its cost, when the financial condition of the issuer of a security has deteriorated, the occurrence of industry, company or geographic events that have negatively impacted the value of a security and rating agency downgrades. We held 280 debt securities that were in an unrealized loss position at December 31, 2017. Based upon our analysis of general market conditions and underlying factors impacting these debt securities, we considered these declines in value to be temporary. We did not recognize any impairment losses in 2017, 2016 or 2015.

We held fixed maturities and equity securities with unrealized losses representing declines that we considered temporary at December 31, 2017 as follows:

	Less than 12 months		**12 months or longer**	
	Fair Value	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$ 24,024,445	$ 286,518	$ 33,987,229	$ 990,759
Obligations of states and political subdivisions	10,223,383	120,076	14,127,415	294,557
Corporate securities	35,203,959	253,241	31,560,591	1,003,047
Mortgage-backed securities	100,533,516	817,315	124,061,502	2,666,650
Equity securities	4,291,875	279,141		
Totals	$ 174,277,178	$ 1,756,291	$ 203,736,737	$ 4,955,013

We held fixed maturities and equity securities with unrealized losses representing declines that we considered temporary at December 31, 2016 as follows:

	Less than 12 months		**12 months or longer**	
	Fair Value	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$ 37,729,947	$ 1,279,510	$	$
Obligations of states and political subdivisions	40,739,099	802,311	710,280	8,936
Corporate securities	80,181,238	2,127,451	4,706,945	472,044
Mortgage-backed securities	168,771,543	2,727,720	416,828	2,602
Equity securities	5,420,875	132,071		
Totals	$ 332,842,702	$ 7,069,063	$ 5,834,053	$ 483,582

We present our investments in available-for-sale fixed maturity and equity securities at estimated fair value. The estimated fair value of a security may differ from the amount that we could realize if we sold the security in a forced transaction. In addition, the valuation of fixed maturity investments is more subjective when markets are less liquid, increasing the potential that the estimated fair value does not reflect the price at which an actual transaction would occur. We utilize nationally recognized independent pricing services to estimate fair values or obtain market quotations for substantially all of our fixed maturity and equity investments. We generally obtain two prices per security. The pricing services utilize market quotations for fixed maturity and equity securities that have quoted prices in active markets. For fixed maturity securities that generally do not trade on a daily basis, the pricing services prepare estimates of fair value measurements based predominantly on observable market inputs. The pricing services do not use broker quotes in determining the fair values of our investments. Our investment personnel review the estimates of fair value the pricing services provide to determine if the estimates we obtain are representative of fair values based upon their general knowledge of the market, their research findings related to unusual fluctuations in value and their comparison of such values to execution prices for similar securities. Our investment personnel monitor the market and are familiar with current trading ranges for similar securities and pricing of specific investments. Our investment personnel review all pricing estimates that we receive from the pricing services against the expectations of our investment personnel with respect to pricing based on fair market curves, security ratings, coupon rates, security type and recent trading activity. Our investment personnel review documentation with respect to the pricing services pricing methodology that they obtain periodically to determine if the primary pricing sources, market inputs and pricing frequency for various security types are reasonable. At December 31, 2017, we received two estimates per security from the pricing services, and we priced substantially all of our Level 1 (quoted prices in active markets for identical assets and liabilities) and Level 2 (directly or indirectly observable inputs other than Level 1 quoted prices) investments using those prices. In our review of the estimates the pricing services provided at December 31, 2017, we did not identify any material discrepancies, and we did not make any adjustments to the estimates the pricing services provided.

We had no sales or transfers from the held to maturity portfolio in 2017, 2016 or 2015.

Policy Acquisition Costs

We defer our insurance subsidiaries policy acquisition costs, consisting primarily of commissions, premium taxes and certain other underwriting costs, reduced by ceded commissions, that vary with and relate directly to the production of business. We amortize these costs over the period in which our insurance subsidiaries earn the premiums on that business. The method our insurance subsidiaries follow in computing deferred policy acquisition costs limits the amount of such deferred costs to their estimated realizable value, which gives effect to the premium to be earned, related investment income, losses and loss expenses and certain other costs we expect to incur as our insurance subsidiaries earn the premium.

Management Evaluation of Operating Results

Despite economic uncertainty, challenging insurance market conditions and unusually adverse weather conditions that affected our results in recent years, we believe that our focused business strategy, including our insurance subsidiaries disciplined underwriting practices, have positioned us well for 2018 and beyond.

The property and casualty insurance industry is highly cyclical, and individual lines of business experience their own cycles within the overall property and casualty insurance industry cycle. Premium rate levels relate to the availability of insurance coverage, which varies according to the level of surplus in the insurance industry and other factors. The level of surplus in the industry varies with returns on capital and regulatory barriers to the withdrawal of surplus. Increases in surplus have generally been accompanied by increased price competition among property and casualty insurers. If our insurance subsidiaries were to find it necessary to reduce premiums or limit premium increases due to competitive pressures on pricing, our insurance subsidiaries could experience a reduction in profit margins and revenues, an increase in ratios of losses and expenses to premiums and, therefore, lower profitability. The cyclicality of the insurance market and its potential impact on our results is difficult to predict with any significant reliability. Because our insurance subsidiaries do not prepare GAAP financial statements, we evaluate the performance of our personal lines and commercial lines segments utilizing statutory accounting practices (SAP), which include financial measures that reflect the growth trends and underwriting results of our insurance subsidiaries.

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We use the following financial data to monitor and evaluate our operating results:

	Year Ended December 31,		
(in thousands)	2017	2016	2015
Net premiums written:			
Personal lines:			
Automobile	$ 255,297	$ 229,789	$ 214,610
Homeowners	125,054	122,811	119,541
Other	19,672	19,057	18,176
Total personal lines	400,023	371,657	352,327
Commercial lines:			
Automobile	99,333	87,849	76,729
Workers compensation	109,884	108,349	98,079
Commercial multi-peril	110,313	104,728	94,219
Other	9,586	9,451	7,483
Total commercial lines	329,116	310,377	276,510
Total net premiums written	$ 729,139	$ 682,034	$ 628,837
Components of GAAP combined ratio:			
Loss ratio	69.4%	64.5%	65.8%
Expense ratio	32.9	33.0	32.6
Dividend ratio	0.7	0.6	0.6
GAAP combined ratio	103.0%	98.1%	99.0%
Revenues:			
Premiums earned:			
Personal lines	$ 384,124	$ 361,128	$ 344,355
Commercial lines	318,391	295,077	261,286
GAAP premiums earned	702,515	656,205	605,641
Net investment income	23,527	22,633	20,950
Realized investment gains	5,705	2,526	1,934
Equity in earnings of DFSC	1,622	1,086	1,277
Other	5,658	5,973	6,585
Total revenues	$ 739,027	$ 688,423	$ 636,387

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(in thousands)		Year Ended December 31, 2017	2016	2015
Components of net income:				
Underwriting (loss) income:				
Personal lines	$	(39,042)	$ (10,745)	$ (6,414)
Commercial lines		13,263	18,284	9,259
SAP underwriting (loss) income		(25,779)	7,539	2,845
GAAP adjustments		4,408	4,642	3,344
GAAP underwriting (loss) income		(21,371)	12,181	6,189
Net investment income		23,527	22,633	20,950
Realized investment gains		5,705		
Cascade Bancorp	Sierra Bancorp			
Westfield Financial, Inc.	Citizens & Northern Corporation			
Provident Financial Holdings, Inc.	NASB Financial, Inc.			
Fox Chase Bancorp, Inc.				

KBW s analysis showed, among other things, the following concerning the financial performance and financial condition of HomeTrust and the selected companies:

	HomeTrust	Selected Companies Top Quartile	Median	Bottom Quartile	Average
Operating Return on Assets(1)	0.70%	1.50%	0.83%	0.55%	0.95%
Operating Return on Equity(1)	3.03%	10.25%	6.59%	4.06%	6.74%
Net Interest Margin	3.80%	3.77%	3.25%	2.91%	3.26%
Efficiency Ratio	72.94%	62.78%	65.49%	71.83%	67.79%
Tangible Common Equity/Tangible Assets	21.83%	13.66%	13.28%	12.67%	13.63%
Tier 1 Capital Ratio	21.64%	21.54%	20.21%	18.98%	20.56%
Total Capital Ratio	22.91%	22.29%	21.52%	20.02%	21.65%
Loans/Deposits	96.24%	95.66%	82.81%	78.15%	85.40%
Loan Loss Reserves/Loans	2.43%	2.28%	1.34%	1.13%	1.56%
Adjusted Nonperforming Assets/Assets	5.98%	1.13%	1.55%	3.31%	2.37%
Net Charge-Offs/Average Loans	0.19%	0.02%	0.06%	0.45%	0.26%

(1) Excludes Cascade Bancorp due to reversal of valuation allowance in the last 12 months.

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KBW s analysis showed, among other things, the following concerning the market performance of HomeTrust and the selected companies (excluding the impact of certain selected company LTM EPS multiples considered to be not meaningful because they were either below 0.0x or greater than 50.0x):

		Selected Companies			
	HomeTrust	Top Quartile	Median	Bottom Quartile	Average
Stock Price/Book Value per Share	0.85x	1.29x	1.23x	1.08x	1.17x
Stock Price/Tangible Book Value Per Share	0.86x	1.32x	1.23x	1.08x	1.18x
Stock Price/ LTM EPS(1)	28.30x	21.89x	14.62x	9.69x	17.11x
Core Deposit Premium	-5.31%	6.19%	4.93%	1.61%	4.04%

(1) Excludes Cascade Bancorp due to reversal of valuation allowance in the last 12 months.

Selected Transactions Analysis. KBW reviewed publicly available information related to 23 selected merger and acquisition transactions announced since January 1, 2012 with bank and thrift targets headquartered in the Southeast Region where the deal value was between $25 million and $75 million. The selected transactions included:

Acquiror	Target
BNC Bancorp	Community First Financial Group, Inc.
BNC Bancorp	South Street Financial Group
Banco de Sabadell, SA	JGB Bank, National Association
Home Bancorp, Inc.	Britton & Koontz Capital Corporation
NewBridge Bancorp	CapStone Bank
New Century Bancorp, Inc.	Select Bancorp, Inc.
Simmons First National Corporation	Metropolitan National Bank
Cardinal Financial Corporation	United Financial Banking Companies, Inc.
Stonegate Bank	Florida Shores Bancorp, Inc.
Community & Southern Holdings, Inc.	Verity Capital Group, Inc.
First Community Corporation	Savannah River Financial Corporation
Bond Street Holdings, Inc.	Great Florida Bank
1st United Bancorp, Inc.	Enterprise Bancorp, Inc.
Bank of the Ozarks, Inc.	First National Bank of Shelby
Old Florida Bancshares, Inc.	New Traditions National Bank
Bank of the Ozarks, Inc.	Genala Banc, Inc.
Crescent Financial Bancshares, Inc.	ECB Bancorp, Inc.
SCBT Financial Corporation	Savannah Bancorp, Inc.
BNC Bancorp	First Trust Bank
Trustmark Corporation	BancTrust Financial Group, Inc.
Capital Bank Financial Corporation	Southern Community Financial Corporation
IBERIABANK Corporation	Florida Gulf Bancorp, Inc.
First Community Bancshares, Inc.	Peoples Bank of Virginia

To the extent publicly available, KBW derived, among other things, the following implied ratios for each selected transaction:

- price per common share paid for the acquired company to tangible book value per share of the acquired company based on the latest publicly available financial statements of the company available prior to the announcement of the acquisition.

- price per common share paid for the acquired company to LTM EPS of the acquired company.

- core deposit premium paid for the acquired company.

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These ratios were compared with corresponding transaction ratios for the proposed merger based on the implied value of the merger consideration of $8.00 per share of Jefferson common stock.

The results of the analysis are set forth in the following table (excluding the impact of certain selected transaction LTM EPS multiples considered to be not meaningful because they were either below 0.0x or greater than 50.0x):

		Selected Transactions			
	Merger	Top Quartile	Median	Bottom Quartile	Average
Price/Tangible Book Value	101.0%	130.1x	105.9%	88.4%	111.4%
Price/ LTM EPS	28.6x	46.0x	20.7x	14.2x	30.1x
Core Deposit Premium	0.2%	3.7%	0.9%	-1.0%	1.5%

Discounted Cash Flow Analysis. KBW performed a discounted cash flow analysis to estimate a range for the implied equity value of Jefferson. In this analysis, KBW used financial forecasts and projections relating to the earnings and assets of Jefferson prepared by and provided to KBW by Jefferson management, and assumed discount rates ranging from 13.0% to 17.0%. The range of values was determined by adding (1) the present value of projected cash flows to Jefferson shareholders from fiscal years 2014 to 2019 and (2) the present value of the terminal value of Jefferson s common stock. In determining cash flows available to shareholders, KBW assumed balance sheet growth of 2.0% per year for fiscal year 2014 and 5.0% per year thereafter through fiscal year 2019, per Jefferson management and assumed that Jefferson would maintain a tangible common equity / tangible asset ratio of 8.0%, and would retain sufficient earnings to maintain these levels. KBW derived implied terminal multiples using two methodologies, one based on 2019 earnings multiples and the other based on fiscal year 2018 tangible book value multiples. Using implied terminal values for Jefferson calculated by applying a range of 11.0x to 15.0x estimated fiscal year 2019 earnings, KBW derived a range of implied value per share of Jefferson common stock of $5.54 per share to $7.51 per share. Using implied terminal values for Jefferson calculated by applying a range of 0.80x to 1.20x fiscal year 2018 tangible book value, KBW derived a range of implied value per share of Jefferson common stock of $5.21 per share to $7.44 per share. Implied per share values derived in this analysis were calculated excluding unallocated ESOP shares to be cancelled in the merger. The discounted cash flow analysis is a widely used valuation methodology, but the results of such methodology are highly dependent on the assumptions that must be made, including asset and earnings growth rates, terminal values, dividend payout rates, and discount rates. The analysis did not purport to be indicative of the actual values or expected values of Jefferson.

Relative Contribution Analysis. KBW prepared a contribution analysis comparing percentages of total assets, total loans, total deposits, total common equity and tangible common equity as of September 30, 2013, and LTM earnings and estimated earnings for fiscal years 2014, 2015 and 2016, for Jefferson and HomeTrust to be contributed to the combined company on a pro forma basis. In the course of this analysis, KBW used earnings estimates for Jefferson for fiscal years 2014, 2015 and 2016 from Jefferson management and used earnings estimates for HomeTrust for fiscal years 2014, 2015 and 2016 from HomeTrust management.

The implied Jefferson contributions to the combined company are set forth, and compared to illustrative pro forma ownership percentages of Jefferson shareholders in the combined company based on a 50% cash/50% stock consideration mix and 100% stock consideration mix, in the following table:

	Jefferson Percentage
Total Assets	23.1%
Total Loans	21.0%
Total Deposits	24.2%
Total Common Equity	13.0%
Total Tangible Common Equity	12.9%
LTM Earnings	14.2%
2014 Earnings	15.6%
2015 Earnings	22.6%
2016 Earnings	25.2%
Ownership at 50% Cash/50% Stock Consideration Mix	7.8%
Ownership at 100% Stock Consideration	14.5%

Financial Impact Analysis. KBW performed a pro forma merger analysis that combined projected income statement and balance sheet information of Jefferson and HomeTrust. Pro forma assumptions regarding, among other things, the accounting treatment, merger adjustments and cost savings per HomeTrust management were used to calculate the financial impact that the merger could have on certain projected financial results of HTBI. In the course of this analysis, KBW used closing book value, closing tangible book value and fiscal years 2015 and 2016 earnings estimates for HomeTrust from HomeTrust management and closing book value, closing tangible book value and fiscal years 2015 and 2016 earnings estimates for Jefferson from Jefferson management. This analysis indicated that the merger could be accretive to HomeTrust s estimated EPS in fiscal years 2015 and 2016. The analysis also indicated that the merger could be dilutive to estimated closing book value per share and tangible book value per share for HomeTrust and that HomeTrust s pro forma capital ratios could be lower at the closing of the merger. For all of the above analyses, the actual results achieved by HTBI following the merger will vary from the projected results, and the variations may be material.

Miscellaneous. KBW served as financial advisor to Jefferson in connection with the proposed merger and did not act as an advisor to or agent of any other person. As part of its investment banking business, KBW is continually engaged in the valuation of bank and bank holding company securities in connection with acquisitions, negotiated underwritings, secondary distributions of listed and unlisted securities, private placements and valuations for various other purposes. As specialists in the securities of banking companies, KBW has experience in, and knowledge of, the valuation of banking enterprises. In the ordinary course of its business as a broker-dealer, KBW may, from time to time, purchase securities from, and sell securities to, Jefferson and HomeTrust. As a market maker in securities, KBW may from time to time have a long or short position in, and buy or sell, debt or equity securities of Jefferson and HomeTrust for its own account and for the accounts of its customers. To the extent KBW held any such positions as of the date of its opinion, it was disclosed to the Board.

Pursuant to the KBW engagement agreement, Jefferson agreed to pay KBW a cash fee equal to 1.50% of the aggregate merger consideration, $150,000 of which became payable upon the rendering of KBW s opinion and the balance of which is contingent upon the consummation of the merger. Jefferson also agreed to reimburse KBW for reasonable out-of-pocket expenses and disbursements incurred in connection with its engagement and to indemnify KBW against certain liabilities relating to or arising out of KBW s engagement or KBW s role in connection therewith.

Other than in connection with the merger, during the two years preceding the date of its opinion, KBW did not provide investment banking or financial advisory services to Jefferson. During the two years preceding the date of its opinion, KBW provided investment banking and financial advisory services to HomeTrust and received compensation for such services. KBW served as conversion agent for HomeTrust s mutual-to-stock conversion, completed in July 2012, and as financial advisor to HomeTrust in its acquisition of BankGreenville Financial Corporation, completed in July 2013. KBW may in the future provide investment banking and financial advisory services to Jefferson or HomeTrust and receive compensation for such services.

Opinion of Professional Bank Services Financial Advisor to Jefferson

Professional Bank Services, Inc. was engaged by Jefferson to advise Jefferson s board of directors as to the fairness of the consideration, from a financial perspective, to be paid by HomeTrust as set forth and further defined in the merger agreement.

PBS is a bank consulting firm with offices located throughout the United States. As part of its investment banking business, PBS is regularly engaged in reviewing the fairness of financial institution acquisition transactions from a financial perspective and in the valuation of financial institutions and other businesses and their securities in connection with mergers, acquisitions, estate settlements, and other transactions. Neither PBS nor any of its affiliates has, or has had within the past two years, a material financial interest in, or other material relationship with, Jefferson or HomeTrust and PBS was selected to advise Jefferson s board of directors based on its knowledge of the banking industry as a whole. PBS did not determine the amount of consideration to be paid to Jefferson stockholders in connection with the transaction, but instead recommended the fairness of the consideration provided for in the merger agreement to Jefferson s board of directors.

PBS performed certain analyses described herein and presented the range of values for Jefferson, resulting from such analyses, to the board of directors of Jefferson in connection with its advice as to the fairness of the consideration to be paid by HomeTrust.

A fairness opinion of PBS was delivered to the board of directors of Jefferson on January 21, 2014 at a special meeting of the board of directors. A copy of the Fairness Opinion, which includes a summary of the assumptions made and information analyzed in deriving the Fairness Opinion, is attached as **Appendix C**.

In arriving at its Fairness Opinion, PBS reviewed certain publicly available business and financial information relating to Jefferson and HomeTrust. PBS considered certain financial and stock price data of Jefferson and HomeTrust, compared that data with similar data for certain publicly-held bank holding companies and considered the financial terms of certain other comparable transactions that had recently been effected. PBS also considered such other information, financial studies, analyses and investigations and financial, economic and market criteria that it deemed relevant. In connection with its review, PBS did not independently verify the foregoing information and relied on such information as being complete and accurate in all material respects. PBS did not make an independent evaluation or appraisal of the assets of Jefferson or HomeTrust. Financial forecasts prepared by PBS were based on assumptions believed by PBS to be reasonable and to reflect currently available information.

In connection with preparing its Fairness Opinion, PBS performed a limited scope due diligence review of HomeTrust, which included an on-site visit to HomeTrust by PBS personnel on December 19, 2013 and January 9, 2014. The review included certain credit quality reports provided by HomeTrust, consolidated financial statements for HomeTrust, HomeTrust Annual Reports for 2011 and 2012, current consolidated month-end delinquency and non-accrual reports for HomeTrust, current and historical consolidated analysis of the allowance for loan and lease losses for HomeTrust, HomeTrust s strategic plan, current consolidated internal loan reports, consolidated problem loan listing with classifications, budget for 2014 and various other current internal financial and operating reports prepared by HomeTrust.

PBS reviewed and analyzed the historical performance of Jefferson, including June 30, 2012 and 2013 audited annual reports of Jefferson, June 30, 2013 and September 30, 2013 Consolidated Reports of Condition and Income (Call Reports) of Jefferson, Jefferson performance reports as of June 30, 2013, Jefferson s 2014 operating budget and various internal asset quality, interest rate sensitivity, liquidity, deposit and loan portfolio reports. PBS reviewed and tabulated statistical data regarding the loan portfolio, securities portfolio and other performance ratios and statistics.

Financial projections were prepared and analyzed as well as other financial studies, analyses and investigations as deemed relevant for the purposes of the Fairness Opinion. In reviewing the aforementioned information, PBS took into account its assessment of general market and financial conditions, its experience in other similar transactions, and its knowledge of the banking industry generally.

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In connection with rendering the Fairness Opinion and preparing its written and oral presentation to Jefferson s board of directors, PBS performed a variety of financial analyses, including those summarized herein. This summary does not purport to be a complete description of the analyses performed by PBS in this regard. The preparation of a Fairness Opinion involves various determinations as to the most appropriate and relevant methods of financial analysis and the application of those methods to the particular circumstances and, therefore, such an opinion is not readily susceptible to summary description. Accordingly, notwithstanding the separate factors summarized below, PBS believes that its analyses must be considered as a whole and that selecting portions of its analyses and the factors considered by it, without considering all analyses and factors, could create an incomplete view of the evaluation process underlying its opinion. In performing its analyses, PBS made numerous assumptions with respect to industry performance, business and economic conditions and other matters, many of which are beyond Jefferson s or HomeTrust s control. The analyses performed by PBS are not necessarily indicative of actual values or future results, which may be significantly more or less favorable than suggested by such analyses. In addition, analyses relating to the values of businesses do not purport to be appraisals or to reflect the process by which businesses actually may be sold.

In the proposed merger, Jefferson shareholders will receive $8.00 per Jefferson common share. Jefferson shareholders will receive $4.00 in HomeTrust common shares (subject to adjustment based on HomeTrust s common stock price) and $4.00 in cash. The value of HomeTrust s common stock price in determining the exchange ratio in the PBS analysis is $16.00 per HomeTrust share.

For purposes PBS s analysis, the calculation of the purchase price is presented in the following table.

Purchase Price	$	52,778
Jefferson Shares Outstanding		6,597,301
Value Per Common Share	$	8.00

In performing its various analyses, PBS utilized the following financial inputs for Jefferson:

JEFFERSON FINANCIAL INPUTS

(Dollars in Thousands)

September 30, 2013 LTM Net Income	$	1,797
September 30, 2013 Stated Common Equity	$	53,316
September 30, 2013 Jefferson Shares Outstanding		6,597,301
Intangibles	$	1,059

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For presentation purposes, PBS utilized a HomeTrust stock price per share of $16.00. The total consideration to be received by Jefferson s shareholders, utilizing an HomeTrust stock price of $16.00 results in a multiple of Jefferson s September 30, 2013 tangible equity of 1.01X. In addition, the proposed consideration to be received by Jefferson s shareholders, utilizing a HomeTrust stock price of $16.00, represents 29.30X Jefferson s September 30, 2013 last-twelve-month net income and 13.30% of Jefferson s September 30, 2013 total deposits.

Transaction Value Method: The Transaction Value represents the price(s) at which shares of common stock in Jefferson have exchanged hands between a willing buyer and seller. Jefferson s stock is traded on NASDAQ under the symbol JFBI. The most recent trades have been at $6.60 per share. Average daily trading volume has been 6,327 shares over the 52 weeks prior to the date of the opinion. The stock is trading at the high of its 52 week trading range. Based on the preceding information the Transaction Value of Jefferson s common stock is $6.60 per common share.

Market Comparison Method: In performing this analysis, PBS reviewed the 100 bank and thrift transactions in the Southeastern United States since January 1, 2009 for which financial information is available (the Comparable Group). The purpose of the analysis was to obtain an evaluation range for Jefferson based on these Comparable Group bank and thrift acquisition transactions. The median multiple of tangible book value, and median deal value to earnings ratio of the Comparable Group transactions were utilized in obtaining a range for the acquisition value of Jefferson. In addition to reviewing recent Comparable Group bank and thrift transactions, PBS performed separate comparable analyses for acquisitions of banks and thrifts which, like Jefferson, had a non performing assets (NPAs) to total assets ratio between 2.5% and 4.5%, had a last twelve month (LTM) return on average assets (ROAA) between 0.25% - 0.75%, had an ROAA between 0.25% - 0.75% since January 1, 2012, had total assets between $300 million and $1.0 billion, and those located in the state of Tennessee. Median values for the 100 Comparable Group acquisitions expressed a multiple of tangible book value equaled 0.97X, and median deal value to earnings equaled 19.74X. The following tables depict the median transaction pricing multiples for the above institution categories as well as the percentile ranking of the proposed offer in terms of the applicable pricing multiple within each comparable category.

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ACQUISITION PRICING FOR COMPARABLE GROUP TRANSACTIONS

MEDIAN MULTIPLES

MULTIPLE OF

TANGIBLE

BOOK VALUE

PROPOSED TRANSACTION @ $16.00 per HomeTrust Share	**1.01X**
<u>Comparable Groups</u>	
All Comparable Southeast Group Acquisitions since 1/1/09	0.97X
All Southeast with NPA s / Assets between 2.5% and 4.5%	0.97X
All Southeast with LTM ROAA between 0.25% and 0.75%	1.19X
All Southeast with LTM ROAA between 0.25% and 0.75% since 1/1/12	1.19X
All Southeast with Assets between $300 million and $1.0 billion	0.86X
Tennessee Transactions	0.82X

DEAL VALUE / EARNINGS

PROPOSED TRANSACTION @ $16.00 per HomeTrust Share	**29.30X**
<u>Comparable Groups</u>	
All Comparable Southeast Group Acquisitions since 1/1/09	19.74X
All Southeast with NPA s / Assets between 2.5% and 4.5%	21.00X
All Southeast with LTM ROAA between 0.25% and 0.75%	22.35X
All Southeast with LTM ROAA between 0.25% and 0.75% since 1/1/12	21.13X
All Southeast with Assets between $300 million and $1.0 billion	19.24X
Tennessee Transactions	16.54X

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COMPARABLE GROUP TRANSACTIONS

PROPOSED TRANSACTION PERCENTILE RANKINGS

MULTIPLE OF

TANGIBLE

BOOK VALUE

PROPOSED TRANSACTION @ $16.00 per HomeTrust Share	**1.01X**
Comparable Groups	
All Comparable Southeast Group Acquisitions since 1/1/09	55.10%
All Southeast with NPA s / Assets between 2.5% and 4.5%	52.90%
All Southeast with LTM ROAA between 0.25% and 0.75%	26.00%
All Southeast with LTM ROAA between 0.25% and 0.75% since 1/1/12	26.30%
All Southeast with Assets between $300 million and $1.0 billion	67.00%
Tennessee Transactions	63.50%

DEAL VALUE / EARNINGS

PROPOSED TRANSACTION @ $16.00 per HomeTrust Share	**29.30X**
Comparable Groups	
All Comparable Southeast Group Acquisitions since 1/1/09	75.20%
All Southeast with NPA s / Assets between 2.5% and 4.5%	76.40%
All Southeast with LTM ROAA between 0.25% and 0.75%	76.80%
All Southeast with LTM ROAA between 0.25% and 0.75% since 1/1/12	78.10%
All Southeast with Assets between $300 million and $1.0 billion	66.70%
Tennessee Transactions	NA

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Asset Value Method: PBS reviewed Jefferson s balance sheet data to determine the amount of material adjustments required to the stockholders equity of Jefferson based on differences between the market value of Jefferson s assets and their value reflected on Jefferson s financial statements. PBS determined that two adjustments were warranted. Jefferson had $1,059,000 in intangible assets as of September 30, 2013. Utilizing a deposit premium of 1.20% of core deposits, PBS reflected a value of Jefferson s September 30, 2013 core deposits of approximately $4,755,000. To determine the core deposit premium a search was conducted for all branch transactions in the United States since January 1, 2011 for which pricing information was available. The transactions that included loans were excluded. There were a total of 39 branch transactions that fit the criteria with a median deposit premium of 1.20%. The aggregate adjusted net asset value of Jefferson was determined to be $57,012,000, or 1.07X Jefferson September 30, 2013 stated equity.

Earnings Method: A dividend discount analysis was performed by PBS pursuant to which a range of values of Jefferson was determined by adding (i) the present value of estimated future dividend streams that Jefferson could generate over a five-year period and (ii) the present value of the terminal value of Jefferson s tangible equity at the end of the fifth year. The terminal value of Jefferson s tangible equity at the end of the five-year period was determined by applying a multiple of 1.19 times the projected terminal year s tangible equity. The 1.19 multiple represents the median price paid as a multiple of tangible equity for all Comparable Group bank and thrift transactions located in the Southeastern United States with LTM ROAA between 0.25% and 0.75% since January 1, 2012.

Projected dividend streams and the terminal value were discounted to present values using a discount rate of 12.99%. This rate reflects assumptions regarding the required rate of return of holders or buyers of Jefferson common shares. The aggregate value of Jefferson, determined by adding the present value of the total cash flows at the end of the five-year period, was $45,559,000, or $6.91 per Jefferson common share. In addition, using the five-year projection as a base, a twenty-year projection was prepared. Assumptions utilized in the analysis included an annual growth rate in assets of 3.0% per year in years one through five and 5.0% per year for the remainder of the analysis. Return on assets was projected to increase to 1.15% by year eleven and remain constant throughout the long-term analysis. It was assumed that Jefferson would pay common dividends in years one through five at a rate equal to 50% of net income and 60% of net income in years six through twenty. This long-term projection resulted in an aggregate value of $36,167,000, or $5.48 per Jefferson common share.

Pro Forma Merger Analysis: The contribution of Jefferson and HomeTrust to the income statement and balance sheet of the pro forma combined organization was analyzed in relation to the pro forma ownership position of Jefferson s shareholders in the combined organization.

The Fairness Opinion is directed only to the question of whether the consideration to be received by Jefferson s shareholders under the merger agreement is fair and equitable from a financial perspective and does not constitute a recommendation to any Jefferson shareholder to vote in favor of the adoption of the merger agreement and approval of the Merger. No limitations were imposed on PBS regarding the scope of its investigation or otherwise by Jefferson.

In forming its opinion as to the fairness of the proposed transaction from a financial perspective, PBS took into consideration multiple factors and circumstances including the following: the Asset Value Method reflects a liquidation value of Jefferson and does not accurately reflect the value of Jefferson as a going concern and therefore was not included in PBS s opinion of value; the values of Jefferson derived from the short and long-term Earnings Method; the percentile rankings of the proposed transaction pricing multiples relative to other transactions in the Comparable Group; HomeTrust s financial performance and operating history and in particular HomeTrust s high level of capital and its ability to support its stock price; the future growth prospects and fundamental performance of Jefferson and HomeTrust; the pro forma capital ratios of HomeTrust and HomeTrust s apparent ability to consummate the proposed transaction; Jefferson s and HomeTrust s relative earnings growth on both a historical and pro forma basis; the increase in Jefferson s projected pro forma book value per share; the relative future growth prospects and fundamental performance of Jefferson and HomeTrust; the due diligence findings of PBS and Jefferson on their review of HomeTrust; and the results of Jefferson s process of contacting possible acquirers and PBS analysis of the potential acquirers and merger partners.

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Based on the results of the various analyses and other factors described above, PBS concluded that the consideration to be received by Jefferson s shareholders under the merger agreement was fair and equitable from a financial perspective to the shareholders of Jefferson.

PBS will receive total fees of $15,000 for all services performed in connection with the rendering of the Fairness Opinion. In addition, Jefferson has agreed to indemnify PBS and its directors, officers and employees from liability in connection with the transaction, and to hold PBS harmless from any losses, actions, claims, damages, expenses or liabilities related to any of PBS acts or decisions made in good faith and in the best interest of Jefferson.

HomeTrust Board of Directors Following Completion of the Merger

In accordance with the merger agreement, upon completion of the merger, HomeTrust will increase the size of each of the HomeTrust and HomeTrust Bank board of directors from twelve members to thirteen members and will appoint Anderson L. Smith to serve on each board until the annual meeting of shareholders in 2016.

Interests of Jefferson s Directors and Executive Officers in the Merger

Jefferson shareholders should be aware that some of Jefferson s directors and executive officers have interests in the merger and have arrangements that are different from, or in addition to, those of Jefferson shareholders generally. Jefferson s board of directors was aware of these interests and considered these interests, among other matters, when making its decision to approve the merger agreement, and in recommending that Jefferson shareholders vote in favor of adopting the merger agreement.

These interests include the following:

- Certain executive officers of Jefferson may be eligible for severance benefits under existing agreements with, and benefit plans offered by, Jefferson.

- Accelerated vesting of all of the unvested stock options held by Jefferson executive officers.

- Anderson L. Smith, President and Chief Executive Officer of Jefferson, will become the Eastern Tennessee Market President of HomeTrust Bank following the bank merger, has entered into an employment agreement with HomeTrust Bank that will become effective upon completion of the merger and will become a director of HomeTrust and HomeTrust Bank.

- John William Beard, Executive Vice President and Chief Credit Officer of Jefferson, will become East Tennessee Senior Officer of HomeTrust Bank following the bank merger and has entered into an employment agreement with HomeTrust Bank that will become effective upon completion of the merger.

- Gary L. Keys, Executive Vice President and Manager of Special Assets of Jefferson, will serve as a commercial relationship manager of HomeTrust Bank following the bank merger and has entered into an employment agreement with HomeTrust, to become effective upon completion of the merger. Further, pursuant to the merger agreement, each director of Jefferson has delivered to HomeTrust an executed voting agreement, and a resignation, non-solicitation and confidentiality agreement effective upon the closing of the merger, each in the form attached as an exhibit to the merger agreement for no additional consideration.

Equity Interests of Directors and Executive Officers

Stock Options. Each Jefferson stock option issued under the Jefferson Federal Savings and Loan Association Stock Option Plan and the Jefferson Bancshares, Inc. 2004 Stock-Based Incentive Plan with an exercise price per share that is less than $8.00 per share and is outstanding immediately prior to the merger will be cancelled by Jefferson at the time of the merger or immediately prior to the merger and entitle its holder to receive a cash

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payment from Jefferson equal to: (i) the excess of (A) $8.00 per share over (B) the exercise price per share of the Jefferson stock option, multiplied by (ii) the number of shares of Jefferson common stock subject to such Jefferson stock option. All Jefferson stock options with an exercise price per share equal to or greater than $8.00 per share will, at the time of the merger or immediately prior to the merger, be cancelled and terminated.

New Employment Agreements

In connection with the execution of the merger agreement, HomeTrust entered into employment agreements with Messrs. Smith, Beard and Keys, executive officers of Jefferson. As described below, these agreements set forth the terms and conditions of each such individual s employment with HomeTrust Bank that will be effective upon and subject to the completion of the merger. When effective, the employment agreements will also supersede and replace any prior Jefferson employment, retention, pre-existing change of control or other similar agreement with Messrs. Smith, Beard and Keys.

The employment agreements with Messrs. Smith, Beard and Keys have initial terms of two years from completion of the merger. Mr. Smith will serve as HomeTrust Bank s Eastern Tennessee President, Mr. Beard will serve as HomeTrust Bank s Eastern Tennessee Senior Credit Officer and Mr. Keys will serve as a commercial relationship manager.

The employment agreements provide for annual base salaries of $210,000, $175,000 and $155,000 for Messrs. Smith, Beard and Keys, respectfully. Mr. Smith s employment agreement also provides for a lump sum payment in the amount of $300,000 in full satisfaction of the change in control benefits provided under his prior Jefferson employment agreement and a loan of $200,000. Each required loan payment is expected to be forgiven as additional compensation to Mr. Smith.

The employment agreements for the executives contain restrictive covenants prohibiting the unauthorized disclosure of confidential information of HomeTrust Bank by the executives during and after their employment, prohibiting each executive from competing with HomeTrust Bank and from soliciting HomeTrust Bank s employees or customers, in each case during employment and for two years after termination of employment.

A Jefferson Director will Become a HomeTrust Director.

Following the completion of the merger, Anderson L. Smith, director, President and Chief Executive Officer of Jefferson will join the board of directors of HomeTrust and HomeTrust Bank for a term expiring at the HomeTrust 2016 annual meeting of shareholders. As an employee director, he will not be entitled to any separate compensation as a director of HomeTrust or HomeTrust Bank.

Mr. Smith has served as the President and Chief Executive Officer of Jefferson Federal Bank and Jefferson since January 2002 and March 2003, respectively, and has been a director of Jefferson Federal Bank since 2002. Prior to joining Jefferson Federal, Mr. Smith was President, Consumer Financial Services - East Tennessee Metro, First Tennessee Bank, National Association. Mr. Smith is 65 years old.

Executive Compensation

Summary Compensation Table. The following sets forth information regarding the executive compensation paid to Mr. Smith by Jefferson:

	Fiscal Year	Salary(1)	Bonus	Stock Awards	Option Awards	All Other Compensation(2)	Total
Anderson L. Smith	2013	$ 229,200	$	$	$	$ 26,113	$ 255,312
President and Chief	2012	231,000				30,806	261,806
Executive Officer	2011	231,700				27,525	259,225

(1) Includes $19,200, $21,000 and $17,700 in Board fees for fiscal 2013, 2012 and 2011, respectively.

(2) Details of the amounts reported in the All Other Compensation column for fiscal 2013 are provided in the table below:

Market value of ESOP contributions	$ 5,318
Taxable fringe benefits	3,600
Perquisites	12,000(a)
BOLI	5,195

(a) Consisted of an automobile allowance.

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Employment Agreement. Jefferson and Jefferson Federal Bank maintain an employment agreement with Anderson L. Smith. The initial term of the employment agreement was for three years beginning on June 25, 2003. The employment agreement provides the Boards of Directors of Jefferson and Jefferson Federal Bank with the authority to extend the term of the agreement for an additional year on each anniversary date of the initial agreement, unless a request for non-renewal is given by Mr. Smith. The Boards of Directors of Jefferson and Jefferson Federal Bank have extended the term of Mr. Smith s employment agreement through June 25, 2014. The employment agreement provides that Mr. Smith s base salary is to be reviewed annually. Mr. Smith s current base salary under the employment agreement is $210,000. In addition to base salary, the employment agreement provides for, among other things, participation in stock benefit plans and other fringe benefits applicable to executive personnel. In addition, the agreement provides Mr. Smith with a bonus opportunity to earn up to 50% of his base salary, on an annual basis, if certain performance criteria are met. The performance criteria and the amount of potential bonus are determined on an annual basis. Mr. Smith s employment agreement also provides for an annual supplemental retirement benefit of $15,083 payable each year over a 15 year period commencing in the year Mr. Smith attains age 65. In addition, Mr. Smith s employment agreement provides for a death benefit of not less than $350,000 through a supplemental life insurance policy. Upon termination of employment Jefferson or Jefferson Federal Bank for any reason, Mr. Smith is subject to a two year non-competition agreement.

Outstanding Equity Awards at June 30, 2013. The following table provides information concerning outstanding unexercised options and stock awards that had not vested for Mr. Smith as of June 30, 2013. No stock options were exercised by Mr. Smith during the 2013 fiscal year and no stock awards vested during the 2013 fiscal year. As indicated below, all stock options held by Mr. Smith at June 30, 2013 expired on January 29, 2014.

	Option Awards				Stock Awards	
Name	**Number of Securities Underlying Unexercised Options (#) Exercisable**	**Number of Securities Underlying Unexercised Options (#) Unexercisable**	**Option Exercise Price ($)**	**Option Expiration Date**	**Number of Shares or Units of Stock That Have Not Vested (#)**	**Market Value of Shares or Units of Stock That Have Not Vested ($)**
Anderson L. Smith	69,875		$ 13.69	01/29/2014		$

Nonqualified Deferred Compensation. Jefferson Federal Bank maintains a supplemental executive retirement plan which provides restorative payments to executives designated by the Board of Directors who are prevented from receiving the full benefits contemplated by the employee stock ownership plan s benefit formula due to limitations imposed by the Internal Revenue Code. The restorative payments under the supplemental executive retirement plan consist of payments in lieu of shares that cannot be allocated to the participant s account under the employee stock ownership plan. In addition to providing for benefits lost under the employee stock ownership plan as a result of limitations imposed by the Internal Revenue Code, the supplemental executive retirement plan also provides supplemental benefits to participants upon a Change in Control (as defined in the plan) before the complete scheduled repayment of the employee stock ownership plan loan. See *Potential Post-Termination Benefits* below for a more complete discussion of these benefits upon a change in control.

The Board of Directors has designated Mr. Smith as a participant in the supplemental executive retirement plan. The following table provides information with respect to the above described supplemental executive retirement plan in which Mr. Smith participated during fiscal 2013.

Name	Plan Name	Registrant Contributions in Last Fiscal Year ($)	Aggregate Balance at Last Fiscal Year End ($)
Anderson L. Smith	Supplemental Executive Retirement Plan		$ 8,414

Potential Post-Termination Benefits

Payments Made Upon Termination for Cause. Under the terms of the employment agreement with Mr. Smith, if Mr. Smith is terminated for cause, he will receive his base salary through the date of termination and retain the rights to any vested benefits under the Jefferson Federal tax-qualified plans. In addition, Mr. Smith will retain all vested benefits under the supplemental executive retirement plan.

Payments Upon Termination Without Cause or for Good Reason. Under the terms of his employment agreement, if Mr. Smith resigns after specified circumstances that would constitute constructive termination, he (or, if he dies, his beneficiary) would be entitled to receive an amount equal to his base salary due for the remaining term of his agreement, and he will receive the contributions that would have been made on his behalf during the remaining term of his agreement to any of our employee benefit plans. Jefferson would also continue and/or pay for Mr. Smith s life, health and disability coverage for the remaining term of the employment agreement. In addition, Mr. Smith would also be subject to a two year non-compete following termination of employment without cause or for Good Reason (as defined in Mr. Smith s employment agreement).

Payments Upon Disability. If Mr. Smith becomes disabled and his employment terminates, he will receive disability pay equal to 75% of his weekly rate of base salary in effect as of the date of his termination of employment due to disability. Mr. Smith is entitled to receive disability payments until the earlier of: (i) the date he returns for full employment with us; (ii) his death; or (iii) the date his employment agreement terminates. All disability payments are reduced by the amount of any short-term or long-term disability benefits payable under Jefferson s disability plans. Mr. Smith would continue to receive insurance coverage for the earlier of the events stated above if employment termination occurs due to his disability.

Payments Made Upon Death. Under the terms of the employment agreement with Mr. Smith, the agreement terminates upon Mr. Smith s death and Mr. Smith s beneficiary or estate is entitled to receive the compensation due to Mr. Smith through the last day of the month of Mr. Smith s death. In addition, Mr. Smith s beneficiary or estate would be entitled to a distribution of his accrued benefit under the supplemental executive retirement plan upon Mr. Smith s death.

Payments Made Upon a Change in Control. Mr. Smith s employment agreement provides for severance payments and other benefits in the event Mr. Smith is terminated without cause or he elects to terminate his employment agreement with good reason (as defined in the agreement) in connection with any change in control of Jefferson or Jefferson Federal Bank. In the event of a change in control (as defined in the agreement) followed by Mr. Smith s voluntary (upon circumstances discussed in the agreement) or involuntary termination of employment, Mr. Smith (or his beneficiary) would be entitled to a severance payment equal to 2.99 times the average of his five preceding taxable years annual compensation (the base amount). In addition, Mr. Smith is entitled to receive the contributions he would have received under our retirement programs for a period of 36 months, as well as health, life and disability coverage for that same time period.

Section 280G of the Internal Revenue Code provides that severance payments that equal or exceed three times an individual s base amount are deemed to be excess parachute payments if they are contingent upon a change in control. Individuals receiving excess parachute payments are subject to a 20% excise tax on the amount of the payment in excess of the base amount, and Jefferson Federal would not be entitled to deduct such an amount. As a result, Mr. Smith s employment agreement provides that the total value of the benefits provided and payments made to Mr. Smith in connection with a change in control may not exceed three times Mr. Smith s base amount (the 280G Limit).

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Jefferson maintains a supplemental executive retirement plan that provides Mr. Smith with a cash payment in the event of a change in control equal to the benefit that he would have received under our employee stock ownership plan, had he remained employed throughout the term of the loan, less the benefits actually provided under the employee stock ownership plan on his behalf. The plan also provides Mr. Smith with a stock benefit equal to the shares of our stock he would have received under Jefferson s employee stock ownership plan had he not been limited by certain provisions of the Internal Revenue Code.

Under the terms of the employee stock ownership plan, upon a change in control (as defined in the plan), the ESOP will terminate and the plan trustee will repay in full any outstanding acquisition loan. After repayment of the acquisition loan, all remaining shares of Jefferson stock held in the loan suspense account, all other stock or securities, and any cash proceeds from the sale or other disposition of any shares of Jefferson common stock held in the loan suspense account will be allocated among the accounts of all participants in the employee stock ownership plan who were employed by us on the date immediately preceding the effective date of the change in control. The allocations of shares or cash proceeds shall be credited to each eligible participant in proportion to the opening balances in their accounts as of the first day of the valuation period in which the change in control occurred. Payments under Jefferson s employee stock ownership plan are not categorized as parachute payments and, therefore, do not count towards an executive s 280G Limit.

Indemnification and Insurance.

As described under The Merger Agreement Director and Officer Indemnification and Insurance for a period of six years following the merger, HomeTrust will maintain and preserve the rights to indemnification of Jefferson s directors and officers, to the maximum extent permitted by Jefferson s charter, bylaws and applicable law, in connection with any claims arising out of or relating to matters existing or occurring at or prior to completion of the merger, and will provide directors and officers liability insurance with respect to claims against Jefferson indemnified persons arising from facts or events occurring upon or before completion of the merger, including the transactions contemplated by the merger agreement.

Merger-Related Compensation for Jefferson s Named Executive Officers

This section sets forth the information required by Item 402(t) of SEC Regulation S-K regarding the compensation that will or may become payable to Jefferson s named executive officers (as defined under SEC rules) that is based on or otherwise relates to the merger. Jefferson shareholders are being asked to approve, on a non-binding, advisory basis, such compensation for these executive officers (see Jefferson Proposals Jefferson Compensation Proposal beginning on page [ ]). Because the vote to approve such compensation is advisory only, it will not be binding on either HomeTrust or Jefferson. Accordingly, if the merger is completed, the compensation will be paid (or payable) regardless of the outcome of the vote to approve such compensation, subject only to the conditions applicable thereto, which are described below. Except as noted in the footnotes to the table, the amounts indicated below are estimates of amounts that would be payable if the merger were consummated on March 31, 2014. See the footnotes to the table for additional information.

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Name	Cash	Equity	Pension/ Nonqualified Deferred Compensation	Perquisites/ Benefits	Tax Reimbursement	Other	Total
Anderson L. Smith	$ 300,000(1)	$	$ 12,784(2)	$	$	$ 200,000(3)	$ 512,784
John W. Beard, Jr.							
Gary L. Keys							

(1) Represents a lump sum cash payment in full satisfaction of the change in control benefits payable to Mr. Smith under his employment agreement with Jefferson and to be paid by HomeTrust. See Interests of Jefferson s Directors and Executive Officers in the Merger New Employment Agreements.
(2) Represents a payment under the Jefferson Federal Bank supplemental executive retirement plan.
(3) Represents a loan from HomeTrust. Each required loan payment is expected to be forgiven as additional compensation to Mr. Smith.

Regulatory Approvals

Under applicable law, the merger must be approved by the Federal Reserve Board, and the bank merger must be approved by the OCC. The U.S. Department of Justice may review the impact of the merger and the bank merger on competition.

We have requested a waiver from the Federal Reserve Board of its application requirements that would apply to the merger. Assuming this waiver is granted by the Federal Reserve Board and the OCC approve the bank merger, we must wait for up to 30 days before we can complete the merger. If, however, there are no adverse comments from the U.S. Department of Justice and we receive permission from the OCC to do so, the merger may be completed on or after the 15th day after approval from the OCC.

As of the date of this proxy statement/prospectus, all of the required applications have been filed. There can be no assurance as to whether all regulatory approvals will be obtained or as to the dates of the approvals. There also can be no assurance that the regulatory approvals received will not contain a condition or requirement that results in a failure to satisfy the conditions to closing set forth in the merger agreement. See The Merger Agreement Conditions to Complete the Merger.

Accounting Treatment

In accordance with current accounting guidance, the merger will be accounted for using the acquisition method in accordance with FASB Topic 805, Business Combinations. The result of this is that the recorded assets and liabilities of HomeTrust will be carried forward at their recorded amounts, the historical operating results will be unchanged for the prior periods being reported on and that the assets and liabilities of Jefferson will be adjusted to fair value at the date of the merger. In addition, all identified intangibles will be recorded at fair value and included as part of the net assets acquired. To the extent that the purchase price, consisting of cash plus the number of shares of HomeTrust common stock to be issued to former Jefferson shareholders, at fair value, exceeds the fair value of the net assets including identifiable intangibles of Jefferson at the merger date, that amount will be reported as goodwill. In accordance with current accounting guidance, goodwill will not be amortized but will be evaluated for impairment annually. Identified intangibles will be amortized over their estimated lives. Further, the acquisition method of accounting results in the operating results of Jefferson being included in the operating results of HomeTrust beginning from the date of completion of the merger.

Jefferson Shareholder Dissenters Rights

Jefferson shareholders are not entitled to dissenters or appraisal rights in connection with the merger.

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HomeTrust s Dividend Policy

The holders of HomeTrust common stock receive cash dividends if and when declared by the HomeTrust board of directors out of legally available funds. The timing and amount of cash dividends depends on HomeTrust s earnings, capital requirements, financial condition, cash on hand and other relevant factors. HomeTrust also has the ability to receive dividends or capital distributions from its bank subsidiary, HomeTrust Bank. There are regulatory restrictions on the ability of HomeTrust Bank to pay dividends. As a savings and loan holding company, HomeTrust s ability to pay dividends is subject to the guidelines of the Federal Reserve Board regarding capital adequacy and dividends and limitations under Maryland law. To date, HomeTrust has not paid any cash dividends. No assurances can be given that any cash dividends will be paid by HomeTrust on its common stock or that any such dividends, if paid, will not be reduced or eliminated in future periods. For additional information, see Comparative Market Prices and Dividends on Common Stock.

Public Trading Markets

HomeTrust s common stock and Jefferson s common stock are listed on NASDAQ under the symbols HTBI and JFBI, respectively. Upon completion of the merger, Jefferson common stock will be delisted from NASDAQ and thereafter will be deregistered under the Exchange Act. The shares of HomeTrust common stock issuable in the merger for shares of Jefferson common stock will be listed on NASDAQ.

Litigation Relating to the Merger

On January 31, 2014, a class action complaint, captioned William P. Cooper III v. Jefferson Bancshares, Inc., et al., was filed under Case No. 2014-cv-35 in the Chancery Court of Hamblen County, Tennessee, against Jefferson, its directors, Jefferson Federal Bank, HomeTrust and HomeTrust Bank challenging the merger. On April 1, 2014, the plaintiff filed an amended class action complaint. The complaint alleges, among other things, that the Jefferson directors breached their fiduciary duties to Jefferson and its stockholders by agreeing to the proposed merger at an unfair price pursuant to a flawed sales process, by agreeing to terms with HomeTrust that discourages other bidders and by filing an initial Form S-4 registration statement which included a preliminary proxy statement/prospectus that purportedly omits material information. The plaintiff further alleges that Jefferson s directors and officers were not independent or disinterested with respect to the merger. The plaintiff also alleges that HomeTrust and HomeTrust Bank aided and abetted the Jefferson directors breaches of fiduciary duties. The complaint seeks, among other things, an order enjoining the defendants from consummating the merger, as well as attorneys and experts fees and certain other damages. Jefferson, its directors, and HomeTrust believe this action is without merit and intend to vigorously defend against the lawsuit.

THE MERGER AGREEMENT

The following describes certain aspects of the merger, including certain material provisions of the merger agreement. The following description of the merger agreement is subject to, and qualified in its entirety by reference to, the merger agreement, which is attached to this proxy statement/prospectus as ***Appendix A*** *and is incorporated by reference into this proxy statement/prospectus. We urge you to read the merger agreement carefully and in its entirety, as it is the legal document governing the merger.*

Structure of the Merger

Each of HomeTrust s and Jefferson s board of directors has approved the merger agreement. The merger agreement provides for the merger of Jefferson with and into HomeTrust, with HomeTrust continuing as the surviving corporation. Immediately following the completion of the merger, Jefferson s wholly owned subsidiary bank, Jefferson Federal Bank, will merge with HomeTrust s wholly owned subsidiary bank, HomeTrust Bank.

Merger Consideration

Consideration for Holders of Jefferson Common Stock

If the merger is completed, each share of Jefferson common stock that is issued and outstanding immediately prior to the completion of the merger, excluding unallocated shares held by the Jefferson Federal Bank Employee Stock Ownership Plan and shares of Jefferson common stock that are owned by Jefferson or HomeTrust (other than shares held in a fiduciary or agency capacity for third parties and other than shares held in respect of a debt previously contracted), will be converted into the right to receive, promptly following the completion of the merger: (1) $4.00 in cash and (2) a number of shares of HomeTrust common stock equal to $4.00 divided by the average HomeTrust common stock price, subject to adjustment (the exchange ratio). If the average HomeTrust common stock price is equal to or less than $15.00 per share, then the exchange ratio will instead be fixed at .2667 per share. If the average HomeTrust common stock price is equal to or greater than $18.00 per share, then the exchange ratio will be fixed at .2222 per share. HomeTrust will not issue any fractional shares of HomeTrust common stock in the merger. Jefferson shareholders who would otherwise be entitled to a fractional share of HomeTrust common stock upon completion of the merger will instead receive an amount in cash equal to such fractional share interest multiplied by the average HomeTrust common stock price. We refer to this cash and stock consideration described above as the merger consideration.

For example, assuming the average closing price was $15.85, the closing price of HomeTrust common stock on January 22, 2014, the last trading day immediately prior to the public announcement of the merger agreement, the exchange ratio would then be .2524 ($4.00 divided by $15.85), if you hold 1,000 shares of Jefferson common stock, then for the stock portion of the merger consideration, you will receive 252 shares of HomeTrust common stock (1,000 shares × .2524 = 252 whole shares) and a cash payment of $6.34 instead of the .40 fractional share of HomeTrust common stock (.40 × $15.85 = $6.34), and for the cash portion of the merger consideration, you will receive a cash payment of $4,000 (1,000 × $4.00).

Treatment of Jefferson Stock Options

Each Jefferson stock option issued under the Jefferson Federal Savings and Loan Association Stock Option Plan and the Jefferson Bancshares, Inc. 2004 Stock-Based Incentive Plan with an exercise price per share that is less than $8.00 per share and is outstanding immediately prior to the merger will be cancelled by Jefferson at the time of the merger or immediately prior to the merger and entitle its holder to receive a cash payment from Jefferson equal to: (i) the excess of (A) $8.00 per share over (B) the exercise price per share of the Jefferson stock option, multiplied by (ii) the number of shares of Jefferson common stock subject to such Jefferson stock option. All Jefferson stock options with an exercise price per share equal to or greater than $8.00 per share will, at the time of the merger or immediately prior to the merger, be cancelled and terminated.

Closing and Effective Time of the Merger

The merger will be completed only if all conditions to the merger set forth in the merger agreement are either satisfied or waived. See Conditions to Complete the Merger.

The merger will become effective as set forth in the articles of merger to be filed with the Secretary of State of the State of Tennessee and the Department of Assessments and Taxation for the State of Maryland. The closing of the merger will be made on or before the last day of the month (but no earlier than five business days) after all of the conditions to completion of the merger have been satisfied or waived (other than those that by their nature are to be satisfied or waived at the closing of the merger). It currently is anticipated that the closing of the merger will occur in the first half of 2014, subject to the receipt of regulatory approvals and other customary closing conditions. No assurances can be given as to when or if the merger will be completed.

Conversion of Shares; Exchange Procedures

The conversion of Jefferson stock into the right to receive the merger consideration will occur automatically at the effective time of the merger. Prior to the effective time of the merger, HomeTrust will appoint its transfer agent or an unrelated bank or trust company, as is reasonably acceptable to Jefferson, to act as exchange agent for the exchange of Jefferson common stock for the merger consideration.

Letter of Transmittal

Within ten days after completion of the merger, the exchange agent will mail to each holder of record of shares of Jefferson common stock immediately prior to the effective time of the merger: (1) a letter of transmittal and instructions on how to surrender such shares in exchange for the merger consideration the holder is entitled to receive under the merger agreement; and (2) instructions for surrendering each certificate in exchange for the merger consideration, any cash in lieu of a fractional share of HomeTrust common stock and any dividends or distributions to which such holder is entitled.

If a certificate for Jefferson common stock has been lost, stolen or destroyed, the exchange agent will issue the merger consideration upon receipt of (1) an affidavit of that fact by the claimant and (2) if required by HomeTrust or the exchange agent, the posting of a bond in an amount as HomeTrust may determine is reasonably necessary as indemnity against any claim that may be made against it with respect to such certificate.

After completion of the merger, there will be no further transfers on the stock transfer books of Jefferson of shares of Jefferson stock that were issued and outstanding immediately prior to the effective time of the merger.

Withholding

HomeTrust or the exchange agent will be entitled to deduct and withhold from any cash consideration payable under the merger agreement to any holder of Jefferson common stock and, from any cash payments made to holders of Jefferson stock options, the amounts it is required to deduct and withhold under the Code or any provision of state, local or foreign tax law. If any such amounts are withheld and paid over to the appropriate governmental authority, these amounts will be treated for all purposes of the merger agreement as having been paid to the persons from whom they were withheld.

Dividends and Distributions

No dividends or other distributions declared with respect to HomeTrust common stock will be paid to the holder of any unsurrendered shares of Jefferson common stock until the holder surrenders such shares in accordance with the merger agreement. After the surrender of such shares in accordance with the merger agreement, the record holder thereof will be entitled to receive any such dividends or other distributions, with a record date after the effective time of the merger, without any interest, which had previously become payable with respect to the whole shares of HomeTrust common stock which the shares of Jefferson common stock have been converted into the right to receive under the merger agreement.

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Representations and Warranties

The representations, warranties and covenants described below and included in the merger agreement were made only for purposes of the merger agreement and as of specific dates, are solely for the benefit of HomeTrust and Jefferson, may be subject to limitations, qualifications or exceptions agreed upon by the parties, including those included in confidential disclosures made for the purposes of, among other things, allocating contractual risk between HomeTrust and Jefferson rather than establishing matters as facts, and may be subject to standards of materiality that differ from those standards relevant to shareholders. You should not rely on the representations, warranties, covenants or any description thereof as characterizations of the actual state of facts or condition of HomeTrust, Jefferson or any of their respective subsidiaries or affiliates. Moreover, information concerning the subject matter of the representations, warranties and covenants may change after the date of the merger agreement, which subsequent information may or may not be fully reflected in public disclosures by HomeTrust or Jefferson. The representations and warranties and other provisions of the merger agreement should not be read alone, but instead should be read only in conjunction with the information provided elsewhere in this proxy statement/prospectus and in the documents incorporated by reference into this proxy statement/prospectus. See Where You Can Find More Information.

The merger agreement contains customary representations and warranties of each of HomeTrust and Jefferson relating to their respective businesses. The representations and warranties in the merger agreement do not survive completion of the merger.

The representations and warranties made by each of Jefferson and HomeTrust in the merger agreement relate to a number of matters, including the following:

- corporate matters, including due organization and qualification and subsidiaries;
- capitalization;
- authority relative to execution and delivery of the merger agreement and the absence of conflicts with, or violations of, organizational documents or other obligations as a result of the merger or bank merger;
- required governmental and other regulatory filings, consents and approvals in connection with the merger and the bank merger;
- reports to regulatory authorities;
- financial statements, internal controls, books and records, and absence of undisclosed liabilities;
- broker s fees payable in connection with the merger;

the absence of certain changes or events;

legal proceedings;

tax matters;

employee benefit matters;

SEC reports;

compliance with applicable laws;

- in the case of Jefferson, certain contracts;
- absence of agreements with regulatory authorities;
- derivative instruments and transactions;
- environmental matters;
- investment securities, commodities and, in the case of Jefferson, bank owned life insurance;
- real property;
- intellectual property;
- in the case of Jefferson, related party transactions;
- inapplicability of takeover statutes;
- absence of action or circumstance that would prevent the merger or the bank merger from qualifying as a reorganization under Section 368(a) of the Code;
- receipt of a fairness opinion from its investment advisor and the absence of any amendment or rescission thereof;
- the accuracy of information supplied for inclusion in this proxy statement/prospectus and other documents;
- loan matters; and
- insurance matters.

Certain representations and warranties of HomeTrust and Jefferson are qualified as to materiality or material adverse effect. For purposes of the merger agreement, a material adverse effect, when used in reference to either HomeTrust, Jefferson or the combined company, means:

(1) a material adverse effect on the business, properties, results of operations or financial condition of such party and its subsidiaries taken as a whole (provided that a material adverse effect will not be deemed to include the impact of (A) changes, after the date of the merger agreement, in GAAP or applicable regulatory accounting requirements, (B) changes, after the date of the merger agreement, in laws, rules or regulations of general applicability to companies in the industries in which such party and its subsidiaries operate, or interpretations thereof by courts or governmental entities, (C) changes, after the date of the merger agreement, in global, national or regional political conditions (including the outbreak of war or acts of terrorism) or in economic or market (including equity, credit and debt markets, as well as changes in interest rates) conditions affecting the financial services industry generally, (D) public disclosure of the transactions contemplated by the merger agreement or actions or inactions expressly required by the merger agreement or that are taken with the prior written consent of the other party in contemplation of the transactions contemplated by the merger agreement, or (E) a decline in the trading price of a party s common stock or the failure, in and of itself, to meet earnings projections, but not, in either case, including the underlying causes thereof; except, with respect to subclauses (A), (B), or (C), to the extent that the effects of such change are materially disproportionately adverse to the business, properties, assets, liabilities, results of operations or financial condition of such party and its subsidiaries, taken as a whole, as compared to other companies in the industry in which such party and its subsidiaries operate); or

(2) a material adverse effect on the ability of such party or its savings bank subsidiary to timely consummate the transactions contemplated by the merger agreement.

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Covenants and Agreements

Conduct of Businesses Prior to the Completion of the Merger

Pursuant to the merger agreement, each of Jefferson and HomeTrust has agreed to certain restrictions on its activities until the merger is completed or terminated. In general, each party has agreed that, except as otherwise permitted by the merger agreement, or as required by applicable law or a governmental entity or with the prior written consent of the other party, it will:

- use commercially reasonable best efforts to maintain and preserve intact its business organization and advantageous business relationships;
- not take any action that is intended to or that would reasonably be expected to adversely affect or materially delay the ability of either party or its subsidiaries to obtain any necessary regulatory approvals or to complete the merger or bank merger;
- not take any action that is intended or that would reasonably be expected to cause the merger or the bank merger to fail to qualify as a reorganization under Section 368(a) of the Internal Revenue Code or cause any of its representations and warranties in the merger agreement to be untrue in any material respect or any of the conditions in the merger agreement to be unsatisfied or to result in a violation of any provision of the merger agreement; and
- not take any action that is likely to materially impair the party s ability to perform any of its obligations under the merger agreement or its subsidiary bank to perform any of its obligations under the bank merger agreement.

HomeTrust has also agreed that it will not and will not permit any of its subsidiaries to amend its articles of incorporation or bylaws in a manner that would adversely affect the economic benefits of the merger to the holders of Jefferson common stock.

Jefferson has also agreed that it will, and will cause each of its subsidiaries to, conduct its business in the ordinary course consistent with past practice in all material respects. Jefferson has further agreed that it will not, and will not permit any of its subsidiaries, to do any of the following without the prior written consent of HomeTrust:

- issue or sell, or authorize the creation of, any additional shares of its capital stock, other ownership interests or any warrants, options, rights, convertible securities or other arrangements or commitment to acquire any shares of the capital stock or other ownership interest, except pursuant to in-the-money Jefferson stock options outstanding on the date of the merger agreement;
- issue any other capital securities, including trust preferred or other similar securities, indebtedness with voting rights or other debt securities;

pay any dividends or other distributions on its capital stock, other than dividends from wholly owned subsidiaries to Jefferson or to another wholly owned subsidiary of Jefferson and regular distribution on Jefferson s trust preferred securities;

(i) enter into, modify, renew or terminate any employment, severance or similar agreement or arrangement with any director, officer, employee or independent contractor, or grant any salary or wage increase or increase any employee benefit (including incentive or bonus payments) other than (A) at will agreements, (B) normal increases in salary to rank and file employees, (C) severance in accordance with past practice and (D) changes that are required by applicable law; (ii) hire any new officers; (iii) promote any employee to a rank of vice president or higher; or (iv) pay expenses in excess of a specified amount for employees and directors to attend conventions or similar meetings;

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except as required by law, establish, modify, renew or terminate any employee benefit plan or take action to accelerate the vesting of benefits under any employee benefit plan;

sell, transfer, lease or encumber any of its assets, except in the ordinary course of business consistent with past practice, and in the case of a sale or transfer, at fair value, or sell or transfer any of its deposit liabilities;

enter into, modify or renew any data processing contract, service provider agreement or any lease, license or maintenance agreement relating to real or personal property or intellectual property, other than the annual renewal of an agreement that is necessary to operate its business in the ordinary course consistent with past practice, or permit to lapse its rights in any material intellectual property;

acquire the assets, business, deposits or properties of any person or entity, other than pursuant to foreclosure, in a fiduciary capacity or in satisfaction of debts contracted prior to the date of the merger agreement;

sell or acquire any loans (excluding originations) or loan participations, except in the ordinary course of business consistent with past practice (but, in the case of a sale, after giving HomeTrust or HomeTrust Bank a first right of refusal to acquire such loan or participation), or sell or acquire any loan servicing rights;

amend its charter or bylaws or similar governing documents;

materially change its accounting principles, practices or methods, except as may be required by accounting principles generally accepted in the United States or any governmental entity;

enter into, materially modify, terminate or renew any Jefferson material contract as defined in the merger agreement;

settle any legal claims involving an amount in excess of $25,000, excluding amounts paid or reimbursed under any insurance policy;

foreclose upon any real property without obtaining a phase one environmental report, except for one- to four-family non-agricultural residential properties of five acres or less which Jefferson does not have reason to believe contains hazardous substances or might be in violation of or require remediation under environmental laws;

in the case of Jefferson Federal Bank, (i) voluntarily make a material change in its deposit mix; (ii) increase or decrease the interest rate paid on its time deposits or certificates of deposit except in a manner consistent with past practice and competitive factors in the marketplace; (iii) incur any liability or obligation relating to retail banking and branch merchandising, marketing and advertising activities and initiatives except in the ordinary course of business consistent with past practice; (iv) open any new branch of deposit taking facility; or (v) close or relocate any existing branch or other facility;

acquire any investment securities outside of the limits specified in the merger agreement;

make capital expenditures outside the limits specified in the merger agreement;

materially change its loan underwriting policies or make loans on extensions of credit in excess of amounts specified in the merger agreement;

invest in any new or existing joint venture or any new real estate development or construction activity;

materially change its interest rate and other risk management policies and practices;

incur any debt for borrowed funds other than in the ordinary course of business consistent with past practice with a term of one year or less;

create any lien on any of Jefferson s assets or properties other than pursuant to agreements with the Federal Home Loan Bank of Cincinnati and federal funds transactions;

make charitable contributions in excess of limits specified in the merger agreement;

enter into any new lines of business;

make, change or revoke any tax election, amend any tax return, enter into any tax closing agreement, or settle any liability with respect to disputed taxes; or

agree to take, make any commitment to take, in support of, any of the foregoing.

Regulatory Matters

HomeTrust has agreed to promptly prepare with Jefferson s assistance and file all necessary documentation, to effect all applications, notices, petitions and filings, to obtain as promptly as practicable all permits, consents, approvals and authorizations of all governmental entities which are necessary or advisable to consummate the transactions contemplated by the merger agreement. HomeTrust and Jefferson have also agreed to furnish each other with all information reasonably necessary or advisable in connection with any statement, filing, notice or application to any governmental entity in connection with the merger and the bank merger, as well as to keep each other apprised of the status of matters related to the completion of the transactions contemplated by the merger agreement or any condition or requirement, which individually or in the aggregate, is deemed unduly burdensome by HomeTrust, including any regulatory condition that would increase the minimum regulatory capital requirements of HomeTrust or HomeTrust Bank (an unduly burdensome condition).

Employee Benefit Plan Matters

Following the effective time of the merger, HomeTrust shall maintain or cause to be maintained employee benefit plans and compensation opportunities for the benefit of full-time active employees (as a group) who are employees of Jefferson and its subsidiaries on the merger closing date (referred to below as covered employees) which, in the aggregate, provide employee benefits and compensation opportunities which, in the aggregate, are substantially comparable and equivalent to the employee benefits and compensation programs that are made available on a uniform and non-discriminatory basis to similarly situated employees of HomeTrust or its subsidiaries, as applicable. Other than with respect to Jefferson s ESOP, which shall be terminated prior to or immediately upon the closing or the merger, until such time as HomeTrust causes covered employees to participate in the benefit plans that are made available to similarly situated employees of HomeTrust or its subsidiaries, a covered employee s continued participation in employee benefit opportunities of Jefferson and its subsidiaries will be deemed to satisfy this provision of the merger agreement. In no event will any covered employee be eligible to participate in any closed or frozen plan of HomeTrust or its subsidiaries.

To the extent that a covered employee becomes eligible to participate in a HomeTrust benefit plan, HomeTrust shall cause the plan to recognize full-time years of prior service from the date of the most recent hire of such covered employee with Jefferson and its subsidiaries, for purposes of eligibility, participation, vesting and, except under any plan that determines benefits on an actuarial basis, for benefit accrual, but only to the extent such service was recognized immediately prior to the merger closing date under a comparable Jefferson benefit plan in which such covered employee was eligible to participate immediately prior to completion of the merger. This recognition of service will not duplicate any benefits of a covered employee with respect to the same period of service.

With respect to any HomeTrust benefit plan that is a health, dental, vision or welfare plan, HomeTrust or a subsidiary of HomeTrust shall use commercially reasonable best efforts to cause the waiver of all limitations as to pre-existing conditions and waiting periods with respect to participation and coverage requirements applicable to the covered employees, to the extent such pre-existing condition was or would have been covered under a Jefferson benefit plan in which such covered employees participated immediately prior to the merger closing date.

Jefferson has agreed to take, and cause its subsidiaries to take, other than with respect to the termination of Jefferson s ESOP, all actions requested by HomeTrust that may be necessary or appropriate to (i) cause one or more Jefferson benefit plan to cease as of the effective time of the merger, or as of the date immediately preceding the effective time of the merger, (ii) cause benefit accruals and entitlements under any Jefferson benefit plan to cease as of the effective time of the merger, or as of the date immediately preceding the effective time, (iii) cause the continuation on and after the effective time of the merger, of any contract, arrangement or insurance policy relating to any Jefferson benefit plan for such period as may be requested by HomeTrust, and (iv) facilitate the merger of any Jefferson benefit plan into any employee benefit plan maintained by HomeTrust or a HomeTrust subsidiary.

HomeTrust has agreed that HomeTrust Bank will assume and honor the obligations of Jefferson Federal Bank for severance benefits under the amended and restated change in control severance plan of Jefferson Federal Bank, subject to such plan being amended as provided in the merger agreement.

Director and Officer Indemnification and Insurance

For a period of six years following the merger, HomeTrust will maintain and preserve the rights to indemnification of Jefferson s directors and officers, to the maximum extent permitted by Jefferson s charter, bylaws and applicable law, in connection with any claims arising out of or relating to matters existing or occurring at or prior to the effective time of the merger, including the transactions contemplated by the merger agreement.

For a period of six years following the effective time of the merger, HomeTrust will provide, at HomeTrust s expense, directors and officers liability insurance with respect to claims against Jefferson indemnified persons arising from facts or events occurring at or before the effective time of the merger, including the transactions contemplated by the merger agreement. This insurance must be equivalent to the coverage currently provided by Jefferson but the cost thereof is limited to 200% of Jefferson s current annual premium for such insurance. Instead of providing this insurance coverage, Jefferson may, or at the request of HomeTrust shall, prior to the effective time of the merger, purchase a prepaid tail policy for directors and officers liability insurance provided that the cost thereof is limited to 450% of the current annual premium for such insurance.

Trust Preferred Securities

The merger agreement provides that upon completion of the merger, HomeTrust will assume the performance and observance of the covenants to be performed by Jefferson under an indenture relating to $10.31 million in trust preferred securities issued in 2006 and the due and punctual payment of the principal of and premium and interest on such trust preferred securities. In connection with such assumption, HomeTrust has agreed to enter into any supplemental indentures or other documents as necessary to make such assumption effective.

Shareholder Meeting and Recommendation of Jefferson s Boards of Directors

Jefferson has agreed to hold the Jefferson special meeting for the purpose of voting upon the Jefferson merger proposal and compensation proposals within 40 days after notice of the Jefferson special meeting is given. The board of directors of Jefferson has agreed to use its commercially reasonable best efforts to hold the Jefferson special meeting to obtain from its shareholders the vote required to approve the Jefferson merger proposal, including by communicating to its shareholders its recommendation (and including such recommendation in this proxy statement/prospectus) that they approve the merger agreement and the transactions contemplated thereby.

Notwithstanding any change in recommendation by the board of directors of Jefferson, unless the merger agreement has been terminated in accordance with its terms, Jefferson is required to convene the Jefferson special meeting and to submit the merger agreement to a vote of its shareholders. Jefferson will adjourn or postpone the Jefferson special meeting if there are insufficient shares of Jefferson common stock, represented (either in person or by proxy) to constitute a quorum necessary to conduct the business of such meeting.

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Agreement Not to Solicit Other Offers

Jefferson has agreed that, from the date of the merger agreement until the effective time of the merger or, if earlier, the termination of the merger agreement, it will not, and will cause its subsidiaries not to: (i) initiate, solicit, encourage or knowingly facilitate inquiries or proposals with respect to, or engage in any discussions or negotiations concerning, or provide to any person any confidential or nonpublic information concerning, its and its subsidiaries business, properties or assets with respect to an acquisition proposal; or (ii) have any discussions with any person or entity relating to an acquisition proposal.

Notwithstanding this agreement, if Jefferson receives an unsolicited written acquisition proposal prior to shareholder approval of the Jefferson merger proposal, that Jefferson s board of directors determines in good faith will constitute or result in a transaction that is more favorable from a financial point of view to the shareholders of Jefferson than the merger with HomeTrust (referred to as a superior proposal), Jefferson may provide confidential information to and negotiate with the third party that submitted such acquisition proposal if the Jefferson board of directors determines in good faith, after consulting with counsel, that the failure to do so would reasonably be likely to violate the board s fiduciary duties. In order to constitute a superior proposal, an acquisition proposal must be for a tender or exchange offer, for a merger or consolidation or other business combination involving Jefferson or Jefferson Federal Bank or for the acquisition of a majority of the voting power in, or a majority of the fair market value of the business, assets or deposits of, Jefferson or Jefferson Federal Bank. Jefferson must promptly advise HomeTrust of any acquisition proposal received and keep it apprised of any related developments.

The merger agreement generally prohibits the Jefferson board of directors from withdrawing or modifying in a manner adverse to HomeTrust the board s recommendation that Jefferson s shareholders vote to approve the merger agreement (referred to as a change in recommendation). At any time prior to the approval of the merger agreement by Jefferson s shareholders, however, the Jefferson board of directors may effect a change in recommendation in response to a bona fide written unsolicited acquisition proposal that the board determines in good faith, after consultation with outside legal counsel, constitutes a superior proposal. The Jefferson board of directors may not make a change in recommendation in response to a superior proposal, or terminate the merger agreement to pursue a superior proposal, unless it has given HomeTrust at least four business days to propose a modification to the merger agreement and, after considering any such proposed modification, the board determines in good faith, after consultation with counsel, that the proposal continues to constitute a superior proposal.

If HomeTrust terminates the merger agreement based on a change in recommendation by the Jefferson board of directions or Jefferson terminates the merger agreement to pursue a superior proposal, Jefferson will be required to pay HomeTrust a termination fee of $1.95 million in cash. See -Termination of the Merger Agreement.

Conditions to Complete the Merger

HomeTrust s and Jefferson s respective obligations to complete the merger are subject to the satisfaction or, to the extent legally permitted, waiver of the following conditions:

- the approval of the Jefferson merger proposal by Jefferson s shareholders;

- the authorization for listing on NASDAQ, subject to official notice of issuance, of the shares of HomeTrust common stock to be issued in the merger;

the receipt of necessary regulatory approvals, including from the Federal Reserve Board and the OCC, and other approvals necessary to consummate the transactions contemplated by the merger agreement, without the imposition of an unduly burdensome condition and such authorizations, consents, orders and approvals shall remain in full force and effect and all statutory waiting period in respect thereof shall have expired;

the effectiveness of the registration statement of which this proxy statement/prospectus is a part, and the absence of any stop order (or proceedings for that purpose initiated or threatened and not withdrawn);

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- the absence of any order, injunction, decree or law preventing or making illegal the completion of the merger or the bank merger;

- subject to the standards set forth in the merger agreement, the accuracy of the representations and warranties of HomeTrust and Jefferson on the date of the merger agreement and the closing date of the merger and the receipt by each party of an officer s certificate from the other party to that effect;

- the performance by the other party in all material respects of all obligations required to be performed by it under the merger agreement and the receipt by each party of an officer s certificate from the other party to that effect;

- receipt by each party of an opinion of its legal counsel to the effect that on the basis of facts, representations and assumptions set forth or referred to in such opinion, the merger will qualify as a reorganization within the meaning of Section 368(a) of the Code; and

- as an additional condition to HomeTrust s obligation to complete the merger, receipt by Jefferson of all designated third party consents in form and substance reasonably satisfactory to HomeTrust.

Neither HomeTrust nor Jefferson can provide assurance as to when or if all of the conditions to the merger can or will be satisfied or waived by the appropriate party.

Termination of the Merger Agreement

The merger agreement can be terminated at any time prior to completion of the merger in the following circumstances:

- by mutual written consent of HomeTrust and Jefferson;

- by either HomeTrust or Jefferson if any governmental entity that must grant a required regulatory approval has denied approval of the merger or bank merger and such denial has become final and non-appealable or any governmental entity of competent jurisdiction has issued a final non-appealable order, injunction or decree permanently enjoining or otherwise prohibiting or making illegal the merger or bank merger, unless the failure to obtain a required regulatory approval is due to the failure of the party seeking to terminate the merger agreement to perform or observe its covenants and agreements under the merger agreement;

- by either HomeTrust or Jefferson if the merger has not been completed on or before September 30, 2014 (which we refer to as the termination date), unless the failure of the merger to be completed by that date is due to the failure of the party seeking to terminate the merger agreement to perform or observe its covenants and agreements under the merger agreement;

by either HomeTrust or Jefferson (provided that the terminating party is not then in material breach of any representation, warranty, covenant or other agreement contained in the merger agreement) if there is a breach of any of the covenants or agreements or any of the representations or warranties set forth in the merger agreement on the part of the other party which, either individually or in the aggregate, would constitute, if occurring or continuing on the date the merger is completed, the failure of a closing condition of the terminating party and which is not cured within 20 days following written notice to the party committing such breach, or by its nature or timing cannot be cured during such period (or such fewer days as remain prior to the termination date);

by HomeTrust, if the board of directors of Jefferson fails to recommend in this proxy statement/prospectus that its shareholders approve the merger proposal, or the Jefferson Board withdraws, modifies or makes or causes to be made by any third party or a public communication an announcement of its intention to modify or withdraw such recommendation in an adverse manner to HomeTrust or Jefferson materially breaches any of its obligations relating to third party acquisition proposals; or by either HomeTrust or Jefferson if the Jefferson special meeting has been held (including any postponement or adjournment thereof) and the required vote to approve the Jefferson merger proposal has not been obtained; provided in the case of a termination by Jefferson that Jefferson has complied in all material respects with its obligations under the merger agreement, including with respect to recommending approval of the Jefferson merger proposal and the non-solicitation of third party acquisition proposals; or

a termination by Jefferson prior to Jefferson obtaining shareholder approval of the merger agreement in order to enter into a definitive acquisition agreement with respect to a third party superior unsolicited acquisition proposal, provided Jefferson has not committed a material breach of its obligation with respect to third party acquisition proposals and concurrently with such termination pays HomeTrust a termination fee of $1.95 million in cash.

Effect of Termination

If the merger agreement is terminated, it will become void and have no effect, except that (1) both HomeTrust and Jefferson will remain liable for any liabilities or damages arising out of its willful and material breach of any provision of the merger agreement except, in the case of Jefferson, if the termination fee is paid, and (2) designated provisions of the merger agreement will survive the termination, including those relating to payment of fees and expenses.

Termination Fee

HomeTrust is entitled to a termination fee of $1.95 million from Jefferson if the merger agreement is terminated under the following circumstances:

a termination by HomeTrust based on (i) the board of directors of Jefferson either failing to continue its recommendation that the Jefferson shareholders approve the merger agreement or adversely changing such recommendation or (ii) Jefferson materially breaching the provisions of the merger agreement relating to the third party acquisition proposals;

a termination by Jefferson prior to it obtaining shareholder approval of the merger agreement in order to enter into a definitive acquisition agreement with respect to a third party superior unsolicited acquisition proposal as described above; or

a termination by either party as a result of the failure of Jefferson s shareholders to approve the merger agreement and if, prior to such termination, there is publicly announced a proposal for a tender or exchange offer, for a merger or consolidation or other business combination involving Jefferson or Jefferson Federal Bank or for the acquisition of a majority of the voting power in, or a majority of the fair market value of the business, assets or deposits of, Jefferson or Jefferson Federal Bank and, within one year of the termination, Jefferson or Jefferson Federal Bank either enters into a definitive agreement with respect to an acquisition proposal or consummates an acquisition proposal.

In the event of a willful and material breach of the merger agreement by Jefferson that would entitle HomeTrust to the termination fee, HomeTrust is not required to accept the termination fee from Jefferson and may pursue alternate relief against Jefferson.

Expenses and Fees

All costs and expenses incurred in connection with the merger agreement and the transactions contemplated thereby will be paid by the party incurring such expense, except that the costs and expenses of printing and mailing this proxy statement/prospectus will be paid by Jefferson and all filing and other fees paid to the SEC in connection with the merger will be paid by HomeTrust.

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Amendment, Waiver and Extension of the Merger Agreement

Subject to compliance with applicable law, the merger agreement may be amended by the parties at any time before or after approval of the merger agreement by the shareholders of Jefferson, except that after approval of the merger agreement by the shareholders of Jefferson, there may not be, without further approval of such shareholders, any amendment of the merger agreement that requires further approval of such shareholders under applicable law.

At any time prior to completion of the merger, the parties may, to the extent legally allowed, extend the time for the performance of any of the obligations or other acts of the other party, waive any inaccuracies in the representations and warranties contained in the merger agreement or in any document delivered pursuant to the merger agreement, and waive compliance with any of the agreements or satisfaction of any conditions contained in the merger agreement, except that after approval of the merger agreement by the Jefferson shareholders, there may not be, without further approval of such shareholders, any extension or waiver of the merger agreement or any portion of the merger agreement that requires further approval under applicable law.

Voting Agreements

As an inducement to HomeTrust to enter into the merger agreement, the directors of Jefferson have entered into voting agreements with HomeTrust with respect to the shares of Jefferson common stock they own. The following summary of the voting agreements is qualified in its entirety by reference to the form of voting agreement, a copy of which is attached as Exhibit A to the merger agreement, which is included in **Appendix A** to this proxy statement/prospectus.

Pursuant to the voting agreements, the directors of Jefferson have agreed:

- to vote, or cause to be voted, all of their shares of Jefferson common stock in favor of approval of the Jefferson merger proposal; and

- not to sell, transfer or otherwise dispose of any such shares of Jefferson common stock until after shareholder approval of the Jefferson merger proposal, as applicable, excluding (i) a transfer where the transferee has agreed in writing to abide by the terms of the voting agreement in a form reasonably satisfactory to HomeTrust, (ii) a transfer by will or operation of law, or (iii) a transfer made with the prior written consent of HomeTrust.

The obligations under each voting agreement will terminate concurrently with any termination of the merger agreement.

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UNAUDITED PRO FORMA COMBINED CONDENSED

CONSOLIDATED FINANCIAL INFORMATION

The following is the unaudited pro forma combined condensed consolidated financial information for HomeTrust and Jefferson Bancshares, giving effect to the merger without including the pro forma financial impact of the pending Bank of Commerce acquisition on HomeTrust. The unaudited pro forma combined condensed consolidated balance sheet as of December 31, 2013 gives effect to the merger as if it occurred on that date. The unaudited pro forma combined condensed consolidated statements of operations for the six months ended December 31, 2013 and the year ended June 30, 2013 give effect to the merger as if it occurred on July 1, 2012.

The unaudited pro forma combined condensed consolidated financial statements have been prepared using the acquisition method of accounting for business combinations under GAAP. HomeTrust is the acquirer for accounting purposes. Certain reclassifications have been made to the historical financial statements of Jefferson Bancshares to conform to the presentation in HomeTrust s financial statements.

A final determination of the fair values of Jefferson Bancshares s assets and liabilities, which cannot be made prior to the completion of the merger, will be based on the actual net tangible and intangible assets of Jefferson Bancshares that exist as of the date of completion of the transaction. Consequently, fair value adjustments and amounts preliminarily allocated to goodwill and identifiable intangibles could change significantly from those allocations used in the unaudited pro forma combined condensed consolidated financial statements presented herein and could result in a material change in amortization of acquired intangible assets. In addition, the value of the final purchase price of the merger will be determined based on HomeTrust s average closing stock price during the ten trading days ending on the fifth trading day prior to the closing date, with the exchange ratio fixed at 0.2667 if the average closing price is equal to or less than $15.00 per share and at 0.2222 if the average closing price is equal to or greater than $18.00 per share. For purposes of the accompanying pro forma financial information, the closing price of HomeTrust common stock on January 22, 2014, the last trading day before the day on which the merger agreement was publicly announced, was used for purposes of presenting the pro forma combined consolidated balance sheet at December 31, 2013.

In connection with the plan to integrate the operations of HomeTrust and Jefferson Bancshares following the completion of the merger, HomeTrust anticipates that nonrecurring charges, such as costs associated with systems implementation, severance and other costs related to exit or disposal activities, will be incurred. HomeTrust is not able to determine the timing, nature and amount of these charges as of the date of this document. However, these charges will affect the results of operations of HomeTrust and Jefferson Bancshares, as well as those of the combined company following the completion of the merger, in the period in which they are recorded. The unaudited pro forma combined condensed consolidated statements of operations do not include the effects of the nonrecurring costs associated with any restructuring or integration activities resulting from the merger, as they are nonrecurring in nature and not factually supportable at this time. Additionally, the unaudited pro forma adjustments do not give effect to any nonrecurring or unusual restructuring charges that may be incurred as a result of the integration of the two companies or any anticipated disposition of assets that may result from such integration.

The actual amounts recorded as of the completion of the merger may differ materially from the information presented in these unaudited pro forma combined condensed consolidated financial statements as a result of:

- changes in the trading price for HomeTrust s common stock;

capital used or generated in Jefferson Bancshares s operations between the signing of the merger agreement and completion of the merger;

changes in the fair values of Jefferson Bancshares s assets and liabilities;

other changes in Jefferson Bancshares s net assets that occur prior to the completion of the merger, which could cause material changes in the information presented below; and

the actual financial results of the combined company.

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The unaudited pro forma combined condensed consolidated financial statements are provided for informational purposes only. The unaudited pro forma combined condensed consolidated financial statements are not necessarily, and should not be assumed to be, an indication of the results that would have been achieved had the transaction been completed as of the dates indicated or that may be achieved in the future. The preparation of the unaudited pro forma combined condensed consolidated financial statements and related adjustments required management to make certain assumptions and estimates. The unaudited pro forma combined condensed consolidated financial information is based on, and should be read together with, the historical consolidated financial statements and related notes of HomeTrust incorporated into this document by reference from its Quarterly Report on Form 10-Q for the quarter ended December 31, 2013 and its Annual Report on Form 10-K for the year ended June 30, 2013, and of Jefferson Bancshares incorporated into this document by reference from its Quarterly Report on Form 10-Q for the quarter ended December 31, 2013 and its Annual Report on Form 10-K for the year ended June 30, 2013.

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HOMETRUST BANCSHARES, INC. AND JEFFERSON BANCSHARES, INC.

UNAUDITED PRO FORMA COMBINED CONDENSED CONSOLIDATED BALANCE SHEET

As of December 31, 2013

(In thousands)

	HomeTrust	Jefferson Bancshares	Pro Forma Adjustments	Pro Forma
Assets				
Cash	$ 14,175	$ 8,555	$	$ 22,730
Interest-bearing deposits	69,897	8,146	(25,638)	52,405
Cash and cash equivalents	84,072	16,701	(25,638)	75,135
Certificates of deposit in other banks	152,027			152,027
Securities available for sale, at fair value	82,661	93,472		176,133
Loans held for sale	8,907	424		9,331
Total loans, net of deferred loan fees and discount	1,170,058	334,180	(10,357)	1,493,881
Allowance for loan losses	(27,125)	(3,973)	3,973	(27,125)
Net loans	1,142,933	330,207	(6,384)	1,466,756
Premises and equipment, net	24,648	25,268	(2,500)	47,416
Federal Home Loan Bank stock, at cost	2,089	4,735		6,824
Accrued interest receivable	5,901	1,357		7,258
Real estate owned	9,935	5,417	(1,000)	14,352
Deferred income taxes	46,748	10,810	3,687	61,245
Bank owned life insurance	63,134	7,222		70,356
Core deposit intangible	586	976	2,727	4,289
Goodwill	2,802		4,769	7,571
Other assets	2,882	1,223		4,105
Total Assets	$ 1,629,325	$ 497,812	$ (24,339)	$ 2,102,798
Liabilities and Stockholders Equity				
Liabilities				
Deposits	$ 1,211,447	$ 388,020	$ 500	$ 1,599,967
Other borrowings	2,217	47,746	602	50,565
Capital lease obligations	2,007			2,007
Subordinated debentures		7,414	2,586	10,000
Other liabilities	55,548	1,088		56,636
Total liabilities	1,271,219	444,268	3,688	1,719,175

Stockholders Equity				
Preferred stock				
Common stock	198	92	(76)	214
Additional paid in capital	211,855	45,639	(20,138)	237,356
Retained earnings	156,193	10,603	(10,603)	156,193
Unearned Employee Stock Ownership Plan (ESOP) shares	(9,787)	(2,160)	2,160	(9,787)
Accumulated other comprehensive loss	(353)	(630)	630	(353)
Total stockholders equity	358,106	53,544	(28,027)	383,623
Total Liabilities and Stockholders Equity	$ 1,629,325	$ 497,812	$ (24,339)	$ 2,102,798

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HOMETRUST BANCSHARES, INC. AND JEFFERSON BANCSHARES, INC.

UNAUDITED PROFORMA COMBINED CONDENSED CONSOLIDATED

STATEMENT OF OPERATIONS

For the Six Months Ended December 31, 2013

(In thousands, except share and per share data)

	HomeTrust	Jefferson Bancshares	Pro Forma Adjustments	Pro Forma
Interest and Dividend Income				
Loans	$ 28,453	$ 8,270	$ 246	$ 36,969
Securities available for sale	721	954		1,675
Certificates of deposit and other interest-bearing deposits	907			907
Federal Home Loan Bank stock	27	114		141
Total interest and dividend income	30,108	9,338	246	39,692
Interest Expense				
Deposits	2,925	658		3,583
Other borrowings	4	652		656
Total interest expense	2,929	1,310		4,239
Net Interest Income	27,179	8,028	246	35,453
Recovery of Loan Losses	(3,000)			(3,000)
Net Interest Income after Recovery of Loan Losses	30,179	8,028	246	38,453
Noninterest Income				
Service charges on deposit accounts	1,333	495		1,828
Mortgage banking income and fees	1,786	80		1,866
Other, net	1,398	402		1,800
Total other income	4,517	977		5,494
Noninterest Expense				
Salaries and employee benefits	14,695	3,527		18,222
Net occupancy expense	2,463	660		3,123
Marketing and advertising	693	155		848
Telephone, postage, and supplies	865			865

Deposit insurance premiums	667	338		1,005
Computer services	1,824	1,257		3,081
Loss on sale and impairment of real estate owned	205	24		438
REO expense	821	209		821
Other	2,988	1,470	(20)	4,438
Total other expense	25,221	7,640	(20)	32,841
Income Before Income Taxes	9,475	1,365	266	11,106
Income Tax Expense	3,272	423	90	3,785
Net Income	$ 6,203	$ 942	$ 176	$ 7,321
Per Share Data:				
Net income per common share:				
Basic	$ 0.32	$ 0.15		$ 0.36
Diluted	$ 0.32	$ 0.15		$ 0.35
Average shares outstanding:				
Basic	18,930,301	6,271,395	1,609,910	20,540,211
Diluted	19,029,109	6,271,395	1,609,910	20,639,019

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HOMETRUST BANCSHARES, INC. AND JEFFERSON BANCSHARES, INC. COMPANY

UNAUDITED PRO FORMA COMBINED CONDENSED CONSOLIDATED

STATEMENT OF OPERATIONS

For the Year Ended June 30, 2013

(In thousands, except share and per share data)

	HomeTrust	Jefferson Bancshares	Pro Forma Adjustments	Pro Forma
Interest and Dividend Income				
Loans	$ 58,404	$ 17,529	$ 616	$ 76,549
Securities available for sale	324	1,689		2,013
Certificates of deposit and other interest-bearing deposits	1,578			1,578
Federal Home Loan Bank stock	83	283		366
Total interest and dividend income	60,389	19,501	616	80,506
Interest Expense				
Deposits	6,975	1,535		8,510
Other borrowings	280	1,595		1,875
Total interest expense	7,255	3,130		10,385
Net Interest Income	53,134	16,371	616	70,121
Recovery of Loan Losses	1,100	800		1,900
Net Interest Income after Recovery of Loan Losses	52,034	15,571	616	68,221
Noninterest Income				
Service charges on deposit accounts	2,589	1,036		3,625
Mortgage banking income and fees	5,107	445		5,552
Other, net	2,691	632		3,323
Total other income	10,387	2,113		12,500
Noninterest Expense				
Salaries and employee benefits	26,438	6,761		33,199
Net occupancy expense	5,497	1,343		6,840
Marketing and advertising	1,705	383		2,088

Telephone, postage, and supplies	1,737			1,737
Deposit insurance premiums	1,407	968		2,375
Computer services	2,386	2,453		4,839
Loss on sale and impairment of real estate owned	951	297		1,683
Federal Home Loan Bank advance prepayment penalty	3,069			3,069
REO expense	2,135	435		2,135
Other	6,068	2,906	143	9,117
Total other expense	51,393	15,546	143	67,082
Income Before Income Taxes	11,028	2,138	473	13,639
Income Tax Expense	1,975	544	161	2,680
Net Income	$ 9,053	$ 1,594	$ 312	$ 10,959
Per Share Data:				
Net income per common share:				
Basic	$ 0.45	$ 0.25		$ 0.51
Diluted	$ 0.45	$ 0.25		$ 0.51
Average shares outstanding:				
Basic	19,922,283	6,270,523	1,609,910	21,532,193
Diluted	19,941,687	6,270,523	1,609,910	21,551,597

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Notes to Unaudited Pro Forma Combined Condensed Consolidated Financial Statements

Note 1 Basis of Presentation

The unaudited pro forma combined condensed consolidated financial information has been prepared under the acquisition method of accounting for business combinations. The unaudited pro forma combined condensed consolidated statements of operations for the year ended June 30, 2013 and six months ended December 31, 2013, are presented as if the acquisition occurred on July 1, 2012. The unaudited pro forma combined condensed consolidated balance sheet as of December 31, 2013 is presented as if the acquisition occurred as of that date. This information is not intended to reflect the actual results that would have been achieved had the acquisition actually occurred on those dates. The pro forma adjustments are preliminary, based on estimates, and are subject to change as more information becomes available and after final analyses of the fair values of both tangible and intangible assets acquired and liabilities assumed are completed. Accordingly, the final fair value adjustments may be materially different from those presented in this document.

Certain historical data of Jefferson Bancshares has been reclassified on a pro forma basis to conform to HomeTrust s classifications.

Note 2 Purchase Price

Each share of Jefferson Bancshares common stock and nonvoting preferred stock will be converted into the right to receive, promptly following completion of the merger, (1) 0.2524 shares of HomeTrust common stock equal to $4.00 per share divided by an assumed average HomeTrust closing price of $15.85, which was the price on January 22, 2014, the last trading day before public announcement of the merger agreement, and (2) $4.00 in cash, representing an aggregate consideration mix of 50% HomeTrust stock and 50% cash. All in-the-money Jefferson Bancshares stock options outstanding immediately prior to the merger will be canceled in exchange for a cash payment as provided in the merger agreement.

HomeTrust will issue approximately 1.6 million shares of common stock in the merger, resulting in approximately 21.4 million shares of common stock outstanding after the merger, and pay aggregate cash consideration in the merger of approximately $25.6 million (Adjustment Note A).

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Note 3 Allocation of Purchase Price of Jefferson Bancshares

At the merger date, Jefferson Bancshares assets and liabilities are required to be adjusted to their estimated fair values. The purchase price is then allocated to the identifiable assets and liabilities based on the fair value. The excess of the purchase price over the fair value of the net assets acquired is allocated to goodwill.

The pro forma purchase price was preliminarily allocated to the assets acquired and liabilities assumed based on their estimated fair values as summarized in the following table:

	At December 31, 2013 (in thousands)	
Pro forma purchase price of Jefferson Bancshares		
Fair value of HomeTrust common stock at $15.85 per share	$	25,517
Cash to be paid		25,517
Consideration value for stock options		121
Total pro forma purchase price	$	51,155
Fair value of assets acquired:		
Cash	$	16,701
Investment securities available for sale		93,472
Loans		324,247
Other real estate owned		4,417
Intangible assets		3,703
Other assets		51,802
Total assets acquired	$	494,342
Fair value of liabilities assumed:		
Deposits	$	388,520
Other borrowed money		48,348
Subordinated debentures		10,000
Accrued expenses and other liabilities		1,088
Total liabilities assumed	$	447,956
Fair value of net assets acquired	$	46,386
Goodwill	$	4,769

Note 4 Pro Forma Condensed Combined Financial Information Adjustments

The following pro forma adjustments have been included in the unaudited pro forma condensed combined financial information. Estimated fair value adjustments are based upon available information, and certain assumptions considered reasonable, and may be revised as additional information becomes available. The following are the pro forma adjustments made to record the transaction and to adjust Jefferson Bancshares assets and liabilities to their estimated fair values at December 31, 2013.

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Statement of Condition

As of December 31, 2013

(In thousands)

A. Adjustments to Cash and cash equivalents	
To reflect cash used to purchase Jefferson Bancshares.	$ (25,638)
B. Adjustments to Loans receivable, excluding Allowance for loan losses	
Fair value adjustment on loans which includes $7,684 to adjust for credit deterioration of the acquired portfolio and $2,673 to reflect current interest rates and spreads to be accreted using the level yield method on purchased performing loans as they are repaid over time. The interest rate market value adjustment was determined based on the present value of estimated future cash flows of the loans to be acquired discounted using a weighted average market rate. The credit market value adjustment was determined based on assigned risk ratings, and the present value of estimated expected cash flows (including the estimated fair value of loan collateral). HomeTrust engaged a third-party advisor to assist in determining the credit adjustment.	$ (10,357)
C. Adjustments to Allowance for loan losses	
To remove the Jefferson Bancshares allowance for loan losses at period end date as the credit risk is accounted for in the fair value adjustment for the loans receivable in Adjustment **B** above.	$ 3,973
D. Adjustments to Core Deposit Intangible (CDI)	
To record the estimated fair value of the CDI identified in the merger as calculated by a third party and to eliminate Jefferson Bancshares CDI created in its prior acquisitions.	
CDI identified in merger	$ 3,703
Elimination of Jefferson Bancshares prior CDI	$ (976)
E. Adjustment to Goodwill	
To record the difference between the consideration transferred and the estimated fair value of net assets acquired in the merger.	$ 4,769
F. Adjustments to Other assets	
To reflect the fair value of the other assets in the merger as follows:	
Premises and equipment, net	$ (2,500)
Real estate owned	$ (1,000)
Deferred tax asset, net	
Subtotal of fair value adjustments is $10,845 at the Company s estimated statutory rate of 34%	$ 3,687
G. Adjustment to Subordinated debentures	
To reflect the fair value of the subordinate debentures in the merger. This adjustment reflects HomeTrust s intention to repay these subordinate debentures at face value as of the merger date.	$ 2,586
H. Adjustment to other liabilities	
To reflect the fair value of other liabilities in the merger as follows:	
To reflect the fair value of certificates of deposit	$ 500

To reflect the fair value of other borrowings	$ 602

I. Adjustments to Common stock and Additional paid in capital (APIC)	
To record the changes in common stock and APIC:	
Issuance of HomeTrust common stock to Jefferson Bancshares shareholders	$ 25,517
Elimination of the historical Jefferson Bancshares common stock and APIC	$ (45,731)

J. Adjustment to Retained earnings	
To eliminate the historical Jefferson Bancshares retained earnings	$ (10,603)

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K. Adjustment to ESOP	
To eliminate the unallocated shares held as collateral in the leveraged Jefferson Bancshares ESOP	$ 2,160
L. Adjustment to Accumulated other comprehensive loss	
To eliminate the historical Jefferson Bancshares accumulated other comprehensive loss.	$ 630

For purposes of determining the pro forma effect of the merger on the statements of operations, the following pro forma adjustments have been made as if the acquisition occurred as of July 1, 2012:

Statements of Income

(In thousands)

	For the Six Months Ended December 31, 2013	For the Year Ended June 30, 2013
M. Adjustments to Interest income: Loans	$ 246	$ 616
To reflect the accretion of interest component of the loan discount resulting from the pro forma loan fair value adjustment in Adjustment B above. The accretion was calculated using the level yield method as these loans are repaid over time.		
N. Adjustments to Noninterest expense: Other		
To eliminate the direct costs for professional services incurred by the companies in connection with the merger	$ (110)	$
To reflect the amortization of the CDI resulting from the pro forma fair value adjustment in Adjustment **D** above and to eliminate the historical Jefferson Bancshares CDI amortization	$ 90	$ 143
Amortization of CDI resulting from the merger based on amortization period of 7 years using the straight-line method of amortization of $265 and $529 for the six months ended 12/31/13 and for the year ended 6/30/13, respectively.		
Elimination of historical Jefferson Bancshares CDI amortization of $(175) and $(386) for the six months ended 12/31/13 and for the year ended 6/30/13, respectively.		
O. Adjustment to Federal income taxes	$ 90	$ 161
To reflect the income tax effect of the pro forma Adjustments M-P above at the Company s estimated 34% statutory tax rate.		

Earnings per share, basic and diluted, (Adjustment Note **P**) were calculated using the calculated pro forma net income divided by the calculated pro forma basic and dilutive average shares outstanding.

Basic and dilutive average shares outstanding (Adjustment Note Q) were calculated by adding the shares assumed to be issued by HomeTrust in the merger (1.6 million shares) to the historical average HomeTrust shares outstanding for the six months ended December 31, 2013 and for the year ended June 30, 2013.

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Note 5 Merger Costs

In connection with the merger, the plan to integrate HomeTrust s and Jefferson Bancshares operations is still being developed. Over the next several months, the specific details of these plans will continue to be refined. Management of both companies is currently in the process of assessing the two companies personnel, benefit plans, computer systems, service contracts and other key factors to determine the most beneficial structure for the merged company. Certain decisions arising from these assessments may involve involuntary termination of employees, changing information systems, canceling contracts with service providers and other actions. To the extent there are costs associated with these actions, the costs will be recorded based on the nature and timing of these integration actions. Most acquisition and restructuring costs are recognized separately from a business combination and generally will be expensed as incurred.

The table below reflects HomeTrust s current estimate of the aggregate estimated merger costs of $3.8 million (net of $1.7 million of taxes, computed using the statutory federal tax rate of 34%) expected to be incurred in connection with the merger, which are excluded from the pro forma financial information. While a portion of these costs may be required to be recognized over time, the current estimate of these costs, primarily comprised of anticipated cash charges, include the following:

	At December 31, 2013 (in thousands)
Professional Fees	$ 1,908
Change of control payments	500
Severance and retention plan	1,200
Data processing, termination and conversion	1,910
Pre-tax merger costs	5,518
Taxes	1,677
Total merger costs	$ 3,841

HomeTrust s cost estimates are forward-looking. While the costs represent HomeTrust s current estimate of merger costs associated with the merger that will be incurred, the ultimate level and timing of recognition of these costs will be based on the final integration in connection with consummation of the merger. Readers are cautioned that the completion of this integration and other actions that may be taken in connection with the merger will impact these estimates. The type and amount of actual costs incurred could vary materially from these estimates if future developments differ from the underlying assumptions used by management in determining the current estimate of these costs.

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MATERIAL U.S. FEDERAL INCOME TAX CONSEQUENCES OF THE MERGER

The following summary describes the material U.S. federal income tax consequences of the merger to U.S. holders (as defined below) of Jefferson common stock. The summary is based upon the Internal Revenue Code of 1986, as amended (which we refer to in this document as the Code), applicable Treasury Regulations, judicial decisions, and administrative rulings and practice, all as in effect as of the date hereof, and all of which are subject to change, possibly with retroactive effect. Any such change could affect the accuracy of the statements and conclusions set forth in this discussion. This summary does not address any tax consequences of the merger under state, local or foreign laws, or any federal laws other than those pertaining to income tax.

This discussion addresses only those holders of Jefferson common stock that hold their Jefferson common stock as a capital asset within the meaning of Section 1221 of the Code. It does not address all the U.S. federal income tax consequences that may be relevant to particular holders of Jefferson common stock in light of their individual circumstances or to holders of Jefferson common stock that are subject to special rules, including, without limitation, holders that are:

- financial institutions;
- S corporations or other pass-through entities, or investors in pass-through entities;
- persons who are subject to alternative minimum tax;
- insurance companies;
- tax-exempt organizations;
- dealers in securities or currencies;
- traders in securities that elect to use a mark-to-market method of accounting;
- persons that hold Jefferson common stock as part of a straddle, hedge, constructive sale, conversion or other integrated transaction;
- regulated investment companies;
- real estate investment trusts;

- persons whose functional currency is not the U.S. dollar;
- persons who are not U.S. holders; and
- holders who acquired their shares of Jefferson common stock through the exercise of an employee stock option, through a tax qualified retirement plan or otherwise as compensation.

If a partnership (or other entity that is taxed as a partnership for federal income tax purposes) holds Jefferson common stock, the tax treatment of a partner in that partnership generally will depend upon the status of the partner and the activities of the partnership. Partnerships and partners in partnerships should consult their own tax advisors about the tax consequences of the merger to them.

For purposes of this discussion, the term U.S. holder means a beneficial owner that is: an individual citizen or resident of the United States; a corporation (or other entity taxable as a corporation for U.S. federal income tax purposes) created or organized under the laws of the United States or any of its political subdivisions; a trust that (i) is subject to the supervision of a court within the United States and the control of one or more U.S. persons or (ii) has a valid election in effect under applicable U.S. Treasury regulations to be treated as a U.S. person; or an estate that is subject to U.S. federal income taxation on its income regardless of its source.

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In connection with the filing with the SEC of the registration statement on Form S-4 of which this proxy statement/prospectus is a part, Kilpatrick Townsend & Stockton LLP, or Kilpatrick Townsend, has rendered its tax opinion to Jefferson and Silver, Freedman, Taff & Tiernan LLP, or SFT&T, has rendered its tax opinion to HomeTrust addressing the U.S. federal income tax consequences of the merger as described below. In rendering their respective tax opinions, each counsel relied upon representations and covenants, including those contained in certificates of officers of Jefferson and HomeTrust, reasonably satisfactory in form and substance to each such counsel. The opinions represent each counsel s best legal judgment. However, if any of the representations or assumptions upon which the opinions are based are inconsistent with the actual facts, the U.S. federal income tax consequences of the merger could be adversely affected. Copies of the tax opinions are attached as Exhibits 8.1 and 8.2 to the registration statement on Form S-4.

Neither HomeTrust nor Jefferson has sought, and neither of them will seek, any ruling from the Internal Revenue Service regarding any matters relating to the merger, and the opinions described above will not be binding on the Internal Revenue Service or any court. Consequently, there can be no assurance that the Internal Revenue Service will not assert, or that a court would not sustain, a position contrary to any of the conclusions set forth below.

The obligations of the parties to complete the merger are conditioned on, among other things, the receipt by Jefferson and HomeTrust of opinions from Kilpatrick Townsend and SFT&T, respectively, each dated the closing date of the merger, that for U.S. federal income tax purposes the merger will qualify as a reorganization within the meaning of Section 368(a) of the Code. These opinions will be based upon representation letters provided by Jefferson and HomeTrust and upon customary factual assumptions. The condition that Jefferson receive an opinion from Kilpatrick Townsend may be waived by Jefferson, and the condition that HomeTrust receive an opinion from SFT&T may be waived by HomeTrust. Neither Jefferson nor HomeTrust currently intends to waive the conditions related to the receipt of the opinions. However, if these conditions were waived and the change in tax consequences would be material, Jefferson would re-solicit the approval of its shareholders prior to completing the merger.

In addition, the obligation of each of Kilpatrick Townsend and SFT&T to deliver such opinions is conditioned on the merger satisfying the statutory and regulatory requirements of a reorganization, including the continuity of proprietary interest requirement. That requirement generally will be satisfied if HomeTrust common stock constitutes at least 40% of the value of the total merger consideration. The determination by tax counsel as to whether the merger will be treated as a reorganization within the meaning of Section 368(a) of the Code is based on the facts and law existing as of the closing date of the merger.

The actual tax consequences of the merger to you may be complex and will depend upon your specific situation and upon factors that are not within the control of HomeTrust or Jefferson. You should consult with your own tax advisor as to the tax consequences of the merger in light of your particular circumstances, including the applicability and effect of the alternative minimum tax and any state, local or foreign income or other tax laws.

Tax Consequences of the Merger Generally

The parties intend for the merger to be treated as a reorganization for U.S. federal income tax purposes. As such, the material U.S. federal income tax consequences of the merger will be as follows:

- no gain or loss will be recognized by HomeTrust or Jefferson as a result of the merger;

gain (but not loss) will be recognized by a U.S. holder of Jefferson common stock who receive shares of HomeTrust common stock and cash in exchange for shares of Jefferson common stock pursuant to the merger in an amount equal to the lesser of (i) the amount by which the sum of the fair market value of the HomeTrust common stock and cash received by such U.S. holder of Jefferson common stock exceeds such U.S. holder s basis in its Jefferson common stock and (ii) the amount of cash received by such U.S. holder of Jefferson common stock;

- the aggregate basis of the HomeTrust common stock received by a U.S. holder of Jefferson common stock in the merger (including a fractional share of HomeTrust common stock deemed received and redeemed as described below) will be the same as the aggregate basis of the Jefferson common stock for which it is exchanged, decreased by the amount of cash received in the merger (other than cash received instead of a fractional share of HomeTrust common stock), and increased by the amount of gain recognized on the exchange, other than with respect to cash received instead of a fractional share in HomeTrust common stock (regardless of whether such gain is classified as capital gain or as dividend income, as discussed below under Potential Recharacterization of Gain as a Dividend); and

- the holding period of HomeTrust common stock received by a U.S. holder of Jefferson common stock in the merger in exchange for such U.S. holder s shares of Jefferson common stock (including fractional share of HomeTrust common stock deemed received and redeemed as described below) will include such U.S. holder s holding period of the Jefferson common stock for which it is exchanged.

If a U.S. holder of Jefferson common stock acquired different blocks of Jefferson common stock at different times or at different prices, any gain or loss (if applicable) will be determined separately with respect to each block of Jefferson common stock. U.S. holders should consult their own tax advisors regarding the manner in which cash and HomeTrust common stock received in the merger should be allocated among different blocks of Jefferson common stock and with respect to identifying the bases or holding periods of the particular shares of HomeTrust common stock received in the merger.

Taxation of Capital Gain

Except as described under Potential Recharacterization of Gain as a Dividend below, gain that a U.S. holder of Jefferson common stock recognizes in connection with the merger generally will constitute capital gain and will constitute long-term capital gain if such U.S. holder has held (or is treated as having held) its Jefferson common stock for more than one year as of the date of the merger. For non-corporate U.S. holders of Jefferson common stock, the maximum U.S. federal income tax rate on long-term capital gains is 20%.

Potential Recharacterization of Gain as a Dividend

All or part of the gain that a particular U.S. holder of Jefferson common stock recognizes could be treated as dividend income rather than capital gain if: (i) such U.S. holder is a significant shareholder of HomeTrust; or (ii) such U.S. holder s percentage ownership in HomeTrust after the merger, taking into account constructive ownership rules, is not meaningfully reduced from what its percentage ownership would have been if it had received solely shares of HomeTrust common stock rather than a combination of cash and shares of HomeTrust common stock in the merger. This could happen, for example, because of ownership of additional shares of HomeTrust common stock by such holder, ownership of shares of HomeTrust common stock by a person related to such holder or a share repurchase by HomeTrust from other holders of HomeTrust common stock. The Internal Revenue Service has indicated in rulings that any reduction in the interest of a minority shareholder that owns a small number of shares in a publicly and widely held corporation and that exercises no control over corporate affairs would result in capital gain as opposed to dividend treatment. Because the possibility of dividend treatment depends primarily upon the particular circumstances of a holder of Jefferson common stock, including the application of certain constructive ownership rules, holders of Jefferson common stock should consult their own tax advisors regarding the potential tax consequences of the merger to them.

Cash Received Instead of a Fractional Share of HomeTrust Common Stock

A U.S. holder of Jefferson common stock who receives cash instead of a fractional share of HomeTrust common stock will be treated as having received the fractional share pursuant to the merger and then as having exchanged the fractional share for cash in a redemption by HomeTrust. As a result, such U.S. holder of Jefferson common stock will generally recognize gain or loss equal to the difference between the amount of cash received and the basis in his or her fractional share interest as set forth above. The gain or loss recognized by the U.S. holders described in this paragraph will generally be capital gain or loss, and will be long-term capital gain or loss if, as of the effective date of the merger, the U.S. holder s holding period for the relevant shares is greater than one year. The deductibility of capital losses is subject to limitations.

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Medicare Tax on Unearned Income

If a U.S. holder that is an individual has modified gross income for the taxable year over a certain threshold (between $125,000 and $250,000 depending on the individual s U.S. federal income tax filing status), such individual is subject to a 3.8% tax on the lesser of: (i) his or her net investment income for the relevant taxable year; or (ii) the excess of his or her modified gross income for the taxable year over his or her applicable certain threshold (between $125,000 and $250,000 depending on the individual s U.S. federal income tax filing status). A similar regime applies to estates and trusts. Net investment income generally would include any capital gain incurred in connection with the merger (including any gain treated as a dividend), as well as, among other items, other interest, dividends, capital gains and rental or royalty income received by such individual.

Backup Withholding and Information Reporting

Payments of cash to a U.S. holder of Jefferson common stock pursuant to the merger may, under certain circumstances, be subject to information reporting and backup withholding unless the holder provides proof of an applicable exemption or, in the case of backup withholding, furnishes its taxpayer identification number and otherwise complies with all applicable requirements of the backup withholding rules. Any amounts withheld from payments to a U.S. holder under the backup withholding rules are not additional tax and generally will be allowed as a refund or credit against the U.S. holder s U.S. federal income tax liability, provided the required information is timely furnished to the Internal Revenue Service.

A U.S. holder of Jefferson common stock who receives HomeTrust common stock as a result of the merger should retain records pertaining to the merger, including records relating to the number of shares and the basis of such U.S. holder s Jefferson common stock. Each U.S. holder of Jefferson common stock who is required to file a U.S. federal income tax return and who is a significant holder that receives HomeTrust common stock in the merger will be required to file a statement with such U.S. federal income tax return in accordance with Treasury Regulations Section 1.368-3 setting forth such U.S. holder s basis in the Jefferson common stock surrendered, the fair market value of the HomeTrust common stock and cash received in the merger, and certain other information. A significant holder is a holder of Jefferson common stock who, immediately before the merger, owned at least 5% of the outstanding stock of Jefferson or securities of Jefferson with a basis for federal income taxes of at least $1.0 million.

This discussion does not address tax consequences that may vary with, or are contingent upon, individual circumstances. Moreover, it does not address any non-income tax or any foreign, state or local tax consequences of the merger. Tax matters are very complicated, and the tax consequences of the merger to you will depend upon the facts of your particular situation. Accordingly, we strongly urge you to consult with a tax advisor to determine the particular federal, state, local or foreign income or other tax consequences to you of the merger.

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INFORMATION ABOUT HOMETRUST

HomeTrust

HomeTrust, headquartered in Asheville, North Carolina, is a savings and loan holding company for HomeTrust Bank, including its banking divisions HomeTrust Bank, Tryon Federal Bank, Shelby Savings Bank, Home Savings Bank, Industrial Federal Bank, Cherryville Federal Bank and Rutherford County Bank. HomeTrust offers traditional financial services within its local communities through its 21 full service offices in Western North Carolina, including the Asheville metropolitan area, the Piedmont region of North Carolina, and Greenville, South Carolina. HomeTrust is the 13th largest community bank based on asset size headquartered in North Carolina. As of December 31, 2013, on a consolidated basis, HomeTrust had total assets of $1.63 billion, deposits of $1.21 billion, and stockholders equity of $358.1 million.

HomeTrust s principal office is located at 10 Woodfin Street, Asheville, North Carolina 28801, and its telephone number is (828) 259-3939. HomeTrust s common stock is listed on NASDAQ under the symbol HTBI.

HomeTrust regularly evaluates opportunities to expand through acquisitions and conducts due diligence activities in connection with such opportunities. As a result, acquisition discussions and, in some cases, negotiations, may take place at any time, and acquisitions involving cash or our debt or equity securities may occur. In this regard, on March 2, 2014, HomeTrust entered into a definitive agreement to acquire Bank of Commerce, which operates a full service banking facility headquartered in Charlotte, North Carolina in a cash transaction valued at approximately $10.1 million. In addition, all $3.2 million of Bank of Commerce s preferred stock will be redeemed. The boards of directors of HomeTrust and Bank of Commerce unanimously approved the transaction, which is subject to regulatory approval and other customary closing conditions. Upon closing of the transaction, Bank of Commerce will be merged into HomeTrust Bank. At December 31, 2013, Bank of Commerce had $129.3 million in assets and deposits of $93.8 million.

Additional information about HomeTrust and its subsidiaries is included in documents incorporated by reference in this proxy statement/prospectus. See Where You Can Find More Information.

Other Acquisitions

On March 2, 2014, HomeTrust entered into a definitive agreement to acquire Bank of Commerce, which operates a full service banking facility headquartered in Charlotte, North Carolina in a cash transaction valued at approximately $10.1 million. In addition, all $3.2 million of Bank of Commerce s preferred stock will be redeemed. The boards of directors of HomeTrust and Bank of Commerce unanimously approved the transaction, which is subject to regulatory approval and other customary closing conditions. Upon closing of the transaction, Bank of Commerce will be merged into HomeTrust Bank. At December 31, 2013, Bank of Commerce had $129.3 million in assets and deposits of $93.8 million.

INFORMATION ABOUT JEFFERSON

General

Jefferson is the holding company for Jefferson Federal Bank. In connection with the Jefferson s acquisition of State of Franklin Bancshares, Jefferson Federal Bank merged with and into State of Franklin Savings Bank, the wholly owned subsidiary of State of Franklin Bancshares. The resulting institution continues to operate as a Tennessee chartered savings bank, Jefferson Federal Bank.

Jefferson Federal operates as a community-oriented financial institution offering traditional financial services to consumers and businesses in its market area. Jefferson Federal attracts deposits from the general public and uses those funds to originate loans, most of which it holds for investment. Jefferson considers its primary market areas to consist of: (i) Hamblen County, Tennessee, and its contiguous counties; (ii) Knoxville, Tennessee, and its surrounding areas; and (iii) the greater Johnson City, Tennessee, Kingsport, Tennessee, and Bristol, Tennessee region (the Tri-Cities region). As of December 31, 2013, on a consolidated basis, Jefferson had total assets of $497.8 million, deposits of $388.0 million, and stockholders equity of $53.5 million.

Jefferson s principal office is located at 120 Evans Avenue, Morristown, Tennessee 37814, and its telephone number is (423) 586-8421. Jefferson s common stock is listed on NASDAQ under the symbol JBFI.

Management of Jefferson and the Jefferson Federal are substantially similar and Jefferson neither owns nor leases any property, but instead uses the premises, equipment and furniture of Jefferson Federal.

Available Information

Jefferson maintains an Internet website at http://www.jeffersonfederal.com. It makes available its annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to such reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities and Exchange Act of 1934, as amended, and other related information, free of charge, on this site as soon as reasonably practicable after Jefferson electronically files those documents with, or otherwise furnish them to, the Securities Exchange Commission. Jefferson s Internet website and the information contained therein or connected thereto are not intended to be incorporated into this proxy statement/prospectus or the reports it files with the Securities Exchange Commission. Jefferson s reports have not been reviewed, or confirmed for accuracy or relevance, by the Securities and Exchange Commission, the FDIC or any other governmental authority.

Market Area

Jefferson Federal currently operates two full-service branch offices and two limited-service drive-through facilities in Hamblen County, Tennessee. The economy of Hamblen County, which has an estimated population of 62,000, is primarily oriented to manufacturing and agriculture. Morristown and Hamblen County also serve as a hub for retail shopping and medical services for a number of surrounding rural counties. The manufacturing sector is focused on three types of products: automotive and heavy equipment components; plastics, paper and corrugated products; and furniture. According to published statistics, the unemployment rate in Hamblen County was 7.6% as of December 2013, the most recent period for which data is available, which was above the national unemployment rate and slightly below the state unemployment rates at that time.

Jefferson Federal also currently operates two full-service branch offices in Knoxville, Tennessee. Knoxville s population is approximately 183,000 and its economy is largely fueled by the location of the main campus of the University of Tennessee, the Oak Ridge National Laboratory, the National Transportation Research Center and the Tennessee Valley Authority. Additionally, Knoxville has many warehousing and distribution companies because of its central location in the eastern half of the United States. The unemployment rate for the Knoxville metropolitan statistical area was 6.7% as of December 2013, which was equal to the national unemployment rate and below the state unemployment rates at that time.

Jefferson Federal also currently operates six full-service branch offices in the Tri-Cities region, which is comprised of Kingsport, Tennessee, Johnson City, Tennessee and Bristol, Tennessee and the surrounding areas. The population of the Tri-Cities region is approximately 500,000 and its economy is largely fueled by manufacturing and trade services. The unemployment rate for the Tri-Cities region combined statistical area was 6.4% as of December 2013, which was below the national and the state unemployment rates at that time.

Competition

Jefferson Federal faces significant competition for the attraction of deposits and origination of loans. The most direct competition for deposits has historically come from the several financial institutions operating in Jefferson Federal s market area and, to a lesser extent, from other financial service companies, such as brokerage firms, credit unions and insurance companies. Jefferson Federal also faces competition for investors funds from money market funds and other corporate and government securities. At June 30, 2013, which is the most recent date for which data is available from the FDIC, Jefferson Federal held: (i) 23.38% of the deposits in Hamblen County, which is the largest market share out of nine financial institutions with offices in the county at that date; (ii) 0.22% of the deposits in the Knoxville, Tennessee, metropolitan statistical area, which is the 38th largest market share out of 52 financial institutions with offices in the metropolitan statistical area at that date; (iii) 4.38% of the deposits in the Johnson City, Tennessee metropolitan statistical area, which is the eighth largest market share out of 22 financial

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institutions located in the metropolitan statistical area at that date; and (iv) 0.98% of the deposits in the Kingsport, Tennessee-Bristol, Virginia metropolitan statistical area, which is the 20th largest market share out of 31 financial institutions located in the metropolitan statistical area at that date. Banks owned by SunTrust Banks, Inc., First Tennessee National Corporation and Regions Financial Corporation and other large regional bank holding companies also operate in Jefferson Federal s primary market areas. These institutions are significantly larger than Jefferson Federal and, therefore, have significantly greater resources.

Jefferson Federal s competition for loans comes primarily from financial institutions in its market area, and to a lesser extent from other financial service providers, such as mortgage companies and mortgage brokers. Competition for loans also comes from non-depository financial service companies, such as insurance companies, securities companies and specialty finance companies.

Jefferson Federal expects to continue to face significant competition in the future as a result of legislative, regulatory and technological changes and the continuing trend of consolidation in the financial services industry. Technological advances, for example, have lowered barriers to entry, allowed banks to expand their geographic reach by providing services over the Internet and made it possible for non-depository institutions to offer products and services that traditionally have been provided by banks. Federal law permits affiliation among banks, securities firms and insurance companies, which promotes a competitive environment in the financial services industry. Competition for deposits and the origination of loans could limit Jefferson s growth in the future.

Lending Activities

General. Jefferson Federal s loan portfolio consists of a variety of mortgage, commercial and consumer loans. As a community-oriented financial institution, Jefferson Federal tries to meet the borrowing needs of consumers and businesses in its market area. Mortgage loans constitute a significant majority of the portfolio, and commercial mortgage loans are the largest segment in that category.

One- to Four-Family Residential Loans. Jefferson Federal originates mortgage loans to enable borrowers to purchase or refinance existing homes or to construct new one- to four-family homes. Jefferson Federal offers fixed-rate mortgage loans with terms up to 30 years and adjustable-rate mortgage loans with terms up to 30 years. Borrower demand for adjustable-rate loans versus fixed-rate loans is a function of the level of interest rates, the expectations of changes in the level of interest rates, the difference between the interest rates and loan fees offered for fixed-rate mortgage loans and the first year interest rates and loan fees for adjustable-rate loans. The relative amount of fixed-rate mortgage loans and adjustable-rate mortgage loans that can be originated at any time is largely determined by the demand for each in a competitive environment and the effect each has on Jefferson Federal s interest rate risk.

The loan fees charged, interest rates and other provisions of mortgage loans are determined by us on the basis of Jefferson Federal s own pricing criteria and competitive market conditions. Interest rates and payments on Jefferson Federal s adjustable-rate loans generally are adjusted annually based on any change in the National Average Contract Mortgage Rate for the Purchase of Previously Occupied Homes by Combined Lenders as published by the Federal Housing Finance Board. Changes in this index tend to lag behind changes in market interest rates. Jefferson Federal s adjustable-rate mortgage loans may have initial fixed-rate periods ranging from one to seven years.

Jefferson Federal s originates all adjustable-rate loans at the fully indexed interest rate. The maximum amount by which the interest rate may be increased or decreased is generally 2% per year and the lifetime interest rate cap is generally 5% over the initial interest rate of the loan. Jefferson Federal s adjustable-rate residential mortgage loans generally do not provide for a decrease in the rate paid below the initial contract rate. The inability of Jefferson Federal s residential real estate loans to adjust downward below the initial contract rate can contribute to increased income in periods of declining interest rates, and also assists us in its efforts to limit the risks to earnings and equity value resulting from changes in interest rates, subject to the risk that borrowers may refinance these loans during periods of declining interest rates.

While one- to four-family residential real estate loans are normally originated with up to 30-year terms, such loans typically remain outstanding for substantially shorter periods because borrowers often prepay their loans in full upon sale of the property pledged as security or upon refinancing the original loan. In addition, substantially all of the mortgage loans in its loan portfolio contain due-on-sale clauses providing that Jefferson Federal may declare the unpaid amount due and payable upon the sale of the property securing the loan. Jefferson Federal enforces these due-on-sale clauses to the extent permitted by law. Therefore, average loan maturity is a function of, among other factors, the level of purchase and sale activity in the real estate market, prevailing interest rates and the interest rates payable on outstanding loans.

In addition to originating loans for its portfolio, Jefferson Federal originates loans for the secondary mortgage market. Loans are sold without recourse and on a servicing-released basis. Jefferson Federal generally does not make conventional loans with loan-to-value ratios exceeding 85% and generally make loans with a loan-to-value ratio in excess of 85% only when secured by first liens on owner-occupied, one- to four-family residences. Loans with loan-to-value ratios in excess of 90% generally require private mortgage insurance or additional collateral. Jefferson Federal requires all properties securing mortgage loans in excess of $250,000 to be appraised by a board-approved appraiser. Jefferson Federal requires title insurance on all mortgage loans in excess of $25,000. Borrowers must obtain hazard or flood insurance (for loans on property located in a flood zone) prior to closing the loan.

Home Equity Lines of Credit. Jefferson Federal offers home equity lines of credit on single family residential property in amounts up to 80% of the appraised value. Rates and terms vary by borrower qualifications, but are generally offered on a variable rate, open-end term basis with maturities of ten years or less.

Commercial Real Estate and Multi-Family Loans. An important segment of Jefferson Federal s loan portfolio is mortgage loans secured by commercial and multi-family real estate. Its commercial real estate loans are secured by professional office buildings, shopping centers, manufacturing facilities, hotels, vacant land, churches and, to a lesser extent, by other improved property such as restaurants and retail operations.

Jefferson Federal originates both fixed- and adjustable-rate loans secured by commercial and multi-family real estate with terms up to 20 years. Fixed-rate loans have provisions that allow us to call the loan after five years. Adjustable-rate loans are generally based on prime and adjust monthly. Loan amounts generally do not exceed 85% of the lesser of the appraised value or the purchase price. When the borrower is a corporation, partnership or other entity, Jefferson Federal generally requires personal guarantees from significant equity holders. Currently, it is Jefferson Federal s philosophy to originate commercial real estate loans only to borrowers known to it and on properties in or near its market area.

At December 31, 2013, loans with principal balances of $500,000 or more secured by commercial real estate totaled $85.1 million, or 66.4% of commercial real estate loans, and loans with principal balances of $500,000 or more secured by multi-family properties totaled $6.5 million, or 69.2% of multi-family loans. At December 31, 2013, nine commercial real estate loans totaling $2.1 million were nonaccrual loans.

Construction Loans. Jefferson Federal originates loans to finance the construction of one- to four-family homes and, to a lesser extent, multi-family and commercial real estate properties. At December 31, 2013, $4.5 million of Jefferson Federal s construction loans was for the construction of one- to four-family homes and $7.3 million was for the construction of commercial or multi-family real estate. Construction loans are generally made on a pre-sold basis; however, contractors who have sufficient financial strength and a proven track record are considered for loans for model and speculative purposes, with preference given to contractors with whom Jefferson Federal has had successful relationships. Jefferson Federal generally limits loans to contractors for speculative construction to a total of $350,000 per contractor. Construction loans generally provide for interest-only payments at fixed-rates of interest and have terms of six to 12 months. At the end of the construction period, the loan generally converts into a permanent loan. Construction loans to a borrower who will occupy the home, or to a builder who has pre-sold the home, will be considered for loan-to-value ratios of up to 85%. Construction loans for speculative purposes, models and commercial properties may be considered for loan-to-value ratios of up to 80%. Loan proceeds are disbursed in increments as construction progresses and as inspections warrant. Jefferson Federal generally uses in-house inspectors for construction disbursement purposes; however, it may rely on architect certifications and independent third party inspections for disbursements on larger commercial loans.

Land Loans. Jefferson Federal originates loans secured by unimproved property, including lots for single family homes, raw land, Jefferson Federal s commercial property and agricultural property. Jefferson Federal originates both fixed- and adjustable-rate land loans with terms up to 20 years. Adjustable-rate loans are generally based on prime and adjust monthly. Loans secured by unimproved commercial property or for land development generally have five-year terms with a longer amortization schedule.

At December 31, 2013, Jefferson Federal s largest land loan had an outstanding balance of $3.5 million and was secured by vacant land. At December 31, 2013, loans with principal balances of $500,000 or more secured by unimproved property totaled $10.0 million, or 45.2% of land loans. At December 31, 2013, 10 land loans totaling $923,000 were nonaccrual loans.

Commercial Business Loans. Jefferson Federal extends commercial business loans on an unsecured and secured basis. Secured loans generally are collateralized by industrial/commercial machinery and equipment, livestock, farm machinery and, to a lesser extent, accounts receivable and inventory. Jefferson Federal originates both fixed- and adjustable-rate commercial loans with terms up to 15 years. Fixed-rate loans have provisions that allow it to call the loan after five years. Adjustable-rate loans are generally based on prime and adjust monthly. Where the borrower is a corporation, partnership or other entity, Jefferson Federal generally requires personal guarantees from significant equity holders.

Consumer Loans. Jefferson Federal offers a variety of consumer loans, including loans secured by automobiles and savings accounts. Other consumer loans include loans on recreational vehicles and boats, debt consolidation loans and personal unsecured debt.

The procedures for underwriting consumer loans include an assessment of the applicant s payment history on other debts and ability to meet existing obligations and payments on the proposed loans. Although the applicant s creditworthiness is a primary consideration, the underwriting process also includes a comparison of the value of the collateral, if any, to the proposed loan amount. Jefferson Federal uses a credit scoring system and charge borrowers with poorer credit scores higher interest rates to compensate for the additional risks associated with those loans.

Loan Underwriting Risks.

Adjustable-Rate Loans. While Jefferson Federal anticipates that adjustable-rate loans will better offset the adverse effects of an increase in interest rates as compared to fixed-rate mortgages, the increased mortgage payments required of adjustable-rate loan borrowers in a rising interest rate environment could cause an increase in delinquencies and defaults. The marketability of the underlying property also may be adversely affected in a high interest rate environment. In addition, although adjustable-rate mortgage loans help make Jefferson Federal s asset base more responsive to changes in interest rates, the extent of this interest sensitivity is limited by the annual and lifetime interest rate adjustment limits.

Commercial and Multi-Family Real Estate Loans. Loans secured by commercial and multi-family real estate are generally larger and involve a greater degree of risk than one- to four-family residential mortgage loans. Of primary concern in commercial and multi-family real estate lending is the borrower s creditworthiness and the feasibility and cash flow potential of the project. Payments on loans secured by income properties are often dependent on the successful operation or management of the properties. As a result, repayment of such loans may be subject to a greater extent than residential real estate loans to adverse conditions in the real estate market or the economy. In order to monitor cash flows on income properties, Jefferson Federal requires borrowers and loan guarantors, if any, to provide annual financial statements and rent rolls on multi-family loans. Jefferson Federal also perform annual reviews on all lending relationships of $500,000 or more where the loan is secured by commercial or multi-family real estate.

Construction Loans. Construction financing is generally considered to involve a higher degree of risk of loss than long-term financing on improved, occupied real estate. Risk of loss on a construction loan is dependent largely upon the accuracy of the initial estimate of the property s value at completion of construction or development and the estimated cost (including interest) of construction. During the construction phase, a number of factors could result in delays and cost overruns. If the estimate of construction costs proves to be inaccurate, Jefferson Federal may be required to advance funds beyond the amount originally committed to permit completion of the development. If the estimate of value proves to be inaccurate, Jefferson Federal may be confronted, at or prior to the maturity of the loan, with a project having a value which is insufficient to assure full repayment. As a result of the foregoing, construction lending often involves the disbursement of substantial funds with repayment dependent, in part, on the success of the ultimate project rather than the ability of the borrower or guarantor to repay principal and interest. If Jefferson Federal is forced to foreclose on a project prior to or at completion due to a default, there can be no assurance that it will be able to recover all of the unpaid balance of, and accrued interest on, the loan as well as related foreclosure and holding costs.

Land Loans. Loans secured by undeveloped land or improved lots generally involve greater risks than residential mortgage lending because land loans are more difficult to evaluate. If the estimate of value proves to be inaccurate, in the event of default and foreclosure, Jefferson Federal may be confronted with a property the value of which is insufficient to assure full repayment.

Commercial Loans. Commercial business lending generally involves greater risk than residential mortgage lending and involves risks that are different from those associated with commercial and multi-family real estate lending. Although the repayment of commercial and multi-family real estate loans depends primarily on the cash-flow of the property or related business, the underlying collateral generally provides a sufficient source of repayment. Although commercial business loans are often collateralized by equipment, inventory, accounts receivable or other business assets, the liquidation of collateral if a borrower defaults is often an insufficient source of repayment because accounts receivable may be uncollectible and inventories and equipment may be obsolete or of limited use, among other things. Accordingly, the repayment of a commercial business loan depends primarily on the cash-flow, character and creditworthiness of the borrower (and any guarantors), while liquidation of collateral is secondary.

Consumer Loans. Consumer loans may entail greater risk than do residential mortgage loans, particularly in the case of consumer loans that are unsecured or secured by assets that depreciate rapidly, such as automobiles, boats and recreational vehicles. In such cases, repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment for the outstanding loan and the remaining deficiency often does not warrant further substantial collection efforts against the borrower. In addition, consumer loan collections are dependent on the borrower s continuing financial stability, and thus are more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy. Furthermore, the application of various federal and state laws, including federal and state bankruptcy and insolvency laws, may limit the amount which can be recovered on such loans.

***Loan Originations*.** All of Jefferson Federal s portfolio loans are originated by in-house lending officers and are underwritten and processed in-house. Jefferson Federal relies on advertising, referrals from realtors and customers, and personal contact by its staff to generate loan originations. Jefferson Federal occasionally purchases participation interests in commercial real estate loans through other financial institutions in its market area.

***Loan Approval Procedures and Authority*.** Loan approval authority has been granted by the Board of Directors to certain officers on an individual and combined basis for consumer (including residential mortgages) and commercial purpose loans up to a maximum of $1.0 million per transaction. All loans with aggregate exposure of $2.0 million or more require the approval of Jefferson Federal s Loan Committee or Board of Directors.

Jefferson Federal s Loan Committee meets every two weeks to review all mortgage loans made within granted lending authority of $75,000 or more and all non-mortgage loans made within granted lending authority of $50,000 or more. The committee approves all requests which exceed granted lending authority or when the request carries aggregate exposure to us of $2.0 million or more. The minutes of the committee are reported to and reviewed by the Board of Directors.

***Loans to One Borrower*.** The maximum amount that Jefferson Federal may lend to one borrower and the borrower s related entities is limited by regulation. At December 31, 2013, its regulatory limit on loans to one borrower was $11.7 million. At that date, Jefferson Federal s largest lending relationship was $5.7 million and consisted of multiple real estate and commercial business loans. These loans were performing according to their original repayment terms at December 31, 2013.

Loan Commitments. Jefferson Federal issues commitments for fixed-rate and adjustable-rate single-family residential mortgage loans conditioned upon the occurrence of certain events. Commitments to originate mortgage loans are legally binding agreements to lend to its customers and generally expire in 90 days or less.

Investment Activities

Jefferson Federal has legal authority to invest in various types of liquid assets, including U.S. Treasury obligations, securities of various federal agencies and of state and municipal governments, deposits at the Federal Home Loan Bank of Cincinnati and certificates of deposit of federally insured institutions. Within certain regulatory limits, Jefferson Federal also may invest a portion of its assets in corporate securities. Jefferson Federal also is required to maintain an investment in Federal Home Loan Bank of Cincinnati stock.

At December 31, 2013, Jefferson Federal s investment portfolio consisted of U.S. agency securities, mortgage-backed securities, municipal securities and corporate securities.

Jefferson Federal s investment objectives are to provide and maintain liquidity, to maintain a balance of high quality investments, to diversify investments to minimize risk, to provide collateral for pledging requirements, to establish an acceptable level of interest rate risk, to provide an alternate source of low-risk investments when demand for loans is weak, and to generate a favorable return. Any two of the following officers are authorized to purchase or sell investments: the President, Executive Vice President and/or Vice President. There is a limit of $2.0 million par value on any single investment purchase unless approval is obtained from the Board of Directors. For mortgage-backed securities, real estate mortgage investment conduits and collateralized mortgage obligations issued by Ginnie Mae, Freddie Mac or Fannie Mae, purchases are limited to a current par value of $2.5 million without Board approval.

Deposit Activities and Other Sources of Funds

General. Deposits and loan repayments are the major sources of Jefferson Federal s funds for lending and other investment purposes. Loan repayments are a relatively stable source of funds, while deposit inflows and outflows and loan prepayments are significantly influenced by general interest rates and money market conditions. Jefferson Federal may use borrowings on a short-term basis to compensate for reductions in the availability of funds from other sources. Borrowings may also be used on a longer-term basis for general business purposes.

Deposit Accounts. Substantially all of Jefferson Federal s depositors are residents of the State of Tennessee. Deposits are attracted from within its primary market area through the offering of a broad selection of deposit instruments, including NOW accounts, money market accounts, regular savings accounts, Christmas club savings accounts, certificates of deposit and retirement savings plans. Jefferson Federal does not utilize brokered funds. Deposit account terms vary according to the minimum balance required, the time periods the funds must remain on deposit and the interest rate, among other factors. In determining the terms of its deposit accounts, Jefferson Federal considers the rates offered by its competition, profitability to us, matching deposit and loan products and customer preferences and concerns. Jefferson Federal generally reviews its deposit mix and pricing monthly. Its current strategy is to offer competitive rates, but not be the market leader in every type and maturity. In recent years, Jefferson Federal s advertising has emphasized transaction accounts, with the goal of shifting its mix of deposits towards a smaller percentage of higher cost time deposits.

Borrowings. Jefferson Federal has relied upon advances from the Federal Home Loan Bank of Cincinnati to supplement its supply of lendable funds and to meet deposit withdrawal requirements. Advances from the Federal Home Loan Bank are typically secured by Jefferson Federal s first mortgage loans.

The Federal Home Loan Bank functions as a central reserve bank providing credit for member financial institutions. As a member, Jefferson Federal is required to own capital stock in the Federal Home Loan Bank and is authorized to apply for advances on the security of such stock and certain of its mortgage loans and other assets (principally securities which are obligations of, or guaranteed by, the United States), provided certain standards related to creditworthiness have been met. Advances are made pursuant to several different programs. Each credit program has its own interest rate and range of maturities. Depending on the program, limitations on the amount of advances are based either on a fixed percentage of an institution s net worth or on the Federal Home Loan Bank s assessment of the institution s creditworthiness. Under its current credit policies, the Federal Home Loan Bank generally limits advances to 50% of a member s assets. The availability of Federal Home Loan Bank advances to each borrower is based on the financial condition and the degree of security provided to collateralize borrowings.

Personnel

As of December 31, 2013, Jefferson Federal had 135 full-time employees and eight part-time employees, none of whom is represented by a collective bargaining unit. Jefferson Federal believes its relationship with its employees is good.

Subsidiaries

In addition to Jefferson Federal, Jefferson currently has one subsidiary, State of Franklin Statutory Trust II. State of Franklin Statutory Trust II is a Delaware statutory trust. In December 2006, State of Franklin Bancshares issued subordinated debentures to State of Franklin Statutory Trust II, which purchased the debentures with the proceeds from the sale of trust preferred securities issued in a private placement. Jefferson s net consolidated principal obligation under the debentures and trust preferred securities is $10.0 million.

Regulation and Supervision of Jefferson

General. Jefferson is a bank holding company subject to regulation by the Board of Governors of the Federal Reserve System (the Federal Reserve Board) under the Bank Holding Company Act of 1956, as amended (the BHCA). As a result, Jefferson activities are subject to certain limitations, which are described below. In addition, as a bank holding company, Jefferson is required to file annual and quarterly reports with the Federal Reserve Board and to furnish such additional information as the Federal Reserve Board may require pursuant to the BHCA. Jefferson is also subject to regular examination by and the enforcement authority of the Federal Reserve Board.

Activities. With certain exceptions, the BHCA prohibits a bank holding company from acquiring direct or indirect ownership or control of more than 5% of the voting shares of a company that engages directly or indirectly in activities other than those of banking, managing or controlling banks, or providing services for its subsidiaries. The principal exceptions to these prohibitions involve certain non-bank activities which, by statute or by Federal Reserve Board regulation or order, have been identified as activities closely related to the business of banking. The activities of Jefferson are subject to these legal and regulatory limitations under the BHCA and the related Federal Reserve Board regulations. Notwithstanding the Federal Reserve Board s prior approval of specific nonbanking activities, the Federal Reserve Board has the power to order a holding company or its subsidiaries to terminate any activity, or to terminate its ownership or control of any subsidiary, when it has reasonable cause to believe that the continuation of such activity or such ownership or control constitutes a serious risk to the financial safety, soundness or stability of any bank subsidiary of that holding company.

Acquisitions. Under the BHCA, a bank holding company must obtain the prior approval of the Federal Reserve Board before: (1) acquiring direct or indirect ownership or control of any voting shares of any bank or bank holding company if, after such acquisition, the bank holding company would directly or indirectly own or control more than 5% of such shares; (2) acquiring all or substantially all of the assets of another bank or bank holding company; or (3) merging or consolidating with another bank holding company. Satisfactory financial condition, particularly with regard to capital adequacy, and satisfactory CRA ratings are generally prerequisites to obtaining federal regulatory approval to make acquisitions.

Under the BHCA, any company must obtain approval of the Federal Reserve Board prior to acquiring control of the Jefferson or Jefferson Federal. For purposes of the BHCA, control is defined as ownership of more than 25% of any class of voting securities of a company or a bank, the ability to control the election of a majority of the directors, or the exercise of a controlling influence over management or policies of a company or a bank. In addition, the Change in Bank Control Act and the related regulations of the Federal Reserve Board require any person or persons acting in concert (except for companies required to make application under the BHCA), to file a written notice with the Federal Reserve Board before such person or persons may acquire control of Jefferson or Jefferson Federal. The Change in Bank Control Act defines control as the power, directly or indirectly, to vote

25% or more of any voting securities or to direct the management or policies of a bank holding company or an insured bank. There is a presumption of control where the acquiring person will own, control or hold with power to vote 10% or more of any class of voting security of a bank holding company or insured bank if, like Jefferson, the company involved has registered securities under Section 12 of the Securities Exchange Act of 1934.

Under Tennessee banking law, prior approval of the Tennessee Department of Financial Institutions is also required before any person may acquire control of a Tennessee bank or bank holding company. Tennessee law generally prohibits a bank holding company from acquiring control of an additional bank if, after such acquisition, the bank holding company would control more than 30% of the FDIC-insured deposits in the State of Tennessee.

Capital Requirements. The Federal Reserve Board has adopted guidelines regarding the consolidated capital adequacy of bank holding companies, which require bank holding companies to maintain specified minimum ratios of capital to total assets and to risk-weighted assets. See *Regulation and Supervision of Jefferson Federal Capital Requirements.*

In July 2013, the Federal Reserve Board approved revisions to its capital adequacy guidelines and prompt corrective action rules that implement the revised standards of the Basel Committee on Banking Supervision, commonly called Basel III, and address relevant provisions of the Dodd-Frank Act Wall Street Reform and Consumer Protection Act of 2010 (the Dodd-Frank Act). The final rule applies to all depository institutions, top-tier bank holding companies with total consolidated assets of $500 million or more, and top-tier savings and loan holding companies (banking organizations). Among other things, the rule establishes a new common equity Tier 1 minimum capital requirement (4.5% of risk-weighted assets), increases the minimum Tier 1 capital to risk-based assets requirement (from 4% to 6% of risk-weighted assets) and assigns a higher risk weight (150%) to exposures that are more than 90 days past due or are on nonaccrual status and to certain commercial real estate facilities that finance the acquisition, development or construction of real property. The final rule also limits a banking organization s capital distributions and certain discretionary bonus payments if the banking organization does not hold a capital conservation buffer consisting of 2.5% of common equity Tier 1 capital to risk-weighted assets in addition to the amount necessary to meet its minimum risk-based capital requirements. The final rule becomes effective for us on January 1, 2015. The capital conservation buffer requirement will be phased in beginning January 1, 2016 and ending January 1, 2019, when the full capital conservation buffer requirement will be effective.

Dividends. The Federal Reserve Board has the power to prohibit dividends by bank holding companies if their actions constitute unsafe or unsound practices. The Federal Reserve Board has issued a policy statement on the payment of cash dividends by bank holding companies, which expresses the Federal Reserve Board s view that a bank holding company should pay cash dividends only to the extent that the company s net income for the past year is sufficient to cover both the cash dividends and a rate of earnings retention that is consistent with the company s capital needs, asset quality and overall financial condition. The Federal Reserve Board also indicated that it would be inappropriate for a bank holding company experiencing serious financial problems to borrow funds to pay dividends. The Federal Reserve Board may prohibit a bank holding company from paying any dividends if the holding company s bank subsidiary is classified as undercapitalized or worse. See *Regulation and Supervision of Jefferson Federal Prompt Corrective Regulatory Action.*

Stock Repurchases. Bank holding companies are required to give the Federal Reserve Board prior written notice of any purchase or redemption of its outstanding equity securities if the gross consideration for the purchase or redemption, when combined with the net consideration paid for all such purchases or redemptions during the preceding 12 months, is equal to 10% or more of Jefferson s consolidated net worth. The Federal Reserve Board may disapprove such a purchase or redemption if it determines that the proposal would violate any law, regulation, Federal Reserve Board order, directive or any condition imposed by, or written agreement with, the Federal Reserve Board.

This requirement does not apply to bank holding companies that are well-capitalized, received one of the two highest examination ratings at their last examination and are not the subject of any unresolved supervisory issues.

Regulation and Supervision of Jefferson Federal

General. Jefferson Federal is subject to extensive regulation by the Tennessee Department of Financial Institutions (the Department) and, as an insured state bank that is not a member of the Federal Reserve System (a nonmember bank), by the FDIC. The lending activities and other investments of Jefferson Federal must comply with various federal regulatory requirements. The Department and FDIC periodically examine Jefferson Federal for compliance with these regulatory requirements and Jefferson Federal must regularly file reports with the Department and the FDIC describing its activities and financial condition. Jefferson Federal is also subject to certain reserve requirements promulgated by the Federal Reserve Board. This supervision and regulation is intended primarily for the protection of depositors.

The Dodd-Frank Act has created the Consumer Financial Protection Bureau (the Bureau) to implement federal consumer protection laws. The Bureau will assume responsibility for the existing federal consumer protection laws and regulations and has the authority to impose new requirements. The prudential regulators, however, will retain examination and enforcement authority over an institution s compliance with such laws and regulations so long as the institution has less than $10 billion in assets.

Tennessee State Law. As a Tennessee-chartered savings bank, Jefferson Federal is subject to the applicable provisions of Tennessee law and the regulations of the Department adopted thereunder. Jefferson Federal derives its lending and investment powers from these laws, and is subject to periodic examination and reporting requirements by and of the Department. Certain powers granted under Tennessee law may be constrained by federal regulation. Banks nationwide are permitted to enter Jefferson Federal s market area and compete for deposits and loan originations. The approval of the Department is required prior to any merger or consolidation, or the establishment or relocation of any branch office. Tennessee savings banks are also subject to the enforcement authority of the Department, which may suspend or remove directors or officers, issue cease and desist orders and appoint conservators or receivers in appropriate circumstances.

Capital Requirements. Under FDIC regulations, nonmember banks are required to maintain a minimum leverage capital requirement consisting of a ratio of Tier 1 capital to total assets of 3% if the FDIC determines that the institution is not anticipating or experiencing significant growth and has well-diversified risk, including no undue interest rate risk exposure, excellent asset quality, high liquidity, good earnings and in general a strong banking organization, rated composite 1 under the Uniform Financial Institutions Rating System (the CAMELS rating system) established by the Federal Financial Institutions Examination Council. For all but the most highly rated institutions meeting the conditions set forth above, the minimum leverage capital ratio is not less than 4%. Tier 1 capital is the sum of common stockholders equity, noncumulative perpetual preferred stock (including any related surplus) and minority interests in consolidated subsidiaries, minus all intangible assets (other than certain mortgage servicing rights and purchased credit card relationships) minus identified losses, disallowed deferred tax assets and investments in financial subsidiaries and certain non-financial equity investments.

In addition to the leverage ratio (the ratio of Tier 1 capital to total assets), state-chartered nonmember banks must currently maintain a minimum ratio of qualifying total capital to risk-weighted assets of at least 8%, of which at least half must be Tier 1 capital. Qualifying total capital consists of Tier 1 capital plus Tier 2 or supplementary capital items. Tier 2 capital items include allowances for loan losses in an amount of up to 1.25% of risk-weighted assets, certain cumulative preferred stock and subordinated debentures, certain other capital instruments and up to 45% of pre-tax net unrealized holding gains on equity securities. The includable amount of Tier 2 capital cannot exceed the institution s Tier 1 capital. Qualifying total capital is further reduced by the amount of Jefferson Federal s investments in banking and finance subsidiaries that are not consolidated for regulatory capital purposes, reciprocal cross-holdings of capital securities issued by other banks, most intangible assets and certain other deductions. Under the FDIC risk-weighted system, all of a bank s balance sheet assets and the credit equivalent amounts of certain off-balance sheet items are assigned to one of four broad risk weight categories from 0% to 100%, based on the risks inherent in the type of assets or item. The aggregate dollar amount of each category is multiplied by risk weight assigned to that category. The sum of these weighted values equals Jefferson Federal s risk-weighted assets.

Dividend Limitations. Jefferson Federal may not pay dividends on its capital stock if its regulatory capital would thereby be reduced below the amount then required for the liquidation account established for the benefit of certain depositors of Jefferson Federal at the time of its conversion to stock form.

Earnings of Jefferson Federal appropriated to bad debt reserves and deducted for federal income tax purposes are not available for payment of cash dividends or other distributions to stockholders without payment of taxes at the then current tax rate by Jefferson Federal on the amount of earnings removed from the reserves for such distributions. Jefferson Federal intends to make full use of this favorable tax treatment and does not contemplate use of any earnings in a manner which would limit Jefferson Federal s bad debt deduction or create federal tax liabilities.

Under FDIC regulations, Jefferson Federal is prohibited from making any capital distributions if, after making the distribution, Jefferson Federal would have: (i) a total risk-based capital ratio of less than 8%; (ii) a Tier 1 risk-based capital ratio of less than 4%; or (iii) a leverage ratio of less than 4%.

Investment Activities. Under federal law, all state-chartered FDIC-insured banks have generally been limited to activities as principal and equity investments of the type and in the amount authorized for national banks, notwithstanding state law, subject to certain exceptions. For example, the FDIC is authorized to permit institutions to engage in state authorized activities or investments that do not meet this standard (other than non-subsidiary equity investments) for institutions that meet all applicable capital requirements if it is determined that such activities or investments do not pose a significant risk to the Deposit Insurance Fund.

Insurance of Deposit Accounts. Jefferson Federal s deposits are insured up to applicable limits by the Deposit Insurance Fund of the Federal Deposit Insurance Corporation. Under the Federal Deposit Insurance Corporation s existing risk-based assessment system, insured institutions are assigned to one of four risk categories based on supervisory evaluations, regulatory capital levels and certain other factors, with less risky institutions paying lower assessments. An institution s assessment rate depends upon the category to which it is assigned. Assessment rates range from seven to 77.5 basis points on the institution s assessment base, which is calculated as total assets minus tangible equity.

Deposit insurance per account owner is currently $250,000. The Federal Deposit Insurance Corporation adopted an optional Temporary Liquidity Guarantee Program by which, for a fee, non-interest bearing transaction accounts would receive unlimited insurance coverage until December 31, 2010, which was later extended to December 31, 2012. Jefferson Federal opted to participate in the unlimited coverage for noninterest bearing transaction accounts.

The Federal Deposit Insurance Corporation has authority to increase insurance assessments. A significant increase in insurance premiums would likely have an adverse effect on the operating expenses and results of operations of Jefferson Federal. Management cannot predict what insurance assessment rates will be in the future.

Prompt Corrective Regulatory Action. Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept broker deposits. The FDIC is required to take certain supervisory actions against undercapitalized institutions, the severity of which depends upon the institution s degree of undercapitalization. In addition, numerous mandatory supervisory actions become immediately applicable to an undercapitalized institution, including, but not limited to, increased monitoring by regulators and restrictions on growth, capital distributions and expansion. The FDIC could also take any one of a number of discretionary supervisory actions, including the issuance of a capital directive and the replacement of senior executive officers and directors. Significantly and critically undercapitalized institutions are subject to additional mandatory and discretionary measures.

Safety and Soundness Guidelines. Each federal banking agency has established safety and soundness standards for institutions under its authority. These agencies, including the FDIC, have released interagency guidelines establishing such standards and adopted rules with respect to safety and soundness compliance plans. The guidelines require savings institutions to maintain internal controls and information systems and internal audit systems that are appropriate for the size, nature and scope of the institution s business. The guidelines also establish certain basic standards for loan documentation, credit underwriting, interest rate risk exposure, and asset growth. The guidelines further provide that savings institutions should maintain safeguards to prevent the payment of compensation, fees and benefits that are excessive or that could lead to material financial loss, and should take into account factors such as comparable compensation practices at comparable institutions. If the agency determines that a savings institution is not in compliance with the safety and soundness guidelines, it may require the institution to submit an acceptable plan to achieve compliance with the guidelines. A savings institution must submit an acceptable compliance plan to the agency within 30 days of receipt of a request for such a plan. Failure to submit or implement a compliance plan may subject the institution to regulatory sanctions. Management believes that Jefferson Federal has met substantially all the standards adopted in the interagency guidelines.

Additionally, federal banking agencies have established standards relating to asset and earnings quality. The guidelines require a bank to maintain systems, commensurate with its size and the nature and scope of its operations, to identify problem assets and prevent deterioration in those assets as well as to evaluate and monitor earnings and ensure that earnings are sufficient to maintain adequate capital and reserves.

Federal Reserve System. The Federal Reserve Board regulations require depository institutions to maintain noninterest-earning reserves against their transaction accounts (primarily NOW and regular checking accounts). The Federal Reserve Board regulations generally provide that reserves be maintained against aggregate transaction accounts as follows: a 3% reserve ratio is assessed on net transaction accounts up to and including $55.2 million; a 10% reserve ratio is applied above $55.2 million. The first $10.7 million of otherwise reservable balances (subject to adjustments by the Federal Reserve Board) are exempted from the reserve requirements. The amounts are adjusted annually. At December 31, 2013, Jefferson Federal met applicable FRB reserve requirements.

Federal Home Loan Bank System. Jefferson Federal is a member of the Federal Home Loan Bank System (FHLBS) which consists of 12 regional Federal Home Loan Banks governed and regulated by the Federal Housing Finance Board (FHFB) of the Federal Home Loan Bank Board. Jefferson Federal, as a member of the FHLB of Cincinnati, is required to purchase and hold shares of capital stock in the FHLB of Cincinnati. As of December 31, 2013, Jefferson Federal held stock in the FHLB of Cincinnati in the amount $4.7 million and was in compliance with the above requirement. The Federal Home Loan Banks are required to provide funds for certain purposes including contributing funds for affordable housing programs. These requirements, or financial stress caused by economic conditions, could reduce the amount of dividends that the Federal Home Loan Banks pay to their members and result in the Federal Home Loan Banks imposing a higher rate of interest on advances to their members.

Loans to Executive Officers, Directors and Principal Stockholders. Under federal law, loans to directors, executive officers and principal stockholders of a state non-member bank like Jefferson Federal must be made on substantially the same terms as those prevailing for comparable transactions with persons who are not executive officers, directors, principal stockholders or employees of Jefferson Federal unless the loan is made pursuant to a compensation or benefit plan that is widely available to employees and does not favor insiders. Loans to any executive officer, director and principal stockholder, together with all other outstanding loans to such person and affiliated interests, generally may not exceed 15% of the bank s unimpaired capital and surplus, and aggregate loans to such persons may not exceed the institution s unimpaired capital and unimpaired surplus. Loans to directors, executive officers and principal stockholders, and their respective affiliates, in excess of the greater of $25,000 or 5% of capital and surplus (and any loan or loans aggregating $500,000 or more) must be approved in advance by a majority of the board of directors of Jefferson Federal with any interested director not participating in the voting. State nonmember banks are prohibited from paying the overdrafts of any of their executive officers or directors unless payment is made pursuant to a written, pre-authorized interest-bearing extension of credit plan that specifies a method of repayment or transfer of funds from another account at Jefferson Federal. Loans to executive officers are further restricted as to type, amount and terms of credit. In addition, the BHCA prohibits extensions of credit to executive officers, directors and greater than 10% stockholders of a depository institution by any other institution which has a correspondent banking relationship with the institution, unless such extension of credit is on substantially the same terms as those prevailing at the time for comparable transactions with other persons and does not involve more than the normal risk of repayment or present other unfavorable features.

Transactions with Affiliates. A state non-member bank or its subsidiaries may not engage in covered transactions with any one affiliate in an amount greater than 10% of such bank s capital stock and surplus, and for all such transactions with all affiliates a state non-member bank is limited to an amount equal to 20% of capital stock and surplus. All such transactions must also be on terms substantially the same, or at least as favorable, to the bank or subsidiary as those provided to a non-affiliate. The term covered transaction includes the making of loans, purchase of assets, issuance of a guarantee and similar types of transactions. Specified collateral requirements apply to covered transactions such as loans to and guarantees issued on behalf of an affiliate. An affiliate of a state

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non-member bank is any company or entity which controls or is under common control with the state non-member bank and, for purposes of the aggregate limit on transactions with affiliates, any subsidiary that would be deemed a financial subsidiary of a national bank. In a holding company context, the parent holding company of a state non-member bank and any companies which are controlled by such parent holding company are affiliates of the state non-member bank. Federal law further prohibits a depository institution from extending credit to or offering any other services, or fixing or varying the consideration for such extension of credit or service, on the condition that the customer obtain some additional service from the institution or certain of its affiliates or not obtain services of a competitor of the institution, subject to certain limited exceptions.

Enforcement. The FDIC has extensive enforcement authority over insured non-member banks, including Jefferson Federal. This enforcement authority includes, among other things, the ability to assess civil money penalties, issue cease and desist orders and remove directors and officers. In general, these enforcement actions may be initiated in response to violations of laws and regulations and unsafe or unsound practices.

The FDIC has authority under federal law to appoint a conservator or receiver for an insured bank under limited circumstances. The FDIC is required, with certain exceptions, to appoint a receiver or conservator for an insured state non-member bank if that bank was critically undercapitalized on average during the calendar quarter beginning 270 days after the date on which the institution became critically undercapitalized. See Prompt Corrective Regulatory Action. The FDIC may also appoint itself as conservator or receiver for an insured state non-member institution under specific circumstances on the basis of the institution s financial condition or upon the occurrence of other events, including: (1) insolvency; (2) substantial dissipation of assets or earnings through violations of law or unsafe or unsound practices; (3) existence of an unsafe or unsound condition to transact business; and (4) insufficient capital, or the incurring of losses that will deplete substantially all of the institution s capital with no reasonable prospect of replenishment without federal assistance.

Community Reinvestment Act. Under the Community Reinvestment Act, as implemented by FDIC regulations, a state non-member bank has a continuing and affirmative obligation consistent with its safe and sound operation to help meet the credit needs of its entire community, including low and moderate-income neighborhoods. The Community Reinvestment Act neither establishes specific lending requirements or programs for financial institutions nor limits an institution s discretion to develop the types of products and services that it believes are best suited to its particular community. The Community Reinvestment Act requires the FDIC, in connection with its examination of an institution, to assess the institution s record of meeting the credit needs of its community and to consider such record when it evaluates applications made by such institution. The Community Reinvestment Act requires public disclosure of an institution s Community Reinvestment Act rating. Jefferson Federal s latest Community Reinvestment Act rating received from the FDIC was satisfactory.

Financial Regulatory Legislation

The previously referenced Dodd-Frank Act contains a wide variety of provisions affecting the regulation of depository institutions. Those include, but are not limited to, restrictions related to mortgage originations, risk retention requirements as to securitized loans and the noted newly created consumer protection agency. The full impact of the Dodd-Frank Act on its business and operations will not be known for years until regulations implementing the statute are written and adopted. The Dodd-Frank Act may have a material impact on Jefferson Federal s operations, particularly through increased compliance costs resulting from possible future consumer and fair lending regulations.

Properties

Jefferson conducts its business through its main office, nine full-service branch offices and two limited-service drive-through facilities located in Hamblen, Knox, Sullivan and Washington Counties, Tennessee. Jefferson Federal owns all of our offices, except for a drive-through facility located in Morristown, Tennessee, the lease on which expires on December 31, 2015. As of December 31, 2013, the total net book value of its offices was $25.3 million. Jefferson believes that its facilities are adequate to meet its present and immediately foreseeable needs.

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Legal Proceedings

Jefferson is not a party to any pending legal proceedings. Periodically, there have been various claims and lawsuits involving Jefferson Federal, such as claims to enforce liens, condemnation proceedings on properties in which Jefferson Federal holds security interests, claims involving the making and servicing of real property loans and other issues incident to Jefferson Federal s business. Jefferson Federal is not a party to any pending legal proceedings that it believes would have a material adverse effect on the financial condition or operations of Jefferson.

JEFFERSON S MANAGEMENT DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The objective of this section is to help shareholders and potential investors understand Jefferson s views on its results of operations and financial condition. You should read this discussion in conjunction with the consolidated financial statements and notes to the consolidated financial statements that appear elsewhere in this proxy statement/prospectus.

Overview.

Income

Jefferson has two primary sources of pre-tax income. The first is net interest income. Net interest income is the difference between interest income which is the income that it earns on its loans and investments and interest expense which is the interest that it pays on its deposits and borrowings.

Jefferson s second principal source of pre-tax income is fee income the compensation it receives from providing products and services. Most of Jefferson s fee income comes from service charges on NOW accounts and fees for late loan payments. Jefferson also earns fee income from ATM charges, insurance commissions, safe deposit box rentals and other fees and charges.

Jefferson occasionally recognizes gains or losses as a result of sales of investment securities or foreclosed real estate. These gains and losses are not a regular part of Jefferson s income.

Expenses

The expenses Jefferson incurs in operating its business consist of compensation and benefits expenses, occupancy expenses, equipment and data processing expense, deposit insurance premiums, advertising expenses, expenses for foreclosed real estate and other miscellaneous expenses.

Compensation and benefits consist primarily of the salaries and wages paid to Jefferson s employees, fees paid to Jefferson s directors and expenses for retirement and other employee benefits.

Occupancy expenses, which are the fixed and variable costs of building and equipment, consist primarily of lease payments, real estate taxes, depreciation charges, maintenance and costs of utilities.

Equipment and data processing expense includes fees paid to Jefferson s third-party data processing service and expenses and depreciation charges related to office and banking equipment.

Deposit insurance premiums are payments Jefferson makes to the Federal Deposit Insurance Corporation for insurance of Jefferson Federal s deposit accounts.

Expenses for foreclosed real estate include maintenance and repairs on foreclosed properties prior to sale.

Other expenses include expenses for attorneys, accountants and consultants, payroll taxes, franchise taxes, charitable contributions, insurance, office supplies, postage, telephone and other miscellaneous operating expenses.

Critical Accounting Policies

Jefferson considers accounting policies involving significant judgments and assumptions by management that have, or could have, a material impact on the carrying value of certain assets or on income to be critical accounting policies. Jefferson considers the following to be its critical accounting policies: allowance for loan losses and deferred income taxes.

***Allowance for Loan Losses*.** Determining the amount of the allowance for loan losses necessarily involves a high degree of judgment. Management reviews the level of the allowance on a monthly basis and establishes the provision for loan losses based on the composition of the loan portfolio, delinquency levels, loss experience, economic condition and other factors related to the collectibility of the loan portfolio. Although Jefferson believes that it uses the best information available to establish the allowance for loan losses, future additions to the allowance may be necessary based on estimates that are susceptible to change as a result of changes in economic conditions and other factors. In addition, Tennessee Department of Financial Institutions and the FDIC, as an integral part of their examination processes, periodically review Jefferson s allowance for loan losses. These agencies may require Jefferson to recognize adjustments to the allowance based on their judgments about information available to them at the time of their examination.

Deferred Income Taxes. Jefferson uses the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. If current available information raises doubt as to the realization of the deferred tax assets, a valuation allowance is established. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Jefferson exercises significant judgment in evaluating the amount and timing of recognition of the resulting tax liabilities and assets, including projections of future taxable income. These judgments and estimates are reviewed on a continual basis as regulatory and business factors change.

Results of Operations for the Three and Six Months Ended December 31, 2013 and 2012

Overview.

	Three Months Ended December 31,		Six Months Ended December 31,	
	2013	**2012**	**2013**	**2012**
	(Dollars in thousands, except per share data)		(Dollars in thousands, except per share data)	
Net earnings	$ 444	$ 348	$ 942	$ 643
Net earnings per share, basic	$ 0.07	$ 0.05	$ 0.15	$ 0.10
Net earnings per share, diluted	$ 0.07	$ 0.05	$ 0.15	$ 0.10
Return on average assets (annualized)	0.36%	0.28%	0.38%	0.25%
Return on average equity (annualized)	3.29%	2.60%	3.52%	2.41%

For the three months ended December 31, 2013, net income totaled $444,000, or $0.07 per diluted share, compared to net income of $348,000, or $0.05 per diluted share, for the quarter ended December 31, 2012. For the six months ended December 31, 2013, net income totaled $942,000, or $0.15 per diluted share, compared to net income of $643,000, or $0.10 per diluted share, for the six months ended December 31, 2012. The improvement in net income is largely the result of a lower provision for loan losses and lower noninterest expense which more than offset a decrease in net interest income and noninterest income during the three and six months ended December 31, 2013.

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Net Interest Income.

The following table summarizes changes in interest income and expense for the three month periods ended December 31, 2013 and 2012:

	Three Months Ended December 31,			
	2013	2012	$ Change	% Change
	(Dollars in thousands)			
Interest income:				
Loans	$ 4,197	$ 4,435	$ (238)	(5.4%)
Investment securities	486	419	67	16.0%
Interest-earning deposits	6	20	(14)	(70.0%)
FHLB stock	48	57	(9)	(15.8%)
Total interest income	4,737	4,931	(194)	(3.9%)
Interest expense:				
Deposits	321	388	(67)	(17.3%)
Repurchase agreements	1	2	(1)	(50.0%)
Borrowings	265	318	(53)	(16.7%)
Subordinated notes & debentures	78	81	(3)	(3.7%)
Total interest expense	665	789	(124)	(15.7%)
Net interest income	$ 4,072	$ 4,142	($ 70)	(1.7%)

Net interest income before loan loss provision decreased $70,000, or 1.7%, to $4.1 million for the three months ended December 31, 2013 compared to the same period in 2012. The interest rate spread and net interest margin for the quarter ended December 31, 2013 were 3.59% and 3.67%, respectively, compared to 3.60% and 3.69%, respectively, for the same period in 2012.

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The following table summarizes changes in interest income and expense for the six month periods ended December 31, 2013 and 2012:

	Six Months Ended December 31,			
	2013	2012	$ Change	% Change
	(Dollars in thousands)			
Interest income:				
Loans	$ 8,270	$ 8,920	$ (650)	(7.3%)
Investment securities	954	829	125	15.1%
Interest-earning deposits	16	44	(28)	(63.6%)
FHLB stock	98	107	(9)	(8.4%)
Total interest income	9,338	9,900	(562)	(5.7%)
Interest expense:				
Deposits	657	832	(175)	(21.0%)
Repurchase agreements	1	3	(2)	(66.7%)
Borrowings	494	637	(143)	(22.4%)
Subordinated notes & debentures	158	163	(5)	(3.1%)
Total interest expense	1,310	1,635	(325)	(19.9%)
Net interest income	$ 8,028	$ 8,265	($ 237)	(2.9%)

Total interest income decreased $194,000, or 3.9%, to $4.7 million for the three months ended December 31, 2013 and decreased $562,000, or 5.7%, to $9.3 million for the six months ended December 31, 2013 compared to the prior year periods due primarily due to lower market interest rates. The average yield on interest-earning assets was 4.27% and 4.21%, respectively, for the three and six months ended December 31, 2013 compared to 4.39% and 4.35%, respectively, for the same periods in 2012.

Interest on loans decreased $238,000, or 5.4%, to $4.2 million for the three months ended December 31, 2013 and decreased $650,000, or 7.3%, to $8.3 million for the six months ended December 31, 2013 compared to the prior year periods. The average balance of loans increased $4.2 million, or 1.29%, to $325.9 million for the three months ended December 31, 2013 and increased $1.1 million, or 0.33%, to $325.5 million for the six months ended December 31, 2013. The increase in the average balance of loans is due to an increase in loan demand. The average yield on loans was 5.11% and 5.04%, respectively, for both the three and six months ended December 31, 2013, compared to 5.47% and 5.45%, respectively, for the same periods in 2012.

Interest on investment securities increased $67,000, or 16.0%, to $486,000 for the three months ended December 31, 2013 and increased $125,000, or 15.1%, to $954,000 for the six months ended December 31, 2013 compared to the prior year periods. The increase for both periods was the result of an increase in the average yield of investment securities coupled with an increase in the average balance. The average yield on investment securities increased 11 basis points to 2.01% for the three months ended December 31, 2013 and increased 3 basis points to 1.98% for the six months ended December 31, 2013 compared to the same periods in 2012.

Total interest expense decreased $124,000, or 15.7%, to $665,000 for the three month period ended December 31, 2013 and decreased $325,000, or 19.9%, to $1.3 million for the six month period ended December 31, 2013 compared to the prior year periods. The decrease for both periods was primarily due to lower interest rates on interest-bearing liabilities. Interest expense on deposits decreased $67,000, or 17.3%, to $321,000 for the three month period ended December 31, 2013 and decreased $175,000, or 21.0%, to $657,000 for the six months ended December 31, 2013 compared to the same periods in 2012. The decrease in interest expense on deposits was primarily due to downward repricing of certificates of deposit coupled with a lower average balance. The average rate paid on deposits decreased 6 basis points to 0.38% for the three months ended December 31, 2013 and

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decreased 8 basis points to 0.38% for the six months ended December 31, 2013 compared to the prior year period. Interest expense on FHLB advances decreased $53,000, or 16.7%, to $265,000 for the three months ended December 31, 2013 and decreased $143,000, or 22.4%, to $494,000 for the six months ended December 31, 2013 compared to the same periods in 2012. The decrease in interest expense on advances is due to the restructuring of $15.0 million in FHLB advances during the first quarter of fiscal 2014.

Average Balances and Yields. The following table presents information regarding average balances of assets and liabilities, as well as the total dollar amounts of interest income and dividends from average interest-earning assets and interest expense on average interest-bearing liabilities and the resulting average yields and costs. The yields and costs for the periods indicated are derived by dividing income or expense by the average balances of assets or liabilities, respectively, for the periods presented. For purposes of this table nonaccrual loan balances and related accrued interest income have been included.

	Three Months Ended December,				Six Months Ended December,			
	2013		2012		2013		2012	
	Average Balance	Yield/ Cost	Average Balance	Yield/ Cost	Average Balance	Yield/ Cost	Average Balance	Yield/ Cost
	(Dollars in thousands)				(Dollars in thousands)			
Loans	$ 325,868	5.11%	$ 321,716	5.47%	$ 325,544	5.04%	$ 324,480	5.45%
Investment securities	98,912	2.01%	90,888	1.90%	98,495	1.98%	87,424	1.95%
Interest-earning deposits	11,748	0.20%	29,812	0.27%	12,977	0.24%	36,548	0.24%
FHLB stock	4,735	4.02%	4,735	4.78%	4,735	4.11%	4,735	4.48%
Deposits	339,149	0.38%	352,098	0.44%	342,237	0.38%	356,794	0.46%
FHLB advances	41,480	2.53%	37,676	3.35%	39,518	2.48%	37,753	3.35%
Repurchase agreements	1,288	0.31%	1,072	0.74%	1,171	0.17%	952	0.63%
Subordinated debentures	7,396	4.18%	7,283	4.41%	7,382	4.25%	7,270	4.45%

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Rate/Volume Analysis. The following table sets forth the effects of changing rates and volumes on Jefferson s net interest income. The rate column shows the effects attributable to changes in rate (changes in rate multiplied by prior volume). The volume column shows the effects attributable to changes in volume (changes in volume multiplied by prior rate). The net column represents the sum of the prior columns. For purposes of this table, changes attributable to changes in both rate and volume that cannot be segregated have been allocated proportionately based on the changes due to rate and the changes due to volume.

	Three Months Ended December 31, 2013 Compared to 2012			Six Months Ended December 31, 2013 Compared to 2012		
	Increase (Decrease) Due To			Increase (Decrease) Due To		
	Volume	**Rate**	**Net**	**Volume**	**Rate**	**Net**
	(In thousands)			(In thousands)		
Interest income:						
Loans receivable	$ 57	($ 295)	($ 238)	$ 29	($ 679)	($ 650)
Investment securities	39	28	67	113	12	125
Daily interest-earning deposits and other interest-earning assets	(10)	(13)	(23)	(29)	(8)	(37)
Total interest-earning assets	86	(280)	(194)	113	(675)	(562)
Interest expense:						
Deposits	(14)	(53)	(67)	(33)	(142)	(175)
FHLB advances	30	(83)	(53)	29	(172)	(143)
Repurchase agreements	0	(1)	(1)	1	(3)	(2)
Subordinated debentures	1	(4)	(3)	2	(7)	(5)
Total interest-bearing liabilities	18	(142)	(124)	(1)	(324)	(325)
Net change in interest income	$ 68	($ 138)	($ 70)	$ 114	($ 351)	($ 237)

Provision for Loan Losses. There was no provision for loan losses for the three and six month periods ended December 31, 2013 compared to $300,000 and $600,000, respectively, for the same periods in 2012. The decrease in the provision for loan losses is the result of improvements in asset quality. Net charge-offs for the three and six month periods ended December 31, 2013 amounted to $1.0 million and $1.7 million, respectively, compared to $359,000 and $750,000 for the comparable periods in 2012. A significant portion of the loan charge-offs during the six months ended December 31, 2013 were against specific reserves and did not require replenishment of the allowance for loan losses. Management reviews the level of the allowance for loan losses on a monthly basis and establishes the provision for loan losses based on changes in the nature and volume of the loan portfolio, the amount of impaired and classified loans, historical loan loss experience and other qualitative factors. In addition, the Federal Deposit Insurance Corporation and Tennessee Department of Financial Institutions, as an integral part of their examination process, periodically review Jefferson s allowance for loan losses and may require Jefferson to recognize adjustments to the allowance for loan losses based on their judgments about information available to them at the time of their examination.

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The following table summarizes changes in noninterest income for the three month periods ended December 31, 2013 and 2012:

	Three Months Ended December 31, 2013	2012	$ Change	% Change
	(Dollars in thousands)			
Noninterest income:				
Mortgage origination fee income	$ 32	$ 131	($ 99)	(75.6%)
Service charges and fees	239	276	(37)	(13.4%)
Gain on investment securities	1	8	(7)	(87.5%)
Loss on sale of foreclosed real estate, net	(40)	(53)	13	(24.5%)
BOLI increase in cash value	61	60	1	1.7%
Other	190	159	31	19.5%
Total noninterest income	$ 483	$ 581	($ 98)	(16.9%)

Noninterest income decreased $98,000, or 16.9%, to $483,000 for the three months ended December 31, 2013 compared to $581,000 for the same period in 2012. The decrease was primarily the result of a decrease in mortgage origination fee income totaling $99,000. The decrease in mortgage origination fee is due to a decline in refinance originations.

The following table summarizes changes in noninterest income for the six month periods ended December 31, 2013 and 2012:

	Six Months Ended December 31, 2013	2012	$ Change	% Change
	(Dollars in thousands)			
Noninterest income:				
Mortgage origination fee income	$ 80	$ 277	($ 197)	(71.1%)
Service charges and fees	495	529	(34)	(6.4%)
Gain on sale of fixed assets		1	(1)	(100.0%)
Gain on investment securities	1	12	(11)	(91.7%)
Loss on sale of foreclosed real estate, net	(64)	(209)	145	(69.4%)
BOLI increase in cash value	122	120	2	1.7%
Other	343	307	36	11.7%
Total noninterest income	$ 977	$ 1,037	($ 60)	(5.8%)

For the six months ended December 31, 2013, noninterest income decreased $60,000, or 5.8%, to $977,000 compared to $1.0 million for the same period in 2012. The decrease was primarily the result of a $197,000 decrease in mortgage origination fee income partially offset by a $145,000 decrease in loss on sale of foreclosed real estate. The decrease in mortgage origination fee income for the six month periods is primarily due to a decline in refinance originations.

Noninterest Expense. The following table summarizes the dollar amounts for each category of noninterest expense, and the dollar and percent changes for the three months ended December 31, 2013 compared to the same period in 2012.

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	Three Months Ended December 31, 2013	2012	$ Change	% Change
	(Dollars in thousands)			
Noninterest expense:				
Compensation and benefits	$ 1,799	$ 1,767	$ 32	1.8%
Occupancy expense	326	341	(15)	(4.4%)
Equipment and data processing expense	647	617	30	4.9%
Deposit insurance premiums	168	210	(42)	(20.0%)
Advertising	68	39	29	74.4%
Professional services	123	139	(16)	(11.5%)
Valuation adjustment and expenses on other real estate owned	133	232	(99)	(42.7%)
Amortization of intangible assets	82	96	(14)	(14.6%)
Other	572	520	52	10.0%
Total noninterest expense	$ 3,918	$ 3,961	($ 43)	(1.1%)

Noninterest expense decreased $43,000, or 1.1%, to $3.9 million for the three months ended December 31, 2013 compared to $4.0 million for the same period in 2012. Valuation adjustments and expenses on OREO decreased $99,000, or 42.7%, to $133,000 for the three months ended December 31, 2013 compared to the same period in 2012.

The following table summarizes the dollar amounts for each category of noninterest expense, and the dollar and percent changes for the six months ended December 31, 2013 compared to the same period in 2012.

	Six Months Ended December 31, 2013	2012	$ Change	% Change
	(Dollars in thousands)			
Noninterest expense:				
Compensation and benefits	$ 3,527	$ 3,447	$ 80	2.3%
Occupancy expense	660	703	(43)	(6.1%)
Equipment and data processing expense	1,257	1,216	41	3.4%
Deposit insurance premiums	338	417	(79)	(18.9%)
Advertising	155	89	66	74.2%
Professional services	210	245	(35)	(14.3%)
Valuation adjustment and expenses on OREO	233	479	(246)	(51.4%)
Amortization of intangible assets	174	202	(28)	(13.9%)
Other	1,086	1,069	17	1.6%
Total noninterest expense	$ 7,640	$ 7,867	($ 227)	(2.9%)

Noninterest expense decreased $227,000, or 2.9%, to $7.6 million for the six months ended December 31, 2013 compared to $7.9 million the same period in 2012. Valuation adjustments and expenses on OREO decreased $246,000, or 51.4%, to $233,000 for the six month period ended December 31, 2013 compared to $479,000 for the same period in 2012.

Income Taxes. Income tax expense for the three and six months ended December 31, 2013 increased to $193,000 and $423,000, respectively, compared to income tax expense of $114,000 and $192,000, respectively, for the same periods in 2012. The increase in income tax expense for both periods was due to higher taxable income.

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Financial Condition at December 31, 2013 and June 30, 2013

Loans. Net loans increased $8.9 million, or 2.8%, to $330.2 million at December 31, 2013, compared to $321.3 million at June 30, 2013 due to an increase in loan demand.

The following table sets forth the composition of Jefferson s loan portfolio at the dates indicated.

	At December 31, 2013		At June 30, 2013			
	Amount	**Percent of Portfolio**	**Amount**	**Percent of Portfolio**	**$ Change**	**% Change**
	(Dollars in thousands)					
Real estate loans:						
Residential one-to four-family	$ 82,416	24.6%	$ 87,233	26.7%	$ (4,817)	(5.5%)
Home equity line of credit	17,664	5.3%	16,259	5.0%	1,405	8.6%
Commercial	128,095	38.3%	120,205	36.7%	7,890	6.6%
Multi-family	9,453	2.8%	13,509	4.1%	(4,056)	(30.0%)
Construction	11,812	3.5%	6,692	2.0%	5,120	76.5%
Land	22,146	6.6%	22,296	6.8%	(150)	(0.7%)
Total real estate loans	271,586	81.2%	266,194	81.3%	5,392	2.0%
Commercial business loans	59,952	17.9%	57,288	17.5%	2,664	4.7%
Consumer loans:						
Automobile loans	464	0.1%	510	0.2%	(46)	(9.0%)
Loans secured by deposits	372	0.1%	340	0.1%	32	9.4%
Other consumer loans	2,211	0.7%	2,971	0.9%	(760)	(25.6%)
Total consumer loans	3,047	0.9%	3,821	1.2%	(774)	(20.3%)
Total gross loans	334,585	100.0%	327,303	100.0%	7,282	2.2%
Less:						
Deferred loan fees, net	(405)		(344)		(61)	17.7%
Allowance for losses	(3,973)		(5,660)		1,687	(29.8%)
Loans receivable, net	$ 330,207		$ 321,299		$ 8,908	2.8%

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The following table sets forth certain information at December 31, 2013 regarding the dollar amount of principal repayments becoming due during the periods indicated for loans. The table does not include any estimate of prepayments which significantly shorten the average life of all loans and may cause Jefferson s actual repayment experience to differ from that shown below. Demand loans having no stated schedule of repayments and no stated maturity are reported as due in one year or less.

	Real Estate Loans	Commercial Business Loans	Consumer Loans	Total Loans
		(In thousands)		
Amounts due in:				
One year or less	$ 43,045	$ 24,090	$ 1,539	$ 68,674
More than one to three years	36,730	9,907	1,022	47,659
More than three to five years	90,406	10,965	486	101,857
More than five to 15 years	46,967	11,550		58,517
More than 15 years	54,438	3,440		57,878
Total	$ 27,586	$ 59,952	$ 3,047	$ 334,585

The following table sets forth the dollar amount of all loans at December 31, 2013 that are due after December 31, 2014 and have either fixed interest rates or floating or adjustable interest rates.

	Fixed-Rates	Floating or Adjustable Rates	Total
		(In thousands)	
Real estate loans:			
One- to four-family	$ 20,402	$ 56,537	$ 76,939
Home equity lines of credit	85	16,308	16,393
Commercial	59,426	46,443	105,869
Multi-family	8,011	264	8,275
Construction	6,746	4,107	10,853
Land	7,895	2,317	10,212
Commercial business loans	20,044	15,818	35,862
Consumer loans	1,487	21	1,508
Total	$ 124,096	$ 141,815	$ 265,911

The following table shows activity in Jefferson s loan portfolio, excluding loans held for sale, during the periods indicated.

		Six Months Ended December 31, 2013
Total loans at beginning of period	$	327,303
Loans originated:		
Real estate		43,202
Commercial business		14,791
Consumer		707
Total loans originated		58,700
Loan principal repayments		(51,418)
Net loan activity		7,282
Total gross loans at end of period	$	334,585

Investments. Jefferson s investment security portfolio primarily consists of U.S. Government agency obligations, mortgage-backed securities issued by government-sponsored entities, and municipal bonds. Investment securities decreased to $93.5 million at December 31, 2013 compared to $96.0 million at June 30, 2013. The decrease in the investment portfolio reflects security purchases totaling $10.9 million, partially offset by sales, paydowns and calls of securities totaling approximately $12.2 million. Investments classified as available-for-sale are carried at fair market value and reflect an unrealized loss of $1.0 million, or $630,000 net of taxes, at December 31, 2013.

	At December 31, 2013		At June 30, 2013	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(Dollars in thousands)		(Dollars in thousands)	
Federal agency securities	$ 20,913	$ 20,301	$ 21,985	$ 21,653
Mortgage-backed securities	65,020	64,799	65,607	65,868
Municipal securities	7,953	7,881	8,004	8,005
Other securities	607	491	607	498
Total	$ 94,493	$ 93,472	$ 96,203	$ 96,024

The following table sets forth the maturities and weighted average yields of investment securities at December 31, 2013.

	More than One Year to Five Years		More than Five Years to Ten Years		More than Ten Years		Total	
	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield
Federal agency securities	$ 1,999	1.76%	$ 11,907	1.67%	$ 868	3.00%	$ 14,774	1.77%
Mortgage-backed securities		0.00	9,141	0.16	55,658	1.91	64,799	2.04
Municipal securities	1,382	1.81	3,526	3.45	2,696	4.77	7,604	2.66
Other securities		0.00		0.00	492	0.00	492	0.00
Total	$ 3,381	1.62%	$ 24,574	1.76%	$ 59,714	2.18%	$ 87,669	2.12

Deposits. Total deposits decreased $11.6 million to $388.0 million at December 31, 2013 compared to $399.6 million at June 30, 2013 primarily due to planned runoff of certificates of deposit through lower interest rates and fluctuations in existing customer balances. Certificates of deposit decreased $6.9 million, or 4.7%, to $141.2 million while transaction accounts decreased $4.7 million, or 1.9%, to $246.8 million at December 31, 2013. Certificates of deposit comprised 36.4% of total deposits at December 31, 2013 compared to 37.1% of total deposits at June 30, 2013.

	At December 31, 2013	At June 30, 2013	$ Change	% Change
	(Dollars in thousands)			
Noninterest-bearing accounts	$ 52,753	$ 54,765	($ 2,012)	(3.7%)
NOW accounts	56,279	54,164	2,115	3.9%
Savings accounts	89,267	91,280	(2,013)	(2.2%)
Money market accounts	48,541	51,324	(2,783)	(5.4%)
Certificates of deposit	141,180	148,109	(6,929)	(4.7%)
Total	$ 388,020	$ 399,642	($ 11,622)	(2.9%)

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The following table indicates the amount of jumbo certificates of deposit by time remaining until maturity as of December 31, 2013. Jumbo certificates of deposit require minimum deposits of $100,000.

Maturity Period	Certificates of Deposit (In thousands)
Three months or less	$ 9,871
Over three through six months	9,684
Over six through twelve months	17,224
Over twelve months	18,138
Total	$ 54,917

The following table sets forth the time deposits classified by rates at the dates indicated.

	At December 31, 2013	At June 30, 2013
	(In thousands)	
0.01 1.00%	$ 113,262	$ 115,563
1.01 2.00%	27,726	31,306
2.01 3.00%	192	533
3.01 4.00%		35
4.01 5.00%		672
Total	$ 141,180	$ 148,109

The following table sets forth the amount and maturities of time deposits at December 31, 2013.

	At December 31, 2013						
	Less Than One Year	1-2 Years	2-3 Years	3-4 Years	4 or More Years	Total	Percent of Total Certificate Accounts
	(In Thousands)						
0.01 1.00%	$ 76,548	$ 24,462	$ 10,621	$ 1,217	$ 414	$ 113,262	80.2%
1.01 2.00%	20,826	1,965	156	3,054	1,725	27,726	19.6
2.01 3.00%	154	38				192	0.1
3.01 4.00%							0.0
4.01 5.00%							0.0
Total	$ 97,528	$ 26,465	$ 10,777	$ 4,271	$ 2,139	$ 141,180	100.0%

Borrowings. Jefferson has relied upon advances from the Federal Home Loan Bank (FHLB) of Cincinnati to supplement its supply of lendable funds and to meet deposit withdrawal requirements. FHLB advances totaled $46.9 million at December 31, 2013 compared to $37.6 million at June 30, 2013. Additional FHLB advances have been utilized during the second quarter of fiscal 2014 to manage daily liquidity needs and to support loan growth.

	Six Months Ended December 31, **2013** **(Dollars in thousands)**	
Maximum amount of advances outstanding at any month end	$	46,909
Average advances outstanding		39,518
Weighted average interest rate during the period		2.48%
Balance outstanding at end of period	$	46,909
Weighted average interest rate at end of period		2.28%

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Stockholders Equity. Stockholders equity was $53.5 million at December 31, 2013 compared to $53.0 million at June 30, 2013. Unrealized gains and losses, net of taxes, in the available-for-sale investment portfolio are reflected as an adjustment to stockholders equity. At December 31, 2013, the adjustment to stockholders equity was a net unrealized loss of $630,000 compared to an unrealized loss of $111,000 at June 30, 2013. Stock repurchases for the three months ended December 31, 2013 totaled 2,438 shares at an average cost of $6.40 per share. On November 13, 2008, Jefferson announced its third stock repurchase program pursuant to which up to 620,770 shares of Jefferson s outstanding common stock may be repurchased. At December 31, 2013, 401,115 shares remained eligible for repurchase under the current stock repurchase program.

Results of Operations for the Years Ended June 30, 2013 and 2012

Overview.

	2013	2012
	(Dollars in thousands, except per share data)	
Net earnings	$ 1,594	($ 4,000)
Net earnings per share, basic	$ 0.25	($ 0.64)
Net earnings per share, diluted	$ 0.25	($ 0.64)
Return on average assets	0.31%	(0.74%)
Return on average equity	2.97%	(7.37%)

For the year ended June 30, 2013, Jefferson reported net income of $1.6 million, or $0.25 per diluted share, compared to a net loss of $4.0 million, or $0.64 per diluted share, for the year ended June 30, 2012. The improvement in net income was primarily due to a lower provision for loan losses totaling $800,000 for fiscal 2013 compared to $9.9 million for fiscal 2012. The decrease in the provision for loan losses was attributable to improvements in asset quality.

Net Interest Income.

The following table summarizes changes in interest income and expense for the years ended June 30, 2013 and 2012:

	Year Ended June 30,		% Change
	2013	2012	2013/2012
Interest income:			
Loans	$ 17,529	$ 20,271	(13.5%)
Investment securities	1,689	1,900	(11.1%)
Interest-earning deposits	75	62	21.0%
FHLB stock	208	199	4.5%
Total interest income	19,501	22,432	(13.1%)
Interest expense:			

Deposits	1,535	2,965	(48.2%)
Borrowings	1,270	1,278	(0.6%)
Subordinated debentures	325	327	(0.6%)
Total interest expense	3,130	4,570	(31.5%)
Net interest income	$ 16,371	$ 17,862	(8.3%)

Net interest income before loan loss provision decreased $1.5 million to $16.4 million for the year ended June 30, 2013. The interest rate spread and net interest margin for the year ended June 30, 2013 were 3.55% and 3.64%, respectively, compared to 3.60% and 3.72%, respectively, for the year ended June 30, 2012.

Total interest income decreased $2.9 million, or 13.1%, to $19.5 million for fiscal 2013 compared to $22.4 million for fiscal 2012 primarily due to a lower volume of interest-earning assets and lower market interest rates. The average volume of earning assets decreased $29.9 million to $451.3 million for fiscal 2013, while the average yield on interest-earning assets decreased 33 basis points to 4.33% compared to fiscal 2012.

Interest on loans decreased $2.7 million, or 13.5%, to $17.5 million for fiscal 2013 as a result of a lower average balance of loans and a lower average yield. The average balance of loans decreased $40.8 million, or 11.2%, to $322.3 million due to the combination of reduced loan demand, normal paydowns on existing loans, transfers to other real estate owned (OREO) and charge-offs. The average yield on loans was 5.44% for fiscal 2013 compared to 5.57% for fiscal 2012.

Interest on investment securities decreased to $1.7 million for fiscal 2013 compared to $1.9 million for fiscal 2012. The average balance of investment securities increased $9.4 million to $92.7 million for fiscal 2013 compared to $83.3 million for fiscal 2012 as excess liquidity has been deployed into the investment portfolio. The average yield on investments decreased to 1.89% for fiscal 2013 compared to 2.36% for fiscal 2012 due to lower market interest rates. Dividends on FHLB stock were $208,000 for fiscal 2013, compared to $199,000 for fiscal 2012.

Total interest expense decreased $1.4 million to $3.1 million for the year ended June 30, 2013, compared to $4.6 million for the year ended June 30, 2012. The average volume of interest-bearing liabilities decreased $29.4 million to $400.2 million while the average rate paid on interest-bearing liabilities decreased 28 basis points to 0.78% for fiscal 2013. Interest expense on deposits decreased $1.4 million to $1.5 million for 2013 compared to $3.0 million for fiscal 2012 as a result of lower interest rates combined with a lower average balance of deposits. The average rate paid on deposits decreased 34 basis points to 0.43% for the year ended June 30, 2013. Interest expense on FHLB advances remained level at $1.3 million for fiscal 2013 compared to fiscal 2012. The average balance of FHLB advances decreased $206,000 to $37.7 million for fiscal 2013 while the average rate paid on FHLB advances remained unchanged at 3.36% compared to fiscal 2012.

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Average Balances and Yields. The following table presents information regarding average balances of assets and liabilities, as well as the total dollar amounts of interest income and dividends from average interest-earning assets and interest expense on average interest-bearing liabilities and the resulting average yields and costs.

The yields and costs for the periods indicated are derived by dividing income or expense by the average balances of assets or liabilities, respectively, for the periods presented. For purposes of this table nonaccrual loan balances and related accrued interest income have been included.

	Year Ended June 30,								
	2013			2012			2011		
	Average Balance	Interest and Dividends	Yield/ Cost	Average Balance	Interest and Dividends	Yield/ Cost	Average Balance	Interest and Dividends	Yield/ Cost
	(Dollars in thousands)								
Interest-earning assets:									
Loans[(1)]	$ 322,331	$ 17,529	5.44%	$ 363,154	$ 20,271	5.57%	$ 415,966	$ 24,251	5.83%
Investment securities	92,721	1,689	1.89	83,276	1,900	2.36	55,013	1,696	3.23
Daily interest deposits	31,466	75	0.24	29,996	62	0.21	72,804	180	0.25
Other earning assets	4,735	208	4.39	4,735	199	4.19	4,735	207	4.37
Total interest-earning assets	451,253	19,501	4.33	481,161	22,432	4.66	548,518	26,334	4.82
Noninterest-earning assets	57,262			57,864			59,553		
Total assets	$ 508,515			$ 539,025			$ 608,071		
Interest-bearing liabilities:									
Passbook accounts	91,745	207	0.23	97,167	485	0.50	86,581	651	0.75
NOW accounts	53,935	59	0.11	48,312	77	0.16	49,609	145	0.29
Money market accounts	51,708	119	0.23	53,797	311	0.58	56,113	521	0.93
Certificates of deposit	156,835	1,150	0.73	184,352	2,092	1.13	239,551	4,284	1.79
Total interest-bearing deposits	354,223	1,535	0.43	383,628	2,965	0.77	431,854	5,601	1.30

Borrowings	37,700	1,266	3.36	37,906	1,272	3.35	60,459	2,105	3.48
Repurchase agreements	985	4	0.41	912	6	0.66	1,053	6	0.57
Subordinated debentures	7,298	325	4.45	7,186	327	4.54	7,073	318	4.50
Total interest-bearing liabilities	400,206	3,130	0.78	429,632	4,570	1.06	500,439	8,030	1.60
Noninterest-bearing deposits	53,680			54,090			49,503		
Other noninterest-bearing liabilities	959			1,014			1,284		
Total liabilities	454,845			484,736			551,226		
Stockholders equity	53,670			54,289			56,845		
Total liabilities and stockholders equity	$ 508,515			$ 539,025			$ 608,071		
Net interest income		$ 16,371			$ 17,862			$ 18,304	
Interest rate spread			3.55%			3.60%			3.21%
Net interest margin			3.64%			3.72%			3.35%
Ratio of average interest-earning assets to average interest-bearing liabilities			112.76%			111.99%			109.61%

(1) Average loan balances include nonaccrual loans.

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Rate/Volume Analysis. The following table sets forth the effects of changing rates and volumes on Jefferson s net interest income. The rate column shows the effects attributable to changes in rate (changes in rate multiplied by prior volume). The volume column shows the effects attributable to changes in volume (changes in volume multiplied by prior rate). The net column represents the sum of the prior columns. For purposes of this table, changes attributable to changes in both rate and volume that cannot be segregated have been allocated proportionately based on the changes due to rate and the changes due to volume.

	2013 Compared to 2012			2012 Compared to 2011		
	Increase (Decrease) Due to			Increase (Decrease) Due to		
	Volume	Rate	Net	Volume	Rate	Net
			(In Thousands)			
Interest income:						
Loans receivable	$ (2,231)	$ (511)	$ (2,742)	$ (2,981)	$ (999)	$ (3,980)
Investment securities	250	(461)	(211)	950	(746)	204
Daily interest-bearing deposits and other interest-earning assets	3	19	22	(92)	(34)	(126)
Total interest-earning assets	(1,978)	(953)	(2,931)	(2,123)	(1,779)	(3,902)
Interest expense:						
Deposits	(212)	(1,218)	(1,430)	(571)	(2,065)	(2,636)
Borrowings	(7)	(1)	(8)	(760)	(73)	(833)
Subordinated debentures	5	(7)	(2)	5	4	9
Total interest-bearing liabilities	(214)	(1,226)	(1,440)	(1,326)	(2,134)	(3,460)
Net change in interest income	$ (1,764)	$ 273	$ (1,491)	$ (797)	$ 355	$ (442)

Provision for Loan Losses.

The provision for loan losses for fiscal 2013 was $800,000 compared to a provision of $9.9 million for fiscal 2012. Management reviews the level of the allowance for loan losses on a monthly basis and establishes the provision for loan losses based on changes in the nature and volume of the loan portfolio, the amount of impaired and classified loans, historical loan loss experience and other qualitative factors. Net charge-offs for the year ended June 30, 2013 amounted to $992,000 compared to $12.2 million for the year ended June 30, 2012. A significant portion of the loan charge-offs during fiscal 2013 and 2012 were against specific reserves and did not require replenishment of the allowance for loan losses.

An analysis of the changes in the allowance for loan losses is presented under *Allowance for Loan Losses and Asset Quality*.

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Noninterest Income. The following table shows the components of noninterest income and the percentage changes from 2013 to 2012.

	2013	2012	% Change 2013/2012
	(Dollars in Thousands)		
Mortgage origination fees	$ 445	$ 306	45.4%
Service charges and fees	1,036	1,106	(6.3)
Gain on investment securities	12	50	(76.0)
Impairment on investment securities		(29)	(100.0)
Loss on sale of fixed assets	1	(12)	(108.3)
Loss on foreclosed real estate	(266)	(169)	57.4
BOLI increase in cash value	239	236	1.3
Other	646	692	(6.6)
Total noninterest income	$ 2,113	$ 2,180	(3.1%)

For the year ended June 30, 2013, noninterest income decreased $67,000 to $2.1 million compared to $2.2 million for fiscal 2012. Mortgage origination fee income increased $139,000, or 45.4%, to $445,000 compared to the prior year due to higher demand for residential mortgage refinancing. Net losses on sale of foreclosed property totaled $266,000 for fiscal 2013 compared to $169,000 for fiscal 2012. Service charges and fees decreased $70,000, or 6.3%, to $1.0 million for fiscal 2013 compared to fiscal 2012.

Noninterest Expense. The following table shows the components of noninterest expense and the percentage changes from 2013 to 2012.

	2013	2012	% Change 2013/2012
	(Dollars in Thousands)		
Compensation and benefits	$ 6,761	$ 6,209	8.9%
Occupancy	1,343	1,379	(2.6)
Equipment and data processing	2,453	2,376	3.2
Deposit insurance premiums	968	811	19.4
Advertising	383	359	6.7
Professional services	463	442	(13.1)
Valuation adjustment and expenses on OREO	732	2,374	(69.2)
Amortization of intangible assets	386	441	(12.5)
Other	2,057	2,302	(7.0)
Total noninterest expense	$ 15,546	$ 16,693	(6.9)

For the year ended June 30, 2013, noninterest expense decreased $1.1 million to $15.5 million compared to $16.7 million for fiscal 2012. Compensation and benefits expense increased $552,000, or 8.9%, to $6.8 million for fiscal 2013 compared to fiscal 2012 due to a higher number of full-time employees combined with increases in commissions, salaries, ESOP expense, and health insurance costs. Valuation adjustments and expenses on other real estate owned decreased $1.6 million to $732,000 for fiscal 2013 compared to $2.4 million for fiscal 2012.

Income Taxes.

For the year ended June 30, 2013, income tax expense was $544,000 compared to a tax benefit of $2.5 million for the year ended June 30, 2012.

Balance Sheet Analysis

***Loans*.** Net loans decreased slightly to $321.3 million at June 30, 2013 compared to $322.5 million at June 30, 2012. Loan principal repayments and payoffs slightly exceeded new loan volume during fiscal year 2013 compared to the year ended June 30, 2012. Jefferson s primary lending activity is the origination of loans secured by real estate. Jefferson originates real estate loans secured by one- to four-family homes, commercial real estate, multi-family real estate and land. Jefferson also originates construction loans and home equity loans. At June 30, 2013, real estate loans totaled $266.2 million, or 81.3% of total loans, compared to $282.4 million, or 85.9% of total loans, at June 30, 2012. Real estate loans decreased $16.2 million, or 5.7%, in fiscal 2013.

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The following table sets forth the composition of Jefferson s loan portfolio at the dates indicated.

	At June 30,									
	2013		2012		2011		2010		2009	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in thousands)									
Real estate loans:										
Residential one- to four-family	$ 87,233	26.7%	$ 97,182	29.6%	$ 110,046	28.4%	$ 136,430	30.7%	$ 144,659	28.7%
Home equity lines of credit	16,259	5.0	18,395	5.6	20,029	5.2	19,768	4.4	22,467	4.5
Commercial	120,205	36.7	127,185	38.7	144,519	37.3	140,024	31.5	159,608	31.7
Multi-family	13,509	4.1	11,564	3.5	14,062	3.6	16,536	3.7	6,584	1.3
Construction	6,692	2.0	548	0.2	2,171	0.6	21,073	4.7	40,831	8.1
Land	22,296	6.8	27,487	8.4	30,053	7.8	37,135	8.4	46,987	9.3
Total real estate loans	266,194	81.3	282,361	85.9	320,880	82.9	370,966	83.5	421,136	83.7
Commercial business loans	57,288	17.5	42,107	12.8	60,497	15.6	66,699	15.0	73,467	14.6
Non-real estate loans:										
Automobile loans	510	0.2	833	0.3	1,237	0.3	1,848	0.4	2,754	0.5
Mobile home loans		0.0	3	0.0	13	0.0	23	0.0	43	0.0
Loans secured by deposits	340	0.1	381	0.1	1,268	0.3	1,372	0.3	1,322	0.3
Other consumer loans	2,971	0.9	2,989	0.9	3,235	0.8	3,566	0.8	4,609	0.9
Total non-real estate loans	3,821	1.2	4,206	1.3	5,753	1.5	6,809	1.5	8,728	1.7
Total gross loans	327,303	100.00%	328,674	100.0%	387,130	100.0%	444,474	100.0%	503,331	100.00%

Less:					
Deferred loan fees, net	(344)	(323)	(362)	(447)	(502)
Allowance for losses	(5,660)	(5,852)	(8,181)	(9,649)	(4,722)
Total loans receivable, net	$ 321,299	$ 322,499	$ 378,587	$ 434,378	$ 498,107

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The following table sets forth certain information at June 30, 2013 regarding the dollar amount of principal repayments becoming due during the periods indicated for loans. The table does not include any estimate of prepayments which significantly shorten the average life of all loans and may cause Jefferson s actual repayment experience to differ from that shown below. Demand loans having no stated schedule of repayments and no stated maturity are reported as due in one year or less.

	Real Estate Loans	Commercial Business Loans	Consumer Loans	Total Loans
		(In thousands)		
Amounts due in:				
One year or less	$ 57,320	$ 25,726	$ 2,450	$ 85,496
More than one to three years	42,694	11,036	841	54,571
More than three to five years	75,075	12,578	522	88,175
More than five to 15 years	37,519	4,986	8	42,513
More than 15 years	53,586	2,962		56,548
Total	$ 266,194	$ 57,288	$ 3,821	$ 327,303

The following table sets forth the dollar amount of all loans at June 30, 2013 that are due after June 30, 2014 and have either fixed interest rates or floating or adjustable interest rates.

	Fixed-Rates	Floating or Adjustable Rates	Total
		(In thousands)	
Real estate loans:			
One- to four-family	$ 19,047	$ 58,001	$ 77,048
Home equity lines of credit	86	14,796	14,882
Commercial	55,225	37,631	92,856
Multi-family	7,897	512	8,409
Construction	2,832	2,205	5,037
Land	8,908	1,734	10,642
Commercial business loans	15,526	16,036	31,562
Consumer loans	1,352	19	1,371
Total	$ 110,873	$ 130,934	$ 241,807

The following table shows activity in Jefferson s loan portfolio, excluding loans held for sale, during the periods indicated.

Year Ended June 30,

	2013	2012	2011
		(In thousands)	
Total loans at beginning of period	$ 328,674	$ 387,130	$ 444,474
Loans originated:			
Real estate	48,757	21,219	25,706
Commercial business	24,279	6,386	14,051
Consumer	1,278	1,011	1,387
Total loans originated	74,314	28,616	41,144
Loan principal repayments	(75,685)	(87,072)	(98,488)
Net loan activity	(1,371)	(58,456)	(57,344)
Total gross loans at end of period	$ 327,303	$ 328,674	$ 387,130

Investments. Jefferson s investment portfolio consists of U.S. agency securities, mortgage-backed securities, corporate securities, and municipal securities. Investment securities increased $12.5 million to $96.0 million at June 30, 2013 compared to $83.5 million at June 30, 2012 as the result of excess liquidity deployed into the investment portfolio. Investments classified as available-for-sale are carried at fair market value and reflect an

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unrealized loss of $179,000, or $111,000 net of taxes. The increase in the investment portfolio reflects security purchases totaling $42.9 million, partially offset by sales, paydowns and calls of securities totaling approximately $27.8 million.

	At June 30,					
	2013		2012		2011	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(Dollars in thousands)					
Federal agency securities	$ 21,985	$ 21,653	$ 24,033	$ 24,296	$ 43,721	$ 43,949
Mortgage-backed securities	65,607	65,868	52,822	54,415	24,551	25,356
Municipal securities	8,004	8,005	4,245	4,563	5,150	5,237
Other securities	607	498	609	209	613	238
Total	$ 96,203	$ 96,024	$ 81,709	$ 83,483	$ 74,035	$ 74,780

The following table sets forth the maturities and weighted average yields of investment securities at June 30, 2013.

	More than One Year to Five Years		More than Five Years to Ten Years		More than Ten Years		Total	
	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield
Federal agency securities	$ 3,549	1.85%	$ 10,627	1.54%	$ 929	3.00%	$ 15,105	1.70%
Mortgage-backed securities		0.00	9,475	1.24	56,386	1.91	65,861	1.82
Municipal securities	1,066	1.09	3,474	2.66	3,211	3.54	7,751	2.66
Other securities		0.00		0.00	499	0.00	499	0.00
Total	$ 4,615	1.67%	$ 23,576	1.58%	$ 61,025	2.00%	$ 89,216	1.86%

Deposits. Jefferson s primary source of funds is its deposit accounts. The deposit base is comprised of checking, savings, money market and time deposits. These deposits are provided primarily by individuals and businesses within Jefferson s market area. Jefferson does not use brokered deposits as a source of funding. Total deposits decreased $24.2 million to $399.6 million at June 30, 2013 primarily due to the planned runoff of higher cost certificates of deposit. Certificates of deposit decreased $22.3 million, or 13.1%, to $148.1 million while transaction accounts decreased $1.9 million to $251.5 million at June 30, 2013. Management monitors the deposit mix and deposit pricing on a regular basis and has focused on growth in lower cost transaction accounts. Jefferson s deposit pricing strategy is to offer competitive rates, but not to offer the highest deposit rates in its markets.

At June 30,

	2013	2012	2011
		(In thousands)	
Noninterest-bearing accounts	$ 54,765	$ 52,436	$ 54,340
NOW accounts	54,164	52,958	46,134
Passbook accounts	91,280	96,588	91,637
Money market deposit accounts	51,324	51,492	51,252
Certificates of deposit	148,109	170,408	210,899
Total	$ 399,642	$ 423,882	$ 454,262

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The following table indicates the amount of jumbo certificates of deposit by time remaining until maturity as of June 30, 2013. Jumbo certificates of deposit require minimum deposits of $100,000.

Maturity Period	Certificates of Deposit (In thousands)
Three months or less	$ 14,988
Over three through six months	9,024
Over six through twelve months	15,792
Over twelve months	17,394
Total	$ 57,198

The following table sets forth the time deposits classified by rates at the dates indicated.

		At June 30,	
	2013	2012	2011
		(In thousands)	
0.01 1.00%	$ 115,563	$ 129,619	$ 82,706
1.01 2.00%	31,306	36,538	108,257
2.01 3.00%	533	2,313	8,046
3.01 4.00%	35	64	4,963
4.01 5.00%	672	1,874	6,927
Total	$ 148,109	$ 170,408	$ 210,899

The following table sets forth the amount and maturities of time deposits at June 30, 2013.

	At June 30, 2013						
	Less Than One Year	1-2 Years	2-3 Years	3-4 Years	4 or More Years	Total	Percent of Total Certificate Accounts
				(In Thousands)			
0.01 1.00%	$ 91,537	$ 11,320	$ 11,323	$ 1,250	$ 133	$ 115,563	78.0%
1.01 2.00%	17,309	9,954	207	955	2,881	31,306	21.1
2.01 3.00%	471	62				533	0.4
3.01 4.00%	35					35	0.0
4.01 5.00%	672					672	0.5

Total	$ 110,024	$ 21,336	$ 11,530	$ 2,205	$ 3,014	$ 148,109	100.0%

Borrowings. Jefferson has relied upon advances from the FHLB to supplement its supply of lendable funds and to meet deposit withdrawal requirements. FHLB advances decreased to $37.6 million at June 30, 2013 from $37.9 million at June 30, 2012. The following table presents certain information regarding Jefferson s use of FHLB advances during the periods and at the dates indicated.

	Year Ended June 30,		
	2013	**2012**	**2011**
	(Dollars in thousands)		
Maximum amount of advances outstanding at any month end	$ 37,856	$ 37,936	$ 85,104
Average advances outstanding	$ 37,700	$ 37,906	$ 60,459
Weighted average interest rate during the period	3.36%	3.36%	3.48%
Balance outstanding at end of period	$ 37,626	$ 37,863	$ 37,942
Weighted average interest rate at end of period	3.36%	3.36%	3.36%

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Stockholders Equity. Stockholders equity was $53.0 million at June 30, 2013 compared to $52.6 million at June 30, 2012. Jefferson Federal s total risk-based capital ratio was 14.18% at June 30, 2013, compared to 13.42% at June 30, 2012. During the year ended June 30, 2013, there were 30,897 shares of Jefferson common stock purchased through Jefferson s stock repurchase program at a cost of $156,000. At June 30, 2013, an additional 406,905 shares remained eligible for repurchase under the current stock repurchase program. Unrealized gains and losses, net of taxes, in the available-for-sale investment portfolio are reflected as an adjustment to stockholders equity. At June 30, 2013, the adjustment to stockholders equity was a net unrealized loss of $111,000 compared to a net unrealized gain of $1.1 million at June 30, 2012.

Allowance for Loan Losses and Asset Quality

Allowance for Loan Losses. The allowance for loan losses is a valuation allowance for probable losses inherent in the loan portfolio. Jefferson evaluates the need to establish reserves against losses on loans on a monthly basis. When additional reserves are necessary, a provision for loan losses is charged to earnings.

In connection with assessing the allowance, Jefferson has established a systematic methodology for determining the adequacy of the allowance for loan losses. The methodology segments loans with similar risk characteristics. Management performs a monthly assessment of the allowance for loan losses based on the nature and volume of the loan portfolio, the amount of impaired and classified loans and historical loan loss experience. In addition, management considers other qualitative factors, including delinquency trends, economic conditions and loan considerations.

The Tennessee Department of Financial Institutions and the FDIC, as an integral part of their examination process, periodically review Jefferson s allowance for loan losses. The Tennessee Department of Financial Institutions and FDIC may require Jefferson to make additional provisions for loan losses based on judgments different from ours.

The allowance for loan losses was $4.0 million at December 31, 2013 compared to $5.7 million at June 30, 2013. Jefferson s allowance for loan losses represented 1.19% of total loans and 59.40% of nonperforming loans at December 31, 2013 compared to 1.73% of total loans and 44.23% of nonperforming loans at June 30, 2013. The allowance for loan losses decreased $192,000 for fiscal 2013 to $5.7 million at June 30, 2013. Primarily as a result of management s evaluation of credit quality and current economic conditions, the provision for loan losses was $800,000 for fiscal 2013, compared to a provision of $9.9 million for fiscal 2012.

Net charge-offs for the three and six month periods ended December 31, 2013 amounted to $1.0 million and $1.7 million, respectively, compared to $359,000 and $750,000 for the comparable periods in 2012. Net charge-offs were $992,000 for fiscal 2013 compared to $12.2 million for fiscal 2012. Net charge-offs for the fiscal year ended June 30, 2013 were primarily attributable to real estate loans. At June 30, 2013, Jefferson s allowance for loan losses represented 1.73% of total gross loans and 44.23% of nonperforming loans, compared to 1.78% of total gross loans and 31.53% of nonperforming loans at June 30, 2012. A significant portion of the loan charge-offs during the six months ended December 31, 2013 and fiscal 2013 were against specific reserves and did not require replenishment of the allowance for loan losses.

Although Jefferson believes that it uses the best information available to establish the allowance for loan losses, future adjustments to the allowance for loan losses may be necessary and results of operations could be adversely affected if circumstances differ substantially from the assumptions used in making the determinations. Furthermore, while Jefferson believes it has established its allowance for loan losses in conformity with generally accepted accounting principles, there can be no assurance that regulators, in reviewing its loan portfolio, will not request Jefferson to increase its allowance for loan losses. In addition, because future events affecting borrowers and collateral cannot be predicted with certainty, there can be no assurance that the existing allowance for loan losses is adequate or that increases will not be necessary should the quality of any loans deteriorate as a result of the factors discussed above. Any material increase in the allowance for loan losses may adversely affect Jefferson s financial condition and results of operations.

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Summary of Loan Loss Experience. The following table sets forth an analysis of the allowance for loan losses for the periods indicated. Where specific loan loss reserves have been established, any difference between the loss reserve and the amount of loss realized has been charged or credited to current income.

	Six Months Ended December 31, 2013	Year Ended June 30, 2013	2012	2011	2010	2009
	(Dollars in thousands)					
Allowance at beginning of period	$ 5,660	$ 5,852	$ 8,181	$ 9,649	$ 4,722	$ 1,836
Provision for loan losses		800	9,873	4,447	8,809	910
Reserve for acquired bank						2,577
Recoveries:						
Real estate loans	114	36	12	110	7	22
Commercial business loans	77	386	897	91	3	29
Consumer loans	9	17	25	18	51	63
Total recoveries	200	439	934	219	61	114
Charge offs:						
Real estate loans	1,289	(950)	(4,363)	(3,853)	(1,955)	(220)
Commercial business loans	540	(441)	(8,673)	(2,150)	(1,869)	(327)
Consumer loans	58	(40)	(100)	(131)	(119)	(168)
Total charge-offs	1,887	(1,431)	(13,136)	(6,134)	(3,943)	(715)
Net charge-offs	1,687	(992)	(12,202)	(5,915)	(3,882)	(601)
Allowance at end of period	$ 3,973	$ 5,660	$ 5,852	$ 8,181	$ 9,649	$ 4,722
Allowance to nonperforming loans	59.40%	44.23%	31.53%	99.19%	51.38%	78.30%
Allowance to total gross loans outstanding at the end of the period	1.19%	1.73%	1.78%	2.11%	2.17%	0.94%
Net charge-offs to average loans outstanding during the period	1.04%	0.31%	3.36%	1.42%	0.83%	0.14%

The following table sets forth the breakdown of the allowance for loan losses by loan category at the dates indicated.

	At December 31, 2013			At June 30, 2013			2012		
	Amount	% of Allowance	% of Loans	Amount	% of Allowance	% of Loans	Amount	% of Allowance	% of Loans

		to Total Allowance	in Category to Total Loans		to Total Allowance	in Category to Total Loans		to Total Allowance	in Category to Total Loans
Real estate	$ 3,221	81.1%	81.2%	$ 3,084	54.5%	81.3%	$ 3,700	63.2%	85.9%
Commercial business	697	15.5	17.9	2,524	44.6	17.5	2,130	36.4	12.8
Consumer	55	1.4	0.9	52	0.9	1.2	22	0.4	1.3
Unallocated		0.0							
Total allowance for loan losses	$ 3,973	100.0%	100.00%	$ 5,660	100.0%	100.0%	$ 5,852	100.0%	100.0%

	At June 30,								
	2011			2010			2009		
	Amount	% of Allowance to Total Allowance	% of Loans in Category to Total Loans	Amount	% of Allowance to Total Allowance	% of Loans in Category to Total Loans	Amount	% of Allowance to Total Allowance	% of Loans in Category to Total Loans
Real estate	$ 6,941	84.8%	80.8%	$ 7,857	81.4%	83.5%	$ 3,819	80.9%	83.7%
Commercial business	1,197	14.6	17.7	1,675	17.4	15.0	755	16.0	14.6
Consumer	43	0.5	1.5	117	1.2	1.5	148	3.1	1.7
Unallocated									
Total allowance for loan losses	$ 8,181	100.0%	100.0%	$ 9,649	100.0%	100.0%	$ 4,722	100.0%	100.0%

Nonperforming and Classified Assets. When a loan becomes 90 days delinquent, the loan is placed on nonaccrual status at which time the accrual of interest ceases and the reserve for any uncollectible accrued interest is established and charged against operations. The interest on these loans is accounted for on the cash basis or cost-recovery method until the loan is returned to accrual status. Loans are returned to accrual status when future payments are reasonably assured. Payments received on non-accrual loans are applied to the remaining principal balance of the loans.

Jefferson considers repossessed assets and loans that are 90 days or more past due to be nonperforming assets. Real estate that Jefferson acquires as a result of foreclosure or by deed-in-lieu of foreclosure is classified as real estate owned until it is sold. When property is acquired, it is recorded at the lower of its cost, which is the unpaid balance of the loan plus foreclosure costs, or fair market value at the date of foreclosure. Holding costs and declines in fair value after acquisition of the property result in charges against income.

Nonperforming assets totaled $13.0 million, or 2.61% of total assets, at December 31, 2013, compared to $19.2 million, or 3.81% of total assets, at June 30, 2013. Nonaccrual loans totaled $6.7 million at December 31, 2013 compared to $12.8 million at June 30, 2013. TDRs were $3.9 million at December 31, 2013 compared to $9.1 million at June 30, 2013. Nonperforming assets decreased to $19.2 million, or 3.81% of total assets, at June 30, 2013, compared to $25.2 million, or 4.82% at June 30, 2012 as a result of a decrease in nonaccrual loans and foreclosed real estate. Nonaccrual loans totaled $12.8 million at June 30, 2013 compared to $18.6 million at June 30, 2012. The decrease in nonaccrual loans is primarily driven by the real estate segments of the portfolio. Nonaccrual loans with a current payment status were approximately 71% of the balance at June 30, 2013. Foreclosed real estate remained relatively unchanged at $5.4 million at December 31, 2013 compared to June 30, 2013. At December 31, 2013, foreclosed real estate consisted of vacant land totaling $3.5 million, residential property totaling $1.1 million, and commercial real estate totaling $792,000. Foreclosed real estate decreased $642,000 for fiscal 2013 to $5.4 million at June 30, 2013. At June 30, 2013, foreclosed real estate consisted of $1.3 million of single family homes, $3.6 million of vacant land, and commercial real estate totaling $525,000.

Under current accounting guidelines, a loan is defined as impaired when, based on current information and events, it is probable that a creditor will be unable to collect all amounts due under the contractual terms of the loan agreement. Jefferson considers consumer installment loans to be homogeneous and, therefore, do not separately evaluate them for impairment. All other loans are evaluated for impairment on an individual basis. At June 30, 2013, impaired loans totaled $14.4 million.

Troubled debt restructuring (TDR) loans were $3.9 million at December 31, 2013 and $9.1 million at June 30, 2013. A TDR exists when Jefferson grants a concession to a borrower experiencing financial difficulty that it normally would not otherwise consider. These concessions can result in avoidance of foreclosure proceedings and can result in the full repayment of the loan principal amount. Troubled debt restructurings are considered to be nonperforming, except for those that have established a sufficient performance history (generally at a minimum of six consecutive months of performance under the restructured terms) under the terms for the restructured loan. The majority of Jefferson Federal s TDRs involve a modification in loan terms such as a temporary period of interest only or extension of the maturity date. The majority of loans in this category are in compliance with their modified loan terms as of June 30, 2013. The amount of accruing TDR loans totaled $2.3 million at December 31, 2013 and $1.6 million at June 30, 2013. Additional information on all of Jefferson s troubled debt restructurings appears in the troubled debt restructurings table below.

The following table provides information with respect to Jefferson s nonperforming assets at the dates indicated.

	At December 31, 2013	At June 30, 2013	2012	2011	2010	2009
	(Dollars in thousands)					
Nonaccrual loans:						
Real estate	$ 3,619	$ 4,597	$ 9,040	$ 5,401	$ 17,367	$ 5,724
Commercial business	1,422	211	1,034	848	1,309	252
Consumer		439	33	41	103	55
Total nonaccrual loans	5,041	5,247	10,107	6,290	18,779	6,031
Nonaccrual restructured loans:						
Real estate	1,465	7,312	8,140	1,531		
Commercial business	182	237	315	427		
Consumer						
Total nonaccrual restructured loans	1,647	7,549	8,455	1,958		
Total nonperforming loans	6,688	12,796	18,562	8,248	18,779	6,031
Nonaccrual investments	904	942	207	464	731	
Real estate owned	5,417	5,433	6,075	9,498	6,865	3,328
Other nonperforming assets[(1)]			348	1		106
Total nonperforming assets	$ 13,009	$ 19,171	$ 25,192	$ 18,211	$ 26,375	$ 9,465
Accruing restructured loans	2,278	$ 1,553	$ 2,304	$ 13,821	$	$
Accruing restructured loans and nonperforming loans	8,966	$ 14,349	$ 20,866	$ 22,069	$ 18,779	$ 6,031
Total nonperforming loans to total loans	2.00%	3.91%	5.65%	2.13%	4.22%	1.20%
Total nonperforming loans to total assets	1.34%	2.54%	3.55%	1.47%	2.98%	0.91%
Total nonperforming assets to total	2.61%	3.81%	4.82%	3.25%	4.18%	1.43%

assets

(1) Consists primarily of repossessed automobiles and mobile homes.

Interest income that would have been recorded for the years ended June 30, 2013, and 2012 had nonaccruing loans and accruing restructured loans been current according to their original terms was $742,000 and $1.2 million, respectively. Interest related to nonaccrual loans or accruing restructured loans totaling $111,000 and $162,000 was included in interest income for the years ended June 30, 2013 and 2012, respectively.

Jefferson reviews and classifies its assets on a regular basis. In addition, the Tennessee Department of Financial Institutions has the authority to identify problem assets and, if appropriate, require them to be classified. There are three classifications for problem assets: substandard, doubtful and loss. Substandard assets must have one or more defined weaknesses and are characterized by the distinct possibility that Jefferson will sustain some loss if the deficiencies are not corrected. Doubtful assets have the weaknesses of substandard assets with the additional characteristic that the weaknesses make collection or liquidation in full on the basis of currently existing facts, conditions and values questionable, and there is a high possibility of loss. An asset classified loss is considered uncollectible and of such little value that continuance as an asset of the institution is not warranted. The regulations also provide for a special mention category, described as assets which do not currently expose Jefferson to a sufficient degree of risk to warrant classification but do possess credit deficiencies or potential weaknesses deserving Jefferson s close attention. When Jefferson classifies an asset as substandard or doubtful it must establish a general allowance for loan losses. If Jefferson classifies an asset as loss, it must either establish specific allowances for loan losses in the amount of 100% of the portion of the asset classified loss or charge off such amount.

The following table shows the aggregate amounts of Jefferson s classified assets at the dates indicated.

	At December 31, 2013	At June 30, 2013	2012	2011
		(In thousands)		
Substandard assets	$ 9,030	$ 18,990	$ 28,886	$ 35,153
Doubtful assets	1,167			
Loss assets				
Total classified assets	$ 10,197	$ 18,990	$ 28,886	$ 35,153

At each of the dates in the above table, substandard assets consisted of nonperforming assets plus other loans that Jefferson believed exhibited weakness. These substandard but performing loans totaled $7.2 million, $11.8 million and $27.4 million at June 30, 2013, 2012 and 2011, respectively. At June 30, 2013, Jefferson also had $14.6 million of loans that it was monitoring because of concerns about the borrowers ability to continue to make payments in the future, none of which were nonperforming or classified as substandard.

Delinquencies. The following table provides information about delinquencies in Jefferson s loan portfolio at the dates indicated.

	At December 31, 2013		At June 30, 2013		2012		2011	
	30-59 Days Past Due	60-89 Days Past Due	30-59 Days Past Due	60-89 Days Past Due	30-59 Days Past Due	60-89 Days Past Due	30-59 Days Past Due	60-89 Days Past Due
					(In thousands)			
Real estate loans	$ 2,008	$ 51	$ 314	$ 270	$ 1,381	$ 372	$ 3,006	$ 449
Commercial business loans	19	25	101	227	133		137	808
Consumer loans	9		10		17		24	
Total	$ 2,036	$ 76	$ 425	$ 497	$ 1,531	$ 372	$ 3,167	$ 1,257

At June 30, 2013, 2012 and 2011, delinquent loans consisted primarily of loans secured by commercial and residential real estate.

Liquidity and Capital Resources

Liquidity is the ability to meet current and future financial obligations of a short-term nature. Jefferson s primary sources of funds consist of deposit inflows, loan repayments, maturities and sales of investment securities and borrowings from the FHLB of Cincinnati. While maturities and scheduled amortization of loans and securities are predictable sources of funds, deposit flows and mortgage prepayments are greatly influenced by general interest rates, economic conditions and competition.

Jefferson regularly adjusts its investments in liquid assets based upon Jefferson s assessment of (1) expected loan demand, (2) expected deposit flows, (3) yields available on interest-earning deposits and securities and (4) the objectives of Jefferson s asset/liability management program. Excess liquid assets are invested generally in interest-earning deposits and short- and intermediate-term U.S. Government agency obligations. The Asset/Liability Committee (ALCO) is responsible for monitoring and implementing liquidity strategies and contingency plans that address Jefferson s ongoing liquidity needs.

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Jefferson s most liquid assets are cash and cash equivalents and interest-bearing deposits. The levels of these assets are dependent on Jefferson s operating, financing, lending and investing activities during any given period.

At December 31, 2013, cash and cash equivalents totaled $16.7 million compared to $24.5 million at June 30, 2013. Securities classified as available-for-sale, which provide additional sources of liquidity, totaled $93.5 million at December 31, 2013 compared to $96.0 million at June 30, 2013. At December 31, 2013, approximately $27.0 million of the investment portfolio was pledged as collateral for municipal deposits, FHLB borrowings and repurchase agreements. Municipal deposits totaled $7.5 million at December 31, 2013. Jefferson s external sources of liquidity include borrowing capacity with the FHLB of Cincinnati, the Federal Reserve, and other correspondent banks. FHLB advances totaled $46.9 million at December 31, 2013 compared to $37.6 million at June 30, 2013. At December 31, 2013, borrowing capacity with the FHLB totaled $51.6 million based on pledged collateral, of which $4.8 million was unused. Additional eligible collateral may be transferred to the FHLB to increase borrowing capacity. Jefferson can borrow from the Federal Reserve Bank of Atlanta s discount window to meet short-term liquidity requirements. At December 31, 2013, Jefferson had approximately $19.0 million of unused borrowing capacity based on pledged collateral with the Federal Reserve Bank discount window. In addition, Jefferson also maintains federal funds lines with two correspondent banks totaling $18.5 million under which no borrowings were outstanding. These federal funds lines may be terminated at any time and may not be outstanding for more than 14 consecutive days.

At December 31, 2013, Jefferson had approximately $15.3 million in commitments to extend credit, consisting entirely of commitments to fund real estate loans. In addition to commitments to originate loans, at December 31, 2013, Jefferson had $547,000 in unused letters of credit and approximately $28.6 million in unused lines of credit. December 31, 2013, Jefferson had approximately $75.5 million in certificates of deposit due within one year, $25.2 million in certificates of deposit without specific maturities and $246.8 million in other deposits without specific maturities. Jefferson believes, based on past experience, that a significant portion of those deposits will remain with it. Jefferson has the ability to attract and retain deposits by adjusting the interest rates offered.

The following table presents certain of Jefferson s contractual obligations as of December 31, 2013.

		Payments due by period			
Contractual Obligations	**Total**	**Less than 1 year**	**1-3 years**	**3-5 years**	**More than 5 years**
			(In thousands)		
Federal Home Loan Bank advances	$ 46,909	$ 26,515	$ 10,029	$ 10,126	$ 239
Subordinated debentures	10,001				10,001
Capital lease obligations					
Operating lease obligations	38	19	19		
Purchase obligations	1,236	1,051	185	0	
Total	$ 58,184	$ 27,585	$ 10,233	$ 10,126	$ 10,240

Jefferson s primary investing activities are the origination of loans and the purchase of securities. In the year ended June 30, 2013, Jefferson originated $74.3 million of loans. In fiscal 2012, Jefferson originated $28.6 million of loans and in fiscal 2011 Jefferson originated $41.1 million of loans.

Financing activities consist primarily of activity in deposit accounts and FHLB advances. Jefferson experienced a net decrease in total deposits of $11.6 million in the six months ended December 31, 2013, $24.2 million in the year ended June 30, 2013, a net decrease in total deposits of $30.4 million for the year ended June 30, 2012 and a net decrease in total deposits of $24.9 million for the year ended June 30, 2011, respectively. Deposit flows are affected by the overall level of interest rates, the interest rates and products offered by Jefferson and its local competitors and other factors. Jefferson generally manages the pricing of its deposits to be competitive and to increase core deposit relationships. Occasionally, Jefferson offers promotional rates on certain deposit products in order to attract deposits. FHLB advance activity reflected a decrease of $237,000 at June 30, 2013 and a decrease of $79,000 and $46.9 million at June 30, 2012 and 2011, respectively.

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Jefferson is subject to various regulatory capital requirements administered by the federal prompt corrective action regulations, including a risk-based capital measure. The risk-based capital guidelines include both a definition of capital and a framework for calculating risk-weighted assets by assigning balance sheet assets and off-balance sheet items to broad risk categories. At December 31, 2013, Jefferson exceeded all of its regulatory capital requirements. Jefferson is considered well capitalized under regulatory guidelines.

Jefferson Bancshares is a separate entity and apart from Jefferson Federal and must provide for its own liquidity. In addition to its operating expenses, Jefferson Bancshares is responsible for the payment of dividends declared for its shareholders, and interest and principal on outstanding debt. At times, Jefferson Bancshares has redeemed its stock. Substantially all of Jefferson Bancshares revenues are obtained from subsidiary service fees and dividends. Payment of such dividends to Jefferson Bancshares by Jefferson Federal is limited under Tennessee law. The amount that can be paid in any calendar year, without prior approval from the Tennessee Department of Financial Institutions, cannot exceed the total of Jefferson Federal s net income for the year combined with its retained net income for the preceding two years. Jefferson Bancshares believes that such restriction will not have an impact on its ability to meet its ongoing cash obligations.

Off-Balance Sheet Arrangements

In the normal course of operations, Jefferson engages in a variety of financial transactions that, in accordance with generally accepted accounting principles, are not recorded in its financial statements. These transactions involve, to varying degrees, elements of credit, interest rate, and liquidity risk. Such transactions are used primarily to manage customers requests for funding and take the form of loan commitments, unused lines of credit, amounts due mortgagors on construction loans, amounts due on commercial loans and commercial letters of credit.

For the six months ended December 31, 2013 and year ended June 30, 2013, Jefferson engaged in no off-balance-sheet transactions reasonably likely to have a material effect on its financial condition, results of operations or cash flows.

Impact of New Accounting Pronouncements

The impact of new accounting pronouncements is discussed in Note 4 to Jefferson s Audited Consolidated Financial Statements beginning on page F-1 and incorporated herein by reference.

Effect of Inflation and Changing Prices

The financial statements and related financial data presented in this proxy statement/prospectus have been prepared in accordance with generally accepted accounting principles, which require the measurement of financial position and operating results in terms of historical dollars without considering the change in the relative purchasing power of money over time due to inflation. The primary impact of inflation on Jefferson s operations is reflected in increased operating costs. Unlike most industrial companies, virtually all the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates generally have a more significant impact on a financial institution s performance than do general levels of inflation. Interest rates do not necessarily move in the same direction or to the same extent as the prices of goods and services.

Jefferson s Quantitative and Qualitative Disclosures About Market Risk

Qualitative Aspects of Market Risk. Jefferson Federal s most significant form of market risk is interest rate risk. Jefferson Federal manages the interest rate sensitivity of our interest-bearing liabilities and interest-earning assets in an effort to minimize the adverse effects of changes in the interest rate environment. Deposit accounts typically react more quickly to changes in market interest rates than mortgage loans because of the shorter maturities of deposits. As a result, sharp increases in interest rates may adversely affect our earnings while decreases in interest rates may beneficially affect our earnings. To reduce the potential volatility of our earnings, Jefferson Federal has sought to improve the match between asset and liability maturities and rates, while maintaining an acceptable interest rate spread. Pursuant to this strategy, Jefferson Federal actively originate adjustable-rate mortgage loans for retention in Jefferson Federal s loan portfolio. These loans generally reprice beginning after five years and annually thereafter. Most of Jefferson Federal s residential adjustable-rate mortgage loans may not adjust downward below their initial interest rate. Although historically Jefferson Federal has been successful in originating adjustable-rate mortgage loans, the ability to originate such loans depends to a great extent on market interest rates and borrowers preferences. This product enables Jefferson Federal to compete in the fixed-rate mortgage market while maintaining a shorter maturity. Fixed-rate mortgage loans typically have an adverse effect on interest rate sensitivity compared to adjustable-rate loans. In recent years, Jefferson Federal has used investment securities with terms of seven years or less and mortgage-backed securities to help manage interest rate risk. Jefferson Federal currently does not participate in hedging programs, interest rate swaps or other activities involving the use of off-balance sheet derivative financial instruments.

Jefferson Federal has established an Asset/Liability Committee to communicate, coordinate and monitor all aspects involving asset/liability management. The committee establishes and monitors the volume and mix of assets and funding sources with the objective of managing assets and funding sources to produce results that are consistent with liquidity, capital adequacy, growth, risk limits and profitability goals.

Quantitative Aspects of Market Risk. Jefferson Federal monitors the impact of changes in interest rates on our net interest income and present value of equity using rate shock analysis. The present value of equity is defined as the present value of assets minus the present value of liabilities. This analysis assesses the risk of loss in market risk sensitive instruments in the event of a sudden and sustained 100 to 400 basis point increase or 100 basis point decrease in market interest rates with no effect given to any steps that Jefferson Federal might take to counter the effect of that interest rate movement. Because of the low level of market interest rates, this analysis is not performed for decreases of more than 100 basis points. Jefferson Federal measures interest rate risk by modeling the changes in net portfolio value over a variety of interest rate scenarios.

The following table presents the estimated impact on net interest income and equity due to immediate changes in interest rates at the specified levels at June 30, 2013:

	Change In:			
	Net Interest Income		**Economic Value of Equity**	
Change in Interest Rates (In Basis Points)	**$ Change**	**% Change**	**Market Value**	**Change**
400	$ 17,718	7.6%	$ 60,575	(15.7%)
300	17,069	3.6	62,018	(13.7)
200	16,508	0.2	64,871	(9.7)
100	16,260	(1.3)	68,366	(4.9)
No change	16,475	0.0	71,874	0.0
(100)	15,969	(3.1%)	75,056	4.4%

Jefferson Federal uses certain assumptions in assessing interest rate risk that relate to interest rates, loan prepayment rates, deposit decay rates and the market values of certain assets under differing interest rate scenarios, among others. As with any method of measuring interest rate risk, certain shortcomings are inherent in the method of analysis presented in the foregoing table. For example, although certain assets and liabilities may have similar maturities or periods to repricing, they may react in different degrees to changes in market interest rates. Also, the interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types may lag behind changes in market rates. Additionally, certain assets, such as adjustable-rate mortgage loans, have features that restrict changes in interest rates on a short-term basis and over the life of the asset. Further, in the event of a change in interest rates, expected rates of prepayments on loans and early withdrawals from certificates could deviate significantly from those assumed in calculating the table.

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS

AND MANAGEMENT OF JEFFERSON

Beneficial Ownership of Jefferson Common Stock

The following table sets forth information regarding beneficial ownership of Jefferson common stock as of April 16, 2014, by: (1) each shareholder known by Jefferson to be the beneficial owner of more than five percent of the outstanding shares of Jefferson common stock; (2) each of Jefferson s named executive officers; (3) each of Jefferson s directors; and (4) all Jefferson directors and executive officers as a group. The information presented in the table is based upon the most recent filings with the SEC by such persons or upon information otherwise provided by such persons to Jefferson prior to April 16, 2014.

Beneficial ownership is determined according to the rules of the SEC and generally includes any shares over which a person possesses sole or shared voting or investment power as of April 16, 2014, as well as any shares that such person has the right to acquire within 60 days of April 16, 2014, through the exercise of options or other rights. Except as otherwise indicated, Jefferson believes that the beneficial owners of stock listed below have sole investment and voting power with respect to the shares described.

The applicable percentage ownership for each person listed below is based upon 6,595,301 shares of Jefferson common stock outstanding as of April 16, 2014. Shares of Jefferson common stock subject to options or other securities currently exercisable or exercisable on or before April 16, 2014, are deemed outstanding for the purpose of calculating the percentage ownership of the person holding those options or other securities, but are not treated as outstanding for the purpose of calculating the percentage ownership of any other person.

Unless otherwise noted, the address for each holder of five percent or more of any of the stock listed in the following table is: c/o Jefferson Bancshares, Inc., 120 Evans Avenue, Morristown, Tennessee 37814.

Names of Beneficial Owners	Beneficial Ownership of Jefferson Common Stock	Percentage of Outstanding Jefferson Common Stock(1)
Beneficial Owners of More Than 5%		
Jefferson Federal Bank Employee Stock Ownership Plan 120 Evans Avenue Morristown, Tennessee 37814	620,426	9.40%
Steven R. Gerbel Brown Trout Management, LLC 311 South Wacker Drive	455,328(2)	6.90

Suite 6025
Chicago, Illinois 60606

(1) Based on 6,595,301 shares outstanding and entitled to votes as of April 16, 2014.
(2) Based upon information in a Schedule 13G filed on March 4, 2014.

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	Beneficial Ownership of Jefferson Common Stock(1)	Percentage of Outstanding Jefferson Common Stock(2)	Number of Shares of Jefferson Common Stock Underlying Options Included in Shares Beneficially Owned
Directors and Named Executive Officer			
John W. Beard, Jr.	833	*%	2,000
Dr. Terry M. Brimer	109,909(3)		
Dr. Jack E. Campbell	73,188	1.67	
William T. Hale	57,811	*	
Gary L. Keys	738	*	2,000
H. Scott Reams	115,627(4)	1.75	
Anderson L. Smith	77,278(5)	1.17	
All directors and executive officers as a group (13 persons)	568,544	8.68%	4,000

* Represents less than 1.0%

(1) Includes 833, 738 and 25,578 shares allocated to the accounts of Mr. Beard, Mr. Keys and Mr. Smith, respectively, under the ESOP with respect to which Mr. Beard, Mr. Keys and Mr. Smith have voting but not investment power.

(2) Based on 6,595,301 shares outstanding and entitled to votes as of April 16, 2014, plus the number of shares that may be acquired by each individual (or group of individuals) by exercising options.

(3) Includes 36,500 shares held by Mr. Brimer s wife.

(4) Includes 2,050 shares held by Mr. Reams wife, 12,500 shares held by 401(k) plan and 1,500 shares held by IRA.

(5) Includes 4,903 shares held by 401(k) plan and 15,000 shares held by IRA.

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COMPARATIVE MARKET PRICES AND DIVIDENDS ON COMMON STOCK

HomeTrust common stock is traded on NASDAQ under the symbol HTBI. Jefferson common stock is traded on NASDAQ under the symbol JFBI. The following table sets forth the reported high and low sales prices of shares of HomeTrust common stock and Jefferson common stock, and the quarterly cash dividends per share declared, in each case for the periods indicated. The high and low sales prices are based on intraday sales for the periods reported.

	HomeTrust Common Stock			Jefferson Common Stock		
	High	Low	Dividends	High	Low	Dividends
Year Ended June 30, 2014						
Fourth Quarter (through April 22, 2014)						
Third Quarter	16.20	15.25		7.85	6.26	
Second Quarter	16.62	15.85		6.65	5.77	
First Quarter	17.00	15.91		5.95	5.35	
Year Ended June 30, 2013						
Fourth Quarter	17.00	15.05		5.95	5.10	
Third Quarter	16.24	13.37		5.84	2.71	
Second Quarter	13.75	12.55		2.96	2.27	
First Quarter	13.29	11.24		2.63	1.92	
Year Ended June 30, 2012						
Fourth Quarter				2.47	1.84	
Third Quarter				2.75	2.00	
Second Quarter				2.90	2.18	
First Quarter				3.37	2.50	

On January 22, 2014, the closing price on NASDAQ immediately prior to the public announcement of the merger agreement, the high and low sales prices of shares of HomeTrust common stock as reported on NASDAQ were $15.93 and $15.59, respectively. On , 2014, the last trading day before the date of this proxy statement/prospectus, the high and low sales prices of shares of HomeTrust common stock as reported on NASDAQ were $ and $, respectively.

On January 22, 2014, the closing price on NASDAQ immediately prior to the public announcement of the merger agreement, the high and low sale prices of shares of Jefferson common stock as reported on NASDAQ were $6.61 and $6.50, respectively. On , 2014, the last trading day before the date of this proxy statement/prospectus, the high and low sale prices of shares of Jefferson common stock as reported on NASDAQ were $ and $, respectively.

As of , 2014, the last date prior to printing this proxy statement/prospectus for which it was practicable to obtain this information for HomeTrust and Jefferson, respectively, there were approximately registered holders of HomeTrust common stock and 578 registered holders of Jefferson common stock.

Each of HomeTrust and Jefferson shareholders are advised to obtain current market quotations for HomeTrust common stock and Jefferson common stock. The market price of HomeTrust common stock and Jefferson common stock will fluctuate between the date of this proxy statement/prospectus and the date of completion of the merger. No assurance can be given concerning the market price of HomeTrust common stock or Jefferson common stock before or after the effective date of the merger. Changes in the market price of HomeTrust common stock prior to the completion of the merger will affect the market value of the stock portion of the merger consideration that Jefferson shareholders will receive upon completion of the merger.

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DESCRIPTION OF HOMETRUST S CAPITAL STOCK

The following information regarding the material terms of HomeTrust s capital stock is qualified in its entirety by reference to HomeTrust s articles of incorporation.

General

HomeTrust s authorized capital stock currently consists of:

60,000,000 shares of common stock, $0.01 par value per share; and

10,000,000 shares of preferred stock, $0.01 value per share.

As of April 22, 2014, there were shares of HomeTrust common stock issued and outstanding. No shares of HomeTrust preferred stock are currently outstanding. HomeTrust s common stock is traded on NASDAQ under the symbol HTBI.

Common Stock

Each share of HomeTrust common stock has the same relative rights and is identical in all respects with each other share of HomeTrust common stock. HomeTrust common stock represents non-withdrawable capital, is not of an insurable type and is not insured by the FDIC or any other government agency.

Subject to any prior rights of the holders of any preferred or other stock of HomeTrust then outstanding, holders of HomeTrust common stock are entitled to receive such dividends as are declared by the board of directors of HomeTrust out of funds legally available for dividends.

Except with respect to greater than 10% shareholders, full voting rights are vested in the holders of HomeTrust common stock and each share is entitled to one vote. See Comparison of Shareholder Rights Voting Limitations. Subject to any prior rights of the holders of any HomeTrust preferred stock then outstanding, in the event of a liquidation, dissolution or winding up of HomeTrust, holders of shares of HomeTrust common stock will be entitled to receive, pro rata, any assets distributable to shareholders in respect of shares held by them. Holders of shares of HomeTrust common stock will not have any preemptive rights to subscribe for any additional securities which may be issued by HomeTrust, nor will they have cumulative voting rights.

Preferred Share Purchase Rights

On September 25, 2012, the Board of Directors of HomeTrust declared a dividend of one preferred share purchase right (a Right) for each share its common stock outstanding at the close of business on October 9, 2012 (the Rights Record Date), and to become outstanding between the Record Date and the earlier of the Distribution Date and the Expiration Date (each as defined below). The Rights will be issued pursuant to a Tax Benefits Preservation Plan, dated as of September 25, 2012 (the Plan), between HomeTrust and Registrar and Transfer Company, as rights agent (the Rights Agent). Each Right represents the right to purchase, upon the terms and subject to the conditions set forth in the Plan, 1/1,000th of a share of Junior Participating Preferred Stock, Series A, par value $0.01 per share (Preferred Share), for $16.14 (the Purchase Price), subject to adjustment as provided in the Plan.

The purpose of the Plan is to protect HomeTrust s ability to use certain tax assets, including net operating loss carryforwards (the Tax Benefits), to offset future taxable income. HomeTrust s use of the Tax Benefits in the future would be substantially limited if it experiences an ownership change for purposes of Section 382 of the Internal Revenue Code of 1986, as amended (the Code). In general, an ownership change will occur if HomeTrust s 5-percent shareholders, as defined in Section 382 of the Code, collectively increase their ownership in HomeTrust by more than 50 percentage points over a rolling three-year period.

The Plan is designed to reduce the likelihood that HomeTrust will experience an ownership change by discouraging any person from becoming a beneficial owner of 4.99% or more of the then outstanding common stock (a Threshold Holder). There is no guarantee, however, that the Plan will prevent HomeTrust from experiencing an ownership change. A corporation that experiences an ownership change will generally be subject to

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an annual limitation on certain of its pre-ownership change tax assets in an amount equal to the fair market value of the corporation s outstanding stock immediately prior to the ownership change, multiplied by the long-term tax-exempt rate.

Distribution Date. Initially, the Rights will be attached to all shares of HomeTrust common stock then outstanding, and no separate Right certificates will be distributed. On or after the Distribution Date, the Rights will separate from the shares of common stock and become exercisable.

The Distribution Date will occur on the earlier of (i) the close of business on the tenth business day after a Shares Acquisition Date (as defined below) and (ii) the close of business on the tenth business day (or such later day as may be designated prior to a Shares Acquisition Date by HomeTrust s Board of Directors) after the date of the commencement of a tender or exchange offer by any person if, upon consummation of the offer, such person would or could be an Acquiring Person (as defined below).

A Shares Acquisition Date is the date of the first public announcement by HomeTrust or an Acquiring Person indicating that an Acquiring Person has become such.

An Acquiring Person means any person who or which, together with its affiliates, beneficially owns 4.99% or more of HomeTrust s common stock (or any other securities of HomeTrust then outstanding that would be treated as stock under Section 382 of the Code), other than (i) the U.S. Government; (ii) HomeTrust or any subsidiary or employee benefit plan or compensation arrangement of HomeTrust; (iii) any person or entity who or which, together with its affiliates, was on the Rights Record Date, the beneficial owner of 4.99% or more of HomeTrust s common stock, unless that person or entity subsequently increases their beneficial ownership percentage (other than as a result of any stock dividend, stock split or similar transaction or stock repurchase by HomeTrust); (iv) any person or entity who or which HomeTrust s Board of Directors determines, in its sole discretion, has inadvertently become a 4.99% or greater stockholder so long as such person or entity promptly divests sufficient shares to no longer be a 4.99% or greater stockholder; (v) any person or entity who or which has become the beneficial owner of 4.99% or more of HomeTrust s common stock as a result of an acquisition of shares of common stock by HomeTrust which, by reducing the number of shares outstanding, increased the proportionate number of shares beneficially owned by that person or entity, provided that the person or entity does not acquire any additional shares other than as a result of any stock dividend, stock split or similar transaction; and (vi) any person or entity who or which has become a 4.99% or greater stockholder if HomeTrust s Board of Directors in good faith determines that the attainment of such status has not jeopardized or endangered the HomeTrust s utilization of the Tax Benefits.

Flip-In. From and after a Shares Acquisition Date, (i) Rights owned by the Acquiring Person and its affiliates and certain of their transferees will automatically be void; and (ii) each other Right will automatically become a Right to buy, for the Purchase Price, in lieu of Series A Preferred Stock, that number of shares of HomeTrust s common stock equal to (a) the Purchase Price multiplied by the number of 1/1000ths of a share of Series A Preferred Stock for which the Right is then exercisable divided by (b) 50% of the then-current per share market price of the HomeTrust s common stock.

Exchange. At any time after a Shares Acquisition Date HomeTrust s Board of Directors may, at its option, exchange all or part of the then outstanding and exercisable Rights for shares of common stock at an exchange ratio of one share of common stock per Right, subject to adjustments and limitations described in the Plan. The Board may enter into a trust agreement pursuant to which HomeTrust would deposit into a trust shares of common stock that would be distributable to stockholders (excluding the Acquiring Person and its affiliates) in the event the exchange is implemented. This feature is intended to facilitate a more orderly distribution of shares of common stock in the event that a Shares Acquisition Date occurs.

Redemption. At any time prior to the Distribution Date, HomeTrust s Board of Directors may, at its option, redeem all, but not fewer than all, of the then outstanding Rights at a redemption price of $0.0001 per Right.

Amendments. HomeTrust may from time to time before the Distribution Date supplement or amend the Tax Benefits Preservation Plan without the approval of any holders of Rights.

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After the Distribution Date, the Plan may not be amended in any manner that would adversely affect the interests of the holders of Rights.

Expiration. The Rights will expire on the earliest of (i) September 25, 2015, (ii) the time at which all Rights have been redeemed by HomeTrust, (iii) the time at which all Rights have been exchanged by HomeTrust, (iv) such time as HomeTrust s Board of Directors determines, in its sole discretion, that the Rights and the Plan are no longer necessary for the preservation of existence of the Tax Benefits, and (v) a date prior to a Shares Acquisition Date on which the Board determines, in its sole discretion, that the Rights and the Plan are no longer in the best interests of HomeTrust and its stockholders.

Anti-Takeover Impact. The Plan could have an anti-takeover effect because it will restrict the ability of a person, entity or group to accumulate 4.99% or more of our common stock, and the ability of persons, entities or groups owning 4.99% or more of our common stock prior to the adoption of the Plan, from acquiring additional shares of our common stock without the approval of HomeTrust s Board of Directors. The Plan also could have an anti-takeover effect because an Acquiring Person s ownership may be diluted substantially upon the occurrence of a triggering event. Accordingly, the overall effects of the Tax Benefits Preservation Plan may be to render more difficult, or discourage, a merger, tender offer, proxy contest or assumption of control by a substantial holder of HomeTrust stock.

Preferred Stock

HomeTrust may issue preferred stock in one or more series at such time or times and for such consideration as the board of directors of HomeTrust may determine, generally without shareholder approval. The board of directors of HomeTrust is expressly authorized at any time, and from time to time, to issue HomeTrust preferred stock, with such voting and other powers, preferences and relative, participating, optional or other special rights, and qualifications, limitations or restrictions, as are stated and expressed in the board resolution providing for the issuance. The board of directors of HomeTrust is authorized to designate the series and the number of shares comprising such series, the dividend rate on the shares of such series, the redemption rights, if any, any purchase, retirement or sinking fund provisions, any conversion rights and any special voting rights. The ability of HomeTrust s board of directors to approve the issuance of preferred or other stock without shareholder approval could make an acquisition by an unwanted suitor of a controlling interest in HomeTrust more difficult, time-consuming or costly, or otherwise discourage an attempt to acquire control of HomeTrust.

Shares of preferred stock redeemed or acquired by HomeTrust may return to the status of authorized but unissued shares, without designation as to series, and may be reissued by HomeTrust upon approval of its board of directors.

Other Anti-Takeover Provisions

In addition to the ability to issue common and preferred stock without shareholder approval, HomeTrust s charter and bylaws contain a number of provisions which may have the effect of delaying, deferring or preventing a change in control of HomeTrust. See Comparison of Shareholder Rights.

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COMPARISON OF SHAREHOLDER RIGHTS

Jefferson is incorporated under the laws of the State of Tennessee. HomeTrust is incorporated under the laws of the State of Maryland. The rights of holders of Jefferson common stock are governed by the Tennessee Business Corporation Act Code (the TBCA) and Jefferson s charter and bylaws. Holders of HomeTrust capital stock are entitled to all the rights and obligations provided to capital shareholders under the Maryland General Corporation Law (the MGCL) and HomeTrust s charter and bylaws. Consequently, after the merger, the rights of former shareholders of Jefferson who receive shares of HomeTrust common stock in the merger will be determined by reference to HomeTrust s charter and bylaws and Maryland law.

This section describes certain differences between the rights of Jefferson shareholders and HomeTrust shareholders, including those which may be material. This section does not include a complete description of all differences among the rights of these shareholders, nor does it include a complete description of the specific rights of these shareholders. In addition, the identification of some of the differences in the rights of these shareholders is not intended to indicate that other differences that are equally important do not exist. The discussion in this section is qualified in its entirety by reference to Tennessee and Maryland law, and to Jefferson certificate of formation and bylaws and HomeTrust s charter and bylaws. Copies of the governing corporate instruments are available, without charge, to any person by following the instructions listed under Where You Can Find More Information.

JEFFERSON	**HOMETRUST**

Authorized Capital Stock

The authorized capital stock of Jefferson currently consists of 40,000,000 shares of capital stock, classified as follows:

30,000,000 shares of common stock, $0.01 par value per share; and

10,000,000 shares of preferred stock, $0.01 par value per share.

The charter of Jefferson authorizes the Board of Directors to establish one or more series of preferred stock and, for any series of preferred stock, to determine the terms and rights of the series, including voting rights, conversion rates and liquidation preferences.

The authorized capital stock of HomeTrust currently consists of 70,000,000 shares of capital stock, presently classified as follows:

60,000,000 shares of common stock, $0.01 par value per share; and

10,000,000 shares of preferred stock, $0.01 par value per share.

HomeTrust s articles of incorporation authorizes HomeTrust s board of directors to classify or reclassify any unissued shares of capital stock from time to time into one or more classes or series of stock by setting or changing in one or more respects the preferences, conversion or other rights, voting powers, restrictions, limitations as to dividends, qualifications or terms and conditions of redemption of such shares. HomeTrust is authorized under its articles of incorporation to issue additional shares of capital stock, up to the amount authorized, generally without stockholder approval. In addition, HomeTrust s articles of incorporation provides by its terms that it may be amended by HomeTrust s board of directors, without a stockholder vote, to change the number of shares of capital stock authorized, which could have the effect of diluting the interests of stockholders. Currently, no HomeTrust preferred stock is issued or outstanding.

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Voting Rights

Holders of Jefferson common stock are entitled to one vote per share in the election of directors and on all other matters submitted to a vote at a meeting of shareholders. The charter of Jefferson generally provides that in no event shall any person, who directly or indirectly beneficially owns in excess of 10% of the then outstanding shares of Jefferson common stock as of the record date for the determination of shareholders entitled or permitted to vote on any matter (the 10% limit), be entitled or permitted to any vote in respect of the shares held in excess of the 10% limit. Beneficial ownership is determined pursuant to the federal securities laws and includes, but is not limited to, shares as to which any person and his or her affiliates (1) have the right to acquire upon the exercise of conversion rights, exchange rights, warrants or options and (2) have or share investment or voting power (except that a person shall not be deemed the beneficial owner of any voting shares solely by reason of a revocable proxy granted for a particular meeting of shareholders, and that are not otherwise beneficially, or deemed by Jefferson to be beneficially, owned by such person and his or her affiliates).

The Tennessee Control Share Acquisition Act generally requires that shareholders of a corporation approve a control-share acquisition. A control share acquisition is defined by Tennessee law as the acquisition by any person of ownership of, or the power to direct the exercise of voting power with respect to, issued and outstanding control shares. All shares acquired within 90 days and all shares acquired pursuant to a plan to make a control share acquisition are deemed to have been acquired in the same acquisition.

Holders of HomeTrust common stock generally are entitled to one vote per share in the election of directors and on all other matters submitted to a vote at a meeting of shareholders, provided that HomeTrust s articles of incorporation generally prohibits any shareholder who beneficially owns more than 10% of the outstanding shares of HomeTrust common stock from voting shares in excess of that amount.

The MGCL contains a control share acquisition statute which, in general terms, provides that where a shareholder acquires issued and outstanding shares of a corporation s voting stock (referred to as control shares) within one of several specified ranges (one-tenth or more but less than one-third, one-third or more but less than a majority, or a majority or more), approval by a supermajority vote of shareholders of the control share acquisition must be obtained before the acquiring shareholder may vote the control shares. A corporation may, however, opt-out of the control share statute through a articles of incorporation or bylaw provision, which HomeTrust has done pursuant to its bylaws. Accordingly, the Maryland control share acquisition statute does not apply to acquisitions of shares of HomeTrust common stock. Though not expected, HomeTrust could decide to become subject to the Maryland control share acquisition statute by amending its bylaws to eliminate the opt-out provision. See Amendments to Bylaws.

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Voting Rights ***(continued)***

The Tennessee Control Share Acquisition Act generally provides that any person or group that acquires the power to vote more than certain specified levels (one-fifth, one-third or a majority) of the shares of certain Tennessee corporations will not have the right to vote such shares unless granted voting rights by the holders of a majority of the vote entitled to be cast, excluding interested shares. Interested shares are those share held by the acquiring person, officers of the corporation and persons who are both employees and directors of the corporation. If approval of voting power for the shares is obtained at one of the specified levels, additional shareholder approval is required when a shareholder seeks to acquire the power to vote shares at the next level. In the absence of such approval, the additional shares acquired by the shareholder may not be voted until they are transferred to another person in a transaction other than a control share acquisition. The statutory provisions will only apply to a Tennessee corporation if, as in the case of Jefferson s charter, its charter or bylaws so provide and if the corporation has: (1) 100 or more shareholders; (2) its principal place of business, its principal office or substantial assets within Tennessee; and (3) either (A) more than 105 of its shareholders resident in Tennessee, (B) more than 10% of its shares owned by shareholders resident in Tennessee, or (C) 10,000 or more shareholders resident in Tennessee.

No shareholder has the right of cumulative voting in the election of directors.	No shareholder has the right of cumulative voting in the election of directors.

Stock Transfer Restriction

None.	None.

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Dividends

Holders of Jefferson common stock are entitled to dividends when, as and if declared by the board of directors out of funds legally available therefor.

The TBCA generally provides that, unless otherwise restricted in a corporation s charter, a corporation s board of directors may authorize and a corporation may pay dividends to shareholders. However, a distribution may not be made if, after giving effect thereto: (1) the corporation would not be able to pay its debts as they become due in the usual course of business; or (2) the total assets of the corporation would be less than the sum of its total liabilities plus (unless otherwise provided in its charter) the amount that would be needed, if the corporation were to be dissolved at the time of the distribution, to satisfy the preferential rights upon dissolution of shareholders whose preferential rights are superior to those receiving the distribution.

Holders of HomeTrust common stock are entitled to dividends when, as and if declared by the board of directors out of funds legally available therefor.

Under the MGCL, HomeTrust is permitted to pay dividends or make other distributions unless after the distribution: (1) HomeTrust would not be able to pay its debts as they become due in the usual course of business; or (2) except as provided in the MGCL, HomeTrust s total assets would be less than the sum of its total liabilities, plus, unless HomeTrust s articles of incorporation permits otherwise, the amount that would be needed, if HomeTrust were dissolved at the time of the distribution, to satisfy preferential rights of stockholders whose preferential rights are superior to those receiving the distribution.

Number of Directors and Director Term

Jefferson s charter provides that the number of Jefferson s shall be no less than five and no more than 15. Subject to this charter limitation, Jefferson s bylaws provide that the number of directors will be fixed by the board of directors from time to time.

There are currently five directors serving on Jefferson s board of directors.

HomeTrust s bylaws provide that the number of directors will be fixed by the board of directors from time to time.

There are currently twelve directors serving on HomeTrust s board of directors. In accordance with the merger agreement, at the effective time of the merger, Jefferson s President and Chief Executive Officer, Anderson L. Smith, will be appointed to HomeTrust s board of directors.

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Number of Directors and Director Term (*continued)*

The charter and bylaws of Jefferson require the Board of Directors to be divided into three classes as nearly equal in number as possible and that the members of each class be elected for a term of three years and until their successors are elected and qualified, with one class being elected annually.

The bylaws of Jefferson provide that to be eligible to serve on the Board of Directors a person must beneficially own 100 shares of Jefferson common stock and reside in a county in which an office of Jefferson or Jefferson Federal is located or in an adjacent county. The bylaws also provide that no person will be eligible to serve on the Board of Directors who has (i) in the past 10 years, been subject to a supervisory action by a financial regulatory agency that involved fraud or other bad actions, (ii) has been convicted of a crime involving dishonesty or breach of trust that is punishable by a year or more in prison, or (iii) is currently charged with such a crime. These provisions may prevent shareholders from nominating themselves or persons of their choosing for election to the Board of Directors. The bylaws of HomeTrust do not contain similar qualifications requirements.

HomeTrust s board of directors is divided into three classes, with the members of each class of directors serving staggered three-year terms and approximately one-third of the directors elected annually. As a result, while the entire board of directors of HomeTrust can be replaced at a single annual meeting of shareholders, it would take a dissident shareholder or shareholder group at least two annual meetings of shareholders to replace a majority of the directors of HomeTrust. Each director holds office for the term for which he or she is elected and until his or her successor is elected and qualified, subject to such director s death, resignation or removal.

Election of Directors

Directors are elected by a plurality of the votes cast by the holders of the shares entitled to vote for directors.

Directors are elected by a plurality of the votes cast by the holders of the shares entitled to vote for directors.

Removal of Directors

The charter of Jefferson provides that any director may be removed by shareholders only for cause at a duly constituted meeting of shareholders called expressly for that purpose upon the affirmative vote of the holders of not less than 80% of the outstanding voting shares.

HomeTrust s articles of incorporation provide that, subject to the rights of the holders of any series of preferred stock then outstanding, directors may be removed from office only for cause and only by the vote of the holders of at least 80% of the voting power of the outstanding shares of capital stock entitled to vote generally in the election of directors (after giving effect to the 10% voting limitation in HomeTrust s articles of incorporation as described above under -Voting Rights), voting together as a single class.

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Filling Vacancies on the Board of Directors

Under the bylaws of Jefferson, any vacancy occurring in the Board of Directors, however, caused, and newly created directorships may be filled by an affirmative vote of the majority of the directors then in office, whether or not a quorum is present, and any director so chosen shall hold office only until the next annual meeting of shareholders at which directors are elected.

HomeTrust s bylaws provide that any vacancies in the board of directors resulting from an increase in the size of the board or the death, resignation or removal of a director may be filled only by a majority vote of the directors then in office, even if less than a quorum, and any director so chosen will hold office for the remainder of the full term of the class of directors in which the vacancy occurred and until a successor is elected and qualified.

Action by Stockholders Without a Meeting

Under the TBCA, action may be taken by shareholders without a meeting if all shareholders entitled to vote on the action consent to taking such action without a meeting.

HomeTrust s bylaws provide that, except as described in the following sentence, any action required or permitted to be taken at a meeting of shareholders may instead be taken without a meeting if a unanimous consent which sets forth the action is given in writing or by electronic transmission by each shareholder entitled to vote on the matter. The bylaws also provide that, unless HomeTrust s articles of incorporation provides otherwise, the holders of any class of HomeTrust stock, other than common stock, that is entitled to vote generally in the election of directors may act by consent without a meeting if the consent is given in writing or by electronic transmission by the holders entitled to cast the minimum number of votes that would be necessary to approve the action at a meeting of shareholders.

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Advance Notice Requirement for Shareholder Nominations and Other Proposals

Jefferson s bylaws establish an advance notice procedure for shareholders to nominate directors or bring other business before an annual meeting of shareholders of Jefferson. A person may not be nominated for election as a director unless that person is nominated by or at the direction of the Jefferson s Board or by a shareholder who has given appropriate notice to Jefferson before the meeting. Similarly, a shareholder may not bring business before an annual meeting unless the shareholder has given Jefferson appropriate notice of its intention to bring that business before the meeting. Jefferson s secretary must receive notice of the nomination or proposal not less than 90 days prior to the annual meeting; provided, however, that in the event that less than 100 days notice of prior public disclosure of the date of the meeting is given or made to the shareholders, notice by the shareholder to be timely must be received not later than the close of business on the 10th day following the day on which such notice of the date of the annual meeting was mailed or such public disclosure was made. A shareholder who desires to raise new business must provide certain information to Jefferson concerning the nature of the new business, the shareholder and the shareholder s interest in the business matter. Similarly, a shareholder wishing to nominate any person for election as a director must provide Jefferson with certain information concerning the nominee and the proposing shareholder.

HomeTrust s bylaws provide that HomeTrust must receive written notice of any shareholder proposal for business at an annual meeting of shareholders not less than 90 days or more than 120 days before the anniversary of the preceding year s annual meeting. If the date of the current year annual meeting is advanced by more than 20 days or delayed by more than 60 days from the anniversary date of the preceding year s annual meeting, notice of the proposal must be received by HomeTrust no earlier than the close of business on the 120th day prior to the date of the annual meeting and no later than the close of business on the later of the 90th day prior to the annual meeting or the 10th day following the day on which notice of the meeting is mailed or otherwise transmitted or public disclosure of the meeting date is first made, whichever occurs first.

HomeTrust s bylaws also provide that HomeTrust must receive written notice of any shareholder director nomination for a meeting of shareholders not less than 90 days or more than 120 days before the date of the meeting. If, however, less than 100 days notice or prior public disclosure of the date of the meeting is given or made to shareholders, notice of the nomination must be received by the secretary no later than the tenth day following the day on which notice of the meeting is mailed or otherwise transmitted or public disclosure of the meeting date is first made, whichever occurs first.

Notice of Shareholder Meeting

Notice of each shareholder meeting must be given to each shareholder entitled to vote not less than ten days nor more than two months before the date of the meeting.

Notice of each shareholder meeting must be given to each shareholder entitled to vote and to each other shareholder entitled to notice not less than 10 nor more than 90 days before the date of the meeting.

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Amendments to Charter/Articles of Incorporation

The charter of Jefferson generally may be amended by the holders of a majority of the shares entitled to vote generally in an election of directors, voting together as a single class; *provided*, however, that any amendment of Articles VIII (Directors), IX (Removal of Directors), X (Elimination of Directors Liability), XI (Indemnification), XII (Limitation of Voting Common Stock), XIII (Approval of Business Combinations), XIV (Evaluations of Business Combinations), XV (Control Share Acquisitions), XVI (Special Meetings of Shareholders) and XVIII (Amendment of Bylaws) must be approved by the affirmative vote of the holders of at least 80% of the outstanding shares entitled to vote generally in the election of directors, voting together as a single class, cast at a meeting of the shareholders called for that purpose, *except* that such repeal, alteration or amendment may be made by the affirmative vote of the majority of the outstanding shares if the same is first approved by a majority of disinterested directors.

HomeTrust s articles of incorporation may be amended in accordance with the MGCL, which generally requires the approval of the board of directors and the holders of a majority of the outstanding shares of HomeTrust common stock. The amendment of certain provisions of HomeTrust s articles of incorporation, however, requires the vote of the holders of at least 80% of the voting power of all of the outstanding shares of capital stock entitled to vote generally in the election of directors, (after giving effect to the 10% voting limitation in HomeTrust s articles of incorporation as described above under -Voting Rights), voting together as a single class. These include provisions relating to: the ability of the board of directors to designate and set the terms of series of preferred stock; the voting limitations on greater than 10% shareholders; the number, classification, election and removal of directors; certain business combinations with greater than 10% shareholders; the prevention of greenmail; indemnification of directors and officers; limitation on liability of directors and officers; and amendments to the articles of incorporation and bylaws. HomeTrust s articles of incorporation provides by its terms that it may be amended by HomeTrust s board of directors, without a shareholder vote, to change the number of shares of capital stock authorized for issuance.

Amendments to Bylaws

The bylaws of Jefferson may be amended by the majority vote of the Board of Directors at any legal meeting. The bylaws may be amended by the shareholders only by a vote of at least 80% of the outstanding shares of capital stock entitled to vote generally in the election of directors, cast at a meeting of the shareholders called for that purpose.

HomeTrust s bylaws may be amended either by the board of directors, by a vote of a majority of the whole board, or by HomeTrust s shareholders, by the vote of the holders of 80% of the outstanding shares of capital stock entitled to vote generally in the election of directors (after giving effect to the 10% voting limitation in HomeTrust s articles of incorporation as described above under -Voting Rights), voting together as a single class.

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Special Meetings of Shareholders

The charter of Jefferson contains a provision pursuant to which, subject to the rights of any holders of preferred stock, special meetings of the shareholders of Jefferson may only be called by the Board of Directors pursuant to a resolution adopted by a majority of the total number of directors which Jefferson would have if there were no vacancies on the Board of Directors.

HomeTrust s bylaws provide that special meetings of shareholders may be called by the President or by the board of directors by vote of a majority of the whole board. In addition, HomeTrust s bylaws provide that a special meeting of shareholders shall be called by the Secretary of HomeTrust on the written request of shareholders entitled to cast at least a majority of all votes entitled to be cast at the meeting.

Quorum

A majority of the shares entitled to vote, represented in person or by proxy, constitutes a quorum at any shareholder meeting.

The holders of at least one-third of all shares entitled to vote at the meeting, present in person or by proxy, constitutes a quorum at any shareholder meeting.

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Limitation of Personal Liability of Directors

Jefferson s charter provides that a director shall not be personally liable to Jefferson or its shareholders for monetary damages for a breach of duty as a director, except for liability for:

- for any breach of the director s duty of loyalty to Jefferson or its shareholders;
- for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law; or
- for unlawful distributions under Section 48-18-304 of the TBCA.

Consistent with the MGCL, HomeTrust s articles of incorporation provides that an officer or director of HomeTrust shall not be liable to HomeTrust or its shareholders for money damages, except to the extent:

- it is proved that the person actually received an improper benefit or profit, for the amount of the benefit or profit;
- a final judgment or adjudication against the person is based on a finding that the person s action, or failure to act, was the result of active and deliberate dishonesty and was material to the cause of action against the person; or
- to the extent otherwise provided in the MGCL.

HomeTrust s articles of incorporation provides that HomeTrust will indemnify and advance expenses to its directors and officers to the fullest extent required or permitted by the MGCL. HomeTrust s articles of incorporation also provides that HomeTrust will indemnify other employees and agents to the extent authorized by its board of directors and permitted by law.

The MGCL permits a corporation to indemnify its directors, officers, employees and agents against judgments, penalties, fines, settlements and reasonable expenses actually incurred unless it is proven that (1) the conduct of the person was material to the matter giving rise to the proceeding and the person acted in bad faith or with active and deliberate dishonesty, (2) the person actually received an improper personal benefit or (3) in the case of a criminal proceeding, the person had reason to believe that his conduct was unlawful.