FIDELITY D & D BANCORP INC
Form 10-Q
November 09, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE

SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2012

OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE

SECURITIES EXCHANGE ACT OF 1934

For the transition period from ______________to______________________

Commission file number: 333-90273

FIDELITY D & D BANCORP, INC.

STATE OF INCORPORATION: IRS EMPLOYER IDENTIFICATION NO:

PENNSYLVANIA 23-3017653

Address of principal executive offices:

BLAKELY & DRINKER ST.

DUNMORE, PENNSYLVANIA 18512

TELEPHONE:

570-342-8281

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 subjected to such filing requirements for the past 90 days. x YES ¨ NO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). x YES ¨ NO

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

¨ YES x NO

The number of outstanding shares of Common Stock of Fidelity D & D Bancorp, Inc. on October 31, 2012, the latest practicable date, was 2,307,606 shares.

FIDELITY D & D BANCORP, INC.

Form 10-Q September 30, 2012

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PART I – Financial Information

Item 1: Financial Statements

Fidelity D & D Bancorp, Inc. and Subsidiary
Consolidated Balance Sheets

(Unaudited)

(dollars in thousands)	September 30, 2012	December 31, 2011
Assets:		
Cash and due from banks	$ 11,685	$ 15,158
Interest-bearing deposits with financial institutions	33,937	37,007
Total cash and cash equivalents	45,622	52,165
Available-for-sale securities	102,833	108,154
Held-to-maturity securities	302	389
Federal Home Loan Bank stock	3,019	3,699
Loans, net (allowance for loan losses of $8,142 in 2012; $8,108 in 2011)	420,928	398,186
Loans held-for-sale (fair value $1,890 in 2012, $4,661 in 2011)	1,844	4,537
Foreclosed assets held-for-sale	1,610	1,169
Bank premises and equipment, net	14,270	13,575
Cash surrender value of bank owned life insurance	9,984	9,740
Accrued interest receivable	1,991	2,082
Other assets	13,044	13,046
Total assets	$ 615,447	$ 606,742
Liabilities:		
Deposits:		
Interest-bearing	$ 409,467	$ 419,647
Non-interest-bearing	114,653	96,155
Total deposits	524,120	515,802
Accrued interest payable and other liabilities	2,705	6,809
Short-term borrowings	14,069	9,507
Long-term debt	16,000	21,000
Total liabilities	556,894	553,118
Shareholders' equity:		

Preferred stock authorized 5,000,000 shares with no par value; none issued	-	-
Capital stock, no par value (10,000,000 shares authorized; shares issued and outstanding; 2,307,606 in 2012; and 2,254,542 in 2011)	23,416	22,354
Retained earnings	34,647	32,380
Accumulated other comprehensive income/ (loss)	490	(1,110)
Total shareholders' equity	58,553	53,624
Total liabilities and shareholders' equity	$ 615,447	$ 606,742

See notes to unaudited consolidated financial statements

Fidelity D & D Bancorp, Inc. and Subsidiary
Consolidated Statements of Income
(Unaudited)

(dollars in thousands except per share data)	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Interest income:				
Loans:				
Taxable	$ 5,313	$ 5,551	$ 15,885	$ 17,119
Nontaxable	107	122	359	382
Interest-bearing deposits with financial institutions	12	34	55	73
Investment securities:				
U.S. government agency and corporations	226	355	747	1,020
States and political subdivisions (nontaxable)	298	305	917	893
Other securities	18	9	54	37
Total interest income	5,974	6,376	18,017	19,524
Interest expense:				
Deposits	585	852	1,886	2,909
Securities sold under repurchase agreements	4	14	27	40
Long-term debt	215	261	667	775
Total interest expense	804	1,127	2,580	3,724
Net interest income	5,170	5,249	15,437	15,800
Provision for loan losses	700	500	2,000	1,350
Net interest income after provision for loan losses	4,470	4,749	13,437	14,450
Other income:				
Service charges on deposit accounts	470	458	1,313	1,319
Interchange fees	276	247	798	713
Fees from trust fiduciary activities	140	97	447	298
Fees from financial services	155	140	441	439
Service charges on loans	195	155	846	488
Fees and other revenue	94	100	269	289
Earnings on bank-owned life insurance	83	80	244	235
Gain (loss) on sale, recovery, or disposal of:				
Loans	500	161	1,329	499
Investment securities	3	13	264	29
Premises and equipment	(16)	(2)	(17)	(2)
Foreclosed assets held-for-sale	(32)	28	(47)	46
Write-down of foreclosed assets held-for-sale	-	-	(60)	(66)
Impairment losses on investment securities:				
Other-than-temporary impairment on investment securities	(1)	(46)	(242)	(351)
	1	40	106	271

Non-credit-related losses on investment securities not expected to be sold (recognized in other comprehensive income/(loss))				
Net impairment losses on investment securities recognized in earnings	-	(6)	(136)	(80)
Total other income	1,868	1,471	5,691	4,207
Other expenses:				
Salaries and employee benefits	2,116	2,164	6,767	6,583
Premises and equipment	889	852	2,593	2,747
Advertising and marketing	552	464	947	814
Professional services	292	314	963	927
FDIC assessment	130	79	379	508
Loan collection	197	286	498	426
Other real estate owned	41	40	131	95
Office supplies and postage	103	98	315	334
Other	133	147	1,251	1,120
Total other expenses	4,453	4,444	13,844	13,554
Income before income taxes	1,885	1,776	5,284	5,103
Provision for income taxes	486	449	1,311	1,260
Net income	$ 1,399	$ 1,327	$ 3,973	$ 3,843
Per share data:				
Net income - basic	$ 0.61	$ 0.59	$ 1.74	$ 1.74
Net income - diluted	$ 0.61	$ 0.59	$ 1.74	$ 1.74
Dividends	$ 0.25	$ 0.25	$ 0.75	$ 0.75

See notes to unaudited consolidated financial statements

Fidelity D & D Bancorp, Inc. and Subsidiary

Consolidated Statements of Comprehensive Income	Three months ended		Nine months ended	
(Unaudited)	September 30,		September 30,	
(dollars in thousands)	2012	2011	2012	2011
Net income	$ 1,399	$ 1,327	$ 3,973	$ 3,843
Other comprehensive income, before tax:				
Unrealized holding gains on available-for-sale securities	1,182	974	2,331	3,257
Reclassification adjustment for gains realized in income	(3)	(13)	(264)	(29)
Net unrealized gains	1,179	961	2,067	3,228
Tax effect	(401)	(327)	(703)	(1,098)
Unrealized gains, net of tax	778	634	1,364	2,130
Non-credit-related impairment gains (losses) on investment securities not expected to be sold	76	7	358	(46)
Tax effect	(26)	(2)	(122)	16
Net non-credit-related impairment gains (losses) on investment securities	50	5	236	(30)
Other comprehensive income, net of tax	828	639	1,600	2,100
Total comprehensive income, net of tax	$ 2,227	$ 1,966	$ 5,573	$ 5,943

See notes to unaudited consolidated financial statements

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Fidelity D & D Bancorp, Inc. and Subsidiary
Consolidated Statements of Changes in Shareholders' Equity
For the nine months ended September 30, 2012 and 2011
(Unaudited)

(dollars in thousands)	Capital stock Shares	Amount	Retained earnings	Accumulated other comprehensive income/ (loss)	Total
Balance, December 31, 2010	2,178,028	$21,047	$29,545	$ (3,817)	$46,775
Comprehensive income			3,843	2,100	5,943
Issuance of common stock through Employee Stock Purchase Plan	4,801	67			67
Issuance of common stock through Dividend Reinvestment Plan	55,844	924			924
Stock-based compensation expense		24			24
Cash dividends declared			(1,650)		(1,650)
Balance, September 30, 2011	2,238,673	$22,062	$31,738	$ (1,717)	$52,083
Balance, December 31, 2011	2,254,542	$22,354	$32,380	$ (1,110)	$53,624
Comprehensive income			3,973	1,600	5,573
Issuance of common stock through Employee Stock Purchase Plan	3,874	67			67
Issuance of common stock through Dividend Reinvestment Plan	49,190	980			980
Stock-based compensation expense		15			15
Cash dividends declared			(1,706)		(1,706)
Balance, September 30, 2012	2,307,606	$23,416	$34,647	$ 490	$58,553

See notes to unaudited consolidated financial statements

Fidelity D & D Bancorp, Inc. and Subsidiary
Consolidated Statements of Cash Flows

(Unaudited) (dollars in thousands)	Nine months ended September 30, 2012	2011
Cash flows from operating activities:		
Net income	$3,973	$3,843
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization and accretion	2,612	2,213
Provision for loan losses	2,000	1,350
Deferred income tax (benefit) expense	(253)	177
Stock-based compensation expense	15	24
Proceeds from sale of loans held-for-sale	64,605	24,752
Originations of loans held-for-sale	(58,395)	(21,896)
Write-down of foreclosed assets held-for-sale	60	66
Earnings on bank-owned life insurance	(244)	(235)
Net gain from sales of loans	(1,329)	(499)
Net gain from sales and recoveries of investment securities	(264)	(29)
Net loss (gain) from sales of foreclosed assets held-for-sale	47	(46)
Loss on disposal of equipment	17	2
Other-than-temporary impairment on securities	136	80
Change in:		
Accrued interest receivable	90	(343)
Other assets	(249)	331
Accrued interest payable and other liabilities	(4,086)	92
Net cash provided by operating activities	8,735	9,882
Cash flows from investing activities:		
Held-to-maturity securities:		
Proceeds from maturities, calls and principal pay-downs	88	76
Available-for-sale securities:		
Proceeds from sales	3,584	841
Proceeds from maturities, calls and principal pay-downs	24,029	18,017
Purchases	(20,891)	(39,348)
Decrease in FHLB stock	680	648
Net (increase) decrease in loans	(28,898)	10,466
Acquisition of bank premises and equipment	(1,809)	(262)
Proceeds from sale of foreclosed assets held-for-sale	719	891
Net cash used by investing activities	(22,498)	(8,671)
Cash flows from financing activities:		
Net increase in deposits	8,318	43,150
Net increase in short-term borrowings	4,561	9,456
Repayments of long-term debt	(5,000)	-
Proceeds from employee stock purchase plan participants	67	67

Dividends paid, net of dividends reinvested	(1,124)	(1,104)
Proceeds from dividend reinvestment plan participants	398	379
Net cash provided by financing activities	7,220	51,948
Net (decrease) increase in cash and cash equivalents	(6,543)	53,159
Cash and cash equivalents, beginning	52,165	22,967
Cash and cash equivalents, ending	$45,622	$76,126

See notes to unaudited consolidated financial statements

FIDELITY D & D BANCORP, INC.

Notes to Consolidated Financial Statements

(Unaudited)

1. Nature of operations and critical accounting policies

Nature of operations

Fidelity Deposit and Discount Bank (the Bank) is a commercial bank chartered in the Commonwealth of Pennsylvania and a wholly-owned subsidiary of Fidelity D & D Bancorp, Inc. (the Company or collectively, the Company). Having commenced operations in 1903, the Bank is committed to provide superior customer service, while offering a full range of banking products and financial and trust services to both our consumer and commercial customers from our main office located in Dunmore and other branches located throughout Lackawanna and Luzerne counties.

Principles of consolidation

The accompanying unaudited consolidated financial statements of the Company and the Bank have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and with the instructions to this Form 10-Q and Rule 8-03 of Regulation S-X. Accordingly, they do not include all of the information and footnote disclosures required by GAAP for complete financial statements. In the opinion of management, all normal recurring adjustments necessary for a fair presentation of the financial condition and results of operations for the periods have been included. All significant inter-company balances and transactions have been eliminated in consolidation.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported periods. Actual results could differ from those estimates. For additional information and disclosures required under GAAP, refer to the Company's Annual Report on Form 10-K for the year ended December 31, 2011.

Management is responsible for the fairness, integrity and objectivity of the unaudited financial statements included in this report. Management prepared the unaudited financial statements in accordance with GAAP. In meeting its responsibility for the financial statements, management depends on the Company's accounting systems and related internal controls. These systems and controls are designed to provide reasonable but not absolute assurance that the financial records accurately reflect the transactions of the Company, the Company’s assets are safeguarded and that the financial statements present fairly the financial condition and results of operations of the Company.

In the opinion of management, the consolidated balance sheets as of September 30, 2012 and December 31, 2011 and the related consolidated statements of income and consolidated statements of comprehensive income for the three- and nine-month periods ended September 30, 2012 and 2011, and consolidated statements of changes in shareholders’ equity and consolidated statements of cash flows for the nine months ended September 30, 2012 and 2011 present fairly the financial condition and results of operations of the Company. All material adjustments required for a fair presentation have been made. These adjustments are of a normal recurring nature. Certain reclassifications have been made to the 2011 financial statements to conform to the 2012 presentation.

This Quarterly Report on Form 10-Q should be read in conjunction with the Company’s audited financial statements for the year ended December 31, 2011, and the notes included therein, included within the Company’s Annual Report filed on Form 10-K.

Critical accounting policies

The presentation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect many of the reported amounts and disclosures. Actual results could differ from these estimates.

A material estimate that is particularly susceptible to significant change relates to the determination of the allowance for loan losses. Management believes that the allowance for loan losses at September 30, 2012 is adequate and reasonable. Given the subjective nature of identifying and valuing loan losses, it is likely that well-informed individuals could make different assumptions and could, therefore, calculate a materially different allowance value. While management uses available information to recognize losses on loans, changes in economic conditions may necessitate revisions in the future. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Company’s allowance for loan losses. Such agencies may require the Company to recognize adjustments to the allowance based on their judgment of information available to them at the time of their examination.

Another material estimate is the calculation of fair values of the Company's investment securities. Except for the Company's investment in corporate bonds, consisting of pooled trust preferred securities, fair values of the other investment securities are determined by prices provided by a third-party vendor, who is a provider of financial market data, analytics and related services to financial institutions. For the pooled trust preferred securities, management is unable to obtain readily attainable and realistic pricing from market traders due to a lack of active market participants and therefore management has determined the market for these securities to be inactive. In order to determine the fair value of the pooled trust preferred securities, management relied on the use of an income valuation approach (present value technique) that maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs, the results of which are more representative of fair value than the market approach valuation technique used for the other investment securities.

Based on experience, management is aware that estimated fair values of investment securities tend to vary among valuation services. Accordingly, when selling investment securities, price quotes may be obtained from more than one source. The majority of the Company's investment securities are classified as available-for-sale (AFS). AFS securities are carried at fair value on the consolidated balance sheets, with unrealized gains and losses, net of income tax, reported separately within shareholders' equity as a component of accumulated other comprehensive income (loss) (OCI).

The fair value of residential mortgage loans, classified as held-for-sale (HFS), is obtained from the Federal National Mortgage Association (FNMA) or the Federal Home Loan Bank (FHLB). Generally, the market to which the Company sells mortgages it originates for sale is restricted and price quotes from other sources are not typically obtained. On occasion, the Company may transfer loans from the loan portfolio to loans HFS. Under these rare circumstances, pricing may be obtained from other entities and the loans are transferred at the lower of cost or market value and simultaneously sold. As of September 30, 2012 and December 31, 2011, loans classified as HFS consisted of residential mortgages.

For purposes of the consolidated statements of cash flows, cash and cash equivalents includes cash on hand, amounts due from banks and interest-bearing deposits with financial institutions. For the nine months ended September 30, 2012 and 2011, the Company paid interest of $2.6 million and $3.8 million, respectively. The Company was required to pay income taxes of $1.8 million and $1.2 million during the first nine months of 2012 and 2011, respectively. Transfers from loans to foreclosed assets held-for-sale amounted to $1.4 million and $0.8 million during the nine months ended September 30, 2012 and 2011. During the same respective periods, transfers from loans to loans HFS amounted to $2.8 million and $4.8 million. Expenditures for construction in process, a component of other assets in the consolidated balance sheets, are included in acquisition of bank premises and equipment.

2. New Accounting Pronouncements

In 2011, the Financial Accounting Standards Board (FASB) issued, and in 2012 the Company adopted, an accounting update related to Fair Value Measurement: Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. This update amends existing Fair Value Measurements, to bring U.S. GAAP for fair value measurements in line with International Accounting Standards. The update clarifies existing guidance for items such as: the application of the highest and best use concept to non-financial assets and liabilities; the application of fair value measurement to financial instruments classified in a reporting entity's stockholder's equity; and disclosure requirements regarding quantitative information about unobservable inputs used in the fair value measurements of level 3 assets. The guidance also creates an exception to existing guidance for entities which carry financial instruments within a portfolio or group, under which the entity is now permitted to base the price used for fair valuation upon a price that would be received to sell the net asset position or transfer a net liability position in an orderly transaction. The guidance also allows for the application of premiums and discounts in a fair value measurement if the financial instrument is categorized in level 2 or 3 of the fair value hierarchy. It also contains new disclosure requirements regarding fair value amounts categorized as level 3 in the fair value hierarchy such as: disclosure of the valuation process used; effects of and relationships between unobservable inputs; usage of non-financial assets for purposes other than their highest and best use when that is the basis of the disclosed fair value; and categorization by level of items disclosed at fair value, but not measured at fair value for financial statement purposes. For public entities, this update is effective for interim and annual periods beginning after December 15, 2011. The adoption of the new accounting guidance did not have an impact on the Company's consolidated financial statements.

In June, 2011, the FASB issued an accounting update related to, Presentation of Comprehensive Income. The provisions of this update amend the accounting topic to facilitate the continued alignment of U.S. GAAP with International Accounting Standards. The update prohibits the presentation of the components of comprehensive income in the statement of stockholder's equity. Reporting entities are allowed to present either: a statement of comprehensive income, which reports both net income and other comprehensive income; or separate, but consecutive, statements of net income and other comprehensive income. Under previous GAAP, all three presentations were acceptable. Regardless of the presentation selected, the reporting entity is required to present all reclassifications between other comprehensive and net income on the face of the new statement or statements. For public entities, the provisions of this update are effective for fiscal years and interim periods beginning after December 31, 2011. The Company has elected to present a separate statement of comprehensive income.

3. Investment securities

The amortized cost and fair value of investment securities at September 30, 2012 and December 31, 2011 are summarized as follows:

(dollars in thousands)	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
September 30, 2012				
Held-to-maturity securities:				
MBS - GSE residential	$ 302	$ 35	$ -	$ 337
Available-for-sale securities:				
Agency - GSE	$ 21,696	$ 114	$ 6	$ 21,804
Obligations of states and political subdivisions	26,829	3,071	-	29,900
Corporate bonds:				
Pooled trust preferred securities	6,366	142	4,845	1,663
MBS - GSE residential	46,906	2,101	-	49,007
Total debt securities	101,797	5,428	4,851	102,374
Equity securities - financial services	295	165	1	459
Total available-for-sale securities	$ 102,092	$ 5,593	$ 4,852	$ 102,833

(dollars in thousands)	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
December 31, 2011				
Held-to-maturity securities:				
MBS - GSE residential	$ 389	$ 42	$ -	$ 431
Available-for-sale securities:				