

FIDELITY D & D BANCORP INC

Form 10-Q

November 06, 2015

Table Of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2015

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. ☒ 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). ☒ 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):

Edgar Filing: FIDELITY D & D BANCORP INC - Form 10-Q

Large accelerated filer	Accelerated
<input type="checkbox"/>	filer <input type="checkbox"/>
Non-accelerated filer <input type="checkbox"/>	Smaller
	reporting
	company <input checked="" type="checkbox"/>
(Do not check if a smaller reporting company)	

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

☐ YES ☒ NO

The number of outstanding shares of Common Stock of Fidelity D & D Bancorp, Inc. on October 31, 2015, the latest practicable date, was 2,439,905 shares.

Table Of Contents

PART I – Financial Information

Item 1: Financial Statements

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

	September 30, 2015	December 31, 2014
(dollars in thousands)		
Assets:		
Cash and due from banks	\$ 13,408	\$ 11,808
Interest-bearing deposits with financial institutions	12,282	14,043
Total cash and cash equivalents	25,690	25,851
Available-for-sale securities	126,782	97,896
Held-to-maturity securities (fair value of \$0 in 2015, \$0 in 2014)	-	-
Federal Home Loan Bank stock	1,085	1,306
Loans and leases, net (allowance for loan losses of \$9,149 in 2015; \$9,173 in 2014)	533,234	506,327
Loans held-for-sale (fair value \$1,133 in 2015, \$1,186 in 2014)	1,114	1,161
Foreclosed assets held-for-sale	1,024	1,972
Bank premises and equipment, net	16,875	14,846
Cash surrender value of bank owned life insurance	10,995	10,741
Accrued interest receivable	2,154	2,086
Other assets	10,255	14,299
Total assets	\$ 729,208	\$ 676,485
Liabilities:		
Deposits:		
Interest-bearing	\$ 492,289	\$ 457,574
Non-interest-bearing	150,714	129,370
Total deposits	643,003	586,944
Accrued interest payable and other liabilities	3,829	3,353
Short-term borrowings	6,743	3,969
Long-term debt	-	10,000
Total liabilities	653,575	604,266
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; 2,439,905 in 2015; and 2,427,767 in 2014)	26,551	26,272
Retained earnings	46,549	43,204
Accumulated other comprehensive income	2,533	2,743
Total shareholders' equity	75,633	72,219
Total liabilities and shareholders' equity	\$ 729,208	\$ 676,485

See notes to unaudited consolidated financial statements

Table Of Contents

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

(dollars in thousands except per share data)

Three months ended Nine months ended
September September September September
30, 2015 30, 2014 30, 2015 30, 2014

Interest income:

Loans and leases:

Taxable	\$ 5,764	\$ 5,521	\$ 16,914	\$ 16,191
---------	----------	----------	-----------	-----------

Nontaxable	170	135	471	397
------------	-----	-----	-----	-----

Interest-bearing deposits with financial institutions	5	3	22	14
---	---	---	----	----

Investment securities:

U.S. government agency and corporations	310	281	843	783
---	-----	-----	-----	-----

States and political subdivisions (nontaxable)	336	323	978	977
--	-----	-----	-----	-----

Other securities	27	31	126	79
------------------	----	----	-----	----

Federal funds sold	-	1	-	1
--------------------	---	---	---	---

Total interest income	6,612	6,295	19,354	18,442
-----------------------	-------	-------	--------	--------

Interest expense:

Deposits	574	507	1,639	1,495
----------	-----	-----	-------	-------

Securities sold under repurchase agreements	3	5	15	17
---	---	---	----	----

Other short-term borrowings and other	3	2	15	8
---------------------------------------	---	---	----	---

Long-term debt	-	216	255	638
----------------	---	-----	-----	-----

Total interest expense	580	730	1,924	2,158
------------------------	-----	-----	-------	-------

Net interest income	6,032	5,565	17,430	16,284
---------------------	-------	-------	--------	--------

Provision for loan losses	200	210	500	810
---------------------------	-----	-----	-----	-----

Net interest income after provision for loan losses	5,832	5,355	16,930	15,474
---	-------	-------	--------	--------

Other income:

Service charges on deposit accounts	433	466	1,260	1,320
-------------------------------------	-----	-----	-------	-------

Interchange fees	337	333	976	970
------------------	-----	-----	-----	-----

Fees from trust fiduciary activities	166	156	580	492
--------------------------------------	-----	-----	-----	-----

Fees from financial services	142	114	379	405
------------------------------	-----	-----	-----	-----

Service charges on loans	264	189	664	613
--------------------------	-----	-----	-----	-----

Fees and other revenue	218	196	629	558
------------------------	-----	-----	-----	-----

Earnings on bank-owned life insurance	86	86	255	252
---------------------------------------	----	----	-----	-----

Gain (loss) on sale or disposal of:

Loans	404	209	871	462
-------	-----	-----	-----	-----

Investment securities	8	-	26	301
-----------------------	---	---	----	-----

Premises and equipment	(35)	(1)	(34)	(66)
------------------------	------	-----	------	------

Total other income	2,023	1,748	5,606	5,307
--------------------	-------	-------	-------	-------

Other expenses:

Salaries and employee benefits	2,696	2,460	7,992	7,424
--------------------------------	-------	-------	-------	-------

Premises and equipment	939	837	2,755	2,634
------------------------	-----	-----	-------	-------

Advertising and marketing	276	198	926	804
---------------------------	-----	-----	-----	-----

Edgar Filing: FIDELITY D & D BANCORP INC - Form 10-Q

Professional services	406	405	1,221	1,044
FDIC assessment	104	85	298	263
Loan collection	48	60	144	177
Other real estate owned	43	187	190	276
Office supplies and postage	95	112	308	318
Automated transaction processing	150	168	408	473
FHLB prepayment fee	-	-	570	-
Data processing and communication	187	100	395	295
Other	295	298	863	748
Total other expenses	5,239	4,910	16,070	14,456
Income before income taxes	2,616	2,193	6,466	6,325
Provision for income taxes	687	562	1,184	1,611
Net income	\$ 1,929	\$ 1,631	\$ 5,282	\$ 4,714
Per share data:				
Net income - basic	\$ 0.79	\$ 0.68	\$ 2.17	\$ 1.96
Net income - diluted	\$ 0.79	\$ 0.67	\$ 2.16	\$ 1.95
Dividends	\$ 0.27	\$ 0.25	\$ 0.79	\$ 0.75

See notes to unaudited consolidated financial statements

Table Of Contents

Fidelity D & D Bancorp, Inc. and Subsidiary

Consolidated Statements of Comprehensive Income (Unaudited) (dollars in thousands)	Three months ended September 30,		Nine months ended September 30,	
	2015	2014	2015	2014
Net income	\$ 1,929	\$ 1,631	\$ 5,282	\$ 4,714
Other comprehensive income (loss), before tax:				
Unrealized holding gain (loss) on available-for-sale securities	949	97	(292)	2,437
Reclassification adjustment for net gains realized in income	(8)	-	(26)	(301)
Net unrealized gain (loss)	941	97	(318)	2,136
Tax effect	(320)	(33)	108	(726)
Unrealized gain (loss), net of tax	621	64	(210)	1,410
Other comprehensive income (loss), net of tax	621	64	(210)	1,410
Total comprehensive income, net of tax	\$ 2,550	\$ 1,695	\$ 5,072	\$ 6,124

See notes to unaudited consolidated financial statements

Table Of Contents

Fidelity D & D Bancorp, Inc. and Subsidiary
Consolidated Statements of Changes in Shareholders' Equity
For the nine months ended September 30, 2015 and
2014
(Unaudited)

	Capital stock		Retained	Accumulated other comprehensive	Total
(dollars in thousands)	Shares	Amount	earnings	income	
Balance, December 31, 2013	2,391,617	\$ 25,302	\$ 39,519	\$ 1,239	\$ 66,060
Net income			4,714		4,714
Other comprehensive income				1,410	1,410
Issuance of common stock through Employee Stock Purchase Plan	4,373	80			80
Issuance of common stock through Dividend Reinvestment Plan	18,347	448			448
Issuance of common stock from vested restricted share grants through stock compensation plans	5,250				
Stock-based compensation expense		162			162
Cash dividends declared			(1,816)		(1,816)
Balance, September 30, 2014	2,419,587	\$ 25,992	\$ 42,417	\$ 2,649	\$ 71,058
Balance, December 31, 2014	2,427,767	\$ 26,272	\$ 43,204	\$ 2,743	\$ 72,219
Net income			5,282		5,282
Other comprehensive loss				(210)	(210)
Issuance of common stock through Employee Stock Purchase Plan	4,358	102			102
Issuance of common stock from vested restricted share grants through stock compensation plans	7,780				
Stock-based compensation expense		177			177
Cash dividends declared			(1,937)		(1,937)
Balance, September 30, 2015	2,439,905	\$ 26,551	\$ 46,549	\$ 2,533	\$ 75,633

See notes to unaudited consolidated financial statements

Table Of ContentsFidelity D & D Bancorp, Inc. and Subsidiary
Consolidated Statements of Cash Flows

(Unaudited)

(dollars in thousands)

Nine months ended
September 30,
2015 2014

Cash flows from operating activities:

Net income	\$ 5,282	\$ 4,714
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization and accretion	2,652	2,321
Provision for loan losses	500	810
Deferred income tax expense (benefit)	816	(111)
Stock-based compensation expense	177	162
Proceeds from sale of loans held-for-sale	37,663	25,125
Originations of loans held-for-sale	(34,350)	(25,222)
Earnings from bank-owned life insurance	(255)	(252)
Net gain from sales of loans	(871)	(462)
Net gain from sales of investment securities	(26)	(301)
Net loss from sale and write-down of foreclosed assets held-for-sale	42	70
Net loss from disposal of equipment	34	64
Change in:		
Accrued interest receivable	(68)	13
Other assets	1,532	(1,396)
Accrued interest payable and other liabilities	476	310
Net cash provided by operating activities	13,604	5,845

Cash flows from investing activities:

Held-to-maturity securities:

Proceeds from sales	-	187
Proceeds from maturities, calls and principal pay-downs	-	3

Available-for-sale securities:

Proceeds from sales	12,614	4,877
Proceeds from maturities, calls and principal pay-downs	14,435	10,350
Purchases	(57,456)	(30,929)
Decrease in FHLB stock	221	358
Net increase in loans and leases	(30,765)	(26,671)
Acquisition of bank premises and equipment	(1,214)	(2,159)
Proceeds from sale of bank premises and equipment	38	-
Proceeds from sale of foreclosed assets held-for-sale	1,364	1,142
Net cash used in investing activities	(60,763)	(42,842)

Cash flows from financing activities:

Edgar Filing: FIDELITY D & D BANCORP INC - Form 10-Q

Net increase in deposits	56,060	42,170
Net increase in short-term borrowings	2,773	2,583
Repayment of long-term debt	(10,000)	-
Proceeds from employee stock purchase plan participants	102	80
Dividends paid, net of dividends reinvested	(1,937)	(1,473)
Proceeds from dividend reinvestment plan participants	-	104
Net cash provided by financing activities	46,998	43,464
Net (decrease) increase in cash and cash equivalents	(161)	6,467
Cash and cash equivalents, beginning	25,851	13,218
 Cash and cash equivalents, ending	 \$ 25,690	 \$ 19,685

See notes to unaudited consolidated financial statements

Table Of Contents

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 under the law of the Commonwealth of Pennsylvania and a wholly-owned subsidiary of Fidelity D & D Bancorp, Inc. (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.

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, 2014.

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, 2015 and December 31, 2014 and the related consolidated statements of income and consolidated statements of comprehensive income for the three and nine months ended September 30, 2015 and 2014, and consolidated statements of changes in shareholders' equity and consolidated statements of cash flows for the nine months ended September 30, 2015 and 2014 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 2014 financial statements to conform to the 2015 presentation.

In preparing these consolidated financial statements, the Company evaluated the events and transactions that occurred after September 30, 2015 through the date these consolidated financial statements were issued.

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, 2014, and the notes included therein, included within the Company's Annual Report filed on Form 10-K.

Critical accounting policies

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.

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, 2015 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. Fair values of investment securities are determined by pricing provided by a third-party vendor, who is a provider of financial market data, analytics and related services to financial institutions. 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

Table Of Contents

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) (AOCI).

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 residential 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 circumstances, pricing may be obtained from other entities and the residential mortgage loans are transferred at the lower of cost or market value and simultaneously sold. For other loans transferred to HFS, pricing may be obtained from other entities or modeled and the other loans are transferred at the lower of cost or market value and then sold. As of December 31, 2014, loans classified as HFS consisted of residential mortgage loans. As of September 30, 2015, \$0.5 million of the loans classified as HFS were residential mortgage loans and \$0.6 million was a commercial loan.

Financing of automobiles, provided to customers under lease arrangements of varying terms, are accounted for as direct finance leases. Interest income on automobile direct finance leasing is determined using the interest method. Generally, the interest method is used to arrive at a level effective yield over the life of the lease.

Foreclosed assets held-for-sale includes other real estate acquired through foreclosure (ORE) and may, from time-to-time, include repossessed assets such as automobiles. ORE is carried at the lower of cost (principal balance at date of foreclosure) or fair value less estimated cost to sell. Any write-downs at the date of foreclosure or within a reasonable period of time after foreclosure are charged to the allowance for loan losses. Expenses incurred to maintain ORE properties, subsequent write downs to the asset's fair value, any rental income received and gains or losses on disposal are included as components of other real estate owned expense in the consolidated statements of income.

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, 2015 and 2014, the Company paid interest of \$1.9 million and \$2.2 million, respectively. The Company made income tax payments of \$0.1 million and \$1.1 million during the first nine months of 2015 and 2014. Transfers from loans to foreclosed assets held-for-sale amounted to \$0.6 million and \$1.2 million during the nine months ended September 30, 2015 and 2014, respectively. During the same respective periods, transfers from loans to loans HFS amounted to \$2.9 million and \$0 and from loans to bank premises and equipment amounted to \$0 and \$1.0 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 an exposure draft issued in the fourth quarter of 2012, the Financial Accounting Standards Board (FASB) proposed changes to the accounting guidance related to the impairment of financial assets and the recognition of credit losses. The FASB proposal would require financial institutions to reserve for losses for the duration of the credit exposure as opposed to reserving for probable losses. The new methodology would be known as the "current expected credit losses" (CECL) methodology. The FASB is currently in the process of re-deliberating significant issues raised through feedback received from comment letters and outreach activities. Among other things, the guidance in the proposed update regarding an entity's estimate of expected credit losses will be clarified as follows:

An entity should revert to a historical average loss experience for the future periods beyond which the entity is able to make or obtain reasonable and supportable forecasts;

- An entity should consider all contractual cash flows over the life of the related financial assets;
- When determining the contractual cash flows and the life of the related financial assets:
 - o An entity should consider expected prepayments;
 - o An entity should not consider expected extensions, renewals, and modifications unless the entity reasonably expects that it will execute a troubled debt restructuring with a borrower;
- An entity's estimate of expected credit losses should always reflect the risk of loss, even when that risk is remote. However, an entity would not be required to recognize a loss on a financial asset in which the risk of nonpayment is greater than zero yet the amount of loss would be zero;
- In addition to using a discounted cash flow model to estimate expected credit losses, an entity would not be prohibited from developing an estimate of credit losses using loss-rate methods, probability-of-default methods or a provision matrix using loss factors;
- The final guidance on expected credit losses will include implementation guidance describing the factors that an entity should consider to adjust historical loss experience for current conditions and reasonable and supportable forecast.

FASB expects to issue this proposed accounting standard update in late 2015. An effective date has yet to be discussed. Upon adoption, the change in this accounting guidance could result in an increase in the Company's allowance for loan losses and require the Company to record loan losses more rapidly. Upon final issuance of the standard, the Company will be able to better evaluate the potential impact of this new standard on its consolidated financial statements.

In August 2014, the FASB issued an accounting standard update (ASU 2014-14) related to; Receivables – Troubled Debt Restructurings by Creditors (Subtopic 310-40) Classification of Certain Government-Guaranteed Mortgage Loans upon Foreclosure.

Table Of Contents

The update requires that a mortgage loan be derecognized and that a separate other receivable be recognized upon foreclosure if the following conditions are met: (1) The loan has a government guarantee that is not separable from the loan before foreclosure; (2) At the time of foreclosure, the creditor has the intent to convey the real estate property to the guarantor and make a claim on the guarantee, and the creditor has the ability to recover under that claim; (3) At the time of foreclosure, any amount of the claim that is determined on the basis of the fair value of the real estate is fixed. Upon foreclosure, the separate other receivable should be measured based on the amount of the loan balance (principal and interest) expected to be recovered from the guarantor. The amendments in the update are effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2014. The Company adopted this accounting standard during the first quarter of 2015 and it did not have a material impact on its consolidated financial statements.

In June 2014, the FASB issued ASU 2014-12, Compensation – Stock Compensation (Topic 718) Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period, an amendment to the stock compensation accounting guidance to clarify that a performance target that affects vesting of a share-based payment and that could be achieved after the requisite service period be treated as a performance condition. As such, the performance target should not be reflected in estimating the grant-date fair value of the award. Compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the period(s) for which the requisite service has already been rendered. This amendment is effective for annual reporting periods, including interim periods within those annual periods, beginning after December 15, 2015. Early adoption is permitted. Entities may apply the amendments in this update either (a) prospectively to all awards granted or modified after the effective date or (b) retrospectively to all awards with performance targets that are outstanding as of the beginning of the earliest annual period presented in the financial statements and to all new or modified awards thereafter. The Company does not expect this amendment to have a material impact on its consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers, which supersedes nearly all existing revenue recognition guidance under U.S. GAAP. The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration to which an entity expects to be entitled for those goods or services. ASU 2014-09 defines a five step process to achieve this core principle and, in doing so, more judgment and estimates may be required within the revenue recognition process than are required under existing U.S. GAAP: identify the contract(s) with a customer; identify the performance obligations in the contract; determine the transaction price; allocate the transaction price to the performance obligations in the contract; recognize revenue when (or as) the entity satisfies a performance obligation. The standard is effective for annual periods beginning after December 15, 2017, and interim periods therein, using either of the following transition methods: a full retrospective approach reflecting the application of the standard in each prior reporting period with the option to elect certain practical expedients, or a retrospective approach with the cumulative effect of initially adopting ASU 2014-09 recognized at the date of adoption (which includes additional footnote disclosures). The Company is evaluating the impact of the adoption of ASU 2014-09 on its consolidated financial statements and has not yet determined the method by which it will adopt the standard effective in the first quarter of 2018.

In January 2014, the FASB issued ASU 2014-04 related to; Receivables – Troubled Debt Restructurings by Creditors (Subtopic 310-40) Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure. The update applies to all creditors who obtain physical possession of residential real estate property collateralizing a consumer mortgage loan in satisfaction of a receivable. The amendments in this update clarify when an in-substance repossession or foreclosure occurs and requires disclosure of both (1) the amount of foreclosed residential real estate property held by a creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The amendments in the update are effective for public business entities for fiscal years,

and interim periods within those fiscal years, beginning after December 15, 2014. The Company adopted this accounting standard during the first quarter of 2015 and it did not have a material impact on its consolidated financial statements.

Table Of Contents

3. Accumulated other comprehensive income

The following tables illustrate the changes in accumulated other comprehensive income by component and the details about the components of accumulated other comprehensive income as of and for the periods indicated:

As of and for the nine months ended September 30, 2015

(dollars in thousands)	Unrealized gains on available-for- sale securities	Total
Beginning balance	\$ 2,743	\$ 2,743
Other comprehensive loss before reclassifications, net of tax	(193)	(193)
Amounts reclassified from accumulated other comprehensive income, net of tax	(17)	(17)
Net current-period other comprehensive loss	(210)	(210)
Ending balance	\$ 2,533	\$ 2,533

As of and for the three months ended September 30, 2015

(dollars in thousands)	Unrealized gains on available-for- sale securities	Total
Beginning balance	\$ 1,912	\$ 1,912
Other comprehensive income before reclassifications, net of tax	626	626
Amounts reclassified from accumulated other comprehensive income, net of tax	(5)	(5)
Net current-period other comprehensive income	621	621
Ending balance	\$ 2,533	\$ 2,533

As of and for the nine months ended September 30, 2014

Edgar Filing: FIDELITY D & D BANCORP INC - Form 10-Q

(dollars in thousands)	Unrealized gains on available-for- sale securities	Total
Beginning balance	\$ 1,239	\$ 1,239
Other comprehensive income before reclassifications, net of tax	1,609	1,609
Amounts reclassified from accumulated other comprehensive income, net of tax	(199)	(199)
Net current-period other comprehensive income	1,410	1,410
Ending balance	\$ 2,649	\$ 2,649

As of and for the three months ended September 30, 2014

(dollars in thousands)	Unrealized gains on available-for- sale securities	Total
Beginning balance	\$ 2,585	\$ 2,585
Other comprehensive income before reclassifications, net of tax	64	64
Amounts reclassified from accumulated other comprehensive income, net of tax	-	-
Net current-period other comprehensive income	64	64
Ending balance	\$ 2,649	\$ 2,649

Table Of Contents

Details about accumulated other

comprehensive income components (dollars in thousands)	Amount reclassified from accumulated other comprehensive income				Affected line item in the statement where net income is presented
	Three months ended September 30, 2015		Nine months ended September 30, 2014		
Unrealized gains on AFS securities	\$ 8	\$ -	\$ 26	\$ 301	Gain on sale of investment securities
	(3)	-	(9)	(102)	Provision for income taxes
Total reclassifications for the period	\$ 5	\$ -	\$ 17	\$ 199	Net income

4. Investment securities

Agency – Government-sponsored enterprise (GSE) and MBS - GSE residential

Agency – GSE and MBS – GSE residential securities consist of short- to long-term notes issued by Federal Home Loan Mortgage Corporation (FHLMC), Federal National Mortgage Association (FNMA), Federal Home Loan Bank (FHLB) and Government National Mortgage Association (GNMA). These securities have interest rates that are fixed and adjustable, have varying short- to long-term maturity dates and have contractual cash flows guaranteed by the U.S. government or agencies of the U.S. government.

Obligations of states and political subdivisions

The municipal securities are bank qualified or bank eligible, general obligation and revenue bonds rated as investment grade by various credit rating agencies and have fixed rates of interest with mid- to long-term maturities. Fair values of these securities are highly driven by interest rates. Management performs ongoing credit quality reviews on these issues.

The amortized cost and fair value of investment securities at September 30, 2015 and December 31, 2014 are summarized as follows:

(dollars in thousands)	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
September 30, 2015				
Held-to-maturity securities:				
MBS - GSE residential	\$ -	\$ -	\$ -	\$ -
Available-for-sale securities:				
Agency - GSE	\$ 18,421	\$ 165	\$ 8	\$ 18,578
Obligations of states and political subdivisions	36,269	2,139	93	38,315
MBS - GSE residential	67,959	1,449	47	69,361
Total debt securities	122,649	3,753	148	126,254
Equity securities - financial services	294	234	-	528
Total available-for-sale securities	\$ 122,943	\$ 3,987	\$ 148	\$ 126,782

Table Of Contents

(dollars in thousands)	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
December 31, 2014				
Held-to-maturity securities:				
MBS - GSE residential	\$ -	\$ -	\$ -	\$ -
Available-for-sale securities:				
Agency - GSE	\$ 14,380	\$ 29	\$ 11	\$ 14,398
Obligations of states and political subdivisions	34,609	2,444	20	37,033
MBS - GSE residential	44,455	1,438	23	45,870
Total debt securities	93,444	3,911	54	97,301
Equity securities - financial services	295	300	-	595
Total available-for-sale securities	\$ 93,739	\$ 4,211	\$ 54	\$ 97,896

The amortized cost and fair value of debt securities at September 30, 2015 by contractual maturity are summarized below:

(dollars in thousands)	Amortized cost	Fair value
Held-to-maturity securities:		
MBS - GSE residential	\$ -	\$ -
Available-for-sale securities:		
Debt securities:		
Due in one year or less	\$ 4,302	\$ 4,312
Due after one year through five years	15,349	15,501
Due after five years through ten years	3,004	3,215
Due after ten years	32,035	33,865
Total debt securities	54,690	56,893
MBS - GSE residential	67,959	69,361
Total available-for-sale debt securities	\$ 122,649	\$ 126,254

Actual maturities will differ from contractual maturities because issuers and borrowers may have the right to call or repay obligations with or without a call or prepayment penalty. Agency – GSE and municipal securities are included

based on their original stated maturity. MBS – GSE residential, which are based on weighted-average lives and subject to monthly principal pay-downs, are listed in total. Most of the securities have fixed rates or have predetermined scheduled rate changes and many have call features that allow the issuer to call the security at par before its stated maturity without penalty.

Table Of Contents

The following table presents the fair value and gross unrealized losses of investment securities aggregated by investment type, the length of time and the number of securities that have been in a continuous unrealized loss position as of September 30, 2015 and December 31, 2014:

(dollars in thousands)	Less than 12 months		More than 12 months		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
September 30, 2015						
Agency - GSE	\$ 2,038	\$ 8	\$ -	\$ -	\$ 2,038	\$ 8
Obligations of states and political subdivisions	5,132	83	481	10	5,613	93
MBS - GSE residential	3,944	47	-	-	3,944	47
Total	\$ 11,114	\$ 138	\$ 481	\$ 10	\$ 11,595	\$ 148
Number of securities	11		1		12	
December 31, 2014						
Agency - GSE	\$ 4,100	\$ 11	\$ 1,024	\$ -	\$ 5,124	\$ 11
Obligations of states and political subdivisions	1,767	11	670	9	2,437	20
MBS - GSE residential	3,761	23	-	-	3,761	23
Total	\$ 9,628	\$ 45	\$ 1,694	\$ 9	\$ 11,322	\$ 54
Number of securities	9		3		12	

Management believes the cause of the unrealized losses is related to changes in interest rates, instability in the capital markets or the limited trading activity due to illiquid conditions in the debt market and is not directly related to credit quality. Quarterly, management conducts a formal review of investment securities for the presence of other-than-temporary impairment (OTTI). The accounting guidance related to OTTI requires the Company to assess whether OTTI is present when the fair value of a debt security is less than its amortized cost as of the balance sheet date. Under those circumstances, OTTI is considered to have occurred if: (1) the entity has intent to sell the security; (2) more likely than not the entity will be required to sell the security before recovery of its amortized cost basis; or (3) the present value of expected cash flows is not sufficient to recover the entire amortized cost. The accounting guidance requires that credit-related OTTI be recognized in earnings while non-credit-related OTTI on securities not expected to be sold be recognized in other comprehensive income (loss) (OCI). Non-credit-related OTTI is based on other factors affecting market value, including illiquidity.

The Company's OTTI evaluation process also follows the guidance set forth in topics related to debt and equity securities. The guidance set forth in the pronouncements require the Company to take into consideration current market conditions, fair value in relationship to cost, extent and nature of changes in fair value, issuer rating changes and trends, volatility of earnings, current analysts' evaluations, all available information relevant to the collectability of debt securities, the ability and intent to hold investments until a recovery of fair value which may be to maturity and other factors when evaluating for the existence of OTTI. The guidance requires that credit-related OTTI be recognized as a realized loss through earnings when there has been an adverse change in the holder's expected cash

flows such that the full amount (principal and interest) will probably not be received. This requirement is consistent with the impairment model in the guidance for accounting for debt and equity securities.

For all security types, as of September 30, 2015, the Company applied the criteria provided in the recognition and presentation guidance related to OTTI. That is, management has no intent to sell the securities and no conditions were identified by management that more likely than not would require the Company to sell the securities before recovery of their amortized cost basis. The results indicated there was no presence of OTTI in the Company's security portfolio.

In addition, management believes the change in fair value is attributable to changes in interest rates.

Table Of Contents

5. Loans and leases

The classifications of loans and leases at September 30, 2015 and December 31, 2014 are summarized as follows:

(dollars in thousands)	September 30, 2015	December 31, 2014
Commercial and industrial	\$ 90,552	\$ 80,301
Commercial real estate:		
Non-owner occupied	94,878	94,771
Owner occupied	101,628	95,780
Construction	3,554	5,911
Consumer:		
Home equity installment	31,848	32,819
Home equity line of credit	45,862	42,188
Auto loans and leases	30,302	27,972
Other	6,595	6,501
Residential:		
Real estate	128,255	119,154
Construction	9,234	10,298
Total	542,708	515,695
Less:		
Allowance for loan losses	(9,149)	(9,173)
Unearned lease revenue	(325)	(195)
Loans and leases, net	\$ 533,234	\$ 506,327

Net deferred loan costs of \$1.5 million and \$1.4 million have been added to the carrying values of loans at September 30, 2015 and December 31, 2014, respectively.

Unearned lease revenue represents the difference between the lessor's investment in the property and the gross investment in the lease. Unearned revenue accretes over the life of the lease using the effective income method.

The Company services real estate loans for investors in the secondary mortgage market which are not included in the accompanying consolidated balance sheets. The approximate amount of mortgages serviced amounted to \$265.2 million as of September 30, 2015 and \$256.8 million as of December 31, 2014. Mortgage servicing rights amounted to \$1.2 million and \$1.0 million as of September 30, 2015 and December 31, 2014, respectively.

Management is responsible for conducting the Company's credit risk evaluation process, which includes credit risk grading of individual commercial and industrial and commercial real estate loans. Commercial and industrial and commercial real estate loans are assigned credit risk grades based on the Company's assessment of conditions that affect the borrower's ability to meet its contractual obligations under the loan agreement. That process includes reviewing borrowers' current financial information, historical payment experience, credit documentation, public information and other information specific to each individual borrower. Upon review, the commercial loan credit risk grade is revised or reaffirmed as the case may be. The credit risk grades may be changed at any time management feels an upgrade or downgrade may be warranted. The Company utilizes an external independent loan review firm

that reviews and validates the credit risk program on at least an annual basis. Results of these reviews are presented to management and the board of directors. The loan review process complements and reinforces the risk identification and assessment decisions made by lenders and credit personnel, as well as the Company's policies and procedures.

Non-accrual loans

The decision to place loans on non-accrual status is made on an individual basis after considering factors pertaining to each specific loan. Commercial and industrial (C&I) and commercial real estate (CRE) loans are placed on non-accrual status when management has determined that payment of all contractual principal and interest is in doubt or the loan is past due 90 days or more as to principal and interest, unless well-secured and in the process of collection. Consumer loans secured by real estate and residential mortgage loans are placed on non-accrual status at 120 days past due as to principal and interest and unsecured consumer loans are charged-off when the loan is 90 days or more past due as to principal and interest. The Company considers all non-accrual loans to be impaired loans.

During the third quarter of 2015, the Company transferred a non-accruing owner occupied commercial real estate loan from the loan portfolio to loans held-for-sale. This loan was charged down to market value at the time it was transferred.

Table Of Contents

Non-accrual loans, segregated by class, at September 30, 2015 and December 31, 2014, were as follows:

(dollars in thousands)	September 30, 2015	December 31, 2014
Commercial and industrial	\$ 54	\$ 27
Commercial real estate:		
Non-owner occupied	945	620
Owner occupied	1,090	2,013
Construction	232	256
Consumer:		
Home equity installment	234	312
Home equity line of credit	517	417
Auto loans and leases	75	1
Other	7	20
Residential:		
Real estate	612	549
Total loans and leases, net	3,766	4,215
Loans held-for-sale	604	-
Total	\$ 4,370	\$ 4,215

Troubled Debt Restructuring

A modification of a loan constitutes a troubled debt restructuring (TDR) when a borrower is experiencing financial difficulty and the modification constitutes a concession. The Company considers all TDRs to be impaired loans. The Company offers various types of concessions when modifying a loan, however, forgiveness of principal is rarely granted. C&I loans modified in a TDR often involve temporary interest-only payments, term extensions, and converting revolving credit lines to term loans. Additional collateral, a co-borrower, or a guarantor is often requested. CRE loans modified in a TDR often involve reducing the interest rate for the remaining term of the loan, extending the maturity date at an interest rate lower than the current market rate for new debt with similar risk, or substituting or adding a new borrower or guarantor. Commercial real estate construction loans modified in a TDR may also involve extending the interest-only payment period. Residential mortgage loans modified in a TDR are primarily comprised of loans where monthly payments are lowered to accommodate the borrowers' financial needs for an extended period of time. After the lowered monthly payment period ends, the borrower would revert back to paying principal and interest pursuant to the original terms with the maturity date adjusted accordingly. Consumer loan modifications are typically not granted and therefore standard modification terms do not exist for loans of this type.

Loans modified in a TDR may or may not be placed on non-accrual status. As of September 30, 2015, total TDRs amounted to \$3.0 million (consisting of 8 CRE loans and 2 C&I loans to 6 unrelated borrowers), of which one with a balance of \$0.6 million was on non-accrual status, compared to \$1.6 million (consisting of 4 CRE loans and 1 C&I loan to 3 unrelated borrowers) and \$0.9 million, respectively, as of December 31, 2014. During the third quarter of 2015, the TDR on non-accrual status was transferred from the loan portfolio to loans held-for-sale. Of the TDRs outstanding as of September 30, 2015 and December 31, 2014, when modified, the concessions granted consisted of temporary interest-only payments or a reduction in the rate of interest to a below-market rate for a contractual period of time. Other than the TDR that was on non-accrual status, the TDRs were performing in accordance with their

modified terms.

16

Table Of Contents

The following presents by class, information related to loans modified in a TDR:

(dollars in thousands)	Loans modified as TDRs for the:					
	Three months ended September 30, 2015			Nine months ended September 30, 2015		
	Number of contracts	Recorded investment (as of period end)	Increase in allowance (as of period end)	Number of contracts	Recorded investment (as of period end)	Increase in allowance (as of period end)
Commercial and industrial	-	\$ -	\$ -	1	\$ 500	\$ 331
Commercial real estate - owner occupied	-	-	-	4	1,182	270
Total	-	\$ -	\$ -	5	\$ 1,682	\$ 601

In the above table, the period end balances are inclusive of all partial pay downs and charge-offs since the modification date.

Loans modified in a TDR are closely monitored for delinquency as an early indicator of possible future default. If loans modified in a TDR subsequently default, the Company evaluates the loan for possible further impairment. There were no loans modified as a TDR within the previous twelve months that subsequently defaulted during the three and nine months ended September 30, 2015.

The allowance for loan losses (allowance) may be increased, adjustments may be made in the allocation of the allowance or partial charge-offs may be taken to further write-down the carrying value of the loan. An allowance for impaired loans that have been modified in a TDR is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or the loan's observable market price. If the loan is collateral dependent, the estimated fair value of the collateral, less any selling costs, is used to establish the allowance.

Past due loans

Loans are considered past due when the contractual principal and/or interest is not received by the due date. An aging analysis of past due loans, segregated by class of loans, as of the period indicated is as follows (dollars in thousands):

	Past due				Recorded investment past		
	30 - 59 Days	60 - 89 Days	90 days or more (1)	Total	Total	due ≥ 90 days	
September 30, 2015	past due	past due	past due	past due	Current loans (3)		and accruing
Commercial and industrial	\$ 21	\$ 33	\$ 54	\$ 108	\$ 90,444	\$ 90,552	\$ -
Commercial real estate:							
Non-owner occupied	947	125	945	2,017	92,861	94,878	-

Edgar Filing: FIDELITY D & D BANCORP INC - Form 10-Q

Owner occupied	281	-	1,090	1,371	100,257	101,628	-
Construction	-	-	232	232	3,322	3,554	-
Consumer:							
Home equity installment	93	55	266	414	31,434	31,848	32
Home equity line of credit	118	210	517	845	45,017	45,862	-
Auto loans and leases	387	66	247	700	29,277	29,977	(2) 172
Other	8	4	7	19	6,576	6,595	-
Residential:							
Real estate	16	857	679	1,552	126,703	128,255	67
Construction	-	-	-	-	9,234	9,234	-
Total loans and leases, net	1,871	1,350	4,037	7,258	535,125	542,383	271
Loans held-for-sale	-	-	604	604	510	1,114	-
Total	\$ 1,871	\$ 1,350	\$ 4,641	\$ 7,862	\$ 535,635	\$ 543,497	\$ 271

(1) Includes \$4.4 million of non-accrual loans. (2) Net of unearned lease revenue of \$0.3 million. (3) Includes net deferred loan costs of \$1.5 million.

Table Of Contents

	30 - 59 Days	60 - 89 Days	Past due 90 days or more (1)	Total past due	Current	Total loans (3)	Recorded investment past due ≥ 90 days and accruing
December 31, 2014	past due	past due	(1)	past due	Current	loans (3)	and accruing
Commercial and industrial	\$ 34	\$ 76	\$ 55	\$ 165	\$ 80,136	\$ 80,301	\$ 28
Commercial real estate:							
Non-owner occupied	624	126	719	1,469	93,302	94,771	99
Owner occupied	366	292	2,113	2,771	93,009	95,780	100
Construction	-	-	256	256	5,655	5,911	-
Consumer:							
Home equity installment	170	142	767	1,079	31,740	32,819	455
Home equity line of credit	13	-	417	430	41,758	42,188	-
Auto loans and leases	545	111	16	672	27,105	27,777	(2) 15
Other	38	147	40	225	6,276	6,501	20
Residential:							
Real estate	700	548	892	2,140	117,014	119,154	343
Construction	-	-	-	-	10,298	10,298	-
Total	\$ 2,490	\$ 1,442	\$ 5,275	\$ 9,207	\$ 506,293	\$ 515,500	\$ 1,060

(1) Includes \$4.2 million of non-accrual loans. (2) Net of unearned lease revenue of \$0.2 million. (3) Includes net deferred loan costs of \$1.4 million.

Impaired loans

A loan is considered impaired when, based on current information and events; it is probable that the Company will be unable to collect the scheduled payments in accordance with the contractual terms of the loan. Factors considered in determining impairment include payment status, collateral value and the probability of collecting payments when due. The significance of payment delays and/or shortfalls is determined on a case-by-case basis. All circumstances surrounding the loan are taken into account. Such factors include the length of the delinquency, the underlying reasons and the borrower's prior payment record. Impairment is measured on these loans on a loan-by-loan basis. Impaired loans include non-accrual loans, TDRs and other loans deemed to be impaired based on the aforementioned factors.

At September 30, 2015, impaired loans consisted of accruing TDRs totaling \$2.4 million, \$4.4 million of non-accrual loans and a \$1.2 million accruing loan. At December 31, 2014, impaired loans consisted of accruing TDRs totaling \$0.7 million, \$4.2 million of non-accrual loans and a \$1.2 million accruing loan. As of September 30, 2015 and December 31, 2014, the non-accrual loans included a non-accruing TDR with a balance of \$0.6 million and \$0.9 million, respectively. Prior to the third quarter of 2015, the non-accruing TDR was in the loan portfolio, but during the third quarter it was transferred to loans held-for-sale. Payments received from non-accruing impaired loans are first applied against the outstanding principal balance, then to the recovery of any charged-off amounts. Any excess is treated as a recovery of interest income. Payments received from accruing impaired loans are applied to principal and interest, as contractually agreed upon.

Impaired loans, segregated by class, as of the period indicated are detailed below:

(dollars in thousands)	Unpaid principal balance	Recorded investment with allowance	Recorded investment with no allowance	Total recorded investment	Related allowance	Average recorded investment	Interest income recognized	Cash basis interest income recognized
September 30, 2015								
Commercial and industrial	\$ 603	\$ 500	\$ 79	\$ 579	\$ 331	\$ 410	\$ 15	\$ 1
Commercial real estate:								
Non-owner occupied	2,726	1,970	635	2,605	498	1,674	62	-
Owner occupied	2,593	925	1,605	2,530	295	2,648	51	-
Construction	422	-	232	232	-	249	-	-
Consumer:								
Home equity installment	319	39	195	234	-	285	2	-
Home equity line of credit	610	28	489	517	1	486	1	-
Auto loans and leases	77	22	53	75	6	16	-	-
Other	6	7	-	7	2	15	2	-
Residential:								
Real estate	661	175	437	612	23	570	6	-
Construction	-	-	-	-	-	-	-	-
Total	8,017	3,666	3,725	7,391	1,156	6,353	139	1

Table Of Contents

(dollars in thousands)	Unpaid principal balance	Recorded investment with allowance	Recorded investment with no allowance	Total recorded investment	Related allowance	Average recorded investment	Interest income recognized	Cash basis interest income recognized
December 31, 2014								
Commercial and industrial	\$ 326	\$ -	\$ 52	\$ 52	\$ -	\$ 67	\$ 1	\$ -
Commercial real estate:								
Non-owner occupied	2,494	1,949	355	2,304	547	1,557	27	-
Owner occupied	2,375	447	1,825	2,272	87	1,996	15	-
Construction	350	-	256	256	-	342	-	-
Consumer:								
Home equity installment	466	-	312	312	-	358	11	-
Home equity line of credit	469	128	289	417	1	382	20	-
Auto	1	-	1	1	-	2	-	-
Other	33	-	20	20	-	22	-	-
Residential:								
Real estate	612	304	245	549	35	762	7	-
Construction	-	-	-	-	-	-	-	-
Total	\$ 7,126	\$ 2,828	\$ 3,355	\$ 6,183	\$ 670	\$ 5,488	\$ 81	\$ -

Credit Quality Indicators

Commercial and industrial and commercial real estate

The Company utilizes a loan grading system and assigns a credit risk grade to its loans in the C&I and CRE portfolios. The grading system provides a means to measure portfolio quality and aids in the monitoring of the credit quality of the overall loan portfolio. The credit risk grades are arrived at using a risk rating matrix to assign a grade to each of the loans in the C&I and CRE portfolios.

The following is a description of each risk rating category the Company uses to classify each of its C&I and CRE loans:

Pass

Loans in this category have an acceptable level of risk and are graded in a range of one to five. Secured loans generally have good collateral coverage. Current financial statements reflect acceptable balance sheet ratios, sales and earnings trends. Management is considered to be competent, and a reasonable succession plan is evident. Payment experience on the loans has been good with minor or no delinquency experience. Loans with a grade of one are of the highest quality in the range. Those graded five are of marginally acceptable quality.

Special Mention

Loans in this category are graded a six and may be protected but are potentially weak. They constitute a credit risk to the Company, but have not yet reached the point of adverse classification. Some of the following conditions may exist: little or no collateral coverage; lack of current financial information; delinquency problems; highly leveraged; available financial information reflects poor balance sheet ratios and profit and loss statements reflect uncertain trends; and document exceptions. Cash flow may not be sufficient to support total debt service requirements.

Substandard

Loans in this category are graded a seven and have a well-defined weakness which may jeopardize the ultimate collectability of the debt. The collateral pledged may be lacking in quality or quantity. Financial statements may indicate insufficient cash flow to service the debt; and/or do not reflect a sound net worth. The payment history indicates chronic delinquency problems. Management is considered to be weak. There is a distinct possibility that the Company may sustain a loss. All loans on non-accrual are rated substandard. Other loans that are included in the substandard category can be accruing, as well as loans that are current or past due. Loans 90 days or more past due, unless otherwise fully supported, are classified substandard. Also, borrowers that are bankrupt or have loans categorized as TDRs can be graded substandard.

Doubtful

Loans in this category are graded an eight and have a better than 50% possibility of the Company sustaining a loss, but the loss cannot be determined because of specific reasonable factors which may strengthen credit in the near-term. Many of the weaknesses present in a substandard loan exist. Liquidation of collateral, if any, is likely. Any loan graded lower than an eight is considered to be uncollectible and charged-off.

Table Of Contents

Consumer and residential

The consumer and residential loan segments are regarded as homogeneous loan pools and as such are not risk rated. For these portfolios, the Company utilizes payment activity, history and recency of payment in assessing performance. Non-performing loans are considered to be loans past due 90 days or more and accruing and non-accrual loans. All loans not classified as non-performing are considered performing.

The following table presents loans including \$1.5 million and \$1.4 million of deferred costs, segregated by class, categorized into the appropriate credit quality indicator category as of September 30, 2015 and December 31, 2014, respectively. There was an owner occupied commercial real estate non-accrual substandard loan in the amount of \$0.6 million at September 30, 2015 that was not included in this table because it was transferred to loans held-for-sale during the third quarter:

Commercial credit exposure

Credit risk profile by creditworthiness category

(dollars in thousands)	Commercial and industrial		Commercial real estate - non-owner occupied		Commercial real estate - owner occupied		Commercial real estate - construction	
	9/30/2015	12/31/2014	9/30/2015	12/31/2014	9/30/2015	12/31/2014	9/30/2015	12/31/2014
Pass	\$ 86,846	\$ 76,904	\$ 81,284	\$ 83,443	\$ 93,032	\$ 88,523	\$ 2,997	\$ 5,153
Special mention	2,217	2,202	6,691	3,611	1,971	2,933	325	502
Substandard	1,489	1,195	6,903	7,717	6,625	4,324	232	256
Doubtful	-	-	-	-	-	-	-	-
Total	\$ 90,552	\$ 80,301	\$ 94,878	\$ 94,771	\$ 101,628	\$ 95,780	\$ 3,554	\$ 5,911

Consumer credit exposure

Credit risk profile based on payment activity

(dollars in thousands)	Home equity installment		Home equity line of credit		Auto loans and leases		Other	
	9/30/2015	12/31/2014	9/30/2015	12/31/2014	9/30/2015	12/31/2014	9/30/2015	12/31/2014
Performing	\$ 31,582	\$ 32,052	\$ 45,345	\$ 41,771	\$ 29,730	\$ 27,761	\$ 6,588	\$ 6,461

Edgar Filing: FIDELITY D & D BANCORP INC - Form 10-Q

Non-performing	266	767	517	417	247	16	7	40
Total	\$ 31,848	\$ 32,819	\$ 45,862	\$ 42,188	\$ 29,977 (1)	\$ 27,777 (2)	\$ 6,595	\$ 6,501

(1) Net of unearned lease revenue of \$0.3 million. (2) Net of unearned revenue of \$0.2 million.

Mortgage lending credit exposure

Credit risk profile based on payment activity

(dollars in thousands)	Residential real estate		Residential construction	
	9/30/2015	12/31/2014	9/30/2015	12/31/2014
Performing	\$ 127,576	\$ 118,262	\$ 9,234	\$ 10,298
Non-performing	679	892	-	-
Total	\$ 128,255	\$ 119,154	\$ 9,234	\$ 10,298

Allowance for loan losses

Management continually evaluates the credit quality of the Company's loan portfolio and performs a formal review of the adequacy of the allowance on a quarterly basis. The allowance reflects management's best estimate of the amount of credit losses in the loan portfolio. Management's judgment is based on the evaluation of individual loans, past experience, the assessment of current economic conditions and other relevant factors including the amounts and timing of cash flows expected to be received on impaired loans. Those estimates may be susceptible to significant change. Loan losses are charged directly against the allowance when loans are deemed to be uncollectible. Recoveries from previously charged-off loans are added to the allowance when received.

Management applies two primary components during the loan review process to determine proper allowance levels. The two components are a specific loan loss allocation for loans that are deemed impaired and a general loan loss allocation for those loans not specifically allocated. The methodology to analyze the adequacy of the allowance for loan losses is as follows:

- § identification of specific impaired loans by loan category;
- § identification of specific loans that are not impaired, but have an identified potential for loss;
- § calculation of specific allowances where required for the impaired loans based on collateral and other objective and quantifiable evidence;
- § determination of loans with similar credit characteristics within each class of the loan portfolio segment and eliminating the impaired loans;
 - § application of historical loss percentages (trailing twelve-quarter average) to pools to determine the allowance allocation;

Table Of Contents

§ application of qualitative factor adjustment percentages to historical losses for trends or changes in the loan portfolio.

§ Qualitative factor adjustments include:

- o levels of and trends in delinquencies and non-accrual loans;
- o levels of and trends in charge-offs and recoveries;
- o trends in volume and terms of loans;
- o changes in risk selection and underwriting standards;
- o changes in lending policies, procedures and practices;
- o experience, ability and depth of lending management;
- o national and local economic trends and conditions; and
- o changes in credit concentrations.

Allocation of the allowance for different categories of loans is based on the methodology as explained above. A key element of the methodology to determine the allowance is the Company's credit risk evaluation process, which includes credit risk grading of individual C&I and CRE loans. C&I and CRE loans are assigned credit risk grades based on the Company's assessment of conditions that affect the borrower's ability to meet its contractual obligations under the loan agreement. That process includes reviewing borrowers' current financial information, historical payment experience, credit documentation, public information and other information specific to each individual borrower. Upon review, the commercial loan credit risk grade is revised or reaffirmed as the case may be. The credit risk grades may be changed at any time management feels an upgrade or downgrade may be warranted. The credit risk grades for the C&I and CRE loan portfolios are taken into account in the reserve methodology and loss factors are applied based upon the credit risk grades. The loss factors applied are based upon the Company's historical experience as well as what we believe to be best practices and common industry standards. Historical experience reveals there is a direct correlation between the credit risk grades and loan charge-offs. The changes in allocations in the C&I and CRE loan portfolio from period to period are based upon the credit risk grading system and from periodic reviews of the loan portfolio. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies.

Each quarter, management performs an assessment of the allowance. The Company's Special Assets Committee meets monthly and the applicable lenders discuss each relationship under review and reach a consensus on the appropriate estimated loss amount, if applicable, based on current accounting guidance. The Special Assets Committee's focus is on ensuring the pertinent facts are considered regarding not only loans considered for specific reserves, but also the collectability of loans that may be past due in payment. The assessment process also includes the review of all loans on a non-accruing basis as well as a review of certain loans to which the lenders or the Company's Credit Administration function have assigned a criticized or classified risk rating.

The Company's policy is to charge-off unsecured consumer loans when they become 90 days or more past due as to principal and interest. In the other portfolio segments, amounts are charged-off at the point in time when the Company deems the balance, or a portion thereof, to be uncollectible.

Information related to the change in the allowance and the Company's recorded investment in loans by portfolio segment as of the period indicated is as follows:

As of and for the nine months ended September
30, 2015

Commercial		
&	Commercial	Residential

Edgar Filing: FIDELITY D & D BANCORP INC - Form 10-Q

(dollars in thousands)	industrial	real estate	Consumer	real estate	Unallocated	Total
Allowance for Loan Losses:						
Beginning balance	\$ 1,052	\$ 4,672	\$ 1,519	\$ 1,316	\$ 614	\$ 9,173
Charge-offs	26	357	270	9	-	662
Recoveries	37	17	56	28	-	138
Provision	392	410	262	49	(613)	500
Ending balance	\$ 1,455	\$ 4,742	\$ 1,567	\$ 1,384	\$ 1	\$ 9,149
Ending balance: individually evaluated for impairment	\$ 331	\$ 793	\$ 9	\$ 23	\$ -	\$ 1,156
Ending balance: collectively evaluated for impairment	\$ 1,124	\$ 3,949	\$ 1,558	\$ 1,361	\$ 1	\$ 7,993
Loans Receivables:						
Ending balance (2)	\$ 90,552	\$ 200,060	\$ 114,282 (1)	\$ 137,489	\$ -	\$ 542,383
Ending balance: individually evaluated for impairment	\$ 579	\$ 5,367	\$ 833	\$ 612	\$ -	\$ 7,391
Ending balance: collectively evaluated for impairment	\$ 89,973	\$ 194,693	\$ 113,449	\$ 136,877	\$ -	\$ 534,992

(1) Net of unearned lease revenue of \$0.3 million. (2) Includes \$1.5 million of net deferred loan costs.

Table Of Contents

As of and for the three months ended
September 30, 2015

(dollars in thousands)	Commercial & industrial	Commercial real estate	Consumer	Residential real estate	Unallocated	Total
Allowance for Loan Losses:						
Beginning balance	\$ 1,370	\$ 4,610	\$ 1,500	\$ 1,369	\$ 410	\$ 9,259
Charge-offs	-	219	119	9	-	347
Recoveries	11	-	26	-	-	37
Provision	74	351	160	24	(409)	200
Ending balance	\$ 1,455	\$ 4,742	\$ 1,567	\$ 1,384	\$ 1	\$ 9,149

As of and for the year ended
December 31, 2014

(dollars in thousands)	Commercial & industrial	Commercial real estate	Consumer	Residential real estate	Unallocated	Total
Allowance for Loan Losses:						
Beginning balance	\$ 944	\$ 4,253	\$ 1,482	\$ 1,613	\$ 636	\$ 8,928
Charge-offs	309	239	361	93	-	1,002
Recoveries	32	91	30	34	-	187
Provision	385	567	368	(238)	(22)	1,060
Ending balance	\$ 1,052	\$ 4,672	\$ 1,519	\$ 1,316	\$ 614	\$ 9,173
Ending balance: individually evaluated for impairment	\$ -	\$ 634	\$ 1	\$ 35	\$ -	\$ 670
Ending balance: collectively evaluated for impairment	\$ 1,052	\$ 4,038	\$ 1,518	\$ 1,281	\$ 614	\$ 8,503
Loans Receivables:						
Ending balance (2)	\$ 80,301	\$ 196,462	\$ 109,285 (1)	\$ 129,452	\$ -	\$ 515,500
Ending balance: individually evaluated for impairment	\$ 52	\$ 4,832	\$ 750	\$ 549	\$ -	\$ 6,183
Ending balance: collectively evaluated for impairment	\$ 80,249	\$ 191,630	\$ 108,535	\$ 128,903	\$ -	\$ 509,317

(1) Net of unearned lease revenue of \$0.2 million. (2) Includes \$1.4 million of net deferred loan costs.

Information related to the change in the allowance for loan losses as of and for the three and nine months ended September 30, 2014 is as follows:

As of and for the nine months ended
September 30, 2014

(dollars in thousands)	Commercial & industrial	Commercial real estate	Consumer	Residential real estate	Unallocated	Total
Allowance for Loan Losses:						
Beginning balance	\$ 944	\$ 4,253	\$ 1,482	\$ 1,613	\$ 636	\$ 8,928
Charge-offs	39	217	287	93	-	636
Recoveries	25	90	26	34	-	175
Provision	49	282	382	(55)	152	810
Ending balance	\$ 979	\$ 4,408	\$ 1,603	\$ 1,499	\$ 788	\$ 9,277

As of and for the three months ended
September 30, 2014

(dollars in thousands)	Commercial & industrial	Commercial real estate	Consumer	Residential real estate	Unallocated	Total
Allowance for Loan Losses:						
Beginning balance	\$ 1,036	\$ 4,342	\$ 1,570	\$ 1,578	\$ 503	\$ 9,029
Charge-offs	3	-	47	16	-	66
Recoveries	11	89	4	-	-	104
Provision	(65)	(23)	76	(63)	285	210
Ending balance	\$ 979	\$ 4,408	\$ 1,603	\$ 1,499	\$ 788	\$ 9,277

Table Of Contents

6. Earnings per share

Basic earnings per share (EPS) is computed by dividing net income available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted EPS is computed in the same manner as basic EPS but also reflects the potential dilution that could occur from the grant of stock-based compensation awards. The Company maintains two active share-based compensation plans that may generate additional potentially dilutive common shares. For granted and unexercised stock options, dilution would occur if Company-issued stock options were exercised and converted into common stock. As of the three and nine months ended September 30, 2015, there were 2,374 and 2,648 potentially dilutive shares related to issued and unexercised stock options compared to 434 and 57 for the same 2014 periods. For restricted stock, dilution would occur from the Company's previously granted but unvested shares. There were 4,141 and 4,622 potentially dilutive shares related to unvested restricted share grants as of the three and nine months ended September 30, 2015 compared to 5,799 and 4,514 for the three and nine months ended September 30, 2014, respectively.

In the computation of diluted EPS, the Company uses the treasury stock method to determine the dilutive effect of its granted but unexercised stock options and unvested restricted stock. Under the treasury stock method, the assumed proceeds, as defined, received from shares issued in a hypothetical stock option exercise or restricted stock grant, are assumed to be used to purchase treasury stock. Proceeds include: amounts received from the exercise of outstanding stock options; compensation cost for future service that the Company has not yet recognized in earnings; and any windfall tax benefits that would be credited directly to shareholders' equity when the grant generates a tax deduction (or a reduction in proceeds if there is a charge to equity). The Company does not consider awards from share-based grants in the computation of basic EPS.

The following table illustrates the data used in computing basic and diluted EPS for the periods indicated:

	Three months ended September 30, 2015		Nine months ended September 30, 2015	
	2015	2014	2015	2014
(dollars in thousands except per share data)				
Basic EPS:				
Net income available to common shareholders	\$ 1,929	\$ 1,631	\$ 5,282	\$ 4,714
Weighted-average common shares outstanding	2,439,905	2,419,587	2,438,579	2,410,100
Basic EPS	\$ 0.79	\$ 0.68	\$ 2.17	\$ 1.96
Diluted EPS:				
Net income available to common shareholders	\$ 1,929	\$ 1,631	\$ 5,282	\$ 4,714
Weighted-average common shares outstanding	2,439,905	2,419,587	2,438,579	2,410,100
Potentially dilutive common shares	6,515	6,233	7,270	4,571
Weighted-average common and potentially dilutive shares outstanding	2,446,420	2,425,820	2,445,849	2,414,671
Diluted EPS	\$ 0.79	\$ 0.67	\$ 2.16	\$ 1.95

7. Stock plans

The Company has two stock-based compensation plans (the stock compensation plans) from which it can grant stock-based compensation awards, and applies the fair value method of accounting for stock-based compensation

provided under current accounting guidance. The guidelines require the cost of share-based payment transactions (including those with employees and non-employees) be recognized in the financial statements. The Company's stock compensation plans were shareholder-approved and permit the grant of share-based compensation awards to its employees and directors. The Company believes that the stock-based compensation plans will advance the development, growth and financial condition of the Company by providing incentives through participation in the appreciation in the value of the Company's common stock. In return, the Company hopes to secure, retain and motivate the employees and directors who are responsible for the operation and the management of the affairs of the Company by aligning the interest of its employees and directors with the interest of its shareholders. In the stock compensation plans, employees and directors are eligible to be awarded stock-based compensation grants which can consist of stock options (qualified and non-qualified), stock appreciation rights (SARs) and restricted stock.

At the 2012 annual shareholders' meeting, the Company's shareholders approved and the Company adopted the 2012 Omnibus Stock Incentive Plan and the 2012 Director Stock Incentive Plan (collectively, the 2012 stock incentive plans). The 2012 stock incentive plans replaced both the expired 2000 Independent Directors Stock Option Plan and the 2000 Stock Incentive Plan (collectively, the 2000 stock incentive plans). Unless terminated by the Company's board of directors, the 2012 stock incentive plans will expire on, and no stock-based awards shall be granted after the year 2022.

In each of the 2012 stock incentive plans, the Company has reserved 500,000 shares of its no-par common stock for future issuance. The Company recognizes share-based compensation expense over the requisite service or vesting period.

Table Of Contents

The following table summarizes the weighted-average fair value and vesting of restricted stock grants awarded during the nine months ended September 30, 2015 and 2014 under the 2012 stock incentive plans:

	2015			2014		
	Shares	Weighted- average grant date fair value	Vesting period	Shares granted	Weighted- average grant date fair value	Vesting period
Director plan	3,200	\$ 32.25	1 year	2,000	\$ 27.00	1 year
Omnibus plan	3,300	32.25	4 yrs - 25% per year	2,120	27.00	4 yrs - 25% per year
Omnibus plan	50	32.50	1 year	-	-	
Omnibus plan	1,400	34.25	4 yrs - 25% per year	-	-	
Total	7,950	\$ 32.60		4,120	\$ 27.00	

A summary of the status of the Company's restricted stock grants as of and changes during the periods indicated are presented in the following table:

	2012 Stock incentive plans		
	Director	Omnibus	Total
Balance at December 31, 2014	6,000	5,870	11,870
Granted	3,200	4,750	7,950
Vested	(6,000)	(1,780)	(7,780)
Balance at September 30, 2015	3,200	8,840	12,040

For restricted stock, intrinsic value represents the closing price of the underlying stock at the end of the period. As of September 30, 2015, the intrinsic value of the Company's restricted stock under the Director and Omnibus plans was \$35.00 per share.

Share-based compensation expense is included as a component of salaries and employee benefits in the consolidated statements of income. The following tables illustrate stock-based compensation expense recognized during the three and nine months ended September 30, 2015 and 2014 and the unrecognized stock-based compensation expense as of September 30, 2015:

Three months	Nine months ended
-----------------	----------------------

	ended September 30,		September 30,	
(dollars in thousands)	2015	2014	2015	2014
Stock-based compensation expense:				
Director plan	\$ 26	\$ 35	\$ 80	\$ 100
Omnibus plan	20	10	53	29
Total stock-based compensation expense	\$ 46	\$ 45	\$ 133	\$ 129

	As of September 30, 2015
(dollars in thousands)	
Unrecognized stock-based compensation expense:	
Director plan	\$ 34
Omnibus plan	202
Total unrecognized stock-based compensation expense	\$ 236

The unrecognized stock-based compensation expense as of September 30, 2015 will be recognized ratably over the periods ended January 2016 and May 2019 for the Director Plan and the Omnibus Plan, respectively.

In addition to the 2012 stock incentive plans, the Company established the 2002 Employee Stock Purchase Plan (the ESPP) and reserved 110,000 shares of its un-issued capital stock for issuance under the plan. The ESPP was designed to promote broad-based employee ownership of the Company's stock and to motivate employees to improve job performance and enhance the financial results of the Company. Under the ESPP, participation is voluntary whereby employees use automatic payroll withholdings to purchase the Company's capital stock at a discounted price based on the fair market value of the capital stock as measured on either the commencement or termination dates, as defined. As of September 30, 2015, 38,687 shares have been issued under the ESPP. The ESPP is considered a compensatory plan and is required to comply with the provisions of current accounting guidance. The Company recognizes compensation expense on its ESPP on the date the shares are purchased. For the nine months ended September 30, 2015 and 2014, compensation expense related to the ESPP approximated \$44 thousand and \$33 thousand, respectively, and is included as a component of salaries and employee benefits in the consolidated statements of income.

Table Of Contents

8. Fair value measurements

The accounting guidelines establish a framework for measuring and disclosing information about fair value measurements. The guidelines of fair value reporting instituted a valuation hierarchy for disclosure of the inputs used to measure fair value. This hierarchy prioritizes the inputs into three broad levels as follows:

Level 1 - inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities;

Level 2 - inputs are quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; or inputs that are observable for the asset or liability, either directly or indirectly through market corroboration, for substantially the full term of the financial instrument;

Level 3 - inputs are unobservable and are based on the Company's own assumptions to measure assets and liabilities at fair value. Level 3 pricing for securities may also include unobservable inputs based upon broker-traded transactions.

A financial asset or liability's classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement.

The Company uses fair value to measure certain assets and, if necessary, liabilities on a recurring basis when fair value is the primary measure for accounting. Thus, the Company uses fair value for AFS securities. Fair value is used on a non-recurring basis to measure certain assets when adjusting carrying values to market values, such as impaired loans, other real estate owned (ORE) and other repossessed assets.

The following table represents the carrying amount and estimated fair value of the Company's financial instruments as of the periods indicated:

September 30, 2015

(dollars in thousands)	Carrying amount	Estimated fair value	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant other unobservable inputs (Level 3)
Financial assets:					
Cash and cash equivalents	\$ 25,690	\$ 25,690	\$ 25,690	\$ -	\$ -
Available-for-sale securities	126,782	126,782	528	126,254	-
Loans and leases, net	533,234	533,060	-	-	533,060
Loans held-for-sale	1,114	1,133	-	529	604
Financial liabilities:					
Deposit liabilities	643,003	642,642	-	642,642	-
Short-term borrowings	6,743	6,743	-	6,743	-

December 31, 2014

(dollars in thousands)	Carrying amount	Estimated fair value	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant other unobservable inputs (Level 3)
Financial assets:					
Cash and cash equivalents	\$ 25,851	\$ 25,851	\$ 25,851	\$ -	\$ -
Available-for-sale securities	97,896	97,896	595	97,301	-
Loans and leases, net	506,327	505,387	-	-	505,387
Loans held-for-sale	1,161	1,186	-	1,186	-
Financial liabilities:					
Deposit liabilities	586,944	586,756	-	586,756	-
Short-term borrowings	3,969	3,969	-	3,969	-
Long-term debt	10,000	10,758	-	10,758	-

Table Of Contents

The carrying value of short-term financial instruments, as listed below, approximates their fair value. These instruments generally have limited credit exposure, no stated or short-term maturities, carry interest rates that approximate market and generally are recorded at amounts that are payable on demand :

- Cash and cash equivalents;
- Non-interest bearing deposit accounts;
- Savings, interest-bearing checking and money market accounts and
- Short-term borrowings.

Securities: Fair values on 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.

Loans: The fair value of loans is estimated by the net present value of the future expected cash flows discounted at current offering rates for similar loans. Current offering rates consider, among other things, credit risk. The carrying value that fair value is compared to is net of the allowance for loan losses and since there is significant judgment included in evaluating credit quality, loans are classified within Level 3 of the fair value hierarchy.

Loans held-for-sale: The fair value of residential loans held-for-sale is estimated using rates currently offered for similar loans and is typically obtained from the Federal National Mortgage Association (FNMA) or the Federal Home Loan Bank of Pittsburgh (FHLB).

Certificates of deposit: The fair value of certificates of deposit is based on discounted cash flows using rates which approximate market rates for deposits of similar maturities.

Long-term debt: Fair value is estimated using the rates currently offered for similar borrowings.

The following tables illustrate the financial instruments measured at fair value on a recurring basis segregated by hierarchy fair value levels as of the periods indicated:

	Total carrying value September 30, 2015	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant other unobservable inputs (Level 3)
(dollars in thousands)				
Available-for-sale securities:				
Agency - GSE	\$ 18,578	\$ -	\$ 18,578	\$ -
Obligations of states and political subdivisions	38,315	-	38,315	-
MBS - GSE residential	69,361	-	69,361	-
Equity securities - financial services	528	528	-	-
Total available-for-sale securities	\$ 126,782	\$ 528	\$ 126,254	\$ -

	Total carrying value December 31, 2014	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant other unobservable inputs (Level 3)
(dollars in thousands)				
Available-for-sale securities:				
Agency - GSE	\$ 14,398	\$ -	\$ 14,398	\$ -
Obligations of states and political subdivisions	37,033	-	37,033	-
MBS - GSE residential	45,870	-	45,870	-
Equity securities - financial services	595	595	-	-
Total available-for-sale securities	\$ 97,896	\$ 595	\$ 97,301	\$ -

Equity securities in the AFS portfolio are measured at fair value using quoted market prices for identical assets and are classified within Level 1 of the valuation hierarchy. Debt securities in the AFS portfolio are measured at fair value using market quotations provided by a third-party vendor, who is a provider of financial market data, analytics and related services to financial institutions. Assets classified as Level 2 use valuation techniques that are common to bond valuations. That is, in active markets whereby bonds of similar characteristics frequently trade, quotes for similar assets are obtained. For the nine months ended September 30, 2015 and the year ended December 31, 2014, there were no transfers to or from Level 1 and Level 2 fair value measurements for financial assets measured on a recurring basis.

Table Of Contents

There were no changes in Level 3 financial instruments measured at fair value on a recurring basis as of and for the periods ending September 30, 2015 and December 31, 2014.

The following table illustrates the financial instruments measured at fair value on a non-recurring basis segregated by hierarchy fair value levels as of the periods indicated:

	Total carrying value at September 30, 2015	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant other unobservable inputs (Level 3)
(dollars in thousands)				
Impaired loans	\$ 2,510	\$ -	\$ -	\$ 2,510
Other real estate owned	850	-	-	850
Other repossessed assets	3	-	-	3
Nonmortgage loan held-for-sale	604	-	-	604
Total	\$ 3,967	\$ -	\$ -	\$ 3,967

	Total carrying value at December 31, 2014	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant other unobservable inputs (Level 3)
(dollars in thousands)				
Impaired loans	\$ 2,158	\$ -	\$ -	\$ 2,158
Other real estate owned	1,506	-	-	1,506
Total	\$ 3,664	\$ -	\$ -	\$ 3,664

From time-to-time, the Company may be required to record at fair value financial instruments on a non-recurring basis, such as impaired loans, nonmortgage loans held-for-sale, ORE and other repossessed assets. These non-recurring fair value adjustments involve the application of lower-of-cost-or-market accounting on write downs of individual assets.

The following describes valuation methodologies used for financial instruments measured at fair value on a non-recurring basis.

The fair value of nonmortgage loans held-for-sale was determined from an independent appraisal of the underlying collateral and was adjusted for liquidation expenses and other valuation adjustments.

Impaired loans that are collateral dependent are written down to fair value through the establishment of specific reserves, a component of the allowance for loan losses, and as such are carried at the lower of net recorded investment or the estimated fair value.

Estimates of fair value of the collateral are determined based on a variety of information, including available valuations from certified appraisers for similar assets, present value of discounted cash flows and inputs that are estimated based on commonly used and generally accepted industry liquidation advance rates and estimates and assumptions developed by management.

Valuation techniques for impaired loans are typically determined through independent appraisals of the underlying collateral or may be determined through present value of discounted cash flows. Both techniques include various Level 3 inputs which are not identifiable. The valuation technique may be adjusted by management for estimated liquidation expenses and qualitative factors such as economic conditions. If real estate is not the primary source of repayment, present value of discounted cash flows and estimates using generally accepted industry liquidation advance rates and other factors may be utilized to determine fair value.

At September 30, 2015 and December 31, 2014, the range of liquidation expenses and other valuation adjustments applied to impaired loans ranged from -19.96% to -50.00% and from -19.96% to -42.41% respectively. The weighted-average of liquidation expenses and other valuation adjustments applied to impaired loans amounted to -26.41% and -27.26% as of September 30, 2015 and December 31, 2014, respectively. Due to the multitude of assumptions, many of which are subjective in nature, and the varying inputs and techniques used to determine fair value, the Company recognizes that valuations could differ across a wide spectrum of techniques employed. Accordingly, fair value estimates for impaired loans are classified as Level 3.

For ORE, fair value is generally determined through independent appraisals of the underlying properties which generally include various Level 3 inputs which are not identifiable. Appraisals form the basis for determining the net realizable value from these properties. Net realizable value is the result of the appraised value less certain costs or discounts associated with liquidation which occurs in the normal course of business. Management's assumptions may include consideration of the location and occupancy of the property, along with current economic conditions. Subsequently, as these properties are actively marketed, the estimated fair values may be periodically adjusted through incremental subsequent write-downs. These write-downs usually reflect decreases in estimated values resulting from sales price observations as well as changing economic and market conditions. At September 30, 2015 and December 31, 2014, the discounts applied to the appraised values of ORE ranged from -15.90% to -100.00% and from -19.00% to

Table Of Contents

-99.00%, respectively. As of September 30, 2015 and December 31, 2014, the weighted-average of discount to the appraisal values of ORE amounted to -40.36% and -27.23%, respectively.

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

The following is management's discussion and analysis of the significant changes in the consolidated financial condition of the Company as of September 30, 2015 compared to December 31, 2014 and a comparison of the results of operations for the three and nine months ended September 30, 2015 and 2014. Current performance may not be indicative of future results. This discussion should be read in conjunction with the Company's 2014 Annual Report filed on Form 10-K.

Forward-looking statements

Certain of the matters discussed in this Quarterly Report on Form 10-Q may constitute forward-looking statements for purposes of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended, and as such may involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of the Company to be materially different from future results, performance or achievements expressed or implied by such forward-looking statements. The words "expect," "anticipate," "intend," "plan," "believe," "estimate," and similar expressions are intended to identify such forward-looking statements.

The Company's actual results may differ materially from the results anticipated in these forward-looking statements due to a variety of factors, including, without limitation:

- § the effects of economic conditions on current customers, specifically the effect of the economy on loan customers' ability to repay loans;
- § the costs and effects of litigation and of unexpected or adverse outcomes in such litigation;
- § the impact of new or changes in existing laws and regulations, including the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 and the regulations promulgated there under;
- § impacts of the new capital and liquidity requirements of the Basel III standards and other regulatory pronouncements, regulations and rules;
- § governmental monetary and fiscal policies, as well as legislative and regulatory changes;
 - § effects of short- and long-term federal budget and tax negotiations and their effect on economic and business conditions;
- § the effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Financial Accounting Standards Board and other accounting standard setters;
- § the risks of changes in interest rates on the level and composition of deposits, loan demand, and the values of loan collateral, securities and interest rate protection agreements, as well as interest rate risks;
- § the effects of competition from other commercial banks, thrifts, mortgage banking firms, consumer finance companies, credit unions, securities brokerage firms, insurance companies, money market and other mutual funds and other financial institutions operating in our market area and elsewhere, including institutions operating locally, regionally, nationally and internationally, together with such competitors offering banking products and services by mail, telephone, computer and the internet;
- § technological changes;
- § the interruption or breach in security of our information systems and other technological risks and attacks resulting in failures or disruptions in customer account management, general ledger processing and loan or deposit updates and potential impacts resulting therefrom including additional costs, reputational damage, regulatory penalties, and financial losses;
- § acquisitions and integration of acquired businesses;
- §

the failure of assumptions underlying the establishment of reserves for loan losses and estimations of values of collateral and various financial assets and liabilities;

§ volatilities in the securities markets;

§ acts of war or terrorism;

§ disruption of credit and equity markets; and

§ the risk that our analyses of these risks and forces could be incorrect and/or that the strategies developed to address them could be unsuccessful.

The Company cautions readers not to place undue reliance on forward-looking statements, which reflect analyses only as of the date of this document. The Company has no obligation to update any forward-looking statements to reflect events or circumstances after the date of this document.

Readers should review the risk factors described in other documents that we file or furnish, from time to time, with the Securities and Exchange Commission, including Annual Reports to Shareholders, Annual Reports filed on Form 10-K and other current reports filed or furnished on Form 8-K.

Executive Summary

The Company is a Pennsylvania corporation and a bank holding company, whose wholly-owned state chartered commercial bank is The Fidelity Deposit and Discount Bank. The Company is headquartered in Dunmore, Pennsylvania. We consider Lackawanna and Luzerne Counties our primary marketplace.

Table Of Contents

As a leading Northeastern Pennsylvania community bank, our goals are to enhance shareholder value while continuing to build a full-service community bank. We focus on growing our core business of retail and business lending and deposit gathering while maintaining strong asset quality and controlling operating expenses. We continue to implement strategies to diversify earning assets and to increase low cost core deposits. These strategies include a greater level of commercial lending and the ancillary business products and services supporting our commercial customers' needs as well as residential lending strategies and an array of consumer products. We focus on developing a full banking relationship with existing, as well as new, small- and middle-sized business prospects. In addition, we explore opportunities to selectively expand our franchise footprint, consisting presently of our 11-branch network, including the relocation of a branch during the second quarter of 2015.

We are impacted by both national and regional economic factors, with commercial, commercial real estate and residential mortgage loans concentrated in Northeastern Pennsylvania, primarily in Lackawanna and Luzerne counties. Although the U.S. economy has shown signs of modest improvement, the general operating environment and our local market area continue to remain challenging. Interest rates have been at or near historical lows and we expect them to remain low in the near-term, but slowly rise with rate increases beginning in 2016. A rising rate environment positions the Company to improve its net interest income performance, but will continue to pressure the interest-rate yield and margin. Long-term interest rates saw some improvement in the first half of 2015 but dropped down at the end of the third quarter, with the ten-year U.S. Treasury rate decreasing from 2.17% at the end of December 2014 to 2.06% at the end of September 2015, and 46 basis points lower than the rate from one year ago. The national unemployment rate for September 2015 was 5.1%, down from 5.6% at December 2014 with new job growth in 2015 continuing at its slow pace. In our region (Scranton, Wilkes-Barre Metropolitan Statistical Area), the unemployment rate has decreased to 5.4% at September 30, 2015, its lowest point in over seven years, from 5.6% as of December 31, 2014. Despite an increase in the unemployment rate in the first half of 2015, more people entered the labor force and enough jobs were added to bring down the unemployment rate at the end of the third quarter which is a positive sign for the local economy. The median home values in the region grew 1.6% from a year ago, and according to Zillow, an online database advertising firm providing access to its real estate search engines to various media outlets, values will rise 2.1% within the next year. In light of these statistics, we will continue to monitor the economic climate in our region and scrutinize growth prospects with credit quality as a principal consideration.

In addition to the challenging economic environment in which we compete, the regulation and oversight of our business has changed significantly in recent years. As described more fully in Part I, Item 1A, "Risk Factors," and in the "Supervisory and Regulation" section of management's discussion and analysis of financial condition and results of operations in our 2014 Annual Report filed on Form 10-K, certain aspects of the Dodd-Frank Wall Street Reform Act (Dodd-Frank Act) continue to have a significant impact on us. In addition, final rules to implement Basel III regulatory capital reform, approved by the federal bank regulatory agencies in 2013, subject many banks including the Company, to capital requirements which will be phased in. The initial provisions effective for us began on January 1, 2015. The rules also revise the minimum risk-based and leverage capital ratio requirements applicable to the Company and revise the calculation of risk-weighted assets to enhance their risk sensitivity. We will continue to prepare for the impacts that the Dodd-Frank Act and the Basel III capital standards, and related rulemaking will have on our business, financial condition and results of operations.

General

The Company's earnings depend primarily on net interest income. Net interest income is the difference between interest income and interest expense. Interest income is generated from yields earned on interest-earning assets, which consist principally of loans and investment securities. Interest expense is incurred from rates paid on interest-bearing liabilities, which consist of deposits and borrowings. Net interest income is determined by the Company's interest rate spread (the difference between the yields earned on its interest-earning assets and the rates paid on its interest-bearing liabilities) and the relative amounts of interest-earning assets and interest-bearing liabilities. Interest rate spread is

significantly impacted by: changes in interest rates and market yield curves and their related impact on cash flows; the composition and characteristics of interest-earning assets and interest-bearing liabilities; differences in the maturity and re-pricing characteristics of assets compared to the maturity and re-pricing characteristics of the liabilities that fund them and by the competition in the marketplace.

The Company's earnings are also affected by the level of its non-interest income and expenses and by the provisions for loan losses and income taxes. Non-interest income consists of: service charges on the Company's loan and deposit products; interchange fees; trust and asset management service fees; increases in the cash surrender value of the bank owned life insurance and from net gains or losses from sales of loans and securities. Non-interest expense consists of: compensation and related employee benefit costs; occupancy; equipment; data processing; advertising and marketing; FDIC insurance premiums; professional fees; loan collection; net other real estate owned (ORE) expenses; supplies and other operating overhead.

Comparison of the results of operations

Three and nine months ended September 30, 2015 and 2014

Overview

For the third quarter of 2015, the company generated net income of \$1.9 million, or \$0.79 per diluted share, compared to \$1.6 million, or \$0.67 per diluted share, for the same 2014 quarter. Net income for the first nine months of 2015 increased \$0.6 million,

Table Of Contents

or 12%, to \$5.3 million, or \$2.16 per diluted share, compared to \$4.7 million, or \$1.95 per diluted share, in the same 2014 period. In the quarter comparison, the increase was due to higher net interest income and non-interest income partially offset by higher non-interest expenses. In the year-to-date comparison, higher net interest income coupled with a lower provision for loan losses, growth in non-interest income and a lower income tax provision were partially offset by higher non-interest expenses. Non-interest expense increased mostly due to higher salaries and benefits and a FHLB prepayment fee.

Return on average assets (ROA) was 1.06% and 0.98% for the third quarters of 2015 and 2014, respectively, and 1.00% and 0.97% for the nine months ended September 30, 2015 and 2014, respectively. Return on average shareholders' equity (ROE) was 10.26% and 9.17% for the three months ended September 30, 2015 and 2014, respectively, and 9.57% and 9.15% for the nine months ended September 30, 2015 and 2014, respectively. ROA and ROE increased in both periods because of the increase in net income.

Net interest income and interest sensitive assets / liabilities

Net interest income increased \$0.5 million, or 8%, from \$5.5 million for the quarter ended September 30, 2014 to \$6.0 million for the quarter ended September 30, 2015 because of higher total interest income and, to a lesser extent, reduced interest expense. Growth in the loan portfolio had the biggest impact on interest income. Higher average balances of \$42.0 million caused an increase of \$0.3 million in interest income and helped offset a 13 basis point net reduction in loan yields. The decrease in interest expense stemmed from \$0.2 million less interest paid on borrowed funds due to a \$6.0 million pay down in the fourth quarter of 2014 and the subsequent \$10.0 million payoff of long-term debt in 2015. The decrease was partially offset by an increase of \$67 thousand in interest expense on deposits due to higher rates paid on \$46.5 million higher balances in interest-bearing checking and money market accounts offset by lower rates paid on certificates of deposit, or CDs.

Net interest income for the nine months ended September 30, 2015 increased \$1.1 million, or 7%, from \$16.3 million in the first nine months of 2014 to \$17.4 million in the first nine months of 2015, respectively. Average interest-earning assets increased \$56.3 million which boosted income by \$1.0 million despite an 18 basis point net reduction in yield. As in the quarterly comparison, higher average balances in the loan portfolio contributed to most of the increase and produced \$0.8 million more interest income despite the negative impact of a twelve basis point reduction in yields. Though all loan portfolios showed more interest income from average growth, the mortgage loan portfolio had the most accretive impact due to the Company's mortgage modification program. This program offered mortgage customers, both secondary-market compliant and held for portfolio, shorter-termed loans with current interest rates for a flat fee. A \$57 thousand one-time special dividend from the FHLB and higher average balances of municipal and mortgage-backed securities produced additional interest income from investments. On the liability side, the smaller average balance in borrowings due to the pay downs of long-term debt reduced interest expense by \$0.4 million for the first nine months of 2015. This decrease was partially offset by an increase in interest expense on deposits due to the higher rates paid on higher average balances of interest-bearing checking and money market accounts from successful relationship-building efforts, promotions, cross-selling, transfers from unpopular CDs, and contractual and negotiated rates.

The fully-taxable equivalent (FTE) net interest rate spread decreased by one and six basis points, respectively, to 3.60% and 3.56% for the three and nine months ended September 30, 2015 compared to 3.61% and 3.62% for the three and nine months ended September 30, 2014. For the same periods, FTE net interest rate margin decreased by six and ten basis points, respectively, to 3.72% and 3.69%. The decrease in the interest rate spread was caused by a more rapid decline of yields of interest-earning assets than the cost reductions of lower rates paid on interest-bearing liabilities. The decrease in net interest margin was due mostly to a lower yielding larger average portfolio of interest-earning assets. The overall cost of funds, which includes the impact of non-interest bearing deposits, was reduced by thirteen and nine basis points for the three and nine months ended September 30, 2015 compared to the

same periods in 2014 because of lower rates paid, notwithstanding higher balances of average interest-bearing liabilities, and the average balance growth of non-interest bearing deposits.

During the last quarter of 2015, the Company expects to continue to operate in a low interest rate environment, with rates slowly rising, likely occurring next year. A rate environment with rising long-term interest rates positions the Company to improve its interest income performance from new and maturing long-term earning assets. Until there is a sustained period of yield curve steepening, with rates rising more sharply at the long end, the interest rate margin may continue to experience compression. However for the last quarter of 2015, the Company anticipates net interest income to improve as increasing volumes of interest-earning assets would help mitigate an adverse impact of rate movements. The Federal Open Market Committee (FOMC) has not adjusted the short-term federal funds rate upward but is expected to do so in 2016, pressuring rates paid on funding sources. Continued growth in the loan portfolios complemented with investment security growth is the Company's strategy for 2015, and when coupled with a proactive approach to deposit cost setting strategies should help grow net interest income and contain the interest rate margin at acceptable levels.

The Company's cost of interest-bearing liabilities was 46 and 52 basis points for the three and nine months ended September 30, 2015 compared to 64 basis points for both the three and nine months ended September 30, 2014, respectively. The reduction was due to the \$16.0 million paid on the FHLB advance between the fourth quarter of 2014 and the second quarter of 2015 which decreased the average balance of long-term debt. Other than retaining maturing long-term CDs, further reductions in deposit rates from the current historic low levels would have an insignificant cost-savings impact. As noted, interest rates along the treasury yield curve have been volatile with stability existing only at the short end. Competition could pressure banks to increase deposit rates. On the asset side, the prime interest rate, the benchmark rate that banks use as a base rate for adjustable rate loans, is not expected to rise in the near-term

Table Of Contents

thereby further pressuring net interest income should deposit rates begin to steadily rise. To help mitigate the impact of the imminent change to the economic landscape, the Company has successfully developed and expects to continue to strengthen its association with existing customers, develop new business relationships, generate new loan volumes, retain and generate higher levels of average non-interest bearing deposit balances. Strategically deploying no- and low-cost deposits into interest earning-assets is an effective margin-enhancing strategy that the Company expects to continue to pursue and expand to help stabilize net interest margin.

The Company's Asset Liability Management (ALM) team meets regularly to discuss among other things, interest rate risk and when deemed necessary adjusts interest rates. ALM also discusses revenue enhancing strategies to help combat the potential for a decline in net interest income. The Company's marketing department, together with ALM, lenders and deposit gatherers, continue to develop prudent strategies that will grow the loan portfolio and accumulate low-cost deposits to improve net interest income performance.

The tables that follow set forth a comparison of average balances of assets and liabilities and their related net tax equivalent yields and rates for the periods indicated. Interest income was adjusted to a tax-equivalent basis (FTE), using the corporate federal tax rate of 34% to recognize the income from tax-exempt interest-earning assets as if the interest was taxable. This treatment allows a uniform comparison among yields on interest-earning assets. Loans include loans HFS and non-accrual loans but exclude the allowance for loan losses. Net deferred loan cost amortization of \$112 thousand and \$65 thousand for the third quarters of 2015 and 2014, respectively, and \$308 thousand and \$213 thousand for the first nine months of 2015 and 2014, respectively, are included in interest income from loans. The one-time FHLB special dividend of \$57 thousand awarded in the first quarter of 2015 was removed from the annualized yield calculation and then added back to interest income. Average balances are based on amortized cost and do not reflect net unrealized gains or losses. Net interest margin is calculated by dividing annualized net interest income - FTE by total average interest-earning assets. Cost of funds includes the effect of average non-interest bearing deposits as a funding source:

Table Of Contents

(dollars in thousands)	Three months ended September 30, 2015			September 30, 2014		
	Average balance	Interest	Yield / rate	Average balance	Interest	Yield / rate
Assets						
Interest-earning assets						
Interest-bearing deposits	\$ 8,464	\$ 5	0.25 %	\$ 3,388	\$ 3	0.31 %
Investments:						
Agency - GSE	18,444	59	1.27	16,618	60	1.43
MBS - GSE residential	67,222	251	1.48	54,574	222	1.61
State and municipal	35,937	524	5.78	33,341	505	6.01
Other	1,474	29	7.73	2,892	33	4.54
Total investments	123,077	863	2.78	107,425	820	3.03
Loans and leases:						
Commercial	289,228	3,268	4.48	267,530	3,130	4.64
Consumer	68,540	959	5.55	67,024	953	5.64
Residential real estate	184,238	1,795	3.87	165,406	1,642	3.94
Total loans and leases	542,006	6,022	4.41	499,960	5,725	4.54
Federal funds sold	-	-	-	162	-	0.25
Total interest-earning assets	673,547	6,890	4.06 %	610,935	6,548	4.25 %
Non-interest earning assets	47,601			49,452		
Total assets	\$ 721,148			\$ 660,387		
Liabilities and shareholders' equity						
Interest-bearing liabilities						
Deposits:						
Interest-bearing checking	\$ 134,447	\$ 82	0.24 %	\$ 115,765	\$ 56	0.19 %
Savings	114,459	52	0.18	103,414	48	0.18
MMDA	124,290	193	0.62	96,495	145	0.60
CDs < \$100,000	59,917	112	0.75	65,078	145	0.88
CDs > \$100,000	53,269	134	1.00	41,236	112	1.08
Clubs	2,226	1	0.15	2,268	1	0.14
Total interest-bearing deposits	488,608	574	0.47	424,256	507	0.47
Repurchase agreements	7,963	3	0.15	11,630	5	0.18
Borrowed funds	1,857	3	0.64	18,441	218	4.68
Total interest-bearing liabilities	498,428	580	0.46 %	454,327	730	0.64 %
Non-interest bearing deposits	143,794			131,201		
Non-interest bearing liabilities	4,327			4,285		
Total liabilities	646,549			589,813		
Shareholders' equity	74,599			70,574		
Total liabilities and shareholders' equity	\$ 721,148			\$ 660,387		

Edgar Filing: FIDELITY D & D BANCORP INC - Form 10-Q

Net interest income - FTE	\$ 6,310	\$ 5,818
Net interest spread	3.60 %	3.61 %
Net interest margin	3.72 %	3.78 %
Cost of funds	0.36 %	0.49 %

Table Of Contents

(dollars in thousands)	Nine months ended					
	September 30, 2015			September 30, 2014		
Assets	Average balance	Interest	Yield / rate	Average balance	Interest	Yield / rate
Interest-earning assets						
Interest-bearing deposits	\$ 11,334	\$ 22	0.26 %	\$ 7,147	\$ 14	0.27 %
Investments:						
Agency - GSE	17,570	167	1.27	15,947	170	1.42
MBS - GSE residential	62,245	676	1.45	51,152	614	1.60
State and municipal	35,497	1,536	5.78	33,735	1,523	6.04
Other	1,742	131	5.72	2,783	85	4.07
Total investments	117,054	2,510	2.80	103,617	2,392	3.09
Loans and leases:						
Commercial	282,455	9,507	4.50	265,913	9,260	4.66
Consumer	67,574	2,813	5.56	64,840	2,697	5.56
Residential real estate	179,616	5,308	3.95	160,074	4,835	4.04
Total loans and leases	529,645	17,628	4.45	490,827	16,792	4.57
Federal funds sold	138	-	0.26	261	-	0.26
Total interest-earning assets	658,171	20,160	4.08 %	601,852	19,198	4.26 %
Non-interest earning assets	49,726			48,520		
Total assets	\$ 707,897			\$ 650,372		
Liabilities and shareholders' equity						
Interest-bearing liabilities						
Deposits:						
Interest-bearing checking	\$ 128,771	\$ 225	0.23 %	\$ 111,944	\$ 165	0.20 %
MMDA	118,667	540	0.61	101,954	130	0.17
Savings	113,100	154	0.18	91,355	389	0.57

Edgar Filing: FIDELITY D & D BANCORP INC - Form 10-Q

CDs < \$100,000	60,759	356	0.78	68,443	471	0.92
CDs > \$100,000	46,737	362	1.04	41,189	338	1.10
Clubs	1,913	2	0.17	1,832	2	0.14
Total interest-bearing deposits	469,947	1,639	0.47	416,717	1,495	0.48
Repurchase agreements	11,220	15	0.18	11,967	17	0.19
Borrowed funds	11,322	270	3.19	19,518	646	4.43
Total interest-bearing liabilities	492,489	1,924	0.52 %	448,202	2,158	0.64 %
Non-interest bearing deposits	137,442			129,348		
Non-interest bearing liabilities	4,151			3,943		
Total liabilities	634,082			581,493		
Shareholders' equity	73,815			68,879		
Total liabilities and shareholders' equity	\$ 707,897			\$ 650,372		
Net interest income - FTE		\$ 18,236			\$ 17,040	
Net interest spread			3.56 %			3.62 %
Net interest margin			3.69 %			3.79 %
Cost of funds			0.41 %			0.50 %

Table Of Contents

Provision for loan losses

The provision for loan losses represents the necessary amount to charge against current earnings, the purpose of which is to increase the allowance for loan losses (the allowance) to a level that represents management's best estimate of known and inherent losses in the Company's loan portfolio. Loans determined to be uncollectible are charged off against the allowance. The required amount of the provision for loan losses, based upon the adequate level of the allowance, is subject to the ongoing analysis of the loan portfolio. The Company's Special Assets Committee meets periodically to review problem loans. The committee is comprised of management, including credit administration officers, loan officers, loan workout officers and collection personnel. The committee reports quarterly to the Credit Administration Committee of the board of directors.

Management continuously reviews the risks inherent in the loan portfolio. Specific factors used to evaluate the adequacy of the loan loss provision during the formal process include:

- specific loans that could have loss potential;
- levels of and trends in delinquencies and non-accrual loans;
- levels of and trends in charge-offs and recoveries;
- trends in volume and terms of loans;
- changes in risk selection and underwriting standards;
- changes in lending policies, procedures and practices;
- experience, ability and depth of lending management;
- national and local economic trends and conditions; and
- changes in credit concentrations.

For the nine months ended September 30, 2015, the Company recorded a provision for loan losses of \$0.5 million, a 38% decrease, compared to a \$0.8 million provision recorded during the nine months ended September 30, 2014. This decrease occurred despite management's recognition of several new TDRs totaling \$1.7 million and a \$26.9 million increase in the total loan portfolio during the first nine months of 2015. These downward changes in the loan portfolio were offset by a decrease in non-performing loans of \$0.6 million from year-end 2014. Provision expense decreased despite the above factors because additional reserves needed from the new TDRs were offset by a decreased reserve requirement from updating the methodology. For a discussion on the allowance for loan losses, see "Allowance for loan losses," located in the comparison of financial condition section of management's discussion and analysis contained herein.

Other income

For the three months ended September 30, 2015, non-interest income amounted to \$2.0 million, a \$0.3 million increase from the \$1.7 million recorded for the three months ended September 30, 2014. The increase was due to more activity in the loan portfolio which caused higher gains from sold mortgage loans of \$0.2 million and \$75 thousand more service charges on commercial loans during the third quarter of 2015.

Non-interest income increased \$0.3 million, or 6%, from \$5.3 million for the nine months ended September 30, 2014 to \$5.6 million for the nine months ended September 30, 2015. More residential loan activity caused most of the increase due to gains on the sale of loans which increased \$0.4 million and \$52 thousand higher mortgage loan service charges during the first nine months of 2015 compared to the first nine months of 2014. Additional income was provided from higher trust income of \$88 thousand and debit card interchange fees of \$70 thousand. These items were offset by \$0.3 million less gains on security sales, \$64 thousand less merchant credit card income and lower fee income from deposits of \$60 thousand.

Other operating expenses

For the three months ended September 30, 2015, total other operating expenses increased \$0.3 million, or 7%, compared to the three months ended September 30, 2014. Salary and employee benefits increased \$0.2 million, or 10%, in the third quarter of 2015 compared to the third quarter of 2014. The basis of the increase includes annual merit increases, staff additions including the hiring of an executive officer during the second quarter of 2015, higher recognized employee incentives and an increase in group insurance from higher claims accruals. Premises and equipment expenses increased \$0.1 million due to furniture and equipment purchased for the new branch and the related depreciation and higher real estate taxes. Advertising increased \$78 thousand due to a special promotion for summer checking and savings accounts. During the third quarter of 2015, the Company outsourced its data processing and incurred \$73 thousand in fees which drove up data processing and communication expense. All of these items were partially offset by a \$0.1 million decrease in other real estate owned (ORE) expense during the three months ended September 30, 2015 compared to the 2014 like period due to subsequent write downs taken during the third quarter of 2014.

For the nine months ended September 30, 2015, total non-interest expenses increased by \$1.6 million, or 11%, to \$16.1 million compared to \$14.5 million recorded for the nine months ended September 30, 2014. Salaries and employee benefits increased \$0.6 million, or 8%, in the first nine months of 2015 compared to the first nine months of 2014. The increase stems from the changes described in the quarterly comparison. Premises and equipment increased by \$0.1 million due to added depreciation on furniture and fixture purchases made for the new branch that opened during the second quarter of 2015. Advertising increased \$0.1 million due to a grand opening and re-opening celebration for 2 branches as well as a checking/savings summer campaign. Professional fees increased \$0.2 million, or 17%, during the first nine months of 2015 compared to the same 2014 period due to the implementing of an enterprise

Table Of Contents

risk management program and an architectural design study completed in 2015. Contributing \$0.6 million to the increase in other operating expenses during the first nine months of 2015 was the FHLB prepayment fee that did not occur during the first nine months of 2014. There was also a \$76 thousand loss on the reacquisition of previously sold loans and the data processing fees mentioned above during the first nine months of the 2015 that were not recognized in the same 2014 period.

Provision for income taxes

The provision for income taxes decreased \$0.4 million, or 26%, from \$1.6 million at September 30, 2014 to \$1.2 million at September 30, 2015. During an audit by the Internal Revenue Service, management discovered additional tax basis on trust preferred securities that were sold during 2013 that was inadvertently omitted from the basis reported on the 2013 tax return. After the basis was corrected, the tax loss that was realized during 2013 and carried back to the 2011 and 2012 tax returns increased. An audit adjustment was made which resulted in recording a \$0.4 million credit for income taxes during the second quarter of 2015. This adjustment coupled with a lower effective tax rate for the first nine months of 2015 from additional expenses reducing the level of pre-tax income caused the lower provision for income taxes.

Comparison of financial condition at

September 30, 2015 and December 31, 2014

Overview

Consolidated assets increased \$52.7 million, or 8%, to \$729.2 million as of September 30, 2015 from \$676.5 million at December 31, 2014. The increase in assets was funded through growth in deposits of \$56.1 million, short-term borrowings of \$2.8 million and a \$3.4 million increase in shareholders' equity which was partially offset by the \$10.0 million payoff of the long-term debt. The increase in the funding sources was used to fund growth of \$26.9 million in loans and \$28.9 million in investments.

Funds Deployed:

Investment securities

At the time of purchase, management classifies investment securities into one of three categories: trading, available-for-sale (AFS) or held-to-maturity (HTM). To date, management has not purchased any securities for trading purposes. Most of the securities the Company purchases are classified as AFS even though there is no immediate intent to sell them. The AFS designation affords management the flexibility to sell securities and position the balance sheet in response to capital levels, liquidity needs or changes in market conditions. Securities AFS are carried at fair value on the consolidated balance sheets with unrealized gains and losses, net of deferred income taxes, reported separately within shareholders' equity as a component of accumulated other comprehensive income (OCI). Securities designated as HTM are carried at amortized cost and represent debt securities that the Company has the ability and intent to hold until maturity.

As of September 30, 2015, the carrying value of investment securities amounted to \$126.8 million, or 17% of total assets, compared to \$97.9 million, or 14% of total assets, at December 31, 2014. On September 30, 2015, 55% of the carrying value of the investment portfolio was comprised of U.S. Government Sponsored Enterprise residential mortgage-backed securities (MBS – GSE residential or mortgage-backed securities) that amortize and provide monthly

cash flow that the Company can use for reinvestment, loan demand, unexpected deposit outflow, facility expansion or operations.

Investment securities were comprised of AFS securities as of September 30, 2015. The AFS securities were recorded with a net unrealized gain of \$3.8 million as of September 30, 2015 compared to a net unrealized gain of \$4.1 million as of December 31, 2014, or a net reduction of \$0.3 million during the first nine months of 2015. The direction and magnitude of the change in value of the Company's investment portfolio is attributable to the direction and magnitude of the change in interest rates along the treasury yield curve. Generally, the values of debt securities move in the opposite direction of the changes in interest rates. As interest rates along the treasury yield curve fall, especially at the intermediate and long end, the values of debt securities tend to increase. Whether or not the value of the Company's investment portfolio will continue to exceed its amortized cost will be largely dependent on the direction and magnitude of interest rate movements and the duration of the debt securities within the Company's investment portfolio. When interest rates rise, the market values of the Company's debt securities portfolio could be subject to market value declines.

Quarterly, management performs a review of the investment portfolio to determine the causes of declines in the fair value of each security. The Company uses inputs provided by independent third parties to determine the fair value of its investment securities portfolio. Inputs provided by the third parties are reviewed and corroborated by management. Evaluations of the causes of the unrealized losses are performed to determine whether impairment exists and whether the impairment is temporary or other-than-temporary. Considerations such as the Company's intent and ability to hold the securities to maturity, recoverability of the invested amounts over the intended holding period, the length of time and the severity in pricing decline below cost, the interest rate environment, the receipt of amounts contractually due and whether or not there is an active market for the securities, for example, are applied, along with an analysis of the financial condition of the issuer for management to make a realistic judgment of the probability that the Company will be unable to collect all amounts (principal and interest) due in determining whether a security is other-than-temporarily impaired. If a decline in value is deemed to be other-than-temporary, the amortized cost of the security is reduced by the

Table Of Contents

credit impairment amount and a corresponding charge to current earnings is recognized. During the nine months ended September 30, 2015 and 2014, the Company did not incur other-than-temporary impairment charges from its investment securities portfolio.

During the first nine months of 2015, the carrying value of total investments increased \$28.9 million, or 30%. The Company attempts to maintain a well-diversified and proportionately level investment portfolio that is structured to complement the strategic direction of the Company. Its growth typically supplements the lending activities but also considers the current and forecasted economic conditions, the Company's liquidity needs and interest rate risk profile. At the end of 2014, the Company began to restructure its investment portfolio by selling mortgage-backed securities with the longest duration and lowest coupon rates as well as intermediate term agency bonds. The proceeds were used to reduce the Company's long-term debt with the balance retained in cash that was reinvested along with available cash holdings and short-term borrowings during the first half of 2015. The Company expects to grow the portfolio and increase its size relative to total assets with a bias toward mortgage-backed securities. If rates rise, the strategy will provide a good source of cash flow to reinvest into higher yielding interest-sensitive assets.

A comparison of investment securities at September 30, 2015 and December 31, 2014 is as follows:

(dollars in thousands)	September 30, 2015		December 31, 2014	
	Amount	%	Amount	%
MBS - GSE residential	\$ 69,361	54.7 %	\$ 45,870	46.9 %
State & municipal subdivisions	38,315	30.2	37,033	37.8
Agency - GSE	18,578	14.7	14,398	14.7
Equity securities - financial services	528	0.4	595	0.6
Total	\$ 126,782	100.0 %	\$ 97,896	100.0 %

Federal Home Loan Bank Stock

Investment in Federal Home Loan Bank (FHLB) stock is required for membership in the organization and is carried at cost since there is no market value available. The amount the Company is required to invest is dependent upon the relative size of outstanding borrowings the Company has with the FHLB of Pittsburgh. Excess stock is repurchased from the Company at par if the amount of borrowings decline to a predetermined level. In addition, the Company earns a return or dividend based on the amount invested. The dividends received from the FHLB totaled \$110 thousand, which included a \$57 thousand one-time special dividend, and \$63 thousand for the nine months ended September 30, 2015 and 2014, respectively. The balance in FHLB stock was \$1.1 million and \$1.3 million as of September 30, 2015 and December 31, 2014, respectively.

Loans held-for-sale (HFS)

Upon origination, most residential mortgages and certain Small Business Administration (SBA) guaranteed loans may be classified as held-for-sale (HFS). In the event of market rate increases, fixed-rate loans and loans not immediately scheduled to re-price would no longer produce yields consistent with the current market. In low interest rate environments, the Company would be exposed to prepayment risk and, as rates on adjustable-rate loans decrease, interest income would be negatively affected. Consideration is given to the Company's current liquidity position and

projected future liquidity needs. To better manage prepayment and interest rate risk, loans that meet these conditions may be classified as HFS. Occasionally, residential mortgage and/or other nonmortgage loans may be transferred from the loan portfolio to HFS. The carrying value of loans HFS is based on the lower of cost or estimated fair value. If the fair values of these loans decline below their original cost, the difference is written down and charged to current earnings. Subsequent appreciation in the portfolio is credited to current earnings but only to the extent of previous write-downs.

A comparison of loans HFS as of September 30, 2015 and December 31, 2014 is as follows:

(dollars in thousands)	September	
	30, 2015 Amount	December 31, 2014 Amount
Commercial real estate - owner occupied	\$ 604	\$ -
Residential real estate	510	1,161
Total loans held-for-sale	\$ 1,114	\$ 1,161

Carrying amounts of loans HFS approximated their fair values.

During the nine months ended September 30, 2015, residential mortgage loans with principal balances of \$37.3 million were sold into the secondary market and the Company recognized net gains of \$0.9 million, compared to \$25.0 million and \$0.5 million, respectively during the nine months ended September 30, 2014. An increase in residential mortgage origination activities caused the increase in gains from loan sales in 2015 compared to 2014.

Table Of Contents

The Company retains mortgage servicing rights (MSRs) on loans sold into the secondary market. MSRs are retained so that the Company can foster personal relationships with its loyal customer base. At September 30, 2015 and December 31, 2014, the servicing portfolio balance of sold residential mortgage loans was \$265.2 million and \$256.8 million, respectively.

Loans and leases

The third quarter of 2015 continued the trend of modest growth. During 2015, the \$27.0 million, or 5%, portfolio growth in the three sectors was commercial \$13.9 million, or 5%, consumer \$5.1 million, or 5%, and residential \$8.0 million, or 6%.

Our market continues to remain primarily located in Lackawanna and Luzerne counties for all categories of loans. The Company continues to utilize loan participations (sharing loans with other financial institutions) and various government guaranty programs to maintain a reasonable level of risk.

Commercial and industrial and commercial real estate

Compared to year-end 2014, the commercial and industrial (C&I) loan portfolio increased \$10.3 million, or 13%, from \$80.3 million to \$90.6 million and the commercial real estate (CRE) loan portfolio increased \$3.6 million, or 2%, from \$196.5 million to \$200.1 million as of September 30, 2015. Especially in the commercial sector, the Company has experienced growth by expanding existing relationships, referrals from existing clients and centers of influence, as well as a dedicated and skilled team of relationship managers, credit professionals and branch personnel. Steady quality growth will continue through the fourth quarter as customers are provided with the necessary products and services and the Company measures, monitors and controls risk.

Consumer

The consumer loan portfolio grew \$5.1 million, or 5%, from \$109.5 million at December 31, 2014 to \$114.6 million at September 30, 2015. Third quarter growth accelerated due to a seasonal home equity line of credit campaign combined with consistent demand from automobile loans and leases. Auto loan and lease growth was the result of focus on maintaining relationships with auto dealers.

Residential

The residential loan portfolio grew \$8.0 million, or 6%, from \$129.5 million at December 31, 2014 to \$137.5 million at September 30, 2015. The held to maturity portfolio grew \$9.1 million, or 8%, from \$119.2 million at December 31, 2014 to \$128.3 million at September 30, 2015. The held to maturity loan portfolio grew due to a mortgage loan modification program and incremental new loan originations. The majority of modifications were 20 years or less in maturity to customers with high credit quality, documented payment history, and strong loan to value profiles.

The composition of the loan portfolio at September 30, 2015 and December 31, 2014, is summarized as follows:

	September 30, 2015		December 31, 2014	
(dollars in thousands)	Amount	%	Amount	%

Commercial and industrial	\$ 90,552	16.7	%	\$ 80,301	15.6	%
Commercial real estate:						
Non-owner occupied	94,878	17.5		94,771	18.4	
Owner occupied	101,628	18.7		95,780	18.5	
Construction	3,554	0.7		5,911	1.1	
Consumer:						
Home equity installment	31,848	5.9		32,819	6.4	
Home equity line of credit	45,862	8.4		42,188	8.2	
Auto and leases	30,302	5.6		27,972	5.4	
Other	6,595	1.2		6,501	1.3	
Residential:						
Real estate	128,255	23.6		119,154	23.1	
Construction	9,234	1.7		10,298	2.0	
Gross loans	542,708	100.0	%	515,695	100.0	%
Less:						
Allowance for loan losses	(9,149)			(9,173)		
Unearned lease revenue	(325)			(195)		
Net loans	\$ 533,234			\$ 506,327		
Loans held-for-sale	\$ 1,114			\$ 1,161		

Table Of Contents

Allowance for loan losses

Management evaluates the credit quality of the Company's loan portfolio and performs a formal review of the adequacy of the allowance for loan losses (the allowance) on a quarterly basis. The allowance reflects management's best estimate of the amount of credit losses in the loan portfolio. Management's judgment is based on the evaluation of individual loans, past experience, the assessment of current economic conditions and other relevant factors including the amounts and timing of cash flows expected to be received on impaired loans. Those estimates may be susceptible to significant change. The provision for loan losses represents the amount necessary to maintain an appropriate allowance. Loan losses are charged directly against the allowance when loans are deemed to be uncollectible. Recoveries from previously charged-off loans are added to the allowance when received.

Management applies two primary components during the loan review process to determine proper allowance levels. The two components are a specific loan loss allocation for loans that are deemed impaired and a general loan loss allocation for those loans not specifically allocated. The methodology to analyze the adequacy of the allowance for loan losses is as follows:

- identification of specific impaired loans by loan category;
- calculation of specific allowances where required for the impaired loans based on collateral and other objective and quantifiable evidence;
- determination of loans with similar credit characteristics within each class of the loan portfolio segment and eliminating the impaired loans;
- application of historical loss percentages (trailing twelve-quarter average) to pools to determine the allowance allocation;
- application of qualitative factor adjustment percentages to historical losses for trends or changes in the loan portfolio, and/or current economic conditions.

Through December 31, 2014, allocation of the allowance for different categories of loans is based on the methodology as explained above. A key element of the methodology to determine the allowance is the Company's credit risk evaluation process, which includes credit risk grading of individual commercial loans. Commercial loans are assigned credit risk grades based on the Company's assessment of conditions that affect the borrower's ability to meet its contractual obligations under the loan agreement. That process includes reviewing borrowers' current financial information, historical payment experience, credit documentation, public information and other information specific to each individual borrower. Upon review, the commercial loan credit risk grade is revised or reaffirmed. The credit risk grades may be changed at any time management determines an upgrade or downgrade may be warranted. The credit risk grades for the commercial loan portfolio are taken into account in the reserve methodology and loss factors are applied based upon the credit risk grades. The loss factors applied are based upon the Company's historical experience as well as what management believes to be best practices and within common industry standards. Historical experience reveals there is a direct correlation between the credit risk grades and loan charge-offs. The changes in allocations in the commercial loan portfolio from period-to-period are based upon the credit risk grading system and from periodic reviews of the loan portfolio.

In order to substantiate flat reserve allocations for certain risk ratings on a recurring basis, management analyzed historical loss experience in those risk rating pools. Management considered peer or industry averages in support of flat rates. However, the lack of consistency in those allowance methodologies rendered flat rate correlation to be inapplicable. As a result, commencing on January 1, 2015 and going forward, the Bank applied the following updates

to the Allowance for Loan and Lease Losses calculation:

- Pass-5 rated loans are included in the loan pools that do not include impaired loans. The Bank reasoned that Pass-5 rated loans did not present any substantive difference in historic loss experience than loans of similar or less risk. Previously, Pass-5 rated loans carried a flat 2% reserve allocation. The impact of this change reduced the reserve requirement by about \$180 thousand.
- Special Mention – 6 rated loans were changed from a flat 5% reserve allocation. Management evaluated historical losses for 6 rated loans based on the greater of either the three (3) year moving average of historical loss experience in the 6 rated loan category OR an adjusted charge-off method. In the adjusted charge-off method, the bank will categorize any charge-off for any commercial loan in terms of what the risk rating on that charge-off (or charge-down) was in the same period 2 years prior. Such loans will be compared against the appropriate pool of loans by assigning the charged-off loan in the appropriate pool in the current period depending upon its risk rating 2 years prior. Each pool will then be calculated for each commercial loan type to develop a relative percentage. These relative percentages will be quantified in rolling 12 quarter averages and applied against the appropriate risk rating class. However, since Special Mention – 6 rated loans are by nature a transitional grade of risk rating, the actual losses incurred in this risk rating class was near 0%. Therefore, management applied a loss factor that, in its opinion, fairly represents the actual risk of loss from loans so rated. The impact of this change reduced the reserve requirement by about \$100 thousand.
- Substandard – 7 rated loans were changed from a flat 15% reserve allocation to pools that are based on historical losses. Going forward, expected loss percentages will be based on the greater of either the three (3) year moving average of historical loss experience in the 7 rated loan category OR an adjusted charge-off method. In the adjusted charge-off method, the bank will categorize any charge-off for any commercial loan in terms of what the risk rating on that charge-off (or charge-down) was in the same period 2 years prior. Such loans will be compared against the appropriate pool of loans by assigning the charged-off loan in the appropriate pool in the current period depending

Table Of Contents

upon its risk rating 2 years prior. Each pool will then be calculated for each commercial loan type to develop a relative percentage. These relative percentages will be quantified in rolling 12 quarter averages and applied against the appropriate risk rating class. The impact of this change reduced the reserve requirement by about \$634 thousand.

- Qualitative factors will be universally applied to all loans in all loan pools. Previously, this was not done for Special Mention - 6 rated and Substandard – 7 rated loans. The impact of this change decreased the reserve requirement by about \$217 thousand.

Each quarter, management performs an assessment of the allowance for loan losses. The Company's Special Assets Committee meets monthly and the applicable lenders discuss each relationship under review and reach a consensus on the appropriate estimated loss amount, if applicable, based on current accounting guidance. The Special Assets Committee's focus is on ensuring the pertinent facts are considered regarding not only loans considered for specific reserves, but also the collectability of loans that may be past due. The assessment process also includes the review of all loans on non-accrual status as well as a review of certain loans to which the lenders or the Credit Administration function have assigned a criticized or classified risk rating.

Net charge-offs were \$0.5 million for the nine months ending September 30, 2015 and 2014, respectively. During the period ended September 30, 2015, no specific loan class significantly underperformed as charge-offs were taken across a variety of consumer, commercial and commercial real estate loans. For a discussion on the provision for loan losses, see the "Provision for loan losses," located in the results of operations section of management's discussion and analysis contained herein.

The allowance for loan losses was \$9.1 million as of September 30, 2015 and \$9.3 million as of September 30, 2014. Management believes that the current balance in the allowance for loan losses is sufficient to withstand the identified potential credit quality issues that may arise and others unidentified but inherent to the portfolio. Potential problem loans are those where there is known information that leads management to believe repayment of principal and/or interest is in jeopardy and the loans are currently neither on non-accrual status nor past due 90 days or more. There could be additional instances which become identified in future periods that may require additional charge-offs and/or increases to the allowance due to continued sluggishness in the economy and pressure on property values. In contrast, an abrupt significant increase in the U.S. Prime lending rate could adversely impact the debt service capacity of existing borrowers' ability to repay.

Table Of Contents

The following tables set forth the activity in the allowance for loan losses and certain key ratios for the period indicated:

	As of and for the nine months ended September 30, 2015	As of and for the twelve months ended December 31, 2014	As of and for the nine months ended September 30, 2014			
(dollars in thousands)						
Balance at beginning of period	\$ 9,173	\$ 8,928	\$ 8,928			
Charge-offs:						
Commercial and industrial	26	309	39			
Commercial real estate	357	239	217			
Consumer	270	361	287			
Residential	9	93	93			
Total	662	1,002	636			
Recoveries:						
Commercial and industrial	37	32	25			
Commercial real estate	17	91	90			
Consumer	56	30	26			
Residential	28	34	34			
Total	138	187	175			
Net charge-offs	524	815	461			
Provision for loan losses	500	1,060	810			
Balance at end of period	\$ 9,149	\$ 9,173	\$ 9,277			
Allowance for loan losses to total loans	1.69	%	1.78	%	1.84	%
Net charge-offs (annualized) to average total loans outstanding	0.13	%	0.16	%	0.13	%
Average total loans	\$ 529,645	\$ 495,758	\$ 490,827			
Loans 30 - 89 days past due and accruing	\$ 3,221	\$ 3,932	\$ 4,239			
Loans 90 days or more past due and accruing	\$ 271	\$ 1,060	\$ 149			
Non-accrual loans	\$ 4,370	\$ 4,215	\$ 4,490			
Allowance for loan losses to net charge-offs (annualized)	13.09	x	11.26	x	15.09	x
Allowance for loan losses to loans 90 days or more past due and accruing	33.76	x	8.65	x	62.26	x
Allowance for loan losses to non-accrual loans	2.09	x	2.18	x	2.07	x
Allowance for loan losses to non-performing loans	1.97	x	1.74	x	2.00	x

Non-performing assets

The Company defines non-performing assets as accruing loans past due 90 days or more, non-accrual loans, troubled debt restructured loans (TDRs), other real estate owned (ORE) and repossessed assets. At September 30, 2015,

non-performing assets represented 1.11% of total assets compared with 1.09% as of September 30, 2014. This was a result of an increase in TDRs. This increase was offset by a decrease in ORE. Most of the non-performing loans are collateralized, thereby mitigating the Company's potential for loss.

Table Of Contents

The following table sets forth non-performing assets data as of the period indicated:

(dollars in thousands)	September 30, 2015	December 31, 2014	September 30, 2014
Loans past due 90 days or more and accruing	\$ 271	\$ 1,060	\$ 149
Non-accrual loans *	4,370	4,215	4,490
Total non-performing loans	4,641	5,275	4,639
Troubled debt restructurings	2,425	753	754
Other real estate owned and repossessed assets	1,024	1,972	1,936
Total non-performing assets	\$ 8,090	\$ 8,000	\$ 7,329
 Total loans, including loans held-for-sale	 \$ 543,497	 \$ 516,661	 \$ 503,453
Total assets	\$ 729,208	\$ 676,485	\$ 673,885
Non-accrual loans to total loans	0.80%	0.82%	0.89%
Non-performing loans to total loans	0.85%	1.02%	0.92%
Non-performing assets to total assets	1.11%	1.18%	1.09%

* In the table above, the amount includes non-accrual TDRs of \$0.6 million as of September 30, 2015, \$0.9 million as of December 31, 2014 and \$0.9 million as of September 30, 2014. The non-accrual TDR of \$0.6 million was in loans held-for-sale at September 30, 2015.

In the review of loans for both delinquency and collateral sufficiency, management concluded that there were a number of loans that lacked the ability to repay in accordance with contractual terms. The decision to place loans on non-accrual status is made on an individual basis after considering factors pertaining to each specific loan. Generally, commercial loans are placed on non-accrual status when management has determined that payment of all contractual principal and interest is in doubt or the loan is past due 90 days or more as to principal and interest, unless well-secured and in the process of collection. Consumer loans secured by residential real estate and residential mortgage loans are placed on non-accrual status at 120 days past due as to principal and interest, and unsecured consumer loans are charged-off when the loan is 90 days or more past due as to principal and interest. Uncollected interest income accrued on all loans placed on non-accrual is reversed and charged to interest income.

Non-performing loans, which consists of accruing loans that are over 90 days past due as well as all non-accrual loans, decreased \$0.6 million, or 12%, from \$5.2 million at December 31, 2014 to \$4.6 million at September 30, 2015. At September 30, 2015, the portion of accruing loans that was over 90 days past due totaled \$0.3 million and consisted of eight loans to eight unrelated borrowers ranging from \$2 thousand to \$67 thousand. At December 31, 2014, the portion of accruing loans that was over 90 days past due totaled \$1.1 million and consisted of eleven loans to seven unrelated borrowers ranging from \$2 thousand to \$0.4 million. The Company seeks payments from all past due customers through an aggressive customer communication process. A past due loan will be placed on non-accrual at the 90 day point when it is deemed that a customer is non-responsive and uncooperative to collection efforts.

At December 31, 2014, there were 46 loans to 41 unrelated borrowers ranging from less than \$1 thousand to \$0.9 million in the non-accrual category. At September 30, 2015, there were 53 loans to 45 unrelated borrowers on non-accrual ranging from less than \$1 thousand to \$0.6 million. At December 31, 2014, non-accrual loans totaled

\$4.2 million compared with \$4.4 million at September 30, 2015, an increase of \$0.2 million. Non-accrual loans increased during the period ending September 30, 2015 for the following reasons: \$1.9 million in new non-accrual loans plus capitalized expenditures on these loans were added; \$0.7 million were paid down or paid off; \$0.4 million were charged off; \$0.5 million were transferred to ORE and \$86 thousand was moved back to accrual status.

Table Of Contents

The composition of non-performing loans as of September 30, 2015 is as follows:

	Gross loan balances	Past due 90 days or more and still accruing	Non- accrual loans	Total non- performing loans	% of gross loans
(dollars in thousands)					
Commercial and industrial	\$ 90,552	\$ -	\$ 54	\$ 54	0.06%
Commercial real estate:					
Non-owner occupied	94,878	-	945	945	1.00%
Owner occupied	101,628	-	1,090	1,090	1.07%
Construction	3,554	-	232	232	6.53%
Consumer:					
Home equity installment	31,848	32	234	266	0.84%
Home equity line of credit	45,862	-	517	517	1.13%
Auto loans and leases *	29,977	172	75	247	0.82%
Other	6,595	-	7	7	0.11%
Residential:					
Real estate	128,255	67	612	679	0.53%
Construction	9,234	-	-	-	-
Loans held-for-sale	1,114	-	604	604	54.20%
Total	\$ 543,497	\$ 271	\$ 4,370	\$ 4,641	0.85%

*Net of unearned lease revenue of \$0.3 million.

Payments received from non-accrual loans are recognized on a cash method. Payments are first applied to the outstanding principal balance, then to the recovery of any charged-off loan amounts. Any excess is treated as a recovery of interest income. If the non-accrual loans that were outstanding as of September 30, 2015 had been performing in accordance with their original terms, the Company would have recognized interest income with respect to such loans of \$90 thousand.

The Company, on a regular basis, reviews changes to loans to determine if they meet the definition of a TDR. TDRs arise when a borrower experiences financial difficulty and the Company grants a concession that it would not otherwise grant based on current underwriting standards in order to maximize the Company's recovery. TDRs aggregated \$3.0 million at September 30, 2015, an increase of \$1.4 million, from \$1.6 million at December 31, 2014, due to the addition of five loans (4 CRE and 1 C&I) from 3 unrelated borrowers being classified as TDRs.

The following tables set forth the activity in TDRs as and for the periods indicated:

As of and for the nine months ended
September 30, 2015

	Accruing Commercial & Commercial		Non-accruing	
(dollars in thousands)	industrial	real estate	Commercial real estate	Total
Troubled Debt Restructures:				
Beginning balance	\$ 25	\$ 728	\$ 875	\$ 1,628
Additions	500	1,267	-	1,767
Pay downs / payoffs	-	(95)	(71)	(166)
Charge offs	-	-	(200)	(200)
Ending balance	\$ 525	\$ 1,900	\$ 604	* \$ 3,029

*This amount was included in loans held-for-sale at September 30, 2015.

Table Of Contents

As of and for the year ended December 31, 2014

(dollars in thousands)	Accruing Commercial & Commercial industrial real estate		Non-accruing Commercial real estate	Total
Troubled Debt Restructures:				
Beginning balance	\$ 35	\$ 1,010	\$ 967	\$ 2,012
Advance on balance	-	1	1	2
Pay downs / payoffs	(10)	(283)	(93)	(386)
Ending balance	\$ 25	\$ 728	\$ 875	\$ 1,628

If applicable, a TDR loan classified as non-accrual would require a minimum of six months of payments before consideration for a return to accrual status. The concessions granted consisted of temporary interest-only payments or a reduction in the rate of interest to a below-market rate for a contractual period of time. The Company believes concessions have been made in the best interests of the borrower and the Company. If loans characterized as a TDR perform according to the restructured terms for a satisfactory period of time, the TDR designation may be removed in a new calendar year if the loan yields a market rate of interest.

Foreclosed assets held-for-sale

Foreclosed assets held-for-sale aggregated \$1.0 million at September 30, 2015 and \$2.0 million at December 31, 2014. The following table sets forth the activity in the ORE component of foreclosed assets held-for-sale:

(dollars in thousands)	September 30, 2015		December 31, 2014	
	Amount	#	Amount	#
Balance at beginning of period	\$ 1,961	12	\$ 2,078	15
Additions	401	8	1,109	7
Pay downs	(1)		(5)	
Write downs	(25)		(155)	
Sold	(1,315)	(7)	(1,066)	(10)
Balance at end of period	\$ 1,021	13	\$ 1,961	12

As of September 30, 2015, ORE consisted of thirteen properties from twelve unrelated borrowers totaling \$1.0 million. Five of these properties (\$0.3 million) were added in 2015; three were added in 2014 (\$84 thousand); two were added in 2013 (\$0.2 million); two were added in 2012 (\$0.3 million); and one was added in 2011 (\$0.2

million). In addition, of the thirteen properties, eight (\$0.8 million) were listed for sale, while the remaining properties (five totaling \$0.2 million) are either in litigation, awaiting closing, have disposition plans or are undergoing renovations.

Other repossessed assets held-for-sale included one automobile with a book value of \$3 thousand at September 30, 2015. At December 31, 2014, other repossessed assets consisted of an automobile with a book value of \$11 thousand which was sold during 2015.

Bank premises and equipment, net

Premises and equipment increased \$2.0 million due to the opening of a new branch and renovations made to an existing branch which were completed during the second quarter of 2015.

Other assets

The \$4.0 million decrease in other assets was due mostly to a \$4.1 million decline in the net deferred tax assets due to an income tax refund and a \$1.9 million decrease in construction in process due to the opening of a new branch during the second quarter of 2015 partially offset by \$2.0 million in higher residual values associated with recording new automobile leases, net of lease disposals.

Funds Provided:

Deposits

The Company is a community based commercial depository financial institution, member FDIC, which offers a variety of deposit products with varying ranges of interest rates and terms. Generally, deposits are obtained from consumers, businesses and public entities within the communities that surround the Company's 11 branch offices and all deposits are insured by the FDIC up to the full extent permitted by law. Deposit products consist of transaction accounts including: savings; clubs; interest-bearing checking; money

Table Of Contents

market and non-interest bearing checking (DDA). The Company also offers short- and long-term time deposits or certificates of deposit (CDs). CDs are deposits with stated maturities which can range from seven days to ten years. Deposit inflow and outflow are influenced by economic conditions, changes in the interest rate environment, pricing and competition. To determine interest rates on its deposit products, the Company considers local competition, spreads to earning-asset yields, liquidity position and rates charged for alternative sources of funding such as short-term borrowings and FHLB advances.

The following table represents the components of deposits as of the date indicated:

(dollars in thousands)	September 30, 2015			December 31, 2014		
	Amount	%		Amount	%	
Money market	\$ 126,254	19.6	%	\$ 118,653	20.3	%
Interest-bearing checking	138,267	21.5		124,009	21.1	
Savings and clubs	115,561	18.0		110,282	18.8	
Certificates of deposit	112,207	17.5		104,630	17.8	
Total interest-bearing	492,289	76.6		457,574	78.0	
Non-interest bearing	150,714	23.4		129,370	22.0	
Total deposits	\$ 643,003	100.0	%	\$ 586,944	100.0	%

Total deposits increased \$56.1 million, or 10%, from \$586.9 million at December 31, 2014 to \$643.0 million at September 30, 2015. There was growth in all deposit types during 2015 with non-interest-bearing and interest-bearing checking contributing the most, \$35.6 million in total, to the increase. Money market, savings and CD accounts increased \$7.6 million, \$5.3 million and \$7.6 million, respectively. The Company has had success in executing on its model of developing new and strengthening existing relationships and offering periodic deposit promotions. Money market deposits increased in part due to promotions which granted higher rates for a specific amount of time. The promotional events create opportunities to cross-sell all of the bank's financial products and provides communication channels for establishing trust and financial service relationships thereby creating a stronger bond with existing customers and creating bonds with potential customers. The Company will continue to execute on its relationship development strategy, explore the demographics within its marketplace and develop creative programs for its customers. The Company's focus of building a relationship of trust with its customers has brought a few large deposits into the bank during 2015. Due to this relationship strategy, in the beginning of the third quarter of 2015, the Company gained a public fund deposit relationship that had balances of over \$10.0 million in CDs and over \$13.0 million in interest-bearing checking at September 30, 2015. Although these deposits fluctuate depending on customer needs, the Company plans to continue to form these types of relationships with customers in order to grow the deposit base to fund loan growth and pay down overnight borrowings.

The Company uses the Certificate of Deposit Account Registry Service (CDARS) reciprocal program to obtain FDIC insurance protection for customers who have large deposits that at times may exceed the FDIC maximum amount of \$250,000 per person. In the CDARS program, deposits with varying terms and interest rates, originated in the Company's own markets, are exchanged for deposits of other financial institutions that are members in the CDARS network. By placing the deposits in other participating institutions, the deposits of our customers are fully insured by the FDIC. In return for deposits placed with network institutions, the Company receives from network institutions deposits that are approximately equal in amount and are comprised of terms similar to those placed for our customers.

Deposits the Company receives, or reciprocal deposits, from other institutions are considered brokered deposits by regulatory definitions. As of September 30, 2015 and December 31, 2014, CDARS represented \$7.7 million, or 1%, of total deposits.

Excluding CDARS, certificates of deposit accounts of \$100,000 or more amounted to \$53.4 million and \$43.1 million at September 30, 2015 and December 31, 2014, respectively. Certificates of deposit of \$250,000 or more amounted to \$30.8 million and \$19.1 million as of September 30, 2015 and December 31, 2014, respectively.

Including CDARS, approximately 17% of the CDs, with a weighted-average interest rate of 0.64%, are scheduled to mature in 2015 and an additional 50%, with a weighted-average interest rate of 0.76%, are scheduled to mature in 2016. Renewing CDs may re-price to lower or higher market rates depending on the rate on the maturing CD, the pace and direction of interest rate movements, the shape of the yield curve, competition, the rate profile of the maturing accounts and depositor preference for alternative, non-term products. The widespread preference has been for customers with maturing CDs to hold their deposits in readily available transaction accounts. The Company does not expect significant net CD growth during the remainder of 2015, but will continue to develop CD promotional programs when the Company deems that it is economically feasible to do so or when demand exists. As with all promotions, the Company will consider the needs of the customers and simultaneously will be mindful of the liquidity levels and the interest rate sensitivity exposure of the Company.

Borrowings

Borrowings are used as a complement to deposit generation as an alternative funding source whereby the Company will borrow under customer repurchase agreements in the local market, advances from the FHLB and other correspondent banks for asset growth and

Table Of Contents

liquidity needs.

Repurchase agreements are non-insured interest-bearing liabilities that have a perfected security interest in qualified investments of the Company as required by the FDIC Depositor Protection Act of 2009. Repurchase agreements are offered through a sweep product. A sweep account is designed to ensure that on a daily basis, an attached DDA is adequately funded and excess funds are transferred, or swept, into an interest-bearing overnight repurchase agreement account. Due to the constant inflow and outflow of funds of the sweep product, their balances tend to be somewhat volatile, similar to a DDA. Customer liquidity is the typical cause for variances in repurchase agreements, which during the first nine months of 2015 increased \$2.8 million from December 31, 2014. In addition, short-term borrowings may include overnight balances which the Company may require to fund daily liquidity needs such as deposit and repurchase agreement cash outflow, loan demand and operations. At September 30, 2015 and December 31, 2014, the Company did not require overnight borrowings.

At the end of the second quarter of 2015, the Company paid off its \$10.0 million in long-term debt outstanding with the FHLB, due to the high interest rate on this debt compared to other available borrowing sources, and incurred a \$0.6 million prepayment fee. The advance carried an interest rate of 5.26% and was scheduled to mature in 2016.

The following table represents the components of borrowings as of the date indicated:

(dollars in thousands)	September 30, 2015		December 31, 2014	
	Amount	%	Amount	%
Securities sold under repurchase agreements	\$ 6,743	100.0 %	\$ 3,969	28.4 %
Long-term FHLB advances	-	-	10,000	71.6
Total	\$ 6,743	100.0 %	\$ 13,969	100.0 %

Item 3. Quantitative and Qualitative Disclosure About Market Risk

Management of interest rate risk and market risk analysis.

The adequacy and effectiveness of an institution's interest rate risk management process and the level of its exposures are critical factors in the regulatory evaluation of an institution's sensitivity to changes in interest rates and capital adequacy. Management believes the Company's interest rate risk measurement framework is sound and provides an effective means to measure, monitor, analyze, identify and control interest rate risk in the balance sheet.

The Company is subject to the interest rate risks inherent in its lending, investing and financing activities. Fluctuations of interest rates will impact interest income and interest expense along with affecting market values of all interest-earning assets and interest-bearing liabilities, except for those assets or liabilities with a short term remaining to maturity. Interest rate risk management is an integral part of the asset/liability management process. The Company has instituted certain procedures and policy guidelines to manage the interest rate risk position. Those internal policies enable the Company to react to changes in market rates to protect net interest income from significant fluctuations. The primary objective in managing interest rate risk is to minimize the adverse impact of changes in interest rates on net interest income along with creating an asset/liability structure that maximizes earnings.

Asset/Liability Management. One major objective of the Company when managing the rate sensitivity of its assets and liabilities is to stabilize net interest income. The management of and authority to assume interest rate risk is the responsibility of the Company's Asset/Liability Committee (ALCO), which is comprised of senior management and members of the board of directors. ALCO meets quarterly to monitor the relationship of interest sensitive assets to interest sensitive liabilities. The process to review interest rate risk is a regular part of managing the Company. Consistent policies and practices of measuring and reporting interest rate risk exposure, particularly regarding the treatment of non-contractual assets and liabilities, are in effect. In addition, there is an annual process to review the interest rate risk policy with the board of directors which includes limits on the impact to earnings from shifts in interest rates.

Interest Rate Risk Measurement. Interest rate risk is monitored through the use of three complementary measures: static gap analysis, earnings at risk simulation and economic value at risk simulation. While each of the interest rate risk measurements has limitations, collectively, they represent a reasonably comprehensive view of the magnitude of interest rate risk in the Company and the distribution of risk along the yield curve, the level of risk through time and the amount of exposure to changes in certain interest rate relationships.

Static Gap. The ratio between assets and liabilities re-pricing in specific time intervals is referred to as an interest rate sensitivity gap. Interest rate sensitivity gaps can be managed to take advantage of the slope of the yield curve as well as forecasted changes in the level of interest rate changes.

To manage this interest rate sensitivity gap position, an asset/liability model commonly known as cumulative gap analysis is used to monitor the difference in the volume of the Company's interest sensitive assets and liabilities that mature or re-price within given time intervals. A positive gap (asset sensitive) indicates that more assets will re-price during a given period compared to liabilities, while a

Table Of Contents

negative gap (liability sensitive) indicates the opposite effect. The Company employs computerized net interest income simulation modeling to assist in quantifying interest rate risk exposure. This process measures and quantifies the impact on net interest income through varying interest rate changes and balance sheet compositions. The use of this model assists the ALCO to gauge the effects of the interest rate changes on interest-sensitive assets and liabilities in order to determine what impact these rate changes will have upon the net interest spread. At September 30, 2015, the Company maintained a one-year cumulative gap of positive (asset sensitive) \$50.3 million, or 7%, of total assets. The effect of this positive gap position provided a mismatch of assets and liabilities which may expose the Company to interest rate risk during periods of falling interest rates. Conversely, in an increasing interest rate environment, net interest income could be positively impacted because more assets than liabilities will re-price upward during the one-year period.

Certain shortcomings are inherent in the method of analysis discussed above and presented in the next table. Although certain assets and liabilities may have similar maturities or periods of re-pricing, they may react in different degrees to changes in market interest rates. 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 of assets and liabilities may lag behind changes in market interest rates. Certain assets, such as adjustable-rate mortgages, have features which restrict changes in interest rates on a short-term basis and over the life of the asset. In the event of a change in interest rates, prepayment and early withdrawal levels may deviate significantly from those assumed in calculating the table amounts. The ability of many borrowers to service their adjustable-rate debt may decrease in the event of an interest rate increase.

The following table illustrates the Company's interest sensitivity gap position at September 30, 2015:

	Three months or less	More than three months to twelve months	More than one year to three years	More than three years	Total
(dollars in thousands)					
Cash and cash equivalents	\$ 12,302	\$ -	\$ -	\$ 13,388	\$ 25,690
Investment securities (1)(2)	6,423	16,221	31,594	73,629	127,867
Loans and leases(2)	196,699	77,150	131,822	128,677	534,348
Fixed and other assets	-	10,995	-	30,308	41,303
Total assets	\$ 215,424	\$ 104,366	\$ 163,416	\$ 246,002	\$ 729,208
Total cumulative assets	\$ 215,424	\$ 319,790	\$ 483,206	\$ 729,208	
Non-interest-bearing transaction deposits (3)	\$ -	\$ 15,087	\$ 41,416	\$ 94,211	\$ 150,714
Interest-bearing transaction deposits (3)	156,982	20,189	136,168	66,743	380,082
Certificates of deposit	18,918	51,593	23,888	17,808	112,207
Repurchase agreements	6,743	-	-	-	6,743
Other liabilities	-	-	-	3,829	3,829
Total liabilities	\$ 182,643	\$ 86,869	\$ 201,472	\$ 182,591	\$ 653,575
Total cumulative liabilities	\$ 182,643	\$ 269,512	\$ 470,984	\$ 653,575	

Interest sensitivity gap	\$ 32,781	\$ 17,497	\$ (38,056)	\$ 63,411
Cumulative gap	\$ 32,781	\$ 50,278	\$ 12,222	\$ 75,633

Cumulative gap to total assets	4.5%	6.9%	1.7%	10.4%
--------------------------------	------	------	------	-------

(1) Includes FHLB stock and the net unrealized gains/losses on available-for-sale securities.

(2) Investments and loans are included in the earlier of the period in which interest rates were next scheduled to adjust or the period in which they are due. In addition, loans were included in the periods in which they are scheduled to be repaid based on scheduled amortization. For amortizing loans and MBS – GSE residential, annual prepayment rates are assumed reflecting historical experience as well as management’s knowledge and experience of its loan products.

(3) The Company’s demand and savings accounts were generally subject to immediate withdrawal. However, management considers a certain amount of such accounts to be core accounts having significantly longer effective maturities based on the retention experiences of such deposits in changing interest rate environments. The effective maturities presented are the recommended maturity distribution limits for non-maturing deposits based on historical deposit studies.

Earnings at Risk and Economic Value at Risk Simulations. The Company recognizes that more sophisticated tools exist for measuring the interest rate risk in the balance sheet that extend beyond static re-pricing gap analysis. Although it will continue to measure its re-pricing gap position, the Company utilizes additional modeling for identifying and measuring the interest rate risk in the overall balance sheet. The ALCO is responsible for focusing on “earnings at risk” and “economic value at risk”, and how both relate to the risk-based capital position when analyzing the interest rate risk.

Earnings at Risk. An earnings at risk simulation measures the change in net interest income and net income should interest rates rise and fall. The simulation recognizes that not all assets and liabilities re-price one-for-one with market rates (e.g., savings rate). The ALCO looks at “earnings at risk” to determine income changes from a base case scenario under an increase and decrease of 200 basis points in interest rate simulation models.

Table Of Contents

Economic Value at Risk. An earnings at risk simulation measures the short-term risk in the balance sheet. Economic value (or portfolio equity) at risk measures the long-term risk by finding the net present value of the future cash flows from the Company's existing assets and liabilities. The ALCO examines this ratio quarterly utilizing an increase and decrease of 200 basis points in interest rate simulation models. The ALCO recognizes that, in some instances, this ratio may contradict the "earnings at risk" ratio.

The following table illustrates the simulated impact of an immediate 200 basis points upward or downward movement in interest rates on net interest income, net income and the change in the economic value (portfolio equity). This analysis assumed that interest-earning asset and interest-bearing liability levels at September 30, 2015 remained constant. The impact of the rate movements was developed by simulating the effect of the rate change over a twelve-month period from the September 30, 2015 levels:

	% change	
	Rates +200	Rates -200
Earnings at risk:		
Net interest income	4.5 %	(1.6) %
Net income	12.8	(4.5)
Economic value at risk:		
Economic value of equity	(8.6)	(20.3)
Economic value of equity as a percent of total assets	(1.1)	(2.6)

Economic value has the most meaning when viewed within the context of risk-based capital. Therefore, the economic value may normally change beyond the Company's policy guideline for a short period of time as long as the risk-based capital ratio (after adjusting for the excess equity exposure) is greater than 10%. At September 30, 2015, the Company's risk-based capital ratio was 15.1%.

The table below summarizes estimated changes in net interest income over a twelve-month period beginning October 1, 2015, under alternate interest rate scenarios using the income simulation model described above:

(dollars in thousands)	Net interest income	\$ variance	% variance
Simulated change in interest rates			
+200 basis points	\$ 25,461	\$ 1,091	4.5 %
+100 basis points	24,804	434	1.8
Flat rate	24,370	-	-
-100 basis points	24,214	(156)	(0.6)
-200 basis points	23,979	(391)	(1.6)

Simulation models require assumptions about certain categories of assets and liabilities. The models schedule existing assets and liabilities by their contractual maturity, estimated likely call date or earliest re-pricing opportunity. MBS – GSE residential securities and amortizing loans are scheduled based on their anticipated cash flow including estimated prepayments. For investment securities, the Company uses a third-party service to provide cash flow estimates in the various rate environments. Savings, money market and interest-bearing checking accounts do not have stated maturities or re-pricing terms and can be withdrawn or re-price at any time. This may impact the margin if more expensive alternative sources of deposits are required to fund loans or deposit runoff. Management projects the re-pricing characteristics of these accounts based on historical performance and assumptions that it believes reflect their rate sensitivity. The model reinvests all maturities, repayments and prepayments for each type of asset or liability into the same product for a new like term at current product interest rates. As a result, the mix of interest-earning assets and interest bearing-liabilities is held constant.

Liquidity

Liquidity management ensures that adequate funds will be available to meet customers' needs for borrowings, deposit withdrawals and maturities, facility expansion and normal operating expenses. Sources of liquidity are cash and cash equivalents, asset maturities and pay-downs within one year, loans HFS, investments AFS, growth of core deposits and repurchase agreements, utilization of borrowing capacities from the FHLB, correspondent banks, CDARs, the Discount Window of the Federal Reserve Bank of Philadelphia (FRB) and proceeds from the issuance of capital stock. Though regularly scheduled investment and loan payments are dependable sources of daily liquidity, sales of both loans HFS and investments AFS, deposit activity and investment and loan prepayments are significantly influenced by general economic conditions including the interest rate environment. During low and declining interest rate environments, prepayments from interest-sensitive assets tend to accelerate and provide significant liquidity that can be used to invest in other interest-earning assets but at lower market rates. Conversely, in periods of high or rising interest rates, prepayments from interest-sensitive assets tend to decelerate causing prepayment cash flows from mortgage loans and mortgage-backed securities to decrease. Rising interest rates may also cause deposit inflow but priced at higher market interest rates or could also cause deposit outflow due to higher rates offered by the Company's competition for similar products. The Company closely

Table Of Contents

monitors activity in the capital markets and takes appropriate action to ensure that the liquidity levels are adequate for funding, investing and operating activities.

The Company's contingency funding plan (CFP) sets a framework for handling liquidity issues in the event circumstances arise which the Company deems to be less than normal. The Company established guidelines for identifying, measuring, monitoring and managing the resolution of potentially serious liquidity crises. The CFP outlines required monitoring tools, acceptable alternative funding sources and required actions during various liquidity scenarios. Thus, the Company has implemented a proactive means for the measurement and resolution for handling potentially significant adverse liquidity conditions. At least quarterly, the CFP monitoring tools, current liquidity position and monthly projected liquidity sources and uses are presented and reviewed by the Company's Asset/Liability Committee. As of September 30, 2015, the Company had not experienced any adverse issues that would give rise to its inability to raise liquidity in an emergency situation.

During the nine months ended September 30, 2015, the Company used \$0.2 million of cash. During the period, the Company's operations provided approximately \$13.6 million mostly from \$18.6 million of net cash inflow from the components of net interest income, \$3.3 million more in proceeds from sales of loans than originations of loans held-for-sale and a \$3.2 million income tax refund; partially offset by net non-interest expense /income related payments of \$9.5 million and a \$2.0 million increase in the residual value from the Company's automobile leasing activities. Cash inflow from interest-earning assets, growth in deposits and short-term borrowings were used to fund loan growth, replace maturing and cash runoff of investment securities, reduce long-term debt and net dividend payments. The growth in the loan portfolio occurred in all sectors and the Company expects to continue growth in the loan portfolio sectors during the last quarter of 2015 funded by deposit growth. The Company will use cash balances to grow the AFS investment portfolio. The seasonal nature of deposits from municipalities and other public funding sources requires the Company to be prepared for the inherent volatility and the unpredictable timing of cash outflow from this customer base. Accordingly, short-term overnight borrowings could be used to fulfill funding gap needs. The CFP is a tool to help the Company ensure that alternative funding sources are available to meet its liquidity needs.

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business in order to meet the financing needs of its customers and in connection with the overall interest rate management strategy. These instruments involve, to a varying degree, elements of credit, interest rate and liquidity risk. In accordance with GAAP, these instruments are either not recorded in the consolidated financial statements or are recorded in amounts that differ from the notional amounts. Such instruments primarily include lending commitments and lease obligations.

Lending commitments include commitments to originate loans and commitments to fund unused lines of credit. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

In addition to lending commitments, the Company has contractual obligations related to operating lease commitments. Operating lease commitments are obligations under various non-cancelable operating leases on buildings and land used for office space and banking purposes. During the second quarter of 2015, the West Pittston branch lease expired and the lease for the new Pittston branch commenced. The Company's position with respect to lending commitments and significant contractual lease obligations, both on a short- and long-term basis has not changed materially from December 31, 2014.

As of September 30, 2015, the Company maintained \$25.7 million in cash and cash equivalents and \$127.9 million of investments AFS and loans HFS. Also as of September 30, 2015, the Company had approximately \$197.8 million available to borrow from the FHLB, \$21.0 million from correspondent banks, \$30.3 million from the FRB and \$36.5 million from the CDARS program. The combined total of \$439.2 million represented 60% of total assets at September 30, 2015. Management believes this level of liquidity to be strong and adequate to support current operations.

Capital

During the nine months ended September 30, 2015, total shareholders' equity increased \$3.4 million, or 5%, due principally from the \$5.3 million in net income added into retained earnings and to a lesser extent, the \$0.3 million from stock incentive plans through stock compensation expense and investments in the Company's common stock via the Employee Stock Purchase (ESPP) plan. These items were partially offset by \$1.9 million of cash dividends declared on the Company's common stock and a \$0.2 million other comprehensive loss. During the second and third quarters of 2015, the Company was able to increase the dividend 8% to \$0.27 per share due to capital growth which was driven by strong net income. The Company's dividend payout ratio, defined as the rate at which current earnings is paid to shareholders, was 37% for the nine months ended September 30, 2015. The balance of earnings is retained to further strengthen the Company's capital position.

As of September 30, 2015, the Company reported a net unrealized gain position of \$2.5 million, net of tax, from the securities AFS portfolio compared to a net unrealized gain of \$2.7 million as of December 31, 2014. The reduction during 2015 was mostly from municipal securities. Management believes that changes in fair value of the Company's securities are due to changes in interest rates and not in the creditworthiness of the issuers. Generally, when U.S. Treasury rates rise, investment securities' pricing declines and fair values of investment securities also decline. While volatility has existed in the yield curve within the past twelve months, a rising

Table Of Contents

rate environment is inevitable and during the period of rising rates, the Company expects pricing in the bond portfolio to decline. There is no assurance that future realized and unrealized losses will not be recognized from the Company's portfolio of investment securities. To help maintain a healthy capital position, the Company can issue stock to participants in the DRP and ESPP plans. The DRP affords the Company the option to acquire shares in open market purchases and/or issue shares directly from the Company to plan participants. During 2015, the Company has acquired shares in open market purchases to fulfill the needs of the DRP. Both the DRP and the ESPP plans have been a consistent source of capital from the Company's loyal employees and shareholders and their participation in these plans will continue to help strengthen the Company's balance sheet. Beginning in 2009, the Company's board of directors had allowed a benefit to its loyal shareholders as a discount on the purchase price for shares issued directly from the Company through the DRP and voluntary cash feature. During the first quarter of 2014, the DRP was amended to discontinue a portion of the discount on the voluntary cash feature as the board of directors had determined that the Company's capital position achieved sufficient levels.

The Company (on a consolidated basis) and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possible additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's and the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk-weightings and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

Under these guidelines, assets and certain off-balance sheet items are assigned to broad risk categories, each with appropriate weights. The resulting ratios represent capital as a percentage of total risk-weighted assets. In July 2013, the federal bank regulatory agencies issued final rules to implement the Basel III regulatory capital reforms and changes required by the Dodd-Frank Act. Under the final rules, which became effective for the Company on January 1, 2015 and are subject to a phase-in period through January 1, 2019, minimum requirements will increase for both the quantity and quality of capital held by the Company. The rules require all banks and bank holding companies to maintain a new common equity Tier 1 capital to risk-weighted assets minimum ratio of 4.5%, raise the minimum ratio of Tier 1 capital to risk-weighted assets (Tier I capital) from 4.0% to 6.0%, require a minimum ratio of total risk-based capital to total risk-weighted assets (Total Risk Based Capital) of 8.0%, and require a minimum Tier I capital to average total assets (Leverage Ratio) of 4.0%. A new capital conservation buffer, comprised of common equity Tier I capital, is also established above the regulatory minimum capital requirements. The rule increases the minimum Tier 1 capital to risk-based assets requirement with a capital conservation buffer to 8.5% by 2019 and increases the minimum total capital requirement with a capital conservation buffer to 10.5% by 2019 and assigns higher risk-weightings to certain assets: certain past due and commercial real estate loans and some equity exposures. As of September 30, 2015, the Company and the Bank exceeded all capital adequacy requirements to which it was subject.

The new rules also include a one-time opportunity to opt-out of the changes to treatment of accumulated other comprehensive income ("AOCI") components. By making the election to opt-out, the institution may continue treating AOCI items in a manner consistent with risk-based capital rules in place prior to January 2015. The permanent opt-out election must be made on the Call Report for the first reporting period after January 1, 2015 and a parent holding company must make the same election as its subsidiary bank. If the institution does not elect to opt-out, the institution will not have an opportunity to change its methodology in future periods. The Company has made the election to opt out of the treatment of AOCI on the appropriate March 31, 2015 filings.

Table Of Contents

The Company continues to closely monitor and evaluate alternatives to enhance its capital ratios as the regulatory and economic environments change. The following table depicts the capital amounts and ratios of the Company and the Bank as of September 30, 2015:

(dollars in thousands) As of September 30, 2015	Actual		For capital		To be well	
	Amount	Ratio	adequacy purposes	Ratio	capitalized	under prompt
			Amount	Ratio	corrective	action provisions
			Amount	Ratio	Amount	Ratio
Total capital (to risk-weighted assets)						
Consolidated	\$ 79,845	15.1% ≥	\$ 42,284 ≥	8.0%	N/A	N/A
Bank	\$ 79,384	15.0% ≥	\$ 42,271 ≥	8.0% ≥	\$ 52,839	≥10.0%
Tier 1 common equity (to risk-weighted assets)*						
Consolidated	\$ 73,101	13.8% ≥	\$ 23,785 ≥	4.5%	N/A	N/A
Bank	\$ 72,746	13.8% ≥	\$ 23,778 ≥	4.5% ≥	34,345	≥6.5%
Tier I capital (to risk-weighted assets)						
Consolidated	\$ 73,101	13.8% ≥	\$ 43,240 ≥	6.0%	N/A	N/A
Bank	\$ 72,746	13.8% ≥	\$ 43,240 ≥	6.0% ≥	\$ 57,654	≥8.0%
Tier I capital (to average assets)						
Consolidated	\$ 73,101	10.1% ≥	\$ 28,827 ≥	4.0%	N/A	N/A
Bank	\$ 72,746	10.1% ≥	\$ 28,827 ≥	4.0% ≥	\$ 36,034	≥5.0%

*New ratio per Basel III.

As of December 31, 2014:

Total capital (to risk-weighted assets)						
Consolidated	\$ 75,756	15.3% ≥	\$ 39,730 ≥	8.0%	N/A	N/A
Bank	\$ 75,230	15.2% ≥	\$ 39,728 ≥	8.0% ≥	\$ 49,660	≥10.0%
Tier I capital (to risk-weighted assets)						
Consolidated	\$ 69,376	14.0% ≥	\$ 19,865 ≥	4.0%	N/A	N/A

Edgar Filing: FIDELITY D & D BANCORP INC - Form 10-Q

Bank	\$ 68,985	13.9% ≥	\$ 19,864 ≥	4.0% ≥	\$ 29,796 ≥	6.0%
Tier I capital (to average assets)						
Consolidated	\$ 69,376	10.0% ≥	\$ 27,679 ≥	4.0%	N/A	N/A
Bank	\$ 68,985	10.0% ≥	\$ 27,658 ≥	4.0% ≥	\$ 34,573 ≥	5.0%

The new guidelines had no material effect between ratios reported at December 31, 2014 and those reported at September 30, 2015.

The Company advises readers to refer to the Supervision and Regulation section of Management's Discussion and Analysis of Financial Condition and Results of Operation, of its 2014 Form 10-K for a discussion on the regulatory environment and recent legislation and rulemaking.

Item 4. Controls and Procedures

As of the end of the period covered by this Quarterly Report on Form 10-Q, an evaluation was carried out by the Company's management, with the participation of its President and Chief Executive Officer and Chief Financial Officer, of the effectiveness of the Company's disclosure controls and procedures, as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934. Based on such evaluation, the President and Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are designed to ensure that information required to be disclosed in the reports the Company files or furnishes under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and regulations, and are effective. The Company made no changes in its internal controls over financial reporting or in other factors that materially affected, or are reasonably likely to materially affect, these controls during the last fiscal quarter ended September 30, 2015.

Table Of Contents

PART II - Other Information

Item 1. Legal Proceedings

The nature of the Company's business generates some litigation involving matters arising in the ordinary course of business. However, in the opinion of the Company after consultation with legal counsel, no legal proceedings are pending, which, if determined adversely to the Company or the Bank, would have a material adverse effect on the Company's undivided profits or financial condition. No legal proceedings are pending other than ordinary routine litigation incidental to the business of the Company and the Bank. In addition, to management's knowledge, no governmental authorities have initiated or contemplated any material legal actions against the Company or the Bank.

Item 1A. Risk Factors

Management of the Company does not believe there have been any material changes to the risk factors that were disclosed in the 2014 Form 10-K filed with the Securities and Exchange Commission on March 17, 2015.

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

None

Item 3. Default Upon Senior Securities

None

Item 4. Mine Safety Disclosures

Not applicable

Item 5. Other Information

None

Item 6. Exhibits

The following exhibits are filed herewith or incorporated by reference as a part of this Form 10-Q:

3(i) Amended and Restated Articles of Incorporation of Registrant. Incorporated by reference to Annex B of the Proxy Statement/Prospectus included in Registrant's Amendment 4 to its Registration Statement No. 333-90273 on Form S-4, filed with the SEC on April 6, 2000.

3(ii) Amended and Restated Bylaws of Registrant. Incorporated by reference to Exhibit 3(ii) to Registrant's Form 8-K filed with the SEC on November 21, 2007.

*10.1 Registrant's 2012 Dividend Reinvestment and Stock Purchase Plan. Incorporated by reference to Exhibit 4.1 to Registrant's Registration Statement No. 333-183216 on Form S-3 filed with the SEC on August 10, 2012 as amended February 3, 2014.

*10.2 Registrant's 2000 Independent Directors Stock Option Plan. Incorporated by reference to Exhibit 4.3 to Registrant's Registration Statement No. 333-64356 on Form S-8 filed with the SEC on July 2, 2001.

*10.3 Amendment, dated October 2, 2007, to the Registrant's 2000 Independent Directors Stock Option Plan. Incorporated by reference to Exhibit 10.2 to Registrant's Form 8-K filed with the SEC on October 4, 2007.

*10.4 Registrant's 2000 Stock Incentive Plan. Incorporated by reference to Exhibit 4.4 to Registrant's Registration Statement No. 333-64356 on Form S-8 filed with the SEC on July 2, 2001.

*10.5 Amendment, dated October 2, 2007, to the Registrant's 2000 Stock Incentive Plan. Incorporated by reference to Exhibit 10.1 to Registrant's Form 8-K filed with the SEC on October 4, 2007.

*10.6 Registrant's 2002 Employee Stock Purchase Plan. Incorporated by reference to Appendix A to Definitive proxy Statement filed with the SEC on March 28, 2002.

*10.7 Change of Control Agreement with Salvatore R. DeFrancesco, the Registrant and The Fidelity Deposit and Discount Bank, dated March 21, 2006. Incorporated by reference to Exhibit 99.2 to Registrant's Current Report on Form 8-K filed with the SEC on March 27, 2006.

*10.8 Amended and Restated Executive Employment Agreement between the Registrant, The Fidelity Deposit and Discount Bank and Daniel J. Santaniello, dated March 23, 2011. Incorporated by reference to Exhibit 99.1 to Registrant's Current Report on Form 8-K filed with the SEC on March 29, 2011.

*10.9 Amended and Restated Executive Employment Agreement between the Registrant, The Fidelity Deposit and Discount Bank and Timothy P. O'Brien, dated March 23, 2011. Incorporated by reference to Exhibit 99.2 to Registrant's Current Report on Form 8-K filed with the SEC on March 29, 2011.

*10.10 2012 Omnibus Stock Incentive Plan. Incorporated by reference to Appendix A to Registrant's Definitive Proxy Statement filed with the SEC on March 30, 2012.

Table Of Contents

*10.11 2012 Director Stock Incentive Plan. Incorporated by reference to Appendix B to Registrant's Definitive Proxy Statement filed with the SEC on March 30, 2012.

*10.12 Change in Control and Severance Agreement between the Registrant, The Fidelity Deposit and Discount Bank and Eugene J. Walsh, dated June 26, 2015. Incorporated by reference to Exhibit 99.1 to Registrant's Current Report on Form 8-K filed with the SEC on June 29, 2015.

11 Statement regarding computation of earnings per share. Included herein in Note No. 6, "Earnings per share," contained within the Notes to Consolidated Financial Statements, and incorporated herein by reference.

31.1 Rule 13a-14(a) Certification of Principal Executive Officer, filed herewith.

31.2 Rule 13a-14(a) Certification of Principal Financial Officer, filed herewith.

32.1 Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350,

as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, filed herewith.

32.2 Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350,

as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, filed herewith.

101 Interactive data files: The following, from Fidelity D&D Bancorp, Inc.'s. Quarterly Report on Form 10-Q for the quarter ended September 30, 2015, is formatted in XBRL (eXtensible Business Reporting Language): Consolidated Balance Sheets as of September 30, 2015 and December 31, 2014; Consolidated Statements of Income for the three and nine months ended September 30, 2015 and 2014; Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2015 and 2014; Consolidated Statements of Changes in Shareholders' Equity for the nine months ended September 30, 2015 and 2014; Consolidated Statements of Cash Flows for the nine months ended September 30, 2015 and 2014 and the Notes to the Consolidated Financial Statements.

* Management contract or compensatory plan or arrangement.

Table Of Contents

Signatures

FIDELITY D & D BANCORP, INC.

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

Fidelity D & D Bancorp, Inc.

Date: November 6, 2015 /s/Daniel J. Santaniello
Daniel J. Santaniello,

President and Chief Executive Officer

Fidelity D & D Bancorp, Inc.

Date: November 6, 2015 /s/Salvatore R. DeFrancesco, Jr.
Salvatore R. DeFrancesco, Jr.,

Treasurer and Chief Financial Officer

Table Of Contents

EXHIBIT INDEX

3(i) Amended and Restated Articles of Incorporation of Registrant. Incorporated by reference to Annex B of the Proxy Statement/Prospectus included in Registrant's Amendment 4 to its Registration Statement No. 333-90273 on Form S-4, filed with the SEC on April 6, 2000.

*

3(ii) Amended and Restated Bylaws of Registrant. Incorporated by reference to Exhibit 3(ii) to Registrant's Form 8-K filed with the SEC on November 21, 2007.

*

10.1 Registrant's Dividend Reinvestment and Stock Purchase Plan. Incorporated by reference to Exhibit 4.1 to Registrant's Registration Statement No. 333-183216 on Form S-3 filed with the SEC on August 10, 2012 as amended February 3, 2014.

*

10.2 Registrant's 2000 Independent Directors Stock Option Plan. Incorporated by reference to Exhibit 4.3 to Registrant's Registration Statement No. 333-64356 on Form S-8 filed with the SEC on July 2, 2001.

*

10.3 Amendment, dated October 2, 2007, to the Registrant's 2000 Independent Directors Stock Option Plan. Incorporated by reference to Exhibit 10.2 to Registrant's Form 8-K filed with the SEC on October 4, 2007.

*

10.4 Registrant's 2000 Stock Incentive Plan. Incorporated by reference to Exhibit 4.4 to Registrant's Registration Statement No. 333-64356 on Form S-8 filed with the SEC on July 2, 2001.

*

10.5 Amendment, dated October 2, 2007, to the Registrant's 2000 Stock Incentive Plan. Incorporated by reference to Exhibit 10.1 to Registrant's Form 8-K filed with the SEC on October 4, 2007.

*

10.6 Registrant's 2002 Employee Stock Purchase Plan. Incorporated by reference to Appendix A to Registrant's Definitive Proxy Statement filed with the SEC on March 28, 2002.

*

10.7 Change of Control Agreement with Salvatore R. DeFrancesco, the Registrant and The Fidelity Deposit and Discount Bank, dated March 21, 2006. Incorporated by reference to Exhibit 99.2 to Registrant's Current Report on Form 8-K filed with the SEC on March 27, 2006.

*

10.8 Amended and Restated Executive Employment Agreement between the Registrant, The Fidelity Deposit and Discount Bank and Daniel J. Santaniello, dated March 23, 2011. Incorporated by reference to Exhibit 99.1 to Registrant's Current Report on Form 8-K filed with the SEC on March 29, 2011.

*

10.9 Amended and Restated Executive Employment Agreement between the Registrant, The Fidelity Deposit and Discount Bank and Timothy P. O'Brien, dated March 23, 2011. Incorporated by reference to Exhibit 99.2 to Registrant's Current Report on Form 8-K filed with the SEC on March 29, 2011.

*

10.10 2012 Omnibus Stock Incentive Plan. Incorporated by reference to Appendix A to Registrant's Definitive Proxy Statement filed with the SEC on March 30, 2012.

*

10.11 2012 Director Stock Incentive Plan. Incorporated by reference to Appendix B to Registrant's Definitive Proxy Statement filed with the SEC on March 30, 2012.

*

10.12 Change in Control and Severance Agreement between the Registrant, The Fidelity Deposit and Discount Bank and Eugene J. Walsh, dated June 26, 2015. Incorporated by reference to Exhibit 99.1 to Registrant's Current Report on Form 8-K filed with the SEC on June 29, 2015.

*

11 Statement regarding computation of earnings per share.

22

31.1 Rule 13a-14(a) Certification of Principal Executive Officer, filed herewith.

31.2 Rule 13a-14(a) Certification of Principal Financial Officer, filed herewith.

32.1 Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, filed herewith.

Table Of Contents

32.2 Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, filed herewith.

101 Interactive data files: The following, from the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2015, is formatted in XBRL (eXtensible Business Reporting Language): Consolidated Balance Sheets as of September 30, 2015 and December 31, 2014; Consolidated Statements of Income for the three and nine months ended September 30, 2015 and 2014; Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2015 and 2014; Consolidated Statements of Changes in Shareholders' Equity for the nine months ended September 30, 2015 and 2014; Consolidated Statements of Cash Flows for the nine months ended September 30, 2015 and 2014 and the Notes to the Consolidated Financial Statements. **

* Incorporated by Reference

** Pursuant to Rule 406T of Regulation S-T, the interactive data files in Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities and Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.