

FRANKLIN FINANCIAL SERVICES CORP /PA/

Form 10-Q

November 07, 2016

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, 2016

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

For the transition period from _____ to _____

Commission file number 0-12126

FRANKLIN FINANCIAL SERVICES CORPORATION

(Exact name of registrant as specified in its charter)

PENNSYLVANIA

(State or other jurisdiction of incorporation or organization)

25-1440803

(I.R.S. Employer Identification No.)

20 South Main Street, Chambersburg PA 17201-0819

(Address of principal executive offices) (Zip Code)

(717) 264-6116

(Registrant's telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

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

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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.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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

There were 4,299,317 outstanding shares of the Registrant’s common stock as of October 31, 2016.

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Part I FINANCIAL INFORMATION

Item 1 Financial Statements

Consolidated Balance Sheets

(Dollars in thousands, except share and per share data)(unaudited)	September 30 2016	December 31 2015
Assets		
Cash and due from banks	\$ 16,770	\$ 20,664
Interest-bearing deposits in other banks	23,824	18,502
Total cash and cash equivalents	40,594	39,166
Investment securities available for sale, at fair value	155,345	159,473
Restricted stock	1,118	782
Loans held for sale	367	461
Loans	858,576	782,016
Allowance for loan losses	(10,685)	(10,086)
Net Loans	847,891	771,930
Premises and equipment, net	14,322	14,759
Bank owned life insurance	22,327	22,364
Goodwill	9,016	9,016
Other real estate owned	5,872	6,451
Deferred tax asset, net	4,044	4,758
Other assets	6,224	6,135
Total assets	\$ 1,107,120	\$ 1,035,295
Liabilities		
Deposits		
Noninterest-bearing checking	\$ 174,390	\$ 152,095
Money management, savings and interest checking	726,845	680,686
Time	77,317	85,731
Total Deposits	978,552	918,512
Short-term borrowings	8,530	-
Other liabilities	3,159	5,407
Total liabilities	990,241	923,919
Shareholders' equity		
Common stock, \$1 par value per share, 15,000,000 shares authorized with 4,688,149 shares issued and 4,299,223 shares outstanding at September 30, 2016 and 4,659,319 shares issued and 4,275,879 shares outstanding at December 31, 2015	4,688	4,659
Capital stock without par value, 5,000,000 shares authorized with no shares issued and outstanding	-	-
Additional paid-in capital	39,584	38,778
Retained earnings	82,262	78,517

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Accumulated other comprehensive loss	(2,547)	(3,722)
Treasury stock, 388,926 shares at September 30, 2016 and 383,440 shares at December 31, 2015, at cost	(7,108)	(6,856)
Total shareholders' equity	116,879	111,376
Total liabilities and shareholders' equity	\$ 1,107,120	\$ 1,035,295

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

Consolidated Statements of Income

(Dollars in thousands, except per share data) (unaudited)	For the Three Months Ended		For the Nine Months Ended	
	September 30 2016	September 30 2015	September 30 2016	September 30 2015
Interest income				
Loans, including fees	\$ 8,343	\$ 7,665	\$ 24,394	\$ 22,518
Interest and dividends on investments:				
Taxable interest	569	584	1,729	1,832
Tax exempt interest	355	402	1,079	1,218
Dividend income	2	3	12	63
Deposits and obligations of other banks	79	66	220	192
Total interest income	9,348	8,720	27,434	25,823
Interest expense				
Deposits	559	554	1,650	1,813
Short-term borrowings	4	1	6	1
Total interest expense	563	555	1,656	1,814
Net interest income	8,785	8,165	25,778	24,009
Provision for loan losses	1,150	400	3,325	1,035
Net interest income after provision for loan losses	7,635	7,765	22,453	22,974
Noninterest income				
Investment and trust services fees	1,211	1,154	3,683	3,805
Loan service charges	102	288	518	784
Deposit service charges and fees	635	623	1,815	1,700
Other service charges and fees	325	309	941	916
Debit card income	373	346	1,095	1,021
Increase in cash surrender value of life insurance	131	137	399	416
Net (loss) gain on sale of other real estate owned	(20)	-	(31)	32
OTTI losses on debt securities	(10)	-	(30)	(20)
Gain on conversion of investment security	-	-	-	728
Securities gains, net	-	-	4	8
Other	56	126	219	363
Total noninterest income	2,803	2,983	8,613	9,753
Noninterest expense				
Salaries and employee benefits	4,566	4,214	13,282	12,500
Occupancy, net	556	535	1,708	1,706
Furniture and equipment	221	232	655	702
Advertising	296	336	839	807
Legal and professional	423	311	1,114	811
Data processing	539	524	1,540	1,547
Pennsylvania bank shares tax	203	206	699	608
Intangible amortization	-	-	-	181
FDIC insurance	188	170	514	479
ATM/debit card processing	214	193	642	566

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Foreclosed real estate	18	322	93	341
Telecommunications	91	145	300	379
Other	665	675	2,119	2,385
Total noninterest expense	7,980	7,863	23,505	23,012
Income before federal income tax expense	2,458	2,885	7,561	9,715
Federal income tax expense	383	306	1,198	1,778
Net income	\$ 2,075	\$ 2,579	\$ 6,363	\$ 7,937

Per share

Basic earnings per share	\$ 0.48	\$ 0.61	\$ 1.48	\$ 1.87
Diluted earnings per share	\$ 0.48	\$ 0.61	\$ 1.48	\$ 1.87
Cash dividends declared	\$ 0.21	\$ 0.19	\$ 0.61	\$ 0.55

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

Consolidated Statements of Comprehensive Income

(Dollars in thousands) (unaudited)	For the Three Months Ended September 30		For the Nine Months Ended September 30	
	2016	2015	2016	2015
Net Income	\$ 2,075	\$ 2,579	\$ 6,363	\$ 7,937
Securities:				
Unrealized (losses) gains arising during the period	(524)	1,097	1,528	561
Reclassification adjustment for losses (gains) included in net income (1)	10	-	26	(716)
Net unrealized (losses) gains	(514)	1,097	1,554	(155)
Tax effect	174	(373)	(528)	53
Net of tax amount	(340)	724	1,026	(102)
Derivatives:				
Unrealized gains arising during the period	-	-	-	31
Reclassification adjustment for losses included in net income (2)	-	-	-	160
Net unrealized gains	-	-	-	191
Tax effect	-	-	-	(65)
Net of tax amount	-	-	-	126
Pension:				
Change in plan assets and benefit obligations	-	-	-	-
Reclassification adjustment for losses included in net income (3)	225	-	225	-
Net unrealized losses	225	-	225	-
Tax effect	(76)	-	(76)	-
Net of tax amount	149	-	149	-
Total other comprehensive (loss) income	(191)	724	1,175	24
Total Comprehensive Income	\$ 1,884	\$ 3,303	\$ 7,538	\$ 7,961
Reclassification adjustment / Statement line item	Tax expense (benefit)			
(1) Securities / gain on conversion & securities (gains) losses, including OTTI losses, net	\$ (3)	\$ -	\$ (9)	\$ 243
(2) Derivatives / interest expense on deposits	-	-	-	(54)
(3) Pension / Salary & Benefits	(77)	-	(77)	-

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

Consolidated Statements of Changes in Shareholders' Equity

For the Nine Months Ended September 30, 2016 and 2015:

	Common	Additional Paid-in	Retained	Accumulated Other Comprehensive	Treasury	Total
(Dollars in thousands, except per share data) (unaudited)	Stock	Capital	Earnings	Loss	Stock	Total
Balance at December 31, 2014	\$ 4,607	\$ 37,504	\$ 71,452	\$ (3,100)	\$ (6,942)	\$ 103,521
Net income	-	-	7,937	-	-	7,937
Other comprehensive income	-	-	-	24	-	24
Cash dividends declared, \$.55 per share	-	-	(2,330)	-	-	(2,330)
Treasury shares issued under stock option plans, 4,794 shares	-	6	-	-	86	92
Common stock issued under dividend reinvestment plan, 36,608 shares	36	833	-	-	-	869
Balance at September 30, 2015	\$ 4,643	\$ 38,343	\$ 77,059	\$ (3,076)	\$ (6,856)	\$ 110,113
Balance at December 31, 2015	\$ 4,659	\$ 38,778	\$ 78,517	\$ (3,722)	\$ (6,856)	\$ 111,376
Net income	-	-	6,363	-	-	6,363
Other comprehensive income	-	-	-	1,175	-	1,175
Cash dividends declared, \$.61 per share	-	-	(2,618)	-	-	(2,618)
Acquisition of 30,196 shares of treasury stock	-	-	-	-	(700)	(700)
Treasury shares issued under employer stock purchase plan, 539 shares	-	2	-	-	10	12
Treasury shares issued under dividend reinvestment plan, 24,171 shares	-	134	-	-	438	572
Common stock issued under dividend reinvestment plan, 25,230 shares	25	527	-	-	-	552
Common stock issued under incentive stock option plan, 3,600 shares	4	55	-	-	-	59
Stock option compensation expense	-	88	-	-	-	88
Balance at September 30, 2016	\$ 4,688	\$ 39,584	\$ 82,262	\$ (2,547)	\$ (7,108)	\$ 116,879

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

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Consolidated Statements of Cash Flows

	Nine Months Ended September 30	
	2016	2015
(Dollars in thousands) (unaudited)		
Cash flows from operating activities		
Net income	\$ 6,363	\$ 7,937
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,002	999
Net amortization of loans and investment securities	1,218	1,248
Amortization and net change in mortgage servicing rights valuation	41	20
Amortization of intangibles	-	181
Provision for loan losses	3,325	1,035
Gain on sales of securities	(4)	(8)
Impairment write-down on securities recognized in earnings	30	20
Gain on conversion of investment security	-	(728)
Loans originated for sale	(6,598)	(6,193)
Proceeds from sale of loans	6,692	6,206
Write-down of other real estate owned	46	250
Write-down on premises and equipment	-	60
Net loss (gain) on sale or disposal of other real estate/other repossessed assets	31	(32)
Increase in cash surrender value of life insurance	(399)	(416)
Gain from surrender of life insurance policy	-	(103)
Stock option compensation	88	-
Decrease in other assets	154	1,877
Decrease in other liabilities	(2,247)	(2,497)
Net cash provided by operating activities	9,742	9,856
Cash flows from investing activities		
Proceeds from sales and calls of investment securities available for sale	1,925	1,381
Proceeds from maturities and pay-downs of securities available for sale	18,984	21,607
Purchase of investment securities available for sale	(16,605)	(21,689)
Net increase in restricted stock	(336)	(417)
Net increase in loans	(79,275)	(47,110)
Capital expenditures	(515)	(765)
Proceeds from surrender of life insurance policy	436	-
Proceeds from sale of other real estate	625	129
Net cash used in investing activities	(74,761)	(46,864)
Cash flows from financing activities		
Net increase in demand deposits, interest-bearing checking, and savings accounts	68,454	45,360
Net decrease in time deposits	(8,414)	(9,094)
Net decrease in repurchase agreements	-	(9,079)
Net increase in short-term borrowings	8,530	3,500
Dividends paid	(2,618)	(2,330)
Common stock issued under stock option plans	71	92

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Common stock issued under dividend reinvestment plan	1,124	869
Purchase of treasury stock	(700)	-
Net cash provided by financing activities	66,447	29,318
Increase (decrease) in cash and cash equivalents	1,428	(7,690)
Cash and cash equivalents as of January 1	39,166	48,593
Cash and cash equivalents as of September 30	\$ 40,594	\$ 40,903
Supplemental Disclosures of Cash Flow Information		
Cash paid during the year for:		
Interest on deposits and other borrowed funds	\$ 1,643	\$ 1,826
Income taxes	\$ 2,100	\$ 2,514
Noncash Activities		
Loans transferred to Other Real Estate	\$ 123	\$ 3,488

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

FRANKLIN FINANCIAL SERVICES CORPORATION and SUBSIDIARIES

UNAUDITED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Basis of Presentation

The consolidated financial statements include the accounts of Franklin Financial Services Corporation (the Corporation), and its wholly-owned subsidiaries, Farmers and Merchants Trust Company of Chambersburg (the Bank) and Franklin Future Fund Inc. Farmers and Merchants Trust Company of Chambersburg is a commercial bank that has one wholly-owned subsidiary, Franklin Financial Properties Corp. Franklin Financial Properties Corp. holds real estate assets that are leased by the Bank. Franklin Future Fund Inc. is a non-bank investment company. The activities of non-bank entities are not significant to the consolidated totals. All significant intercompany transactions and account balances have been eliminated.

In the opinion of management, all adjustments (which include only normal recurring adjustments) necessary to present fairly the consolidated financial position, results of operations, and cash flows as of September 30, 2016, and for all other periods presented have been made.

Certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") have been condensed or omitted. It is suggested that these consolidated financial statements be read in conjunction with the audited consolidated financial statements and notes thereto included in the Corporation's 2015 Annual Report on Form 10-K. The consolidated results of operations for the three and nine month periods ended September 30, 2016 are not necessarily indicative of the operating results for the full year. Management has evaluated subsequent events for potential recognition and/or disclosure through the date these consolidated financial statements were issued.

The consolidated balance sheet at December 31, 2015 has been derived from the audited consolidated financial statements at that date, but does not include all of the information and footnotes required by GAAP for complete consolidated financial statements.

For purposes of reporting cash flows, cash and cash equivalents include cash and due from banks, interest-bearing deposits in other banks and federal funds sold. Generally, federal funds are purchased and sold for one-day periods.

Earnings per share are computed based on the weighted average number of shares outstanding during each period end. A reconciliation of the weighted average shares outstanding used to calculate basic earnings per share and diluted earnings per share follows:

(Dollars and shares in thousands, except per share data)	For the Three Months Ended September 30		For the Nine Months Ended September 30	
	2016	2015	2016	2015
Weighted average shares outstanding (basic)	4,307	4,252	4,295	4,236
Impact of common stock equivalents	7	5	3	7
Weighted average shares outstanding (diluted)	4,314	4,257	4,298	4,243
Anti-dilutive options excluded from calculation	9	26	37	27
Net income	\$ 2,075	\$ 2,579	\$ 6,363	\$ 7,937
Basic earnings per share	\$ 0.48	\$ 0.61	\$ 1.48	\$ 1.87
Diluted earnings per share				