

PEOPLES FINANCIAL SERVICES CORP.

Form 10-Q

November 06, 2015

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 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

001-36388

(Commission File Number)

PEOPLES FINANCIAL SERVICES CORP.

(Exact name of registrant as specified in its charter)

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(State of incorporation)	(IRS Employer ID Number)
150 North Washington Avenue, Scranton, PA (Address of principal executive offices)	18503 (Zip code)

(570) 346-7741

(Registrant's telephone number, including area code)

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of the registrant's common stock, as of the latest practicable date: 7,426,282 at October 30, 2015.

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PEOPLES FINANCIAL SERVICES CORP.

FORM 10-Q

For the Quarter Ended September 30, 2015

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CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(Dollars in thousands, except share data)

	September 30, 2015	December 31, 2014
Assets:		
Cash and due from banks	\$ 36,015	\$ 24,656
Interest-bearing deposits in other banks	4,970	6,770
Federal funds sold		
Investment securities:		
Available-for-sale	299,832	339,586
Held-to-maturity: Fair value September 30, 2015, \$13,582; December 31, 2014, \$15,215	13,107	14,665
Total investment securities	312,939	354,251
Loans held for sale	3,439	3,486
Loans, net	1,270,545	1,209,894
Less: allowance for loan losses	12,043	10,338
Net loans	1,258,502	1,199,556
Premises and equipment, net	27,002	25,433
Accrued interest receivable	5,327	5,580
Goodwill	63,370	63,370
Intangible assets	4,606	5,501
Other assets	56,600	53,066
Total assets	\$ 1,772,770	\$ 1,741,669
Liabilities:		
Deposits:		
Noninterest-bearing	\$ 303,741	\$ 313,498
Interest-bearing	1,140,909	1,112,060
Total deposits	1,444,650	1,425,558
Short-term borrowings	30,250	19,557
Long-term debt	31,000	33,140
Accrued interest payable	496	574
Other liabilities	14,286	16,061
Total liabilities	1,520,682	1,494,890
Stockholders' equity:		
Common stock, par value \$2.00, authorized 25,000,000 shares, issued and outstanding: September 30, 2015, 7,519,109 shares; December 31, 2014, 7,548,358 shares	15,038	15,097
Capital surplus	139,263	140,214
Retained earnings	99,165	92,297
Accumulated other comprehensive loss	(1,378)	(829)
Total stockholders' equity	252,088	246,779

Total liabilities and stockholders' equity	\$ 1,772,770	\$ 1,741,669
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See notes to consolidated financial statements

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Peoples Financial Services Corp.

CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME (UNAUDITED)

(Dollars in thousands, except per share data)

September 30,	Three Months Ended		Nine Months Ended	
	2015	2014	2015	2014
Interest income:				
Interest and fees on loans:				
Taxable	\$ 13,341	\$ 13,876	\$ 40,072	\$ 41,035
Tax-exempt	585	465	1,714	1,607
Interest and dividends on investment securities:				
Taxable	792	1,007	2,508	2,877
Tax-exempt	858	816	2,498	2,462
Dividends	9	2	24	32
Interest on interest-bearing deposits in other banks	13	10	39	29
Interest on federal funds sold		16	9	64
Total interest income	15,598	16,192	46,864	48,106
Interest expense:				
Interest on deposits	1,229	1,354	3,689	4,125
Interest on short-term borrowings	11	9	23	67
Interest on long-term debt	245	279	756	864
Total interest expense	1,485	1,642	4,468	5,056
Net interest income	14,113	14,550	42,396	43,050
Provision for loan losses	900	666	2,400	2,724
Net interest income after provision for loan losses	13,213	13,884	39,996	40,326
Noninterest income:				
Service charges, fees and commissions	1,531	1,634	4,685	4,815
Merchant services income	1,183	1,002	2,936	2,784
Commission and fees on fiduciary activities	541	575	1,487	1,690
Wealth management income	224	217	627	569
Mortgage banking income	197	142	667	434
Life insurance investment income	192	109	569	565
Net gain on sale of investment securities available-for-sale	147	701	979	861
Total noninterest income	4,015	4,380	11,950	11,718
Noninterest expense:				
Salaries and employee benefits expense	5,397	4,754	16,243	14,883
Net occupancy and equipment expense	2,246	2,020	6,863	6,080
Merchant services expense	823	662	2,006	1,722
Amortization of intangible assets	296	334	896	1,010
Acquisition related expense		109		1,725

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Other expenses	2,944	3,205	8,303	9,190
Total noninterest expense	11,706	11,084	34,311	34,610
Income before income taxes	5,522	7,180	17,635	17,434
Income tax expense	1,113	1,944	3,751	4,169
Net income	4,409	5,236	13,884	13,265
Other comprehensive income (loss):				
Unrealized gain (loss) on investment securities available-for-sale	826	(825)	134	2,811
Reclassification adjustment for net gain on sales included in net income	(147)	(701)	(979)	(861)
Other comprehensive income (loss)	679	(1,526)	(845)	1,950
Income tax expense (benefit) related to other comprehensive loss	237	(534)	(296)	682
Other comprehensive income (loss), net of income taxes	442	(992)	(549)	1,268
Comprehensive income	\$ 4,851	\$ 4,244	\$ 13,335	\$ 14,533
Per share data:				
Net income:				
Basic	\$ 0.58	\$ 0.70	\$ 1.84	\$ 1.76
Diluted	\$ 0.58	\$ 0.70	\$ 1.84	\$ 1.76
Average common shares outstanding:				
Basic	7,536,824	7,548,358	7,543,751	7,548,983
Diluted	7,536,824	7,548,358	7,543,751	7,566,456
Dividends declared	\$ 0.31	\$ 0.31	\$ 0.93	\$ 0.93

See notes to consolidated financial statements

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Peoples Financial Services Corp.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (UNAUDITED)

(Dollars in thousands, except per share data)

	Common Stock	Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Income/(Loss)	Treasury Stock	Total
Balance, January 1, 2015	\$ 15,097	\$ 140,214	\$ 92,297	\$ (829)	\$	\$ 246,779
Stock based compensation		52				52
Net income			13,884			13,884
Other comprehensive loss, net of income taxes				(549)		(549)
Dividends declared: \$0.93 per share			(7,016)			(7,016)
Shares retired: 29,249 shares	(59)	(1,003)				(1,062)
Balance, September 30, 2015	15,038	139,263	99,165	(1,378)		252,088
Balance, January 1, 2014	15,614	146,109	84,008	(698)	(6,241)	238,792
Net income			13,265			13,265
Other comprehensive income, net of income taxes				1,268		1,268
Dividends declared: \$0.93 per share			(7,021)			(7,021)
Shares retired: 3,386 shares	(7)	(102)				(109)
Reissuance under option plan: 600 shares		28			11	39
Repurchase and held: 1,800 shares					(70)	(70)
Retirement of stock options		(95)				(95)
Retirement of treasury stock	(510)	(5,790)			6,300	
Balance, September 30, 2014	\$ 15,097	\$ 140,150	\$ 90,252	\$ 570	\$	\$ 246,069

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Peoples Financial Services Corp.

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(Dollars in thousands, except per share data)

For the Nine Months Ended September 30,	2015	2014
Cash flows from operating activities:		
Net income	\$ 13,884	\$ 13,265
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation of premises and equipment	1,178	1,322
Amortization of deferred loan costs	440	171
Amortization of intangibles	896	1,010
Net accretion of purchase accounting adjustments on tangible assets	(708)	(2,683)
Provision for loan losses	2,400	2,724
Net gain on sale of other real estate owned	(132)	(60)
Net loss on disposal of equipment	87	63
Loans originated for sale	(20,664)	(7,346)
Proceeds from sale of loans originated for sale	21,378	6,752
Net gain on sale of loans originated for sale	(667)	(610)
Net amortization of investment securities	3,171	3,230
Net gain on sale of investment securities	(979)	(861)
Life insurance investment income	(569)	(592)
Deferred income tax expense	119	
Stock based compensation	52	11
Net change in:		
Accrued interest receivable	253	485
Other assets	(3,062)	(3,455)
Accrued interest payable	(78)	(126)
Other liabilities	(1,827)	1,546
Net cash provided by operating activities	15,172	14,846
Cash flows from investing activities:		
Proceeds from sales of investment securities available-for-sale	65,858	15,389
Proceeds from repayments of investment securities:		
Available-for-sale	41,659	32,022
Held-to-maturity	1,526	1,989
Purchases of investment securities:		
Available-for-sale	(70,768)	(98,898)
Held-to-maturity		
Net redemption of restricted equity securities	343	56
Net increase in lending activities	(61,940)	(3,341)
Purchases of premises and equipment	(2,924)	(1,059)
Proceeds from the sale of premises and equipment	14	25
Proceeds from sale of other real estate owned	484	409
Net cash used in investing activities	(25,748)	(53,408)
Cash flows from financing activities:		

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Net increase in deposits	19,619	46,939
Repayment of long-term debt	(2,099)	(2,682)
Net increase (decrease) in short-term borrowings	10,693	(15,538)
Redemption of common stock	(1,062)	(70)
Settlement of stock options		(95)
Purchase of treasury stock		(70)
Cash dividends paid	(7,016)	(7,021)
Net cash provided by financing activities	20,135	21,463
Net increase (decrease) in cash and cash equivalents	9,559	(17,099)
Cash and cash equivalents at beginning of year	31,426	51,310
Cash and cash equivalents at end of year	\$ 40,985	\$ 34,211

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Peoples Financial Services Corp.

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(Dollars in thousands, except per share data)

For the Nine Months Ended September 30,	2015	2014
Supplemental disclosures:		
Cash paid during the period for:		
Interest	\$ 5,114	\$ 5,182
Income taxes	2,900	3,100
Noncash items:		
Transfers of loans to other real estate	\$ 370	\$ 541
Retirement of treasury shares		6,300
Acquisition:		
Fair value of assets acquired:		
Loans, net	\$ 216	\$ 1,900
Premises and equipment	(76)	(76)
Core deposit and other intangible assets	(896)	(1,010)
	\$ (756)	\$ 814
Fair value of liabilities assumed:		
Deposits	\$ 527	\$ 818
Long-term debt	41	41
	\$ 568	\$ 859

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Peoples Financial Services Corp.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

1. Summary of significant accounting policies:

Nature of operations:

Peoples Financial Services Corp., a bank holding company incorporated under the laws of Pennsylvania, provides a full range of financial services through its wholly-owned subsidiary, Peoples Security Bank and Trust Company (“Peoples Bank”), including its subsidiaries, Peoples Advisors, LLC and Pensco Realty, Inc. (collectively, the “Company” or “Peoples”). The Company services its retail and commercial customers through twenty-six full-service community banking offices located within the Lackawanna, Lehigh, Luzerne, Monroe, Susquehanna, Wayne and Wyoming Counties of Pennsylvania and Broome County of New York.

Basis of presentation:

The accompanying unaudited consolidated financial statements of the Company 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 Form 10-Q and Article 10-01 of Regulation S-X. In the opinion of management, all normal recurring adjustments necessary for a fair presentation of the financial position and results of operations for the periods presented have been included. All significant intercompany balances and transactions have been eliminated in consolidation. Prior-period amounts are reclassified when necessary to conform to the current year’s presentation. These reclassifications did not have any effect on the operating results or financial position of the Company. The operating results and financial position of the Company for the three and nine months ended and as of September 30, 2015, are not necessarily indicative of the results of operations and financial position that may be expected in the future.

The preparation of consolidated 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 consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates that are particularly susceptible to material change in the near term relate to the determination of the allowance for loan losses, fair value of financial instruments, the valuation of real estate acquired in connection with foreclosures or in satisfaction of loans, the valuation of deferred tax assets, determination of other-than-temporary impairment losses on securities, impairment of goodwill and fair value of

assets acquired and liabilities assumed in business combinations. Actual results could differ from those estimates. For additional information and disclosures required under GAAP, reference is made to the Company's Annual Report on Form 10-K for the period ended December 31, 2014.

The Company has evaluated events and transactions occurring subsequent to the balance sheet date of September 30, 2015, for items that should potentially be recognized or disclosed in these consolidated financial statements. The evaluation was conducted through the date these consolidated financial statements were issued.

Recent accounting standards:

In April 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2015-03, "Interest—Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs."

ASU 2015-03 requires that debt issuance costs be reported in the balance sheet as a direct deduction from the face amount of the related liability, consistent with the presentation of debt discounts. Prior to the amendments, debt issuance costs were presented as a deferred charge (i.e., an asset) on the balance sheet. The ASU provides examples illustrating the balance sheet presentation of notes net of their related discounts and debt issuance costs. Further, the amendments require the amortization of debt issuance costs to be reported as interest expense. Similarly, debt issuance costs and any discount or premium are considered in the aggregate when determining the effective interest rate on the debt.

The amendments are effective for public business entities for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. The amendments must be applied retrospectively. The adoption of ASU 2015-03 on January 1, 2016, is not expected to have a material effect on the operating results or financial position of the Company.

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In July 2015, the FASB issued ASU 2015-12, “Plan Accounting: Defined Benefit Pension Plans (Topic 960), Defined Contribution Pension Plans (Topic 962), Health and Welfare Benefit Plans (Topic 965): (Part I) Fully Benefit-Responsive Investment Contracts, (Part II) Plan Investment Disclosures, (Part III) Measurement Date Practical Expedient.”

The amendments in ASU 2015-12 (i) require fully benefit-responsive investment contracts to be measured, presented and disclosed only at contract value, not fair value; (ii) simplify the investment disclosure requirements; and (iii) provide a measurement date practical expedient for employee benefit plans.

Part I. Fully Benefit-Responsive Investment Contracts – the amendments designate contract value as the only required measurement for fully benefit-responsive investments contracts within the scope of Topics 962 and 965, eliminating the requirement to measure, present and disclose such contracts also at fair value and reconcile fair value to contract value.

Part II. Plan Investment Disclosures – the amendments eliminate certain disclosure requirements for both participant-directed investments and nonparticipant-directed investments, and also reduce disclosures required specifically for investments using the net asset value per share practical expedient. The amendments also require that both participant-directed and nonparticipant-directed investments be grouped only by general type, eliminating the need to disaggregate the investments in multiple ways (i.e., also on the basis of nature, characteristics, and risks as required by Topic 820, Fair Value Measurement).

Part III. Measurement Date Practical Expedient – the amendments provide a measurement date practical expedient for employee benefit plans similar to the practical expedient allowing employers to measure defined benefit plan assets on a month-end date that is nearest to the employer’s fiscal year-end, when the fiscal period does not coincide with a month-end.

The amendments are effective for fiscal years beginning after December 15, 2015. Early adoption is permitted for all three parts individually or in the aggregate. Parts I and II of the ASU should be applied retrospectively, while Part III should be applied prospectively. Only the nature and reason for the change in accounting principle is required to be disclosed in the annual period of adoption. The adoption of ASU 2015-12 on January 1, 2016, is not expected to have a material effect on the operating results or financial position of the Company.

In August 2015, the FASB issued ASU 2015-14, “Revenue from Contracts (Topic 606): Deferral of the Effective Date.”

ASU 2015-14 defers the effective date of the new revenue recognition standard by one year. As such, it now takes effect for public entities in fiscal years beginning after December 15, 2017. Early adoption is permitted for any entity that chooses to adopt the new standard as of the original effective date. The adoption of ASU 2015-14 on January 1, 2018, is not expected to have a material effect on the operating results or financial position of the Company.

In August 2015, the FASB issued ASU 2015-15, “Interest – Imputation of Interest (Subtopic 835-30): Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements.”

ASU 2015-15 codifies a Securities and Exchange Commission (“SEC”) staff announcement that entities are permitted to defer and present debt issuance costs related to line-of-credit arrangements as assets. ASU 2015-15 clarifies that the SEC staff would not object to an entity deferring and presenting debt issuance costs as an asset and subsequently amortizing the deferred debt issuance costs ratably over the term of the line-of-credit arrangement, regardless of whether there are any outstanding borrowings on the line-of-credit arrangement. ASU 2015-15 is effective immediately. The adoption of ASU 2015-15 did not have a material effect on the operating results or financial position of the Company.

In September, 2015, the FASB issued ASU 2015-16, “Business Combination (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments.”

ASU 2015-16 requires adjustments to provisional amounts that are identified during the measurement period to be recognized in the reporting period in which the adjustment amounts are determined. This includes any effect on earnings

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Peoples Financial Services Corp.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

of changes in depreciation, amortization, or other income effects as a result of the change to the provisional amounts, calculated as if the accounting had been completed at the acquisition date.

In addition, the amendments in the proposed Update would require an entity to disclose, either on the face of the income statement or in the notes, the nature and amount of measurement-period adjustments recognized in the current period, including separately the amounts in current-period income statement line items that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date.

The amendments are effective for public business entities for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted. The amendments in this Update should be applied prospectively to measurement-period adjustments that occur after the effective date of this ASU. The adoption of ASU 2015-16 on January 1, 2016, is not expected to have a material effect on the operating results or financial position of the Company.

2. Other comprehensive income (loss):

The components of other comprehensive loss and their related tax effects are reported in the Consolidated Statements of Income and Comprehensive Income. The accumulated other comprehensive income (loss) included in the Consolidated Balance Sheets relates to net unrealized gains and losses on investment securities available-for-sale and benefit plan adjustments.

The components of accumulated other comprehensive loss included in stockholders' equity at September 30, 2015 and December 31, 2014 is as follows:

September 30, 2015

December 31, 2014

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Net unrealized gain on investment securities available-for-sale	\$ 5,447	\$ 6,292
Income tax expense (benefit)	1,906	2,202
Net of income taxes	3,541	4,090
Benefit plan adjustments	(7,567)	(7,567)
Income tax expense (benefit)	(2,648)	(2,648)
Net of income taxes	(4,919)	(4,919)
Accumulated other comprehensive loss	\$ (1,378)	\$ (829)

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Peoples Financial Services Corp.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

Other comprehensive income (loss) and related tax effects for the three and nine months ended September 30, 2015 and 2014 is as follows:

Three Months Ended September 30,	2015	2014
Unrealized gain (loss) on investment securities available-for-sale	\$ 826	\$ (825)
Net gain on the sale of investment securities available-for-sale(1)	(147)	(701)
Other comprehensive income (loss) gain before taxes	679	(1,526)
Income tax expense (benefit)	237	(534)
Other comprehensive income (loss)	\$ 442	\$ (992)
Nine Months Ended September 30,	2015	2014
Unrealized gain (loss) on investment securities available-for-sale	\$ 134	\$ 2,811
Net gain on the sale of investment securities available-for-sale(1)	(979)	