

FIDELITY D & D BANCORP INC
Form 10-Q
August 10, 2012

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 June 30, 2012

OR

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

For the transition period from _____ to _____

Commission file number: 333-90273

FIDELITY D & D BANCORP, INC.

STATE OF INCORPORATION: IRS EMPLOYER IDENTIFICATION NO:
PENNSYLVANIA 23-3017653

Address of principal executive offices:

BLAKELY & DRINKER ST.

DUNMORE, PENNSYLVANIA 18512

TELEPHONE:

570-342-8281

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subjected to such filing requirements for the past 90 days. 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):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(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 July 31, 2012, the latest practicable date, was 2,290,515 shares.

FIDELITY D & D BANCORP, INC.

Form 10-Q June 30, 2012

Index

	Page
<u>Part I. Financial Information</u>	
Item 1. Financial Statements (unaudited):	
Consolidated Balance Sheets as of June 30, 2012 and December 31, 2011	3
Consolidated Statements of Income for the three- and six-months ended June 30, 2012 and 2011	4
Consolidated Statements of Comprehensive Income for the three- and six- months ended June 30, 2012 and 2011	5
Consolidated Statements of Changes in Shareholders' Equity for the six months ended June 30, 2012 and 2011	6
Consolidated Statements of Cash Flows for the six months ended June 30, 2012 and 2011	7
Notes to Consolidated Financial Statements (Unaudited)	8
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	28
Item 3. Quantitative and Qualitative Disclosure about Market Risk	43
Item 4. Controls and Procedures	48
Part II. Other Information	
Item 1. Legal Proceedings	49
Item 1A. Risk Factors	49
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	49
Item 3. Defaults upon Senior Securities	49
Item 4. Mine Safety Disclosures	49
Item 5. Other Information	49
Item 6. Exhibits	49

Signatures	51
Exhibit index	52

PART I – Financial Information**Item 1: Financial Statements**Fidelity D & D Bancorp, Inc. and Subsidiary
Consolidated Balance Sheets
(Unaudited)

(dollars in thousands)	June 30, 2012	December 31, 2011
Assets:		
Cash and due from banks	\$ 12,063	\$ 15,158
Interest-bearing deposits with financial institutions	10,728	37,007
 Total cash and cash equivalents	 22,791	 52,165
Available-for-sale securities	110,471	108,154
Held-to-maturity securities	338	389
Federal Home Loan Bank stock	3,339	3,699
Loans, net (allowance for loan losses of \$8,151 in 2012; \$8,108 in 2011)	417,967	398,186
Loans held-for-sale (fair value \$4,661 in 2011)	-	4,537
Foreclosed assets held-for-sale	2,086	1,169
Bank premises and equipment, net	13,686	13,575
Cash surrender value of bank owned life insurance	9,901	9,740
Accrued interest receivable	2,143	2,082
Other assets	13,014	13,046
 Total assets	 \$ 595,736	 \$ 606,742
Liabilities:		
Deposits:		
Interest-bearing	\$ 401,787	\$ 419,647
Non-interest-bearing	110,283	96,155
 Total deposits	 512,070	 515,802
Accrued interest payable and other liabilities	2,997	6,809
Short-term borrowings	8,106	9,507
Long-term debt	16,000	21,000
 Total liabilities	 539,173	 553,118
Shareholders' equity:		
Preferred stock authorized 5,000,000 shares with no par value; none issued	-	-
Capital stock, no par value (10,000,000 shares authorized; shares issued and outstanding; 2,290,515 in 2012; and 2,254,542 in 2011)	23,080	22,354

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Retained earnings	33,821	32,380
Accumulated other comprehensive loss	(338)	(1,110)
Total shareholders' equity	56,563	53,624
Total liabilities and shareholders' equity	\$595,736	\$ 606,742

See notes to unaudited consolidated financial statements

- 3 -

Fidelity D & D Bancorp, Inc. and Subsidiary

Consolidated Statements of Income

(Unaudited)

(dollars in thousands except per share data)

	Three months ended		Six months ended	
	June 30, 2012	June 30, 2011	June 30, 2012	June 30, 2011
Interest income:				
Loans:				
Taxable	\$5,292	\$5,760	\$10,572	\$11,568
Nontaxable	116	133	252	260
Interest-bearing deposits with financial institutions	15	22	43	39
Investment securities:				
U.S. government agency and corporations	240	366	521	665
States and political subdivisions (nontaxable)	310	300	619	588
Other securities	18	16	36	28
Total interest income	5,991	6,597	12,043	13,148
Interest expense:				
Deposits	617	1,015	1,301	2,057
Securities sold under repurchase agreements	8	7	23	26
Long-term debt	213	258	452	514
Total interest expense	838	1,280	1,776	2,597
Net interest income	5,153	5,317	10,267	10,551
Provision for loan losses	600	375	1,300	850
Net interest income after provision for loan losses	4,553	4,942	8,967	9,701
Other income:				
Service charges on deposit accounts	424	443	843	860
Interchange fees	268	250	522	467
Fees from trust fiduciary activities	149	107	307	201
Fees from financial services	118	152	286	299
Service charges on loans	357	213	651	333
Fees and other revenue	101	109	175	189
Earnings on bank-owned life insurance	81	78	161	155
Gain (loss) on sale, recovery, or disposal of:				
Loans	434	93	829	339
Investment securities	7	16	261	16
Premises and equipment	(1)	-	(1)	-
Foreclosed assets held-for-sale	-	3	(15)	18
Write-down of foreclosed assets held-for-sale	(35)	(66)	(60)	(66)

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Impairment losses on investment securities:				
Other-than-temporary impairment on investment securities	(31)	(91)	(241)	(306)
Non-credit-related losses on investment securities not expected to be sold (recognized in other comprehensive income/(loss))	-	91	105	231
Net impairment losses on investment securities recognized in earnings	(31)	-	(136)	(75)
Total other income	1,872	1,398	3,823	2,736
Other expenses:				
Salaries and employee benefits	2,294	2,194	4,651	4,419
Premises and equipment	806	918	1,704	1,894
Advertising and marketing	243	199	395	350
Professional services	365	359	671	613
FDIC assessment	127	199	249	429
Loan collection	180	125	301	140
Other real estate owned	73	30	90	55
Office supplies and postage	93	124	212	236
Other	497	472	1,118	974
Total other expenses	4,678	4,620	9,391	9,110
Income before income taxes	1,747	1,720	3,399	3,327
Provision for income taxes	430	431	825	811
Net income	\$1,317	\$1,289	\$2,574	\$2,516
Per share data:				
Net income - basic	\$0.57	\$0.59	\$1.13	\$1.15
Net income - diluted	\$0.57	\$0.59	\$1.13	\$1.15
Dividends	\$0.25	\$0.25	\$0.50	\$0.50

See notes to unaudited consolidated financial statements

Fidelity D & D Bancorp, Inc. and Subsidiary

Consolidated Statements of Comprehensive Income

(Unaudited)

(dollars in thousands)

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Net income	\$1,317	\$1,289	\$2,574	\$2,516
Other comprehensive income, before tax:				
Unrealized holding gains on available-for-sale securities	545	1,570	1,149	2,283
Reclassification adjustment for gains realized in income	(7)	(16)	(261)	(16)
Net unrealized gains	538	1,554	888	2,267
Tax effect	(183)	(528)	(302)	(771)
Unrealized gains, net of tax	355	1,026	586	1,496
Non-credit-related impairment gains (losses) on investment securities not expected to be sold	238	(58)	282	(53)
Tax effect	(81)	20	(96)	18
Net non-credit-related impairment gains (losses) on investment securities	157	(38)	186	(35)
Other comprehensive income, net of tax	512	988	772	1,461
Total comprehensive income, net of tax	\$1,829	\$2,277	\$3,346	\$3,977

See notes to unaudited consolidated financial statements

Fidelity D & D Bancorp, Inc. and Subsidiary

Consolidated Statements of Changes in Shareholders' Equity

For the six months ended June 30, 2012 and 2011

(Unaudited)

(dollars in thousands)	Capital stock		Retained	Accumulated other comprehensive	Total
	Shares	Amount	earnings	loss	
Balance, December 31, 2010	2,178,028	\$21,047	\$29,545	\$ (3,817)	\$46,775
Comprehensive income			2,516	1,461	3,977
Issuance of common stock through Employee Stock Purchase Plan	4,801	67			67
Issuance of common stock through Dividend Reinvestment Plan	34,623	600			600
Stock-based compensation expense		24			24
Cash dividends declared			(1,096)		(1,096)
Balance, June 30, 2011	2,217,452	\$21,738	\$30,965	\$ (2,356)	\$50,347
Balance, December 31, 2011	2,254,542	\$22,354	\$32,380	\$ (1,110)	\$53,624
Comprehensive income			2,574	772	3,346
Issuance of common stock through Employee Stock Purchase Plan	3,874	67			67
Issuance of common stock through Dividend Reinvestment Plan	32,099	644			644
Stock-based compensation expense		15			15
Cash dividends declared			(1,133)		(1,133)
Balance, June 30, 2012	2,290,515	\$23,080	\$33,821	\$ (338)	\$56,563

See notes to unaudited consolidated financial statements

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

(Unaudited)	Six months ended	
(dollars in thousands)	June 30,	
	2012	2011
Cash flows from operating activities:		
Net income	\$2,574	\$2,516
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization and accretion	1,750	1,587
Provision for loan losses	1,300	850
Deferred income tax (benefit) expense	(225)	40
Stock-based compensation expense	15	24
Proceeds from sale of loans held-for-sale	39,972	13,625
Originations of loans held-for-sale	(32,995)	(10,483)
Write-down of foreclosed assets held-for-sale	60	66
Earnings on bank-owned life insurance	(161)	(155)
Net gain from sales of loans	(829)	(339)
Net gain from sales and recoveries of investment securities	(261)	(16)
Net loss (gain) from sales of foreclosed assets held-for-sale	15	(18)
Loss on disposal of equipment	1	-
Other-than-temporary impairment on securities	136	75
Change in:		
Accrued interest receivable	(61)	(79)
Other assets	51	500
Accrued interest payable and other liabilities	(3,812)	(409)
Net cash provided by operating activities	7,530	7,784
Cash flows from investing activities:		
Held-to-maturity securities:		
Proceeds from maturities, calls and principal pay-downs	52	48
Available-for-sale securities:		
Proceeds from sales	3,581	823
Proceeds from maturities, calls and principal pay-downs	15,505	12,745
Purchases	(20,885)	(27,403)
Decrease in FHLB stock	361	443
Net (increase) decrease in loans	(24,191)	5,572
Acquisition of bank premises and equipment	(936)	(178)
Proceeds from sale of foreclosed assets held-for-sale	164	366
Net cash used by investing activities	(26,349)	(7,584)
Cash flows from financing activities:		
Net (decrease) increase in deposits	(3,733)	24,480
Net decrease in short-term borrowings	(1,401)	(542)
Repayments of long-term debt	(5,000)	-

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Proceeds from employee stock purchase plan participants	67	67
Dividends paid, net of dividends reinvested	(748)	(734)
Proceeds from dividend reinvestment plan participants	260	239
Net cash (used) provided by financing activities	(10,555)	23,510
Net (decrease) increase in cash and cash equivalents	(29,374)	23,710
Cash and cash equivalents, beginning	52,165	22,967
Cash and cash equivalents, ending	\$22,791	\$46,677

See notes to unaudited consolidated financial statements

- 7 -

FIDELITY D & D BANCORP, INC.

Notes to Consolidated Financial Statements

(Unaudited)

1. Nature of operations and critical accounting policies

Nature of operations

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

Principles of consolidation

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

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

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

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

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

Critical accounting policies

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

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

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

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

The fair value of residential mortgage loans, classified as held-for-sale (HFS), is obtained from the Federal National Mortgage Association (FNMA) or the Federal Home Loan Bank (FHLB). Generally, the market to which the Company sells mortgages it originates for sale is restricted and price quotes from other sources are not typically obtained. On occasion, the Company may transfer loans from the loan portfolio to loans HFS. Under these rare circumstances, pricing may be obtained from other entities and the loans are transferred at the lower of cost or market value and simultaneously sold. As of December 31, 2011, loans classified as HFS consisted of residential mortgages. There were no loans classified as HFS as of June 30, 2012.

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 six months ended June 30, 2012 and 2011, the Company paid interest of \$1.8 million and \$2.7 million, respectively. The Company was required to pay income taxes of \$1.2 million and \$1.0 million during the six months of 2012 and 2011, respectively. Transfers from loans to foreclosed assets held-for-sale amounted to \$1.2 million during the six months ended June 30, 2012. There were no transfers from loans to foreclosed assets held-for-sale during the six months ended June 30, 2011. During the same respective periods, transfers from loans to loans HFS amounted to \$2.0 million and \$3.3 million. Expenditures for construction in process, a component of other assets in the consolidated balance sheets, are included in acquisition of bank premises and equipment.

2. New Accounting Pronouncements

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

In June, 2011, the FASB issued an accounting update related to, Presentation of Comprehensive Income. The provisions of this update amend the accounting topic to facilitate the continued alignment of U.S. GAAP with International Accounting Standards. The update prohibits the presentation of the components of comprehensive income in the statement of stockholder's equity. Reporting entities are allowed to present either: a statement of comprehensive income, which reports both net income and other comprehensive income; or separate, but consecutive, statements of net income and other comprehensive income. Under previous GAAP, all three presentations were acceptable. Regardless of the presentation selected, the reporting entity is required to present all reclassifications between other comprehensive and net income on the face of the new statement or statements. For public entities, the provisions of this update are effective for fiscal years and interim periods beginning after December 31, 2011. The adoption of this accounting update did not have an impact on the Company's consolidated financial statements.

3. Investment securities

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

(dollars in thousands)	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
June 30, 2012				
Held-to-maturity securities:				
MBS - GSE residential	\$ 338	\$ 39	\$ -	\$ 377
Available-for-sale securities:				
Agency - GSE	\$ 24,741	\$ 93	\$ 9	\$ 24,825
Obligations of states and political subdivisions	28,415	2,410	-	30,825
Corporate bonds:				
Pooled trust preferred securities	6,407	128	4,934	1,601
MBS - GSE residential	51,125	1,660	10	52,775
Total debt securities	110,688	4,291	4,953	110,026
Equity securities - financial services	295	150	-	445
Total available-for-sale securities	\$ 110,983	\$ 4,441	\$ 4,953	\$ 110,471

(dollars in thousands)	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
December 31, 2011				
Held-to-maturity securities:				
MBS - GSE residential	\$ 389	\$ 42	\$ -	\$ 431
Available-for-sale securities:				
Agency - GSE	\$ 25,773	\$ 108	\$ 8	\$ 25,873
Obligations of states and political subdivisions	28,402	1,937	180	30,159
Corporate bonds:				
Pooled trust preferred securities	6,574	123	5,231	1,466

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MBS - GSE residential	48,792	1,482	57	50,217
Total debt securities	109,541	3,650	5,476	107,715
Equity securities - financial services	295	144	-	439
Total available-for-sale securities	\$ 109,836	\$ 3,794	\$ 5,476	\$ 108,154

- 10 -

The amortized cost and fair value of debt securities at June 30, 2012 by contractual maturity are summarized below:

(dollars in thousands)	Amortized cost	Fair value
Held-to-maturity securities:		
MBS - GSE residential	\$ 338	\$377
Available-for-sale securities:		
Debt securities:		
Due in one year or less	\$4,122	\$4,127
Due after one year through five years	20,135	20,215
Due after five years through ten years	3,548	3,740
Due after ten years	31,758	29,169
Total debt securities	59,563	57,251
MBS - GSE residential	51,125	52,775
Total available-for-sale debt securities	\$ 110,688	\$ 110,026

Expected maturities will differ from contractual maturities because issuers and borrowers may have the right to call or repay obligations with or without call or prepayment penalty. Federal agency and municipal securities are included based on their original stated maturity. Mortgage-backed securities, which are based on weighted-average lives and subject to monthly principal pay-downs, are listed in total.

The following tables present 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 June 30, 2012 and December 31, 2011:

(dollars in thousands)	Less than 12 months		More than 12 months		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses

June 30, 2012

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Agency - GSE	\$3,068	\$ 9	\$-	\$ -	\$3,068	\$ 9
Obligations of states and political subdivisions	-	-	-	-	-	-
Corporate bonds:						
Pooled trust preferred securities	-	-	1,473	4,934	1,473	4,934
MBS - GSE residential	3,777	10	-	-	3,777	10
Total temporarily impaired securities	\$6,845	\$ 19	\$1,473	\$ 4,934	\$8,318	\$ 4,953
Number of securities	5		8		13	

December 31, 2011

Agency - GSE	\$4,011	\$8	\$-	\$-	\$4,011	\$8
Obligations of states and political subdivisions	-	-	941	180	941	180
Corporate bonds:						
Pooled trust preferred securities	-	-	1,343	5,231	1,343	5,231
MBS - GSE residential	6,126	57	-	-	6,126	57
Total securities Total temporarily impaired securities	\$10,137	\$65	\$2,284	\$5,411	\$12,421	\$5,476
Number of securities	7		9		16	

Most of the securities in the investment portfolio 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. 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.

Management conducts a formal review of investment securities on a quarterly basis 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 at the balance sheet date. Under these 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 conditions, including illiquidity. Presentation of OTTI is made in the consolidated statements of income on a gross basis with an offset for the amount of non-credit-related OTTI recognized in OCI.

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 these 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 maturity and other factors when evaluating for the existence of OTTI. The guidance requires that 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 discussed below, as of June 30, 2012, 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 for the Company's portfolios of Agency – Government Sponsored Enterprise (GSE), Mortgage-backed securities (MBS) – GSE residential and Obligations of states and political subdivisions.

Agency - GSE and MBS - GSE residential

Agency – GSE and MBS – GSE residential securities consist of short- and medium-term notes issued by Federal Home Loan Mortgage Corporation (FHLMC), Federal National Mortgage Association (FNMA), Federal Home Loan Bank (FHLB), Federal Farm Credit Bank (FFCB) and Government National Mortgage Association (GNMA). These securities have interest rates that are largely fixed-rate issues, have varying short- to mid-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.

In the above security types, the change in fair value is attributable to changes in interest rates and those instruments with unrealized losses were not caused by deterioration of credit quality. Accordingly, as of June 30, 2012, recognition of OTTI on these securities was unnecessary.

Pooled trust preferred securities

A Pooled Trust Preferred Collateralized Debt Obligation (CDO) is a type of investment security collateralized by trust preferred securities (TPS) issued by banks, insurance companies and real estate investment trusts. The primary collateral type is a TPS issued by a bank. A TPS is a hybrid security that consists of both debt and equity characteristics which includes the ability of the issuer to voluntarily defer interest payments for up to 20 consecutive quarters. A TPS is considered a junior security in the capital structure of the issuer.

There are various investment classes or tranches issued by the CDO. The most senior tranche has the lowest yield but the most protection from credit losses. Conversely, the most junior tranche has the highest yield and the most risk of credit loss. Junior tranches are subordinate to senior tranches and losses are generally allocated from the lowest tranche with the equity component holding the most risk of credit loss and then subordinate tranches in reverse order up to the most senior tranche. The allocation of losses is defined in the indenture when the CDO was formed.

Unrealized losses in the pooled trust preferred securities (PreTSLs) are caused mainly by the following factors: (1) collateral deterioration due to bank failures and credit concerns across the banking sector; (2) widening of credit spreads and (3) illiquidity in the market. The Company's review of its portfolio of pooled trust preferred securities determined that in 2012, credit-related OTTI be recorded on two holdings, both of which are contained in the Company's AFS securities portfolio, from credit quality downgrades on the underlying collateral, including the collateral of four banks deferring interest payments within these two securities and one bank fully redeeming which removes all future earnings cash flow.

The following table summarizes the amount of OTTI recognized in earnings, by security during the periods indicated:

(dollars in thousands)	Three months ended		Six months ended,	
	June 30, 2012	2011	June 30, 2012	2011
Pooled trust preferred securities:				
PreTSL IX, B1, B3	\$-	\$ -	\$18	\$ -
PreTSL XVIII, C	31	-	118	-
PreTSL XXIV, B1	-	-	-	75
Total	\$31	\$ -	\$136	\$ 75

The following is a tabular roll-forward of the cumulative amount of credit-related OTTI recognized in earnings:

(dollars in thousands)	Six months ended	
	HTM	Total
Beginning balance of credit-related OTTI	\$- \$(15,280)	\$(15,280)
Additions for credit-related OTTI not previously recognized	- -	-
Additional credit-related OTTI previously recognized when there is no intent to sell before recovery of amortized cost basis	- (136)	(136)
Ending balance of credit-related OTTI	\$- \$(15,416)	\$(15,416)

To determine credit-related OTTI, the Company analyzes the collateral of each individual tranche within each of the 13 individual pools in the Company's portfolio of pooled trust preferred securities (PreTSLs). The Company engaged a third party structured finance firm to: review the underlying collateral of each PreTSL; research trustee reports to update relevant data and credit ratings of the underlying collateral; project default rates and cash flows of the collateral and simulate 10,000 Monte Carlo time-to-default scenarios, performed quarterly to arrive at the single best estimate of future cash flow for each tranche.

The sub-topics of the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 320 provide the scope, steps and accounting guidance for impairment: 1) determine whether an investment is impaired; 2) evaluate whether impairment is other-than-temporary; then 3) recognition of OTTI. The guidance in ASC 320 retains and emphasizes the objective of OTTI assessment and the related disclosure requirements by aligning the OTTI methodology for certain securitizations. ASC 325 provides a scope exception for investments that were considered of high credit quality (i.e. rated "AA" or higher) at the time of acquisition. The application of the guidance contained in

ASC 320 is used for two investments considered of high credit quality and ASC 325 is used for the remaining eleven securities. The quarterly evaluations indicated there was a significant adverse change in cash flows in two of the securities, thereby signifying the likelihood of the Company not being able to recover its principal. As a result, \$0.1 million of credit related OTTI was recorded during the six months ended June 30, 2012.

The guidance prescribed in ASC 320 is used for investments that, upon purchase, were rated of high credit quality, "AA" or higher, by a nationally recognized statistical rating organization. The Company has two PreTSLs (XXIV and XXVII) that were of high credit quality, "AA" rated, upon acquisition. The PreTSL XXVII evaluation proved a high probability that the Company will be able to collect all amounts due, both principal and interest, by maturity and thus, determined the impairment is temporary. PreTSL XXIV was evaluated under ASC 320 to determine if the Company expects to recover the remaining amortized cost basis and if OTTI is deemed to have occurred. An adverse change or short-fall in the expected cash flows compared to the amortized cost would be recorded as credit-related OTTI. To assess the likelihood of recoverability, the present value of the best estimate of future cash flows is compared to the amortized cost. In this situation, the discount rate used was the interest rate implicit in the security at the date of acquisition. The application of the guidance on this security did not result in an adverse change in cash flows when compared quarterly to the last measurement date of March 31, 2012 and therefore, no credit related OTTI was recorded in the first half of 2012.

The remaining eleven PreTSLs were rated "A" by a nationally recognized statistical rating organization at the date of acquisition and as such are considered beneficial interests of securitized financial assets. For these securities, the Company applies the guidance of ASC 325. Under this and other relevant guidance, if the fair value is below amortized cost and the present value of the best estimate of future cash flows declines significantly, evidencing a probable material adverse change in cash flows since the last measurement date, credit-related OTTI is deemed to exist and written down to the determined present value through a charge to current earnings. The discount rate used under ASC 325 is the yield to accrete beneficial interest, which is representative of the resulting interest from the total gross estimated future cash flows less the current amortized cost. In applying this guidance to the remaining securities, PreTSLs IX and XVIII measured an adverse change in cash flows when compared to the last estimate and credit related OTTI of \$18,000 and \$118,000, respectively, was recorded in the first half of 2012.

The following table is the composition of the Company's non-accrual PreTSL securities as of the period indicated:

(dollars in thousands)		June 30, 2012		December 31, 2011	
Deal	Class	Book value	Fair value	Book value	Fair value
Pre TSL V	Mezzanine	\$-	\$25	\$-	\$25
Pre TSL VII	Mezzanine	-	79	-	79
Pre TSL IX	B-1,B-3	1,547	489	1,605	529
Pre TSL XI	B-3	1,112	303	1,119	357
Pre TSL XV	B-1	-	24	-	20
Pre TSL XVIII	C	167	-	285	5
Pre TSL XIX	C	316	-	316	8
Pre TSL XXIV	B-1	407	15	407	15
		\$3,549	\$935	\$3,732	\$1,038

The securities included in the above table, have experienced impairment of principal, and interest was "paid-in-kind". When these two conditions exist, the security is placed on non-accrual status. Quarterly, each of the other PreTSL issues is evaluated for the presence of these two conditions and if necessary placed on non-accrual status.

The following table provides additional information with respect to the Company's pooled trust preferred securities as of June 30, 2012:

(dollars in thousands)						Current	Actual	Excess Effective			
						number	deferrals	subordination	subordination		
						of	and	as a	as a		
						banks	defaults	% of	% of		
						/	of	current	current		
						insurand	collateral	performing	performing		
Deal	Class	Book value	Fair value	Unrealized gain (loss)	Fitch ratings (1)	companies	and defaults	collateral	subordination	collateral	collateral
Pre TSL IV	Mezzanine	\$412	\$400	\$(12)	Caa2 / CCC	6/-	\$18,000	27.1	\$10,214	19.7	37.6
Pre TSL V	Mezzanine	-	25	25	C / D	3/-	28,950	100.0	None	N/A	N/A
Pre TSL VII	Mezzanine	-	79	79	Ca / C	17/-	135,000	64.0	None	N/A	N/A
Pre TSL IX	B-1,B-3	1,547	489	(1,058)	Ca / C	47/-	134,510	31.8	None	N/A	N/A

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Pre TSL XI	B-3	1,112	303	(809)	Ca / C	62/-	185,280	32.3	None	N/A	N/A
Pre TSL XV	B-1	-	24	24	C / C	63 / 8	195,200	33.8	None	N/A	N/A
Pre TSL XVI	C	-	-	-	C / C	49 / 7	273,478	47.7	None	N/A	N/A
Pre TSL XVII	C	-	-	-	C / C	50 / 6	179,270	37.9	None	N/A	N/A
Pre TSL XVIII	C	167	-	(167)	Ca / C	66 / 13	200,340	30.4	None	N/A	N/A
Pre TSL XIX	C	316	-	(316)	C / C	55 / 14	179,150	27.6	None	N/A	N/A
Pre TSL XXIV	B-1	407	15	(392)	Ca / CC	77 / 12	346,300	34.3	None	N/A	15.0
Pre TSL XXV	C-1	-	-	-	C / C	58 / 9	271,100	34.2	None	N/A	N/A
Pre TSL XXVII	B	2,446	266	(2,180)	Ca / CC	42 / 7	91,800	28.1	None	N/A	23.8
		\$6,407	\$1,601	\$(4,806)							

(1) All ratings have been updated through June 30, 2012.

(2) Excess subordination represents the excess (if any) of the amount of performing collateral over the given class of bonds.

Effective subordination represents the estimated percentage of the performing collateral that would need to defer or (3) default at the next payment in order to trigger a loss of principal or interest. This differs from excess subordination in that it considers the effect of excess interest earned on the performing collateral.

For a further discussion on the fair value determination of the Company's investment in PreTSLs and other financial instruments, see Note 7, "Fair value measurements".

4. Loans

The classifications of loans at June 30, 2012 and December 31, 2011 are summarized as follows:

(dollars in thousands)	June 30, 2012	December 31, 2011
Commercial and industrial	\$ 68,733	\$ 68,372
Commercial real estate:		
Non-owner occupied	80,611	79,475
Owner occupied	75,363	76,611
Construction	12,021	9,387
Consumer:		
Home equity installment	34,339	36,390
Home equity line of credit	32,670	32,486
Auto	16,609	13,539
Other	5,760	5,833
Residential:		
Real estate	95,646	80,091
Construction	4,366	4,110
Total	426,118	406,294
Less:		
Allowance for loan losses	(8,151)	(8,108)
Loans, net	\$ 417,967	\$ 398,186

Net deferred loan costs of \$0.9 million and \$0.8 million have been added to the carrying values of loans at June 30, 2012 and December 31, 2011, respectively.

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 \$198.5 million as of June 30, 2012 and \$193.5 million as of December 31, 2011.

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 and commercial real estate 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.

- 15 -

Non-accrual loans, segregated by class, at June 30, 2012 and December 31, 2011, were as follows:

(dollars in thousands)	June 30, 2012	December 31, 2011
Commercial and industrial	\$ 273	\$ 458
Commercial real estate:		
Non-owner occupied	2,357	2,406
Owner occupied	5,817	6,288
Construction	1,138	656
Consumer:		
Home equity installment	835	1,017
Home equity line of credit	435	730
Auto	-	-
Other	20	-
Residential:		
Real estate	2,541	2,329
Construction	70	78
Total	\$ 13,486	\$ 13,962

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 offers various types of concessions when modifying a loan, however, forgiveness of principal is rarely granted. Commercial and industrial 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. Commercial real estate and construction 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. 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 per the original terms with the maturity date adjusted accordingly. Home equity modifications and automobile loan modifications are typically not made and therefore standard terms do not exist for loans of this type.

Loans modified in a TDR may or may not be placed in non-accrual status. As of June 30, 2012, total TDRs amounted to \$6.4 million of which \$1.1 million were on non-accrual status. As of December 31, 2011, total TDRs amounted to

\$6.7 million of which \$1.4 million were on non-accrual status. Partial charge-offs may be taken against the outstanding loan balance, but, only in rare instances. As a result, loans modified in a TDR for the Company may have the financial effect of increasing the specific allowance for loan losses associated with the loan. The Company considers all TDRs to be impaired loans. 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. Management exercises significant judgment in developing these estimates.

There were no loans modified in a TDR during the three and six months ended June 30, 2012. The following presents by class, loans modified as TDRs during the twelve months ended June 30, 2012 that subsequently defaulted (i.e., 90 days or more past due following a modification) during the three- and six-months ended June 30, 2012:

Loans modified as a TDR within the previous twelve months that subsequently defaulted during the:

(dollars in thousands)	Three months ended June 30, 2012		Six months ended June 30, 2012	
	Number of contracts	Recorded investment	Number of contracts	Recorded investment
Commercial real estate - owner occupied	-	\$ -	1	\$ 1,118

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

The \$1.1 million commercial real estate loan TDR that subsequently defaulted had been modified to lower payments. The Company has been applying all payments during this time to principal. An updated appraisal was obtained on the collateral during the first quarter of 2012 which necessitated an increase in the reserve for loan losses on this loan. The borrower has recently resumed making payments under a new agreement.

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. The 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.

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):

June 30, 2012	Past due			Total past due	Current	Total loans receivables	Recorded investment past due ≥ 90 days and accruing
	30 - 59 Days past due	60 - 89 Days past due	90 days or more *				
Commercial and industrial	\$ 93	\$ 295	\$ 278	\$666	\$68,067	\$ 68,733	\$ 5
Commercial real estate:							
Non-owner occupied	832	-	2,357	3,189	77,422	80,611	-
Owner occupied	155	567	5,883	6,605	68,758	75,363	66
Construction	-	-	1,138	1,138	10,883	12,021	-
Consumer:							
Home equity installment	285	42	835	1,162	33,177	34,339	-
Home equity line of credit	33	-	435	468	32,202	32,670	-
Auto	413	167	20	600	16,009	16,609	20
Other	8	78	22	108	5,652	5,760	2
Residential:							
Real estate	794	-	2,655	3,449	92,197	95,646	114
Construction	-	-	70	70	4,296	4,366	-
Total	\$ 2,613	\$ 1,149	\$ 13,693	\$ 17,455	\$ 408,663	\$ 426,118	\$ 207

* Includes \$13.5 million of non-accrual loans.

December 31, 2011	30 - 59 Days past due	60 - 89 Days past due	Past due		Current	Total loans receivables	Recorded investment past due ≥ 90 days and accruing
			90 days or more *	Total past due			
Commercial and industrial	\$ 61	\$ 20	\$ 458	\$ 539	\$ 67,833	\$ 68,372	\$ -
Commercial real estate:							
Non-owner occupied	1,802	386	2,406	4,594	74,881	79,475	-
Owner occupied	134	71	6,288	6,493	70,118	76,611	-
Construction	-	-	656	656	8,731	9,387	-
Consumer:							
Home equity installment	450	161	1,017	1,628	34,762	36,390	-
Home equity line of credit	11	-	730	741	31,745	32,486	-
Auto	437	181	-	618	12,921	13,539	-
Other	19	11	-	30	5,803	5,833	-
Residential:							
Real estate	297	317	2,594	3,208	76,883	80,091	265
Construction	-	-	78	78	4,032	4,110	-
Total	\$ 3,211	\$ 1,147	\$ 14,227	\$ 18,585	\$ 387,709	\$ 406,294	\$ 265

* Includes \$14.0 million of non-accrual loans.

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 and other loans deemed to be impaired based on the aforementioned factors. At June 30, 2012, impaired loans consisted of TDRs totaling \$5.3 million in addition to the \$13.5 million of non-accrual loans. At December 31, 2011, impaired loans consisted of TDRs totaling \$5.3 million in addition to the \$14.0 million of non-accrual loans. Payments received on non-accrual loans are recognized on a cash basis. Payments 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.

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
<u>June 30, 2012</u>								
Commercial & industrial	\$ 322	\$ 95	\$ 220	\$ 315	\$ 34	\$ 431	\$ 2	\$ -
Commercial real estate:								
Non-owner occupied	5,428	1,037	4,230	5,267	314	4,318	94	-
Owner occupied	8,830	6,807	1,366	8,173	1,048	6,777	75	-
Construction	1,138	662	476	1,138	187	735	-	-
Consumer:								
Home equity installment	987	285	550	835	44	868	-	-
Home equity line of credit	479	162	273	435	41	473	-	-
Auto	-	-	-	-	-	-	-	-
Other	20	-	20	20	-	17	-	-
Residential:								
Real Estate	2,865	1,282	1,259	2,541	108	2,371	10	-
Construction	94	70	-	70	23	81	-	-
Total	\$ 20,163	\$ 10,400	\$ 8,394	\$ 18,794	\$ 1,799	\$ 16,071	\$ 181	\$ -

(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
<u>December 31, 2011</u>								
Commercial & industrial	\$ 549	\$ 322	\$ 179	\$ 501	\$ 63	\$ 355	\$ 2	\$ -
Commercial real estate:								
Non-owner occupied	5,434	3,144	2,176	5,320	301	3,026	53	-
Owner occupied	8,538	5,730	2,915	8,645	792	4,953	108	14
Construction	656	656	-	656	152	375	-	-
Consumer:								
Home equity installment	1,050	395	622	1,017	88	751	6	3
Home equity line of credit	730	229	501	730	55	488	2	1
Auto	-	-	-	-	-	3	-	-
Other	-	-	-	-	-	12	-	-
Residential:								
Real Estate	2,619	1,083	1,246	2,329	84	2,867	155	59
Construction	94	78	-	78	-	91	-	-
Total	\$ 19,670	\$ 11,637	\$ 7,639	\$ 19,276	\$ 1,535	\$ 12,921	\$ 326	\$ 77

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 commercial and industrial and commercial real estate 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 commercial and industrial and commercial real estate portfolios.

The following is a description of each risk rating category the Company uses to classify each of its commercial and industrial and commercial real estate loans:

Pass

Loans in this category have an acceptable level of risk and are graded in 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 good, and there is some depth existing. 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. Loans in this category should not remain on the list for an inordinate period of time (no more than one year) and then the loan should be passed or classified appropriately. 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. Loans 90+ days past due unless otherwise fully supported should be classified substandard. Also, borrowers that are bankrupt are 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.

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. 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, segregated by class, categorized into the appropriate credit quality indicator category as of the period indicated:

Commercial credit exposure

Credit risk profile by creditworthiness category

&