

First Federal of Northern Michigan Bancorp, Inc.
Form 10-Q
August 11, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

☒ QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2011

OR
☐ TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number 000-31957

FIRST FEDERAL OF NORTHERN MICHIGAN BANCORP, INC.
(Exact name of registrant as specified in its charter)

Maryland
(State or other jurisdiction of
incorporation or organization)

32-0135202
(I.R.S. Employer
Identification No.)

100 S. Second Avenue, Alpena, Michigan 49707
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (989) 356-9041

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. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer <input type="checkbox"/>	Accelerated filer <input type="checkbox"/>
Non-accelerated filer <input type="checkbox"/>	Smaller reporting company <input checked="" type="checkbox"/>

(Do not check if a smaller reporting company)

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

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Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date.

Common Stock, Par Value \$0.01
(Title of Class)

Outstanding at August 10, 2011
2,884,049 shares

FIRST FEDERAL OF NORTHERN MICHIGAN BANCORP, INC.
FORM 10-Q
Quarter Ended June 30, 2011

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When used in this Form 10-Q or future filings by First Federal of Northern Michigan Bancorp, Inc. (the "Company") with the Securities and Exchange Commission ("SEC"), in the Company's press releases or other public or stockholder communications, or in oral statements made with the approval of an authorized executive officer, the words or phrases "would be," "will allow," "intends to," "will likely result," "are expected to," "will continue," "is anticipated," "estimate," "project," or similar expressions are intended to identify "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995.

The Company wishes to caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made, and to advise readers that various factors, including regional and national economic conditions, changes in levels of market interest rates, credit and other risks of lending and investment activities and competitive and regulatory factors, could affect the Company's financial performance and could cause the Company's actual results for future periods to differ materially from those anticipated or projected.

The Company does not undertake, and specifically disclaims any obligation, to update any forward-looking statements to reflect occurrences or unanticipated events or circumstances after the date of such statements.

PART I - FINANCIAL INFORMATION

ITEM 1 - FINANCIAL STATEMENTS

First Federal of Northern Michigan Bancorp, Inc. and Subsidiaries
Consolidated Balance Sheet

	June 30, 2011 (Unaudited)	December 31, 2010
ASSETS		
Cash and cash equivalents:		
Cash on hand and due from banks	\$3,951,713	\$ 1,889,999
Overnight deposits with FHLB	34,756	72,658
Total cash and cash equivalents	3,986,469	1,962,657
Securities AFS	47,671,712	35,301,238
Securities HTM	2,485,000	2,520,000
Loans held for sale	550,613	-
Loans receivable, net of allowance for loan losses of \$2,190,949 and \$2,831,332 as of June 30, 2011 and December 31, 2010, respectively	144,825,894	157,143,918
Foreclosed real estate and other repossessed assets	4,625,417	2,818,343
Federal Home Loan Bank stock, at cost	3,266,100	3,775,400
Premises and equipment	5,924,907	6,026,793
Accrued interest receivable	1,158,565	1,230,938
Intangible assets	481,081	627,306
Prepaid FDIC premiums	852,890	967,143
Deferred tax asset	471,751	659,194
Other assets	2,623,837	2,700,034
Total assets	\$218,924,236	\$ 215,732,964
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Deposits	\$156,110,486	\$ 155,465,896
Advances from borrowers for taxes and insurance	370,215	130,030
Federal Home Loan Bank Advances	32,000,000	29,000,000
REPO Sweep Accounts	4,847,231	6,172,362
Accrued expenses and other liabilities	1,530,196	1,728,735
Total liabilities	194,858,128	192,497,023
Stockholders' equity:		
Common stock (\$0.01 par value 20,000,000 shares authorized 3,191,799 shares issued)	31,918	31,918
Additional paid-in capital	23,851,341	23,822,152
Retained earnings	2,661,488	2,238,064
Treasury stock at cost (307,750 shares)	(2,963,918)	(2,963,918)
Unearned compensation	(556)	(38,382)
Accumulated other comprehensive income	485,835	146,107
Total stockholders' equity	24,066,108	23,235,941

Total liabilities and stockholders' equity	\$218,924,236	\$ 215,732,964
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See accompanying notes to consolidated financial statements.

First Federal of Northern Michigan Bancorp, Inc. and Subsidiaries
Consolidated Statement of Income

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2011	2010	2011	2010
	(Unaudited)		(Unaudited)	
Interest income:				
Interest and fees on loans	\$2,317,197	\$2,552,986	\$4,590,517	\$5,093,399
Interest and dividends on investments				
Taxable	134,402	106,843	229,217	239,406
Tax-exempt	40,011	58,455	80,339	111,267
Interest on mortgage-backed securities	199,702	165,313	383,068	321,846
Total interest income	2,691,312	2,883,597	5,283,141	5,765,918
Interest expense:				
Interest on deposits	407,875	601,733	845,128	1,239,557
Interest on borrowings	172,681	298,657	340,755	617,239
Total interest expense	580,556	900,390	1,185,883	1,856,796
Net interest income	2,110,756	1,983,207	4,097,258	3,909,122
Provision for loan losses	(19,238)	594,840	48,120	605,928
Net interest income after provision for loan losses	2,129,994	1,388,367	4,049,138	3,303,194
Non-interest income:				
Service charges and other fees	181,228	199,340	345,719	403,514
Mortgage banking activities	182,463	315,223	418,446	563,315
Gain on sale of investments	-	447,387	-	496,817
Net gain (loss) on sale of premises and equipment, real estate owned and other repossessed assets	(37,756)	42,691	(46,431)	53,867
Other	67,048	260,723	124,601	326,336
Total non-interest income	392,983	1,265,364	842,335	1,843,849
Non-interest expense:				
Compensation and employee benefits	1,159,252	1,194,299	2,328,188	2,365,241
FDIC Insurance Premiums	51,170	94,348	122,387	188,548
Advertising	33,817	36,103	56,838	55,992
Occupancy	267,652	288,237	537,694	600,813
Amortization of intangible assets	73,112	73,112	146,225	146,225
Service bureau charges	79,292	86,114	155,498	165,696
Professional services	133,570	149,091	221,147	252,202
Other	462,389	515,103	900,072	850,786
Total non-interest expense	2,260,254	2,436,407	4,468,049	4,625,503
Income before income tax benefit	262,723	217,324	423,424	521,540
Income tax benefit	-	(101,913)	-	-
Net Income	\$262,723	\$319,237	\$423,424	\$521,540

Per share data:

Net income per share				
Basic	\$0.09	\$0.11	\$0.15	\$0.18
Diluted	\$0.09	\$0.11	\$0.15	\$0.18
Weighted average number of shares outstanding				
Basic and diluted	2,884,049	2,884,249	2,884,049	2,884,249
Dividends per common share	\$-	\$-	\$-	\$-
See accompanying notes to consolidated financial statements.				

First Federal of Northern Michigan Bancorp Inc. and Subsidiaries
Consolidated Statement of Changes in Stockholders' Equity (Unaudited)

	Common Stock	Treasury Stock	Additional Paid-in Capital	Unearned Compensation	Retained Earnings	Accumulated Other Comprehensive Income	Total
Balance at December 31, 2010	\$ 31,918	\$(2,963,918)	\$23,822,152	\$ (38,382)	\$2,238,064	\$ 146,107	\$23,235,941
Treasury Stock at Cost	-	-	-	-	-	-	-
Stock-based compensation	-	-	29,189	37,826	-	-	67,015
Net income for the period	-	-	-	-	423,424	-	423,424
Change in unrealized gain: on available-for-sale securities (net of tax of \$175,011)	-	-	-	-	-	339,728	339,728
Total comprehensive income	-	-	-	-	-	-	763,152
Balance at June 30, 2011	\$ 31,918	\$(2,963,918)	\$23,851,341	\$ (556)	\$2,661,488	\$ 485,835	\$24,066,108

See accompanying notes to the consolidated financial statements.

First Federal of Northern Michigan Bancorp, Inc. and Subsidiaries
Consolidated Statement of Cash Flows

	For Six Months Ended June 30,	
	2011	2010
	(Unaudited)	
Cash Flows from Operating Activities:		
Net income	\$423,424	\$521,540
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	360,115	410,565
Provision for loan loss	48,120	605,928
Amortization and accretion on securities	133,688	60,794
Gain on sale of investment securities	-	(496,817)
Stock-based compensation	67,015	109,429
Gain on sale of loans held for sale	(162,421)	(225,014)
Originations of loans held for sale	(11,516,189)	(17,133,098)
Proceeds from sale of loans held for sale	11,127,997	16,639,206
Gain on sale of fixed assets	(990)	(9,423)
Net change in		
Accrued interest receivable	72,373	132,706
Other assets	568,753	867,161
Prepaid FDIC insurance premiums	114,253	179,338
Deferred income tax expense (benefit)	187,443	(84,193)
Accrued expenses and other liabilities	(198,539)	194,306
Net cash provided by operating activities		
	1,225,042	1,772,428
Cash Flows from Investing Activities:		
Net decrease in loans (loans originated, net of principal payments)	9,795,262	6,787,517
Proceeds from maturity and sale of available-for-sale securities	3,374,182	19,558,755
Proceeds from sale of property and equipment	1,480	30,874
Purchase of securities	(15,328,604)	(18,604,083)
Purchase of premises and equipment	(112,494)	(11,086)
Proceeds from sale of Federal Home Loan Bank Stock	509,300	-
Net cash (used for) provided by investing activities	(1,760,874)	7,761,977
Cash Flows from Financing Activities:		
Net increase/(decrease) in deposits	644,590	(273,222)
Net decrease in Repo Sweep accounts	(1,325,131)	(162,167)
Net increase in advances from borrowers	240,185	268,295
Advances from Federal Home Loan Bank and notes payable	7,350,000	11,925,000
Repayments of Federal Home Loan Bank advances and notes payable	(4,350,000)	(18,955,927)
Net cash provided by (used for) financing activities	2,559,644	(7,198,021)
Net increase in cash and cash equivalents		
	2,023,812	2,336,384
Cash and cash equivalents at beginning of period	1,962,657	3,099,058
Cash and cash equivalents at end of period	\$3,986,469	\$5,435,442
Supplemental disclosure of cash flow information:		

Cash paid during the period for

Interest	\$ 1,203,998	\$ 1,929,931
Income taxes	-	-
Transfers of loans to foreclosed real estate and repossessed assets	2,474,642	208,902

See accompanying notes to the consolidated financial statements.

FIRST FEDERAL OF NORTHERN MICHIGAN BANCORP, INC.
AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1—BASIS OF FINANCIAL STATEMENT PRESENTATION

The accompanying unaudited condensed consolidated interim financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America and with the instructions to Form 10-Q. Accordingly, certain information and disclosures required by accounting principles generally accepted in the United States of America for complete financial statements are not included herein. The interim financial statements should be read in conjunction with the financial statements of First Federal of Northern Michigan Bancorp, Inc. and Subsidiaries and the notes thereto included in the Company's annual report on Form 10-K for the year ended December 31, 2010.

All adjustments, consisting only of normal recurring adjustments, which in the opinion of management are necessary for a fair presentation of financial position, results of operations and cash flows, have been made. The results of operations for the three and six months ended June 30, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011.

Note 2— PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of First Federal of Northern Michigan Bancorp, Inc., First Federal of Northern Michigan, and the Bank's wholly owned subsidiaries, Financial Services & Mortgage Corporation ("FSMC") and FFM Agency, Inc. FSMC invests in real estate, which includes leasing, selling, developing, and maintaining real estate properties. The main activity of FFM Agency is to collect the stream of income associated with the sale of the Blue Cross/Blue Shield override to the Grotenhuis Group (as discussed further below). All significant intercompany balances and transactions have been eliminated in the consolidation.

Note 3—SECURITIES

Investment securities have been classified according to management's intent. The carrying value and estimated fair value of securities are as follows:

		June 30, 2011		
	Amortized Cost	Gross Unrealized Gains (in thousands)	Gross Unrealized Losses	Market Value
Securities Available for Sale				
U.S. Government and agency obligations	\$ 14,396	\$ 85	\$ -	14,481
Municipal obligations	7,976	288	-	8,264
Mortgage-backed securities	24,562	372	(8)	24,926
Equity securities	2	-	(1)	1
Total	\$ 46,936	\$ 745	\$ (9)	\$ 47,672

Securities Held to Maturity

Municipal obligations	\$ 2,485	\$ 159	\$ (1)	\$ 2,643
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		December 31, 2010		
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Market Value
	(in thousands)			
Securities Available for Sale				
U.S. Government and agency obligations	\$ 4,518	\$ 44	\$ -	4,562
Municipal obligations	4,875	171	-	5,046
Mortgage-backed securities	25,684	83	(75)	25,692
Equity securities	3	-	(2)	1
Total	\$ 35,080	\$ 298	\$ (77)	\$ 35,301
Securities Held to Maturity				
Municipal obligations	\$ 2,520	\$ 90	\$ (15)	\$ 2,595

The amortized cost and estimated market value of securities at June 30, 2011, by contract maturity, are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties. Securities with no specified maturity date are separately stated.

	June 30, 2011	
	Amortized Cost	Market Value
	(in thousands)	
Available For Sale:		
Due in one year or less	\$ 1,557	\$ 1,561
Due after one year through five years	13,871	14,030
Due in five year through ten years	6,528	6,671
Due after ten years	416	483
Subtotal	22,372	22,745
Equity securities	2	1
Mortgage-backed securities	24,562	24,926
Total	\$ 46,936	\$ 47,672
Held To Maturity:		
Due in one year or less	\$ 90	\$ 91
Due after one year through five years	395	424
Due in five year through ten years	645	695
Due after ten years	1,355	1,433
Total	\$ 2,485	\$ 2,643

At June 30, 2011 and December 31, 2010, securities with a carrying value of \$35,833,000 and \$34,981,000, respectively, were pledged to secure certain deposit accounts, FHLB advances and our line of credit at the Federal

Reserve.

Gross proceeds from the sale of securities for the six-months ended June 30, 2011 and 2010 were \$0 and \$10,354,000, respectively, resulting in gross gains of \$0 and \$497,000, respectively and gross losses of \$0 and \$0, respectively.

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The following is a summary of temporarily impaired investments that have been impaired for less than and more than twelve months as of June 30, 2011 and December 31, 2010:

		June 30, 2011		
		Gross Unrealized Losses <12 months	Fair Value	Gross Unrealized Losses > 12 months
	Fair Value	(in thousands)		
Available For Sale:				
U.S. Government and agency obligations	\$ -	\$ -	\$ -	\$ -
Municipal obligations	-	-	-	-
Mortgage-backed securities	1,658	(8)	-	-
Equity securities	-	-	2	(1)
Total	\$ 1,658	\$ (8)	\$ 2	\$ (1)

Held to Maturity:				
Municipal obligations	\$ -	\$ -	\$ 29	\$ (1)

		December 31, 2010		
		Gross Unrealized Losses <12 months	Fair Value	Gross Unrealized Losses > 12 months
	Fair Value	(in thousands)		
Available For Sale:				
U.S. Government and agency obligations	\$ -	\$ -	\$ -	\$ -
Municipal obligations	-	-	-	-
Mortgage-backed securities	12,626	(75)	-	-
Equity securities	3	(2)	-	-
Total	\$ 12,629	\$ (77)	\$ -	\$ -

Held to Maturity:				
Municipal obligations	\$ 382	\$ (13)	\$ 28	\$ (2)

The unrealized losses on the securities held in the portfolio are not considered other than temporary and have not been recognized into income. This decision is based on the Company's ability and intent to hold any potentially impaired security until maturity. The performance of the security is based on the contractual terms of the agreement, the extent of the impairment and the financial condition and credit quality of the issuer. The decline in market value is considered temporary and a result of changes in interest rates and other market variables.

Note 4—LOANS

The following table sets forth the composition of our loan portfolio by loan type at the dates indicated.

	At June 30, 2011	At December 31, 2010
	(in thousands)	
Real estate loans:		
Residential mortgage	\$ 65,060	\$ 71,697
Commercial loans:		
Secured by real estate	57,465	61,010
Other	8,208	8,848
Total commercial loans	65,673	69,858
Consumer loans:		
Secured by real estate	15,056	16,547
Other	1,474	2,118
Total consumer loans	16,530	18,665
Total gross loans	\$ 147,263	\$ 160,220
Less:		
Net deferred loan fees	(246)	(245)
Allowance for loan losses	(2,191)	(2,831)
Total loans, net	\$ 144,826	\$ 157,144

The following table illustrates the contractual aging of the recorded investment in past due loans by class of loans as of June 30, 2011 and December 31, 2010:

As of June 30, 2011					Recorded Investment > 90 Days and Accruing		
	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater than 90 Days	Total Past Due	Current	Total Financing Receivables	
Commercial Real Estate:							
Commercial Real Estate - construction	\$ -	\$ -	\$ 290	\$ 290	\$ 70	\$ 360	\$ -
Commercial Real Estate - other	447	-	514	961	56,144	57,105	-
Commercial - non real estate	-	-	-	-	8,208	8,208	-
Consumer:							
Consumer - Real Estate	272	112	158	542	14,514	15,056	-
Consumer - Other	17	13	1	31	1,443	1,474	1
Residential:							
Residential	2,935	1,191	2,771	6,897	58,163	65,060	340
Total	\$ 3,671	\$ 1,316	\$ 3,734	\$ 8,721	\$ 138,542	\$ 147,263	\$ 341

As of December 31, 2010

	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater than 90 Days	Total Past Due	Current	Total Financing Receivables	Recorded Investment > 90 Days and Accruing
Commercial Real Estate:							
Commercial Real Estate - construction	\$ -	\$ -	\$ 1,772	\$ 1,772	\$ 1,498	\$ 3,270	\$ -
Commercial Real Estate - other	891	488	784	2,163	55,577	57,740	82
Commercial - non real estate	-	6	-	6	8,842	8,848	-
Consumer:							
Consumer - Real Estate	650	108	205	963	15,584	16,547	-
Consumer - Other	27	14	2	43	2,075	2,118	2
Residential:							
Residential	3,919	2,056	2,434	8,409	63,288	71,697	282
Total	\$ 5,487	\$ 2,672	\$ 5,197	\$ 13,356	\$ 146,864	\$ 160,220	\$ 366

The Bank uses an eight tier risk rating system to grade its commercial loans. The grade of a loan may change during the life of the loans. The risk ratings are described as follows:

Risk Grade 1 (Excellent) - Prime loans based on liquid collateral, with adequate margin or supported by strong financial statements. Probability of serious financial deterioration is unlikely. High liquidity, minimum risk, strong ratios, and low handling costs are common to these loans. This classification also includes all loans secured by certificates of deposit