

NORWOOD FINANCIAL CORP

Form 10-Q

November 08, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2018

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 0-28364

Norwood Financial Corp.

(Exact name of registrant as specified in its charter)

Pennsylvania

(State or other jurisdiction of incorporation or organization)

23-2828306

(I.R.S. employer identification no.)

717 Main Street, Honesdale, Pennsylvania 18431

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code (570) 253-1455

N/A

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

Indicate by check (x) 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 (§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, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer", "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐

Accelerated filer ☒

Non-accelerated filer ☐

Smaller reporting company ☒

Emerging growth company ☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

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

Class	Outstanding as of November 1, 2018
Common stock, par value \$0.10 per share	6,268,783

NORWOOD FINANCIAL CORP.
FORM 10-Q
FOR THE QUARTER ENDED SEPTEMBER 30, 2018

	Page Number
PART I - CONSOLIDATED FINANCIAL INFORMATION OF NORWOOD FINANCIAL CORP.	
Item 1. <u>Financial Statements</u> (unaudited)	3
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	33
Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	47
Item 4. <u>Controls and Procedures</u>	48
PART II - OTHER INFORMATION	
Item 1. <u>Legal Proceedings</u>	49
Item 1A. <u>Risk Factors</u>	49
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	49
Item 3. <u>Defaults Upon Senior Securities</u>	49
Item 4. <u>Mine Safety Disclosures</u>	49
Item 5. <u>Other Information</u>	49
Item 6. <u>Exhibits</u>	50
Signatures	52

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NORWOOD FINANCIAL CORP.

Consolidated Balance Sheets (unaudited)

(dollars in thousands, except share and per share data)

	September 30, 2018	December 31, 2017
ASSETS		
Cash and due from banks	\$17,073	\$16,212
Interest-bearing deposits with banks	295	485
Cash and cash equivalents	17,368	16,697
Securities available for sale, at fair value	247,517	281,121
Loans receivable	819,197	764,092
Less: Allowance for loan losses	8,280	7,634
Net loans receivable	810,917	756,458
Regulatory stock, at cost	3,261	3,505
Bank premises and equipment, net	13,797	13,864
Bank owned life insurance	37,718	37,060
Accrued interest receivable	3,792	3,716
Foreclosed real estate owned	1,209	1,661
Goodwill	11,331	11,331
Other intangibles	364	462
Deferred tax asset	6,268	4,781
Other assets	3,206	2,260
TOTAL ASSETS	\$1,156,748	\$1,132,916
LIABILITIES		
Deposits:		
Non-interest bearing demand	\$218,979	\$205,138
Interest-bearing	720,735	724,246
Total deposits	939,714	929,384
Short-term borrowings	52,820	42,530
Other borrowings	36,649	35,945
Accrued interest payable	1,705	1,434
Other liabilities	9,180	7,884
TOTAL LIABILITIES	1,040,068	1,017,177
STOCKHOLDERS' EQUITY		
Common stock, \$.10 par value per share, authorized 10,000,000 shares; issued 2018: 6,274,513 shares, 2017: 6,256,063 shares	628	626
Surplus	48,087	47,431
Retained earnings	76,645	70,426
Treasury stock at cost: 2018: 5,729 shares, 2017: 2,608 shares	(188)	(77)
Accumulated other comprehensive loss	(8,492)	(2,667)

TOTAL STOCKHOLDERS' EQUITY	116,680	115,739
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$1,156,748	\$1,132,916

See accompanying notes to the unaudited consolidated financial statements.

NORWOOD FINANCIAL CORP.

Consolidated Statements of Income (unaudited)

(dollars in thousands, except per share data)

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2018	
	2017		2017	
INTEREST INCOME				
Loans receivable, including fees	\$9,301	\$8,289	\$26,645	\$24,020
Securities	1,483	1,605	4,543	4,856
Other	2	2	63	37
Total interest income	10,786	9,896	31,251	28,913
INTEREST EXPENSE				
Deposits	1,116	828	3,198	2,392
Short-term borrowings	111	82	201	138
Other borrowings	171	116	442	360
Total interest expense	1,398	1,026	3,841	2,890
NET INTEREST INCOME	9,388	8,870	27,410	26,023
PROVISION FOR LOAN LOSSES	375	600	1,350	1,800
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	9,013	8,270	26,060	24,223
OTHER INCOME				
Service charges and fees	1,129	1,105	3,211	3,056
Income from fiduciary activities	151	160	463	395
Net realized gains on sales of securities	13	129	213	167
Gain on sale of loans, net	15	-	15	67
Gain on sale of deposits	-	-	-	209
Earnings and proceeds on bank owned life insurance	297	320	848	850
Other	392	144	716	414
Total other income	1,997	1,858	5,466	5,158
OTHER EXPENSES				
Salaries and employee benefits	3,577	3,209	10,445	9,639
Occupancy, furniture & equipment, net	910	799	2,659	2,519
Data processing and related operations	368	354	1,027	1,022
Taxes, other than income	153	233	480	693
Professional fees	301	217	760	706
Federal Deposit Insurance Corporation insurance	87	97	265	283
Foreclosed real estate	(26)	303	68	1,028
Amortization of intangibles	29	35	97	115
Other	1,173	992	3,372	2,979
Total other expenses	6,572	6,239	19,173	18,984

Edgar Filing: NORWOOD FINANCIAL CORP - Form 10-Q

INCOME BEFORE INCOME TAXES	4,438	3,889	12,353	10,397
INCOME TAX EXPENSE	728	948	2,001	2,356
NET INCOME	\$3,710	\$2,941	\$10,352	\$8,041

BASIC EARNINGS PER SHARE	\$0.59	\$0.47	\$1.66	\$1.29
--------------------------	--------	--------	--------	--------

DILUTED EARNINGS PER SHARE	\$0.58	\$0.47	\$1.64	\$1.28
----------------------------	--------	--------	--------	--------

See accompanying notes to the unaudited consolidated financial statements.

NORWOOD FINANCIAL CORP.

Consolidated Statements of Comprehensive (Loss) Income (unaudited)
(dollars in thousands)

	Three Months Ended September 30,	
	2018	2017
Net income	\$3,710	\$2,941
Other comprehensive (loss) income:		
Investment securities available for sale:		
Unrealized holding (loss) gain	(1,830)	529
Tax effect	384	(180)
Reclassification of investment securities gains recognized in net income	(13)	(129)
Tax effect	3	43
Other comprehensive (loss) income	(1,456)	263
Comprehensive Income	\$2,254	\$3,204

	Nine Months Ended September 30,	
	2018	2017
Net income	\$10,352	\$8,041
Other comprehensive (loss) income:		
Investment securities available for sale:		
Unrealized holding (loss) gain	(7,160)	4,486
Tax effect	1,503	(1,526)
Reclassification of investment securities gains recognized in net income	(213)	(167)
Tax effect	45	57
Other comprehensive (loss) income	(5,825)	2,850
Comprehensive Income	\$4,527	\$10,891

See accompanying notes to the unaudited consolidated financial statements.

NORWOOD FINANCIAL CORP.

Consolidated Statements of Changes in Stockholders' Equity (unaudited)

Nine Months Ended September 30, 2018

(dollars in thousands, except share and per share data)

	Common Stock			Retained	Treasury	Stock	Accumulated Other Comprehensive	
	Shares	Amount	Surplus	Earnings	Shares	Amount	Loss	Total
Balance, December 31, 2017	6,256,063	\$ 626	\$47,431	\$70,426	2,608	\$ (77)	\$ (2,667)	\$115,739
Net Income	-	-	-	10,352	-	-	-	10,352
Other comprehensive loss	-	-	-	-	-	-	(5,825)	(5,825)
Cash dividends declared (\$0.66 per share)	-	-	-	(4,133)	-	-	-	(4,133)
Compensation expense related to restricted stock	-	-	154	-	-	-	-	154
Acquisition of treasury stock	-	-	-	-	5,446	(179)	-	(179)
Stock options exercised	18,450	2	325	-	(2,325)	68	-	395
Compensation expense related to stock options	-	-	177	-	-	-	-	177
Balance, September 30, 2018	6,274,513	\$ 628	\$48,087	\$76,645	5,729	\$ (188)	\$ (8,492)	\$116,680

See accompanying notes to the unaudited consolidated financial statements.

NORWOOD FINANCIAL CORP.
Consolidated Statements of Cash Flows (Unaudited)

(dollars in thousands)

	Nine Months Ended September 30,	
	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Income	\$10,352	\$8,041
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	1,350	1,800
Depreciation	665	703
Amortization of intangible assets	97	115
Deferred income taxes	(198)	(783)
Net amortization of securities premiums and discounts	1,308	1,651
Net realized gain on sales of securities	(213)	(167)
Gain on sale of deposits	-	(209)
Earnings and proceeds on bank owned life insurance	(848)	(850)
(Gain) loss on sales and writedowns of fixed assets and foreclosed real estate owned	(42)	673
Gain on sale of loans	(15)	(67)
Loans originated for sale	(752)	(1,693)
Proceeds from sale of loans originated for sale	767	1,760
Compensation expense related to stock options	177	69
Compensation expense related to restricted stock	154	107
Decrease in accrued interest receivable	(76)	(86)
Increase in accrued interest payable	271	98
Other, net	1,062	1,278
Net cash provided by operating activities	14,059	12,440
CASH FLOWS FROM INVESTING ACTIVITIES		
Securities available for sale:		
Proceeds from sales	17,745	13,027
Proceeds from maturities and principal reductions on mortgage-backed securities	22,848	20,570
Purchases	(15,458)	(13,905)
Purchase of regulatory stock	(3,865)	(3,737)
Redemption of regulatory stock	4,109	2,741
Net increase in loans	(56,275)	(42,783)
Purchase of premises and equipment	(598)	(484)
Proceeds from sales of fixed assets and foreclosed real estate owned	696	777
Net cash used in investing activities	(30,798)	(23,794)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in deposits	10,330	12,505
Deposits sold	-	(13,659)
Net increase in short-term borrowings	10,290	14,418
Repayments of other borrowings	(9,296)	(20,230)
Proceeds from other borrowings	10,000	20,000
Stock options exercised	395	766

Edgar Filing: NORWOOD FINANCIAL CORP - Form 10-Q

Purchase of treasury stock	(179)	(1,290)
Cash dividends paid	(4,130)	(4,015)
Net cash provided by financing activities	17,410	8,495
Increase (decrease) in cash and cash equivalents	671	(2,859)
 CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	 16,697	 17,174
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$17,368	\$14,315

NORWOOD FINANCIAL CORP.

Consolidated Statements of Cash Flows (Unaudited) (continued)

(dollars in thousands)

	Nine Months Ended September 30,	
	2018	2017
Supplemental Disclosures of Cash Flow Information		
Cash payments for:		
Interest on deposits and borrowings	\$3,570	\$2,792
Income taxes paid, net of refunds	\$1,547	\$1,825
Supplemental Schedule of Noncash Investing Activities:		
Transfers of loans to foreclosed real estate and repossession of other assets	\$333	\$112
Cash dividends declared	\$4,133	\$4,037

See accompanying notes to the unaudited consolidated financial statements.

Notes to the Unaudited Consolidated Financial Statements

1. Basis of Presentation

The unaudited consolidated financial statements include the accounts of Norwood Financial Corp. (Company) and its wholly-owned subsidiary, Wayne Bank (Bank) and the Bank's wholly-owned subsidiaries, WCB Realty Corp., Norwood Investment Corp., Norwood Settlement Services, LLC, and WTRO Properties, Inc. On June 13, 2017, the Company approved and adopted a Plan of Dissolution for Norwood Settlement Services, LLC. Effective May 29, 2018, the existence of Norwood Settlement Services, LLC was terminated. All activity prior to the dissolution is included in the consolidated financial statements. All significant intercompany transactions have been eliminated in consolidation.

The accompanying unaudited consolidated financial statements have been prepared in conformity with generally accepted accounting principles for interim financial statements and with instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenues and expenses for the period. Actual results could differ from those estimates. The financial statements reflect, in the opinion of management, all normal, recurring adjustments necessary to present fairly the consolidated financial position and results of operations of the Company. The operating results for the three month and nine month periods ended September 30, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018 or any other future interim period.

2. Revenue Recognition

Effective January 1, 2018, the Company adopted ASU 2014-09 Revenue from Contracts with Customers – Topic 606 and all subsequent ASCs that modified ASC 606. The Company has elected to apply the standard utilizing the modified retrospective approach with a cumulative effect of adoption for the impact from uncompleted contracts as the date of adoption. The implementation of the new standard had no material impact to the measurement or recognition of revenue of prior periods.

Management determined that the primary sources of revenue emanating from interest income on loans and investments along with noninterest revenue resulting from investment security gains, loan servicing, gains on the sale of loans, commitment fees, and fees from financial guarantees are not within the scope of ASC 606. As a result, no changes were made during the period related to these sources of revenue, which cumulatively comprise 94.2% percent of the total revenue of the Company.

The main types of noninterest income within the scope of the standard are as follows:

Service charges on deposit accounts – The Company has contracts with its deposit customers where fees are charged if the account balance falls below predetermined levels defined as compensating balances. The agreements can be cancelled at any time by either the Company or the deposit customer. Revenue from the transactions is recognized on a monthly basis as the Company has an unconditional right to the fee consideration. The Company also has transaction fees related to specific transactions or activities resulting from a customer request or activity that include overdraft fees, online banking fees, and other transaction fees. All of these fees are attributable to specific performance obligations of the Company where the revenue is recognized at a defined point in time or at the completion of the requested service/transaction.

Fiduciary/trust fees – Typical contracts for trust services are based on a fixed percentage of assets earned ratably over a defined period and billed on a monthly or quarterly basis. Fees charged to customers' accounts are recognized as revenue over the period during which the Company fulfills its performance obligation under the contract (i.e. holding client assets in a managed fiduciary trust account). For these accounts, the performance obligation of the Company is

typically satisfied by holding and managing the customer's assets over time. Other fees related to specific customer requests are attributable to specific performance obligations

of the Company where the revenue is recognized at a defined point in time or at the completion of the requested service/transaction.

The Company has evaluated the nature of its contracts with customers and determined that further disaggregation of revenue from contracts with customers into more granular categories beyond what is presented in the Consolidated Statements of Income was not necessary. The Company generally fully satisfies its performance obligations on its contracts with customers as services are rendered and the transaction prices are typically fixed; charged either on a periodic basis or based on activity.

3. Earnings Per Share

Basic earnings per share represents income available to common stockholders divided by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflect additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. Potential common shares that may be issued by the Company relate solely to outstanding stock options and are determined using the treasury stock method.

The following table sets forth the weighted average shares outstanding used in the computations of basic and diluted earnings per share.

(in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Weighted average shares outstanding	6,264	6,239	6,259	6,239
Less: Unvested restricted shares	(30)	(28)	(30)	(28)
Basic EPS weighted average shares outstanding	6,234	6,211	6,229	6,211
Basic EPS weighted average shares outstanding	6,234	6,211	6,229	6,211
Add: Dilutive effect of stock options	70	52	72	56
Diluted EPS weighted average shares outstanding	6,304	6,263	6,301	6,267

For the three and nine month periods ending September 30, 2018, there were no stock options that would be anti-dilutive to the earnings per share calculations based upon the closing price of Norwood common stock of \$39.16 per share on September 30, 2018.

For the three and nine month periods ending September 30, 2017, there were no anti-dilutive options based on Norwood's closing price of \$30.52 per share on September 30, 2017.

4. Stock-Based Compensation

No awards were granted during the nine-month period ending September 30, 2018. As of September 30, 2018, there was \$59,000 of total unrecognized compensation cost related to non-vested options granted in 2017 under the 2014 Equity Incentive Plan, which will be fully amortized by December 31, 2018. Compensation costs related to stock

options amounted to \$177,000 and \$69,000 during the nine-month periods ended September 30, 2018 and 2017, respectively.

A summary of the Company's stock option activity for the nine-month period ended September 30, 2018 is as follows:

	Options	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (\$000)
Outstanding at January 1, 2018	212,725	\$ 20.76	6.1 Yrs.	\$2,604
Granted	-	-	-	-
Exercised	(20,775)	19.01	5.4 Yrs.	395
Forfeited	(1,500)	32.81	9.2 Yrs.	49
Outstanding at September 30, 2018	190,450	\$ 20.85	5.3 Yrs.	\$3,972
Exercisable at September 30, 2018	157,200	\$ 18.33	4.5 Yrs.	\$2,881

Intrinsic value represents the amount by which the market price of the stock on the measurement date exceeded the exercise price of the option. The stock price was \$39.16 per share as of September 30, 2018 and \$33.00 per share as of December 31, 2017.

A summary of the Company's restricted stock activity for the nine-month periods ended September 30, 2018 and 2017 is as follows:

	2018		2017	
	Number of Restricted Stock	Weighted-Average Grant Date Fair Value	Number of Restricted Stock	Weighted-Average Grant Date Fair Value
Non-vested, January 1,	30,415	\$ 24.46	28,035	\$ 20.64
Granted	-	-	-	-
Vested	-	-	-	-
Forfeited	-	-	-	-
Non-vested, September 30,	30,415	\$ 24.46	28,035	\$ 20.64

The expected future compensation expense relating to the 30,415 shares of non-vested restricted stock outstanding as of September 30, 2018 is \$591,000. This cost will be recognized over the remaining vesting period of 4.25 years. Compensation costs related to restricted stock amounted to \$154,000 and \$107,000 during the nine-month periods ended September 30, 2018 and 2017, respectively.

5. Accumulated Other Comprehensive Income (Loss)

The following table presents the changes in accumulated other comprehensive loss (in thousands) by component net of tax for the three months and nine months ended September 30, 2018 and 2017:

	Unrealized losses on available for sale securities (a)
Balance as of June 30, 2018	\$ (7,036)
Other comprehensive loss before reclassification	(1,446)
Amount reclassified from accumulated other comprehensive loss	(10)
Total other comprehensive loss	(1,456)
Balance as of September 30, 2018	\$ (8,492)

	Unrealized gains (losses) on available for sale securities (a)
Balance as of June 30, 2017	\$ (1,532)
Other comprehensive income before reclassification	349
Amount reclassified from accumulated other comprehensive loss	(86)
Total other comprehensive income	263
Balance as of September 30, 2017	\$ (1,269)

	Unrealized losses on available for sale securities (a)
Balance as of December 31, 2017	\$ (2,667)
Other comprehensive loss before reclassification	(5,657)
Amount reclassified from accumulated other comprehensive loss	(168)
Total other comprehensive loss	(5,825)
Balance as of September 30, 2018	\$ (8,492)

	Unrealized gains (losses) on available for sale securities (a)
Balance as of December 31, 2016	\$ (4,119)
Other comprehensive income before reclassification	2,960
Amount reclassified from accumulated other comprehensive loss	(110)
Total other comprehensive income	2,850