

PEOPLES FINANCIAL SERVICES CORP.
Form 10-Q
May 10, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

Form 10-Q

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended March 31, 2011 or

Transition report pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934 for the transition period from

0-23863
(Commission File Number)

PEOPLES FINANCIAL SERVICES CORP.
(Exact name of registrant as specified in its charter)

Pennsylvania
(State of incorporation)

23-2391852
(IRS Employer ID Number)

82 Franklin Avenue, Hallstead, PA
(Address of principal executive offices)

18822
(Zip code)

(570) 879-2175
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months or for such shorter period that the registrant was required to submit and post such files. Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company as defined in Rule 12b-2 of the Exchange Act.

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

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

APPLICABLE ONLY TO CORPORATE REGISTRANTS:

Indicate the number of shares outstanding of the registrant's common stock, as of the latest practicable date:
3,147,481 at April 30, 2011.

PEOPLES FINANCIAL SERVICES CORP.

PEOPLES FINANCIAL SERVICES CORP.

FORM 10-Q

For the Quarter Ended March 31, 2011

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PEOPLES FINANCIAL SERVICES CORP.

CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(Dollars in thousands, except per share data)

ASSETS:	March 31, 2011	December 31, 2010
Cash and due from banks	\$ 9,661	\$ 6,731
Interest-bearing balances with banks	1,110	107
Federal funds sold	15,791	11,003
Investment securities available-for-sale	109,602	124,414
Loans held for sale	517	30
Loans, net	407,842	390,772
Less: allowance for loan losses	4,356	4,100
Net loans	403,486	386,672
Premises and equipment, net	8,361	8,238
Accrued interest receivable	3,020	3,003
Other assets	18,780	18,389
Total assets	\$ 570,328	\$ 558,587
LIABILITIES:		
Deposits:		
Noninterest-bearing	\$ 76,958	\$ 73,663
Interest-bearing	376,614	365,071
Total deposits	453,572	438,734
Short-term borrowings	35,293	38,724
Long-term debt	27,100	27,336
Accrued interest payable	398	311
Other liabilities	1,471	2,966
Total liabilities	517,834	508,071
STOCKHOLDERS' EQUITY:		
Common stock, par value \$2.00, authorized 12,500,000 shares, issued 3,341,251 shares	6,683	6,683
Capital surplus	3,122	3,118
Retained earnings	47,219	46,048
Accumulated other comprehensive loss	(59)	(834)
Less: Treasury stock, at cost, held: March 31, 2011, 197,970 shares; December 31, 2010, 199,520	4,471	4,499
Total stockholders' equity	52,494	50,516
Total liabilities and stockholders' equity	\$ 570,328	\$ 558,587

See Notes to Consolidated Financial Statements

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PEOPLES FINANCIAL SERVICES CORP.

CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME (UNAUDITED)

(Dollars in thousands, except per share data)

	Three Months Ended	
	March 31, 2011	March 31, 2010
INTEREST INCOME:		
Interest and fees on loans:		
Taxable	\$5,136	\$4,717
Tax-exempt	357	270
Interest and dividends on investment securities available-for-sale:		
Taxable	666	751
Tax-exempt	475	494
Dividends	9	13
Interest on interest-bearing balances with banks	2	1
Interest on federal funds sold	2	4
Total interest income	6,647	6,250
I INTEREST EXPENSE:		
Interest on deposits	1,044	1,252
Interest on short-term borrowings	86	71
Interest on long-term debt	257	392
Total interest expense	1,387	1,715
Net interest income	5,260	4,535
Provision for loan losses	421	895
Net interest income after provision for loan losses	4,839	3,640
NONINTEREST INCOME:		
Service charges, fees and commissions	709	953
Wealth management income	139	60
Mortgage banking income	48	77
Net gains on sale of investment securities available-for-sale	10	22
Other than temporary investment securities impairment	(84))
Total noninterest income	822	1,112
NONINTEREST EXPENSE:		
Salaries and employee benefits expense	1,446	1,311
Net occupancy and equipment expense	676	622
Other expenses	1,273	1,104
Total noninterest expense	3,395	3,037
Income before income taxes	2,266	1,715
Provision for income tax expense	467	197
Net income	1,799	1,518
O OTHER COMPREHENSIVE INCOME:		
Unrealized holding gains on investment securities available-for-sale	1,100	1,172
Reclassification adjustment for gains included in net income	(10)) (22)
Reclassification adjustment for other than temporary impairment charges	84)
Income tax expense related to other comprehensive income	399	391
Other comprehensive income, net of income taxes	775	759
Comprehensive income	\$2,574	\$2,277
P PER SHARE DATA:		

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Net income	\$0.57	\$0.48
Cash dividends declared	\$0.20	\$0.19
Average common shares outstanding	3,142,137	3,136,228

See Notes to Consolidated Financial Statements

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PEOPLES FINANCIAL SERVICES CORP.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (UNAUDITED)
(Dollars in thousands, except per share data)

	Common Stock	Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total
Balance, December 31, 2010	\$6,683	\$3,118	\$46,048	\$ (834)	\$(4,499)	\$50,516
Net income			1,799			1,799
Other comprehensive income, net of income taxes				775		775
Cash dividends declared: \$0.20 per share			(628)			(628)
Treasury stock issued: 1,550 shares		4			28	32
Balance, March 31, 2011	\$6,683	\$3,122	\$47,219	\$ (59)	\$(4,471)	\$52,494
Balance, December 31, 2009	\$6,683	\$3,098	\$42,043	\$ (2,258)	\$(4,596)	\$44,970
Net income			1,518			1,518
Other comprehensive income, net of income taxes				759		759
Cash dividends declared: \$0.19 per share			(596)			(596)
Treasury stock issued: 650 shares		2			12	14
Balance, March 31, 2010	\$6,683	\$3,100	\$42,965	\$ (1,499)	\$(4,584)	\$46,665

See Notes to Consolidated Financial Statements

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PEOPLES FINANCIAL SERVICES CORP.

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(Dollars in thousands, except per share data)

	Three Months Ended	
	March 31, 2011	March 31, 2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 1,799	\$ 1,518
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	283	228
Provision for loan losses	421	895
Loss on sale of equipment	1	
Net amortization of available for sale securities	96	35
Amortization of deferred loan costs	49	57
Gain on sales of available for sale securities	(10)	(22)
Other than temporary security impairment	84	
Proceeds from the sale of loans originated for sale	2,260	1,017
Net gain on sale of loans originated for sale	(69)	(77)
Loans originated for sale	(2,678)	(1,661)
Net earnings on investment in life insurance	(81)	(82)
Gain from investment in life insurance		(320)
Net change in:		
Accrued interest receivable	(17)	(390)
Other assets	1,056	(432)
Accrued interest payable	87	24
Other liabilities	(1,495)	515
Net cash provided by operating activities	1,786	1,305
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sale of available for sale securities	15,149	31,668
Proceeds from maturities of and principal repayments on available for sale securities	668	2,879
Purchase of available for sale securities		(32,638)
Net increase in loans	(17,284)	(18,798)
Purchase of premises and equipment	(314)	(633)
Proceeds from investment in life insurance		549
Purchase of investment in life insurance	(2,000)	
Proceeds from sale of other real estate	141	1,790
Net cash used in investing activities	(3,640)	(15,183)
CASH FLOWS FROM FINANCING ACTIVITIES		
Cash dividends paid	(628)	(596)
Increase in deposits	14,838	19,353
Repayment of long-term borrowings	(236)	(224)
Net increase (decrease) in short-term borrowings	(3,431)	3,605
Issuance of common stock	32	14
Net cash provided by financing activities	10,575	22,152
Net increase in cash and cash equivalents	8,721	8,274

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CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	17,841	18,915
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 26,562	\$ 27,189
SUPPLEMENTAL DISCLOSURES		
Cash paid during the period for:		
Interest	\$ 1,300	\$ 1,691
Income taxes	\$ 100	\$ (656)
Noncash items:		
Transfers of loans to other real estate owned		\$ 138

See Notes to Consolidated Financial Statements

PEOPLES FINANCIAL SERVICES CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

NOTE 1. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements of Peoples Financial Services Corp, and subsidiaries (collectively, the “Company”) have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Article 10-01 of Regulation S-X. In the opinion of management, all normal recurring adjustments necessary for a fair presentation of the financial position and results of operations for the periods presented have been included. All significant intercompany balances and transactions have been eliminated in consolidation. Prior-period amounts are reclassified when necessary to conform with the current year’s presentation. These reclassifications did not have any effect on the operating results or financial position of the Company. The operating results and financial position of the Company for the three months ended and as of March 31, 2011, are not necessarily indicative of the results of operations and financial position that may be expected in the future.

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, reference is made to the Company’s Annual Report on Form 10-K for the period ended December 31, 2010.

In preparing these consolidated financial statements, the Company evaluated the events and transactions that occurred after March 31, 2011 through the date these consolidated financial statements were issued.

NOTE 2. EARNINGS PER SHARE

The following table sets forth the computation of basic and diluted earnings per share:

	Net Income	Average Common Shares Outstanding	EPS
March 31, 2011:			
Basic EPS	\$1,799	3,142,137	\$0.57
Diluted EPS	\$1,799	3,144,804	\$0.57
March 31, 2010:			
Basic EPS	\$1,518	3,136,228	\$0.48
Diluted EPS	\$1,518	3,137,660	\$0.48

Stock options for 9,650 and 17,228 shares of common stock were not considered in computing diluted earnings per share for the three months ended March 31, 2011 and 2010, respectively, because they were antidilutive.

PEOPLES FINANCIAL SERVICES CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

NOTE 3. INVESTMENT SECURITIES AVAILABLE-FOR-SALE

At March 31, 2011 and December 31, 2010, the amortized cost and fair values of securities available-for-sale are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
March 31, 2011				
U.S. Government agencies and sponsored enterprises	\$33,191	\$885	\$115	\$33,961
Obligations of state and political subdivisions	41,434	223	958	40,699
Taxable obligations of state and political subdivisions	18,629	123	439	18,313
Corporate debt securities	4,465	343	311	4,497
Mortgage-backed securities-residential	8,215	81	105	8,191
Preferred equity securities	54	123		177
Common equity securities	1,193	126	66	1,253
Restricted Stock	2,511			2,511
Total	\$109,692	\$1,904	\$1,994	\$109,602
December 31, 2010				
U.S. Government agencies and sponsored enterprises	\$38,133	\$1,094	\$109	\$39,118
Obligations of state and political subdivisions	51,789	146	1,626	50,309
Taxable obligations of state and political subdivisions	18,634	127	387	18,374
Corporate debt securities	4,467	208	655	4,020
Mortgage-backed securities-residential	8,682	85	97	8,670
Preferred equity securities	54			54
Common equity securities	1,277	114	164	1,227
Restricted Stock	2,642			2,642
Total	\$125,678	\$1,774	\$3,038	\$124,414

PEOPLES FINANCIAL SERVICES CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

NOTE 3. INVESTMENT SECURITIES AVAILABLE-FOR-SALE (Continued)

The amortized cost and fair value of securities as of March 31, 2011, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to prepay obligations with or without any penalties.

	Amortized Cost	Fair Value
Due in one year or less	\$480	\$483
Due after one year through five years	9,556	9,725
Due after five years through ten years	35,939	36,491
Due after ten years	51,744	50,771
	97,719	97,470
Mortgage-backed securities-residential	8,215	8,191
Equity securities	1,247	1,430
Restricted stock	2,511	2,511
Total	\$109,692	\$109,602

Securities with a carrying value of \$79,194 and \$84,281 at March 31, 2011 and December 31, 2010, respectively, were pledged to secure public deposits and repurchase agreements as required or permitted by law.

PEOPLES FINANCIAL SERVICES CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

NOTE 3. INVESTMENT SECURITIES AVAILABLE-FOR-SALE (Continued)

The following tables show the Company's investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at March 31, 2011 and December 31, 2010:

March 31, 2011:

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
US Govt./Agency	\$4,395	\$115			\$4,395	\$115
Obligations of state and political subdivisions	18,733	395	\$2,743	\$563	21,476	958
Taxable obligations of state and political subdivisions	12,002	375	430	64	12,432	439
Corporate debt securities			2,701	311	2,701	311
Mortgage-backed securities-residential	3,926	105			3,926	105
Common equity securities			369	66	369	66
	\$39,056	\$990	\$6,243	\$1,004	\$45,299	\$1,994

December 31, 2010:

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
US Govt./Agency	\$4,414	\$109			\$4,414	\$109
Obligations of state and political subdivisions	33,643	977	\$2,645	\$649	36,288	1,626
Taxable obligations of state and political subdivisions	12,576	324	430	63	13,006	387
Corporate debt securities			2,358	655	2,358	655
Mortgage-backed securities-residential	3,562	97			3,562	97
Common equity securities			374	164	374	164
	\$54,195	\$1,507	\$5,807	\$1,531	\$60,002	\$3,038

PEOPLES FINANCIAL SERVICES CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

NOTE 3. INVESTMENT SECURITIES AVAILABLE-FOR-SALE (Continued)

At March 31, 2011, the securities portfolio contained four (all less than 12 months) agency securities with an unrealized loss of \$115, 65 (57 less than 12 months, eight greater than 12 months) obligations of state and political subdivisions with unrealized losses totaling \$1,397, two (both greater than 12 months) corporate debt securities with unrealized losses of \$311, five (all less than 12 months) mortgage-backed securities with unrealized losses of \$105, and six (all greater than 12 months) common equity securities with unrealized losses of \$66. Management does not consider the unrealized losses, as a result of changes in interest rates, to be other-than-temporary impairment (“OTTI”) based on historical evidence that indicates the cost of these securities is recoverable within a reasonable period of time in relation to normal cyclical changes in the market rates of interest. Moreover, because there has been no material change in the credit quality of the issuer or other events or circumstances that may cause a significant adverse impact on the fair value of these securities, and management does not intend to sell these securities and it is unlikely that the Company will be required to sell these securities before recovery of their amortized cost basis, which may be maturity, the Company does not consider the unrealized losses to be OTTI at March 31, 2011.

For comparison, at December 31, 2010, the Company had four (all less than 12 months) U.S. Government Agency securities with unrealized losses of \$109, 90 (82 less than 12 months, eight greater than 12 months) obligations of state and political subdivisions with unrealized losses of \$2,013, four (all less than 12 months) mortgage-backed securities with unrealized losses of \$97, two (both greater than 12 months) corporate debt securities with unrealized losses of \$655, and six (all greater than 12 months) common equity securities with unrealized losses of \$164.

An other than temporary impairment of \$84 was recognized for the quarter ended March 31, 2011. The impairment was the result of writing down a common equity security. The write-down was determined based on public market prices. In reaching the determination to record the impairment, management reviewed the facts and circumstances available surrounding the security, including the duration and amount of the unrealized loss, the financial condition of the issuer and the prospects for a change in market value within a reasonable period of time. Based on its assessment, management determined that the impairment was other-than-temporary and that a charge to operating results was appropriate for the security. The charge was recognized based entirely on the assessment of the credit quality deterioration of the underlying company.

None of the corporate debt securities are private label trust preferred issuances. Rather, this portfolio contains corporate bond issuances in large, national financial institutions.

Management evaluates securities for OTTI at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. All of the investment securities classified as available-for-sale are evaluated for OTTI under the rules for accounting for certain investments in debt and equity securities.

PEOPLES FINANCIAL SERVICES CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

NOTE 3. INVESTMENT SECURITIES AVAILABLE-FOR-SALE (Continued)

In determining OTTI under the rules for accounting for certain debt and equity securities, management considers many factors, including: (i) the length of time and the extent to which the fair value has been less than amortized cost, (ii) the financial condition and near-term prospects of the issuer, (iii) whether the market decline was affected by macroeconomic conditions, and (iv) whether the Company has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. The assessment of whether an OTTI decline exists involves a high degree of subjectivity and judgment and is based on information available to management at a point in time. An OTTI is deemed to have occurred if there has been an adverse change in the remaining expected future cash flows.

NOTE 4. LOANS, NET

The major classifications of loans outstanding, net of deferred loan origination fees and costs at March 31, 2011 and December 31, 2010 are summarized as follows. Net deferred loan costs were \$533 at March 31, 2011, and \$523 at December 31, 2010.

	March 31, 2011	December 31, 2010
Commercial	\$ 137,698	\$ 112,526
Real estate:		
Commercial	130,610	136,910
Residential	118,323	119,424
Consumer	21,211	21,912
Total	\$ 407,842	\$ 390,772

PEOPLES FINANCIAL SERVICES CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

NOTE 4. LOANS, NET (Continued)

The changes in the allowance for loan losses account by major classification of loan for the three months ended March 31, 2011, is summarized as follows: