TRI COUNTY FINANCIAL CORP /MD/
Form 10-Q
August 05, 2011

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

FORM 10-Q
(Mark One)

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

For the Quarterly Period Ended June 30, 2011

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 0-18279

Tri-County Financial Corporation
(Exact name of registrant as specified in its charter)

Maryland	52-1652138
(State of other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

3035 Leonardtown Road, Waldorf, Maryland	20601
(Address of principal executive offices)	(Zip Code)

(301) 645-5601
(Registrant's telephone number, including area code)

Not applicable
(Former name, former address and former fiscal year, if changed since last report)

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 x 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 x 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 x
(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 x

As of July 26, 2011, the registrant had 3,016,305 shares of common stock outstanding.

TRI-COUNTY FINANCIAL CORPORATION

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PART I FINANCIAL STATEMENTS
ITEM I. FINANCIAL STATEMENTS
TRI-COUNTY FINANCIAL CORPORATION
CONSOLIDATED BALANCE SHEETS JUNE 30, 2011 AND DECEMBER 31, 2010

	June 30, 2011 (Unaudited)	December 31, 2010
Assets		
Cash and due from banks	$12,398,545	$8,695,590
Federal funds sold	820,000	615,000
Interest-bearing deposits with banks	768,044	512,846
Securities available for sale (AFS), at fair value	29,324,105	34,946,225
Securities held to maturity (HTM), at amortized cost	106,780,655	126,988,316
Federal Home Loan Bank and Federal Reserve Bank stock - at cost	5,957,800	6,315,600
Loans receivable - net of allowance for loan losses of $7,099,659 and $7,669,147	692,247,025	654,449,936
Premises and equipment, net	13,493,936	12,132,141
Foreclosed real estate	10,546,881	10,469,302
Accrued interest receivable	3,012,870	2,784,396
Investment in bank owned life insurance	17,771,896	17,447,692
Other assets	12,653,040	10,579,058
Total Assets	$905,774,797	$885,936,102
Liabilities and Stockholders' Equity		
Deposits		
Noninterest-bearing deposits	$84,199,169	$75,642,197
Interest-bearing deposits	669,732,661	648,940,129
Total deposits	753,931,830	724,582,326
Short-term borrowings	1,860,549	816,422
Long-term debt	60,600,557	70,624,044
Guaranteed preferred beneficial interest in junior subordinated debentures	12,000,000	12,000,000
Accrued expenses and other liabilities	6,437,512	6,808,383
Total Liabilities	834,830,448	814,831,175
Stockholders' Equity		
Fixed Rate Cumulative Perpetual Preferred Stock, Series A - par value $1,000; authorized 15,540; issued 15,540	15,540,000	15,540,000
Fixed Rate Cumulative Perpetual Preferred Stock, Series B - par value $1,000; authorized 777; issued 777	777,000	777,000
Common stock - par value $.01; authorized - 15,000,000 shares; issued 3,023,534 and 3,002,616 shares, respectively	30,235	30,026
Additional paid in capital	17,296,309	16,962,460
Retained earnings	37,496,035	37,892,557
Accumulated other comprehensive gain	443,745	411,188
Unearned ESOP shares	(638,975)	(508,304)
Total Stockholders’ Equity	70,944,349	71,104,927
Total Liabilities and Stockholders' Equity	$905,774,797	$885,936,102

See notes to consolidated financial statements

TRI-COUNTY FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)
THREE AND SIX MONTHS ENDED JUNE 30, 2011 AND 2010

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Interest and Dividend Income				
Loans, including fees	$ 9,012,635	$ 8,728,673	$ 17,873,206	$ 17,487,459
Taxable interest and dividends on investment securities	889,515	1,160,439	1,859,352	2,363,013
Interest on deposits with banks	2,282	3,970	3,664	6,147
Total Interest and Dividend Income	9,904,432	9,893,082	19,736,222	19,856,619
Interest Expenses				
Deposits	2,595,961	2,691,842	5,204,481	5,511,123
Short-term borrowings	10,022	6,025	24,455	16,879
Long-term debt	562,446	631,989	1,161,810	1,280,755
Total Interest Expenses	3,168,429	3,329,856	6,390,746	6,808,757
Net Interest Income	6,736,003	6,563,226	13,345,476	13,047,862
Provision for loan losses	890,861	804,430	2,896,691	1,662,804
Net Interest Income After Provision For Loan Losses	5,845,142	5,758,796	10,448,785	11,385,058
Noninterest Income				
Loan appraisal, credit, and miscellaneous charges	193,633	83,388	351,731	253,800
Gain on sale of asset	-	22,500	-	22,500
Income from bank owned life insurance	164,509	106,168	324,204	210,914
Service charges	539,874	442,611	966,833	846,655
Gain on sale of loans held for sale	54,583	89,677	80,158	171,700
Total Noninterest Income	952,599	744,344	1,722,926	1,505,569
Noninterest Expenses				
Salary and employee benefits	2,675,393	2,398,821	5,426,867	4,761,355
Occupancy expense	467,581	466,398	884,972	894,042
Advertising	115,341	101,853	234,037	178,602
Data processing expense	288,356	248,677	571,109	494,817
Professional fees	233,153	285,394	450,241	444,233
Depreciation of furniture, fixtures, and equipment	102,663	134,345	202,192	261,943
Telephone communications	44,207	42,109	86,231	82,228
Office supplies	37,109	33,690	75,900	79,436
FDIC insurance	330,022	394,659	656,341	746,765
Valuation allowance on foreclosed real estate	-	287,934	315,883	287,934
Other	629,473	505,753	1,130,749	906,687
Total Noninterest Expenses	4,923,298	4,899,633	10,034,522	9,138,042
Income before income taxes	1,874,443	1,603,507	2,137,189	3,752,585
Income tax expense	654,648	567,423	675,896	1,352,077
Net Income	$ 1,219,795	$ 1,036,084	$ 1,461,293	$ 2,400,508
Preferred stock dividends	211,732	211,732	423,465	423,465
Net Income Available to Common Shareholders	$ 1,008,063	$ 824,352	$ 1,037,828	$ 1,977,043

Per Common Share				
Basic earnings	$ 0.33	$ 0.28	$ 0.34	$ 0.66
Diluted earnings	$ 0.33	$ 0.27	$ 0.34	$ 0.66
Cash dividends paid	$ 0.40	$ 0.40	$ 0.40	$ 0.40

See notes to consolidated financial statements

TRI-COUNTY FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
SIX MONTHS ENDED JUNE 30, 2011 AND 2010

	Six Months Ended June 30, 2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$1,461,293	$2,400,508
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	2,896,691	1,662,804
Depreciation and amortization	434,471	511,453
Loans originated for resale	(2,992,200)	(5,038,460)
Proceeds from sale of loans originated for sale	3,051,520	4,891,118
Gain on sale of loans held for sale	(80,158)	(171,700)
Gain on sale of asset	-	(22,500)
Net amortization of premium/discount on investment securities	85,186	(188,148)
Increase in foreclosed real estate valuation allowance	315,883	287,934
Increase in cash surrender of bank owned life insurance	(324,204)	(210,914)
Deferred income tax benefit	259,178	(574,839)
(Increase) decrease in accrued interest receivable	(228,474)	43,343
Decrease in deferred loan fees	(456,619)	(43,245)
(Decrease) increase in accounts payable, accrued expenses, other liabilities	(370,871)	127,453
Increase in other assets	(2,349,931)	(822,209)
Net cash provided by operating activities	1,701,765	2,852,598
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of investment securities available for sale	(60,648)	(66,099)
Proceeds from redemption or principal payments of investment securities available for sale	5,758,869	10,015,172
Purchase of investment securities held to maturity	(99,951)	(26,526,103)
Proceeds from maturities or principal payments of investment securities held to maturity	20,195,654	15,222,385
Net decrease of FHLB and Federal Reserve stock	357,800	-
Loans originated or acquired	(142,803,152)	(125,936,531)
Principal collected on loans	102,193,367	106,782,306
Purchase of premises and equipment	(1,796,266)	(456,157)
Proceeds from sale of assets	-	22,500
Net cash used in investing activities	(16,254,327)	(20,942,527)

TRI-COUNTY FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
SIX MONTHS ENDED JUNE 30, 2011 AND 2010 (continued)

	Six Months Ended June 30,	
	2011	2010
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase in deposits	$29,349,504	$43,259,919
Payments of long-term borrowings	(10,023,487)	(5,022,565)
Net increase (decrease) in short-term borrowings	1,044,127	(12,939,213)
Exercise of stock options	303,578	31,858
Dividends Paid	(1,633,321)	(1,619,654)
Redemption of common stock	(224,625)	
Net change in unearned ESOP shares	(100,061)	64,141
Net cash provided by financing activities	18,715,715	23,774,486
INCREASE IN CASH AND CASH EQUIVALENTS	$4,163,153	$5,684,557
CASH AND CASH EQUIVALENTS - JANUARY 1	9,823,436	11,247,967
CASH AND CASH EQUIVALENTS - JUNE 30	$13,986,589	$16,932,524
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the six months for:		
Interest	$6,516,129	$7,034,142
Income taxes	$929,500	$2,699,000
Transfer from loans to foreclosed real estate	$6,230,707	$10,241,740
Issuance of common stock for payment of compensation	$245,294	$-

See notes to consolidated financial statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
SIX MONTHS ENDED JUNE 30, 2011 AND 2010

1. BASIS OF PRESENTATION

General - The consolidated financial statements of Tri-County Financial Corporation (the "Company") and its wholly owned subsidiary, Community Bank of Tri-County (the "Bank"), and the Bank's wholly owned subsidiary Community Mortgage Corporation of Tri-County, included herein are unaudited. However, they reflect all adjustments consisting only of normal recurring accruals that, in the opinion of management, are necessary to present fairly the Company's financial condition, results of operations, and cash flows for the periods presented. Certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission. The Company believes that the disclosures are adequate to make the information presented not misleading. The balances as of December 31, 2010 have been derived from audited financial statements. There have been no significant changes to the Company's accounting policies as disclosed in the 2010 Annual Report. The results of operations for the three and six months ended June 30, 2011 are not necessarily indicative of the results of operations to be expected for the remainder of the year or any other period. Certain previously reported amounts have been restated to conform to the 2011 presentation.

These consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in the Company's 2010 Annual Report.

2. NATURE OF BUSINESS

The Company provides a variety of financial services to individuals and businesses through its offices in Southern Maryland. Its primary deposit products are demand, savings and time deposits, and its primary lending products are commercial and consumer mortgage loans, commercial loans, construction and land development loans, home equity and second mortgages and commercial equipment loans.

3. FAIR VALUE MEASUREMENTS

The Company adopted the Financial Accounting Standards Board's ("FASB") Accounting Standard's Codification ("ASC") Topic 820, "Fair Value Measurements" and FASB ASC Topic 825, "The Fair Value Option for Financial Assets and Financial Liabilities" which provides a framework for measuring and disclosing fair value under generally accepted accounting principles. FASB ASC Topic 820 requires disclosures about the fair value of assets and liabilities recognized in the balance sheet in periods subsequent to initial recognition, whether the measurements are made on a recurring basis (for example, available for sale investment securities) or on a nonrecurring basis (for example, impaired loans).

FASB ASC Topic 820 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. FASB ASC Topic 820 also establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

The Company utilizes fair value measurements to record fair value adjustments to certain assets and to determine fair value disclosures. Securities available for sale are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record at fair value other assets on a nonrecurring basis, such as loans held for investment and certain other assets. These nonrecurring fair value adjustments typically involve application of lower of cost or market accounting or write-downs of individual assets.

Under FASB ASC Topic 820, the Company groups assets and liabilities at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine the fair value. These hierarchy levels are:

Level 1 inputs - Unadjusted quoted prices in active markets for identical assets or liabilities that the entity has the ability to access at the measurement date.

Level 2 inputs - Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets and liabilities in active markets, and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals.

Level 3 inputs - Unobservable inputs for determining the fair values of assets or liabilities that reflect an entity's own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

Transfers between levels of the fair value hierarchy are recognized on the actual date of the event or circumstances that caused the transfer, which generally coincides with the Company's monthly or quarterly valuation process.

There were no transfers between levels of the fair value hierarchy and the Company had no Level 3 fair value assets or liabilities for the six months ended June 30, 2011 and 2010, respectively. Following is a description of valuation methodologies used for assets and liabilities recorded at fair value:

Securities Available for Sale
Investment securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange such as the New York Stock Exchange, Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage backed securities issued by government sponsored entities ("GSEs"), municipal bonds and corporate debt securities. Securities classified as Level 3 include asset-backed securities in less liquid markets.

Loans Receivable
The Company does not record loans at fair value on a recurring basis, however, from time to time, a loan is considered impaired and an allowance for loan loss is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan are considered impaired. Management estimates the fair value of impaired loans using one of several methods, including the collateral value, market value of similar debt, enterprise value, liquidation value and discounted cash flows. Impaired loans not requiring a specific allowance represent loans for which the fair value of expected repayments or collateral exceed the recorded investment in such loans. At June 30, 2011, substantially all of the impaired loans were evaluated based upon the fair value of the collateral. In accordance with FASB ASC 820, impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the loan as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the loan as nonrecurring Level 3.

Loans Held for Sale
Loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated fair value, in the aggregate. Fair value is derived from secondary market quotations for similar instruments. Net unrealized losses, if any, are recognized through a valuation allowance by charges to income.

Mortgage loans held for sale are generally sold with the mortgage servicing rights retained by the Company. The carrying value of mortgage loans sold is reduced by the cost allocated to the associated servicing rights. Gains or losses on sales of mortgage loans are recognized based on the difference between the selling price and the carrying value of the related mortgage loans sold, using the specific identification method.

Foreclosed Real Estate

Foreclosed real estate is adjusted for fair value upon transfer of the loans to foreclosed real estate. Subsequently, foreclosed real estate is carried at the lower of carrying value or fair value. Fair value is based upon independent market prices, appraised value of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the foreclosed asset as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the foreclosed asset as nonrecurring Level 3.

Assets and Liabilities Recorded at Fair Value on a Recurring Basis:
The table below presents the recorded amount of assets and liabilities, as of June 30, 2011 measured at fair value on a recurring basis.

		Fair Value Measurements At June 30, 2011 Using:		
	Estimated Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Description of Asset				
Securities available for sale:				
Asset-backed securities issued by GSEs				
Collateralized Mortgage Obligations (CMO)	$ 22,289,847	$ -	$ 22,289,847	$ -
Mortgage Backed Securities (MBS)	3,077,532	-	3,077,532	-
Corporate equity securities	37,433	-	37,433	-
Bond mutual funds	3,919,293	-	3,919,293	-
Total securities available for sale	$ 29,324,105	$ -	$ 29,324,105	$ -

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis:
The Company may be required from time to time, to measure certain assets at fair value on a nonrecurring basis in accordance with U.S. generally accepted accounting principles. These include assets that are measured at the lower of cost or market that were recognized at fair value below cost at the end of the period. Assets measured at fair value on a nonrecurring basis as of June 30, 2011 are included in the table below:

		Fair Value Measurements At June 30, 2011 Using:		
	Estimated Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)