

TRI COUNTY FINANCIAL CORP /MD/  
Form 10-Q  
May 11, 2012

**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 March 31, 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 0-18279

**Tri-County Financial Corporation**

(Exact name of registrant as specified in its charter)

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Maryland  
(State of other jurisdiction of  
incorporation or organization)

52-1652138  
(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  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. (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

As of April 30, 2012, the registrant had 3,041,582 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 MARCH 31, 2012 AND DECEMBER 31, 2011**

	March 31, 2012 (Unaudited)	December 31, 2011
<b>Assets</b>		
Cash and due from banks	\$ 10,830,866	\$ 13,074,091
Federal funds sold	370,000	5,040,000
Interest-bearing deposits with banks	563,011	1,004,098
Securities available for sale (AFS), at fair value	34,147,730	41,827,612
Securities held to maturity (HTM), at amortized cost	140,636,265	153,516,839
Federal Home Loan Bank and Federal Reserve Bank stock - at cost	5,988,900	5,587,000
Loans receivable - net of allowance for loan losses of \$7,915,798 and \$7,655,041	722,942,471	710,088,775
Premises and equipment, net	17,963,404	16,440,902
Foreclosed real estate	4,467,834	5,028,513
Accrued interest receivable	2,996,328	3,027,784
Investment in bank owned life insurance	18,257,291	18,098,085
Other assets	9,427,404	10,746,024
<b>Total Assets</b>	<b>\$968,591,504</b>	<b>\$983,479,723</b>
<b>Liabilities and Stockholders' Equity</b>		
<b>Deposits</b>		
Noninterest-bearing deposits	\$ 78,817,029	\$ 81,097,622
Interest-bearing deposits	726,872,082	746,155,579
<b>Total deposits</b>	<b>805,689,111</b>	<b>827,253,201</b>
Short-term borrowings	7,000,000	-
Long-term debt	60,564,433	60,576,595
Guaranteed preferred beneficial interest in junior subordinated debentures	12,000,000	12,000,000
Accrued expenses and other liabilities	6,643,551	8,195,829
<b>Total Liabilities</b>	<b>891,897,095</b>	<b>908,025,625</b>
<b>Stockholders' Equity</b>		
Preferred Stock, Senior Non-Cumulative Perpetual, Series C - par value \$1,000; authorized 20,000; issued 20,000	20,000,000	20,000,000
Common stock - par value \$.01; authorized - 15,000,000 shares; Issued 3,045,949 and 3,026,557 shares, respectively	30,459	30,266
Additional paid in capital	17,635,165	17,367,403
Retained earnings	39,762,446	38,712,194

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Accumulated other comprehensive gain	247,693	289,599
Unearned ESOP shares	(981,354 )	(945,364 )
Total Stockholders' Equity	76,694,409	75,454,098
Total Liabilities and Stockholders' Equity	\$968,591,504	\$983,479,723

*See notes to consolidated financial statements*

**TRI-COUNTY FINANCIAL CORPORATION****CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME (UNAUDITED)****THREE MONTHS ENDED MARCH 31, 2012 AND 2011**

	Three Months Ended	
	March 31,	
	2012	2011
Interest and Dividend Income		
Loans, including fees	\$9,224,883	\$8,860,571
Taxable interest and dividends on investment securities	881,817	969,837
Interest on deposits with banks	1,684	1,382
Total Interest and Dividend Income	10,108,384	9,831,790
Interest Expenses		
Deposits	2,412,342	2,608,520
Short-term borrowings	15,841	14,433
Long-term debt	595,502	599,364
Total Interest Expenses	3,023,685	3,222,317
Net Interest Income	7,084,699	6,609,473
Provision for loan losses	341,074	2,005,830
Net Interest Income After Provision For Loan Losses	6,743,625	4,603,643
Noninterest Income		
Loan appraisal, credit and miscellaneous charges	181,314	158,098
Net losses on sale of foreclosed real estate	(96,917)	-
Income from bank owned life insurance	159,206	159,695
Service charges	536,512	426,959
Gain on sale of loans held for sale	65,975	25,575
Total Noninterest Income	846,090	770,327
Noninterest Expenses		
Salary and employee benefits	3,319,866	2,751,474
Occupancy expense	437,472	417,391
Advertising	80,008	118,696
Data processing expense	368,440	282,753
Professional fees	225,209	217,088
Depreciation of furniture, fixtures, and equipment	134,925	99,529
Telephone communications	43,774	42,024
Office supplies	62,062	38,791
FDIC insurance	443,615	326,319
Valuation allowance on foreclosed real estate	300,000	315,883
Other	482,048	501,276
Total Noninterest Expenses	5,897,419	5,111,224



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Income before income taxes	1,692,296	262,746
Income tax expense	587,043	21,248
<b>Net Income</b>	<b>\$1,105,253</b>	<b>\$241,498</b>
Preferred stock dividends	50,000	211,733
Net Income Available to Common Shareholders	\$1,055,253	\$29,765
Net Income	\$1,105,253	\$241,498
Other comprehensive income net of tax:		
Net unrealized holding losses arising during period	(41,906 )	(97,450 )
Comprehensive income	\$1,063,347	\$144,048
Earnings Per Common Share		
Basic	\$0.35	\$0.01
Diluted	0.35	0.01
Cash dividends declared per common share	\$0.40	\$0.40

See notes to consolidated financial statements

**TRI-COUNTY FINANCIAL CORPORATION****CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)****THREE MONTHS ENDED MARCH 31, 2012 AND 2011**

	Three Months Ended March 31,	
	2012	2011
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$1,105,253	\$241,498
Adjustments to reconcile net income to net cash provided (used) by operating activities:		
Provision for loan losses	341,074	2,005,830
Depreciation and amortization	249,149	214,957
Loans originated for resale	(1,718,600 )	(1,476,600 )
Proceeds from sale of loans originated for sale	1,774,555	1,491,984
Gain on sale of loans held for sale	(65,975 )	(25,575 )
Net loss on the sale of foreclosed real estate	96,917	-
Net amortization of premium/discount on investment securities	116,842	45,142
Increase in foreclosed real estate valuation allowance	300,000	315,883
Increase in cash surrender of bank owned life insurance	(159,206 )	(159,695 )
Deferred income tax benefit	(333,582 )	(37,136 )
Decrease (Increase) in accrued interest receivable	31,456	(206,567 )
Stock based compensation	201,060	241,036
(Decrease) Increase in deferred loan fees	(33,169 )	75,657
Decrease in accounts payable, accrued expenses, other liabilities	(1,552,278 )	(1,151,934 )
Decrease (Increase) in other assets	1,673,791	(1,738,166 )
Net cash provided (used) by operating activities	2,027,287	(163,686 )
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchase of investment securities available for sale	(27,457 )	(30,943 )
Proceeds from sale, redemption or principal payments of investment securities available for sale	7,641,683	4,055,862
Purchase of investment securities held to maturity	(849,785 )	(99,951 )
Proceeds from maturities or principal payments of investment securities held to maturity	13,615,678	13,367,862
Net decrease of FHLB and Federal Reserve stock	(401,900 )	(38,400 )
Loans originated or acquired	(58,330,528)	(47,637,459)
Principal collected on loans	45,043,677	51,751,940
Purchase of premises and equipment	(1,771,651 )	(229,705 )
Proceeds from sale of foreclosed real estate	299,032	-

Net cash provided by investing activities	5,218,749	21,139,206
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TRI-COUNTY FINANCIAL CORPORATION  
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)  
THREE MONTHS ENDED MARCH 31, 2012 AND 2011

	Three Months Ended March 31,	
	2012	2011
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Net decrease in deposits	\$(21,564,090)	\$(2,574,582 )
Payments of long-term borrowings	(12,162 )	(10,011,685)
Net increase (decrease) in short term borrowings	7,000,000	(363,332 )
Exercise of stock options	66,895	49,560
Dividends paid	(55,001 )	(211,733 )
Net change in unearned ESOP shares	(35,990 )	(32,742 )
Redemption of common stock	-	(141,863 )
 Net cash used in financing activities	 (14,600,348)	 (13,286,377)
 (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	 \$(7,354,312 )	 \$7,689,143
CASH AND CASH EQUIVALENTS - JANUARY 1	19,118,189	9,823,436
CASH AND CASH EQUIVALENTS - MARCH 31	\$11,763,877	\$17,512,579

**SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:**

Cash paid during the three months for:		
Interest	\$2,941,360	\$3,329,167
Income taxes	\$-	\$-
Transfer from loans to foreclosed real estate	\$135,270	\$1,156,723
Issuance of common stock for payment of compensation	\$201,060	\$241,036

*See notes to consolidated financial statements*

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**THREE MONTHS ENDED MARCH 31, 2012 AND 2011**

**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, 2011 have been derived from audited financial statements. There have been no significant changes to the Company’s accounting policies as disclosed in the 2011 Annual Report. The results of operations for the three months ended March 31, 2012 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 2012 presentation.

These consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in the Company’s 2011 Annual Report.

**2. NATURE OF BUSINESS**

The Company provides a variety of financial services to individuals and businesses through its offices in Southern Maryland and King George, Virginia. Its primary deposit products are demand, savings and time deposits, and its primary lending products are commercial and residential 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 FASB 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 on 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 three months ended March 31, 2012 and the year ended December 31, 2011, 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 December 31, 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.

#### ***Foreclosed Real Estate***

Foreclosed real estate is adjusted for fair value upon transfer of the loans to foreclosed assets. Subsequently, foreclosed real estate is carried at the lower of carrying value and 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 at nonrecurring Level 3.



*Assets and Liabilities Recorded at Fair Value on a Recurring Basis*

The tables below present the recorded amount of assets as of March 31, 2012 and December 31, 2011 measured at fair value on a recurring basis.

Description of Asset	March 31, 2012			
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Available for sale securities				
Asset-backed securities issued by GSEs				
CMOs	\$27,591,074	\$ -	\$ 27,591,074	\$ -
MBS	2,419,025	-	2,419,025	-
Corporate equity securities	37,383	-	37,383	-
Bond mutual funds	4,100,248	-	4,100,248	-
Total available for sale securities	\$34,147,730	\$ -	\$ 34,147,730	\$ -