

TRI COUNTY FINANCIAL CORP /MD/  
Form 10-Q  
August 14, 2013

**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 June 30, 2013

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)

Edgar Filing: TRI COUNTY FINANCIAL CORP /MD/ - Form 10-Q

Maryland 52-1652138  
(State of other jurisdiction of (I.R.S. Employer  
incorporation or organization) 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 July 31, 2013, the registrant had 3,045,543 shares of common stock outstanding.

**TRI-COUNTY FINANCIAL CORPORATION**

**FORM 10-Q**

**INDEX**

	<b>Page</b>
<b>PART I - FINANCIAL INFORMATION</b>	
Item 1 – Financial Statements (Unaudited)	
Consolidated Balance Sheets – June 30, 2013 and December 31, 2012	3
Consolidated Statements of Income and Comprehensive Income - Three and Six Months Ended June 30, 2013 and 2012	4
Consolidated Statements of Cash Flows - Six Months Ended June 30, 2013 and 2012	5
Notes to Consolidated Financial Statements	7
Item 2 – Management’s Discussion and Analysis of Financial Condition and Results of Operations	31
Item 3 – Quantitative and Qualitative Disclosures about Market Risk	51
Item 4 – Controls and Procedures	51
<b>PART II - OTHER INFORMATION</b>	
Item 1 – Legal Proceedings	51
Item 1A – Risk Factors	51
Item 2 – Unregistered Sales of Equity Securities and Use of Proceeds	51
Item 3 – Defaults Upon Senior Securities	52
Item 4 – Mine Safety Disclosures	52
Item 5 – Other Information	52
Item 6 – Exhibits	52

**SIGNATURES**

53

2

**PART I FINANCIAL STATEMENTS****ITEM I. FINANCIAL STATEMENTS****TRI-COUNTY FINANCIAL CORPORATION****CONSOLIDATED BALANCE SHEETS JUNE 30, 2013 AND DECEMBER 31, 2012**

	June 30, 2013 (Unaudited)	December 31, 2012
<b>Assets</b>		
Cash and due from banks	\$ 10,768,998	\$ 10,696,653
Federal funds sold	3,470,000	190,000
Interest-bearing deposits with banks	1,336,720	409,002
Securities available for sale (AFS), at fair value	54,103,851	47,205,663
Securities held to maturity (HTM), at amortized cost	99,896,483	112,619,434
Federal Home Loan Bank (FHLB) and Federal Reserve Bank (FRB) stock - at cost	6,666,550	5,476,050
Loans held for sale	320,000	-
Loans receivable - net of allowance for loan losses of \$8,033,553 and \$8,246,957	745,251,604	747,640,752
Premises and equipment, net	19,289,816	19,782,236
Other real estate owned (OREO)	6,932,177	6,891,353
Accrued interest receivable	2,902,627	2,904,325
Investment in bank owned life insurance	19,039,007	18,730,580
Other assets	10,124,507	9,093,164
<b>Total Assets</b>	<b>\$ 980,102,340</b>	<b>\$ 981,639,212</b>
<b>Liabilities and Stockholders' Equity</b>		
<b>Liabilities</b>		
<b>Deposits</b>		
Non-interest-bearing deposits	\$ 89,565,889	\$ 102,319,581
Interest-bearing deposits	695,115,348	717,910,707
<b>Total deposits</b>	<b>784,681,237</b>	<b>820,230,288</b>
Short-term borrowings	24,000,000	1,000,000
Long-term debt	70,501,763	60,527,208
Guaranteed preferred beneficial interest in junior subordinated debentures (TRUPs)	12,000,000	12,000,000
Accrued expenses and other liabilities	7,846,870	8,834,455
<b>Total Liabilities</b>	<b>899,029,870</b>	<b>902,591,951</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
	30,455	30,524

Edgar Filing: TRI COUNTY FINANCIAL CORP /MD/ - Form 10-Q

Common stock - par value \$.01; authorized - 15,000,000 shares; issued  
3,045,543 and 3,052,416 shares, respectively

Additional paid in capital	18,222,907	17,873,560
Retained earnings	44,283,597	41,986,633
Accumulated other comprehensive gain (loss)	(679,594 )	139,184
Unearned ESOP shares	(784,895 )	(982,640 )
Total Stockholders' Equity	81,072,470	79,047,261
Total Liabilities and Stockholders' Equity	\$ 980,102,340	\$ 981,639,212

*See notes to Consolidated Financial Statements*

**TRI-COUNTY FINANCIAL CORPORATION****CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME (UNAUDITED)****THREE AND SIX MONTHS ENDED JUNE 30, 2013 AND 2012**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Interest and Dividend Income				
Loans, including fees	\$ 9,116,080	\$ 9,286,377	\$ 18,363,746	\$ 18,511,260
Taxable interest and dividends on investment securities	631,347	815,101	1,221,040	1,696,918
Interest on deposits with banks	2,686	1,064	5,284	2,748
Total Interest and Dividend Income	9,750,113	10,102,542	19,590,070	20,210,926
Interest Expense				
Deposits	1,434,338	2,197,377	2,967,301	4,609,719
Short-term borrowings	15,421	15,910	37,827	31,751
Long-term debt	568,496	552,054	1,036,414	1,147,556
Total Interest Expense	2,018,255	2,765,341	4,041,542	5,789,026
Net Interest Income	7,731,858	7,337,201	15,548,528	14,421,900
Provision for loan losses	200,427	436,431	354,600	777,505
Net Interest Income After Provision For Loan Losses	7,531,431	6,900,770	15,193,928	13,644,395
Noninterest Income				
Loan appraisal, credit, and miscellaneous charges	130,721	202,127	319,149	383,441
Gain on sale of asset	11,000	-	11,000	-
Net losses on sale of OREO	-	-	-	(96,917 )
Income from bank owned life insurance	156,994	159,911	308,427	319,117
Service charges	632,547	465,391	1,103,180	1,001,903
Gain on sale of loans held for sale	137,466	69,366	516,050	135,341
Total Noninterest Income	1,068,728	896,795	2,257,806	1,742,885
Noninterest Expense				
Salary and employee benefits	3,589,610	3,170,213	7,146,606	6,490,079
Occupancy expense	569,479	464,319	1,052,250	901,791
Advertising	168,843	179,083	272,731	259,091
Data processing expense	366,480	421,153	730,314	789,593
Professional fees	264,354	343,295	461,691	568,504
Depreciation of furniture, fixtures, and equipment	197,092	162,364	389,522	297,289
Telephone communications	53,781	48,312	102,729	92,086
Office supplies	46,015	71,928	109,468	133,990
FDIC Insurance	272,837	447,587	574,269	891,202
Valuation allowance on OREO	19,476	326,176	329,976	626,176
Other	558,453	729,256	1,079,688	1,211,304
Total Noninterest Expense	6,106,420	6,363,686	12,249,244	12,261,105



Edgar Filing: TRI COUNTY FINANCIAL CORP /MD/ - Form 10-Q

Income before income taxes	2,493,739	1,433,879	5,202,490	3,126,175
Income tax expense	908,290	492,727	1,898,650	1,079,770
Net Income	\$ 1,585,449	\$ 941,152	\$ 3,303,840	\$ 2,046,405
Preferred stock dividends	50,000	50,000	100,000	100,000
Net Income Available to Common Shareholders	\$ 1,535,449	\$ 891,152	\$ 3,203,840	\$ 1,946,405
Net Income	\$ 1,585,449	\$ 941,152	\$ 3,303,840	\$ 2,046,405
Net unrealized holding gains (losses) arising during period, net of tax	(743,170 )	49,657	(818,778 )	7,751
Comprehensive Income	\$ 842,279	\$ 990,809	\$ 2,485,062	\$ 2,054,156
Earnings Per Common Share				
Basic	\$ 0.51	\$ 0.29	\$ 1.06	\$ 0.64
Diluted	\$ 0.51	\$ 0.29	\$ 1.05	\$ 0.64
Cash dividends paid per common share	\$ 0.10	\$ 0.40	\$ 0.20	\$ 0.40

*See notes to Consolidated Financial Statements*

**TRI-COUNTY FINANCIAL CORPORATION****CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)****SIX MONTHS ENDED JUNE 30, 2013 AND 2012**

	Six Months Ended June 30,	
	2013	2012
Cash Flows from Operating Activities		
Net income	\$3,303,840	\$2,046,405
Adjustments to reconcile net income to net cash provided by operating activities		
Provision for loan losses	354,600	777,505
Depreciation and amortization	648,119	521,935
Loans originated for resale	(17,882,950 )	(3,292,600 )
Proceeds from sale of loans originated for sale	17,963,029	3,402,426
Gain on sale of loans held for sale	(516,050 )	(135,341 )
Net losses on the sale of OREO	-	96,917
Gain on sale of asset	(11,000 )	-
Net amortization of premium/discount on investment securities	327,305	204,597
Increase in OREO valuation allowance	329,976	626,176
Increase in cash surrender of bank owned life insurance	(308,427 )	(319,116 )
Deferred income tax benefit	(96,796 )	(345,542 )
Decrease (Increase) in accrued interest receivable	1,698	(51,308 )
Stock based compensation	249,129	263,612
Increase (Decrease) in deferred loan fees	265,828	(11,099 )
Decrease in accounts payable, accrued expenses and other liabilities	(987,585 )	(9,524 )
(Increase) Decrease in other assets	(505,754 )	1,388,154
Net Cash Provided by Operating Activities	3,134,962	5,163,197
Cash Flows from Investing Activities		
Purchase of AFS investment securities	(13,464,967 )	(10,077,772 )
Proceeds from redemption or principal payments of AFS investment securities	5,234,496	11,252,526
Purchase of HTM investment securities	(10,932,813 )	(849,785 )
Proceeds from maturities or principal payments of HTM investment securities	23,420,169	27,246,045
Net increase of FHLB and FRB stock	(1,190,500 )	(193,450 )
Loans originated or acquired	(112,182,444)	(125,552,773)
Principal collected on loans	113,696,335	98,929,725
Purchase of premises and equipment	(155,699 )	(3,403,294 )
Proceeds from sale of OREO	-	299,302
Proceeds from disposal of asset	11,000	-
Net Cash Provided by (Used in) Investing Activities	4,435,577	(2,349,476 )



**TRI-COUNTY FINANCIAL CORPORATION**

**CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**

**SIX MONTHS ENDED JUNE 30, 2013 AND 2012 (continued)**

	Six Months Ended June 30,	
	2013	2012
Cash Flows from Financing Activities		
Net decrease in deposits	\$(35,549,051)	\$(11,478,877)
Proceeds from long-term borrowings	10,000,000	-
Payments of long-term borrowings	(25,445 )	(24,447 )
Net increase in short term borrowings	23,000,000	3,000,000
Exercise of stock options	75,235	67,391
Dividends Paid	(709,238 )	(1,321,571 )
Net change in unearned ESOP shares	215,824	(1,942 )
Redemption of common stock	(297,801 )	(153,800 )
Net Cash Used in Financing Activities	(3,290,476 )	(9,913,246 )
Increase (Decrease) in Cash and Cash Equivalents	\$4,280,063	\$(7,099,525 )
Cash and Cash Equivalents - January 1	11,295,655	19,118,189
Cash and Cash Equivalents - June 30	\$15,575,718	\$12,018,664
Supplemental Disclosures of Cash Flow Information		
Cash paid during the six months for:		
Interest	\$4,017,398	\$5,797,788
Income taxes	\$2,600,000	\$1,020,000
Supplemental Schedule of Non-Cash Operating Activities		
Issuance of common stock for payment of compensation	\$249,129	\$263,612
Transfer from loans to OREO	\$370,800	\$1,555,770

*See notes to Consolidated Financial Statements*

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

**SIX MONTHS ENDED JUNE 30, 2013 AND 2012**

**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, 2012 have been derived from audited financial statements. There have been no significant changes to the Company’s accounting policies as disclosed in the 2012 Annual Report. The results of operations for the three and six months ended June 30, 2013 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 2013 presentation.

These consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in the Company’s 2012 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 and six months ended June 30, 2013 and the year ended December 31, 2012, 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, 2013 and December 31, 2012, 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 (loans with impairment) 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.

***Other Real Estate Owned (“OREO”)***

OREO is adjusted for fair value upon transfer of the loans to foreclosed assets. Subsequently, OREO 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 June 30, 2013 and December 31, 2012 measured at fair value on a recurring basis.

Description of Asset	June 30, 2013			
	Fair Value	Level 1	Level 2	Level 3
Available for sale securities				
Asset-backed securities issued by GSEs				
Collateralized Mortgage Obligations ("CMOs")	\$49,689,627	\$ -	\$49,689,627	\$ -
Mortgage Backed Securities ("MBS")	217,102	-	217,102	-
Corporate equity securities	38,860	-	38,860	-
Bond mutual funds	4,158,262	-	4,158,262	-
Total available for sale securities	\$54,103,851	\$ -	\$54,103,851	\$ -

Description of Asset	December 31, 2012			
	Fair Value	Level 1	Level 2	Level 3
Available for sale securities				
Asset-backed securities issued by GSEs				
CMOs	\$42,655,799	\$ -	\$42,655,799	\$ -
MBS	231,386	-	231,386	-
Corporate equity securities	37,332	-	37,332	-
Bond mutual funds	4,281,146	-	4,281,146	-
Total available for sale securities	\$47,205,663	\$ -	\$47,205,663	\$ -

**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. GAAP. 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, 2013 and December 31, 2012 are included in the tables below.

Description of Asset	June 30, 2013			
	Fair Value	Level 1	Level 2	Level 3
Loans with impairment				
Commercial real estate	\$3,770,616	\$ -	\$3,770,616	\$ -
Residential first mortgage	500,685	-	500,685	-
Construction and land development	1,038,300	-	1,038,300	-
Commercial loans	117,000	-	117,000	-
Total loans with impairment	\$5,426,601	\$ -	\$5,426,601	\$ -
Other real estate owned	\$6,932,177	\$ -	\$6,932,177	\$ -

Description of Asset	December 31, 2012			
	Fair Value	Level 1	Level 2	Level 3
Loans with impairment				
Commercial real estate	\$2,028,534	\$ -	\$2,028,534	\$ -
Residential first mortgage	602,290	-	602,290	-
Commercial loans	94,355	-	94,355	-
Total loans with impairment	\$2,725,179	\$ -	\$2,725,179	\$ -
Other real estate owned	\$6,891,353	\$ -	\$6,891,353	\$ -

Loans with impairment have unpaid principal balances of \$6,660,269 and \$4,272,836 at June 30, 2013 and December 31, 2012, respectively, and include impaired loans with a specific allowance.

**4.****INCOME TAXES**

The Company files a consolidated federal income tax return with its subsidiaries. Deferred tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the temporary differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws and when it is considered more likely than not that deferred tax assets will be realized. It is the Company's policy to recognize accrued interest and penalties related to unrecognized tax benefits as a component of tax expense.

**5.****EARNINGS PER COMMON SHARE (EPS)**

Basic earnings per common share represent income available to common shareholders, 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. Potential common shares that may be issued by the Company relate to outstanding stock options and are determined using the treasury stock method. As of June 30, 2013 and 2012, there were 101,549 and 187,367 shares, respectively, excluded from the diluted net income per share computation because the exercise price of the stock options were greater than the market price, and thus were anti-dilutive. Basic and diluted earnings per share have been computed based on weighted-average common and common equivalent shares outstanding as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Net Income	\$ 1,585,449	\$ 941,152	\$ 3,303,840	\$ 2,046,405
Less: dividends paid and accrued on preferred stock	(50,000 )	(50,000 )	(100,000 )	(100,000 )
Net income available to common shareholders	\$ 1,535,449	\$ 891,152	\$ 3,203,840	\$ 1,946,405
Average number of common shares outstanding	3,000,389	3,045,979	3,026,651	3,041,679
Effect of dilutive options	23,379	24,786	22,597	14,841
Average number of shares used to calculate diluted EPS	3,023,768	3,070,765	3,049,248	3,056,520

**6. STOCK-BASED COMPENSATION**

The Company has stock option and incentive arrangements to attract and retain key personnel. In May 2005, the 2005 Equity Compensation Plan (the "Plan") was approved by the shareholders, which authorizes the issuance of restricted stock, stock appreciation rights, stock units and stock options to the Board of Directors and key employees. Compensation expense for service based awards is recognized over the vesting period. Performance based awards are recognized based on a vesting, if applicable, and the probability of achieving the goals.

Stock-based compensation expense totaled \$146,965 and \$81,189 for the six months ended June 30, 2013 and 2012, respectively, which consisted of grants of restricted stock and restricted stock units. Stock-based compensation for the six months ended June 30, 2013 and 2012 included director compensation of \$3,320 and \$12,640, respectively, for stock granted in lieu of cash compensation. All outstanding options are fully vested and the Company has not granted

any stock options since 2007.

The fair value of the Company's outstanding employee stock options is estimated on the date of grant using the Black-Scholes option pricing model. The Company estimates expected market price volatility and expected term of the options based on historical data and other factors.

The exercise price for options granted is set at the discretion of the committee administering the Plan, but is not less than the market value of the shares as of the date of grant. An option's maximum term is 10 years and the options vest at the discretion of the committee.

The following tables below summarize outstanding and exercisable options at June 30, 2013 and December 31, 2012.

	Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value	Weighted-Average Contractual Life Remaining In Years
Outstanding at January 1, 2013	236,059	\$ 18.49	\$ 164,304	
Granted at fair value	-	-		
Exercised	(12,863 )	13.08	64,517	
Expired	-			
Forfeited	(2 )	13.05		
Outstanding at June 30, 2013	223,194	\$ 18.80	\$ 415,264	1.0
Exercisable at June 30, 2013	223,194	\$ 18.80	\$ 415,264	1.0

	Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value	Weighted-Average Contractual Life Remaining In Years
Outstanding at January 1, 2012	264,156	\$ 17.90	\$ 175,911	
Granted at fair value	-	-		
Exercised	(24,780 )	12.25	88,607	
Expired	-			
Forfeited	(3,317 )	18.25		
Outstanding at December 31, 2012	236,059	\$ 18.49	\$ 164,304	1.0
Exercisable at December 31, 2012	236,059	\$ 18.49	\$ 164,304	1.0

Options outstanding are all currently exercisable and are summarized as follows:

Shares Outstanding June 30, 2013	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price
39,668	1 years	\$ 12.97
81,977	2 years	15.89
80,138	3 years	22.29
21,411	4 years	27.70
223,194		\$ 18.80

The aggregate intrinsic value of outstanding stock options and exercisable stock options was \$415,264 and \$164,304 at June 30, 2013 and December 31, 2012, respectively. Aggregate intrinsic value represents the difference between the Company's closing stock price on the last trading day of the period, which was \$18.35 and \$15.98 per share at June 30, 2013 and December 31, 2012, respectively, and the exercise price multiplied by the number of options outstanding.

The Company has outstanding restricted stock and stock units granted in accordance with the Plan. The following tables summarize the unvested restricted stock awards and units outstanding at June 30, 2013 and December 31, 2012, respectively.

	Restricted Stock		Restricted Stock Units	
	Number of Shares	Weighted Average Grant Date Fair Value	Number of Units	Fair Value
Nonvested at December 31, 2012	23,569	\$ 15.64	5,211	\$ 15.98
Granted	13,656	18.00	2,105	16.87
Vested	(16,678 )	16.35	(3,106 )	15.98
Nonvested at June 30, 2013	20,547	\$ 16.63	4,210	\$ 18.35