FRANKLIN FINANCIAL SERVICES CORP /PA/
Form 10-Q
May 11, 2009

Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549
FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2009,

OR

o **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 0-12126

FRANKLIN FINANCIAL SERVICES CORPORATION

(Exact name of registrant as specified in its charter)

PENNSYLVANIA	**25-1440803**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

20 SOUTH MAIN STREET (P.O. BOX 6010), CHAMBERSBURG, PA 17201-0819

(Address of principal executive offices)

717/264-6116

(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 þ No o

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 o No o

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.

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

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Act) Yes o No þ

There were 3,833,947 outstanding shares of the Registrant s common stock as of April 30, 2009.

INDEX

2

Table of Contents

Part I FINANCIAL INFORMATION

Item 1 Financial Statements

Consolidated Balance Sheets
(Amounts in thousands, except per share data)
(unaudited)

	March 31 2009	December 31 2008
Assets		
Cash and due from banks	$ 14,169	$ 16,505
Federal funds sold	1,550	
Interest-bearing deposits in other banks	141	208
Total cash and cash equivalents	15,860	16,713
Investment securities available for sale	140,246	147,559
Restricted stock	6,482	6,482
Loans	696,773	676,217
Allowance for loan losses	(7,843)	(7,357)
Net Loans	688,930	668,860
Premises and equipment, net	15,908	15,625
Bank owned life insurance	19,039	18,875
Goodwill	9,159	9,152
Other intangible assets	2,812	2,929
Other assets	16,836	16,265
Total assets	$ 915,272	$ 902,460
Liabilities and Shareholders Equity		
Liabilities		
Deposits		
Demand (non-interest bearing)	$ 78,322	$ 86,954
Savings and interest checking	347,531	335,418
Time	228,552	204,969
Total Deposits	654,405	627,341
Securities sold under agreements to repurchase	68,728	64,312
Short-term borrowings		18,850
Long-term debt	105,218	106,141
Other liabilities	13,673	12,757
Total liabilities	842,024	829,401
Shareholders equity		
Common stock $1 par value per share, 15,000 shares authorized with 4,299 shares issued, and 3,834 shares and 3,825 shares outstanding at March 31,	4,299	4,299

2009 and December 31, 2008, respectively		
Capital stock without par value, 5,000 shares authorized with no shares issued or outstanding		
Additional paid-in capital	**32,854**	32,883
Retained earnings	**53,194**	52,126
Accumulated other comprehensive loss	**(8,773)**	(7,757)
Treasury stock, 465 shares and 474 shares at cost at March 31, 2009 and December 31, 2008, respectively	**(8,326)**	(8,492)
Total shareholders equity	**73,248**	73,059
Total liabilities and shareholders equity	**$ 915,272**	$ 902,460

The accompanying notes are an integral part of these financial statements.

Table of Contents

Consolidated Statements of Income
(Amounts in thousands, except per share data)
(unaudited)

	For the Three Months Ended March 31 **2009**	2008
Interest income		
Loans, including fees	**$ 9,192**	$ 9,643
Interest and dividends on investments:		
Taxable interest	**1,089**	1,366
Tax exempt interest	**474**	562
Dividend income	**57**	75
Federal funds sold		32
Deposits and obligations of other banks		4
Total interest income	**10,812**	11,682
Interest expense		
Deposits	**2,482**	2,856
Securities sold under agreements to repurchase	**45**	608
Short-term borrowings	**11**	13
Long-term debt	**1,055**	691
Total interest expense	**3,593**	4,168
Net interest income	**7,219**	7,514
Provision for loan losses	**593**	215
Net interest income after provision for loan losses	**6,626**	7,299
Noninterest income		
Investment and trust services fees	**894**	915
Loan service charges	**277**	177
Mortgage banking activities	**(28)**	(109)
Deposit service charges and fees	**580**	592
Other service charges and fees	**302**	299
Increase in cash surrender value of life insurance	**164**	166
Equity method investment		(166)
Other	**295**	22
Impairment writedown on equity securities	**(209)**	(222)
Securities gains, net	**12**	329
Total noninterest income	**2,287**	2,003

Noninterest Expense				
Salaries and benefits		**3,153**		3,101
Net occupancy expense		**480**		458
Furniture and equipment expense		**217**		216
Advertising		**315**		314
Legal and professional fees		**251**		248
Data processing		**401**		357
Pennsylvania bank shares tax		**145**		170
Intangible amortization		**117**		90
FDIC insurance		**231**		18
Other		**840**		877
Total noninterest expense		**6,150**		5,849
Income before federal income taxes		**2,763**		3,453
Federal income tax expense		**662**		921
Net income	**$**	**2,101**	$	2,532
Per share				
Basic earnings per share	**$**	**0.55**	$	0.66
Diluted earnings per share	**$**	**0.55**	$	0.66
Cash dividends declared per share	**$**	**0.27**	$	0.26

The accompanying notes are an integral part of these financial statements.

Table of Contents

Consolidated Statements of Changes in Shareholders Equity
for the three months ended March 31, 2009 and 2008
(unaudited)

(Dollars in thousands, except per share data)	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total
Balance at December 31, 2007	$ 4,299	$ 32,620	$ 47,946	$ 664	$ (7,887)	$ 77,642
Comprehensive income:						
Net income			2,532			2,532
Unrealized loss on securities, net of reclassification adjustments and taxes				(621)		(621)
Unrealized loss on hedging activities, net of reclassification adjustments and taxes				(3)		(3)
Total Comprehensive income						1,908
Cash dividends declared, $.26 per share			(997)			(997)
Cumulative adjustment for change in accounting principle			(422)			(422)
Acquisition of 17,648 shares of treasury stock					(419)	(419)
Treasury shares issued to dividend reinvestment plan, 7,327 shares		46			128	174
Stock option compensation		28				28
Balance at March 31, 2008	$ 4,299	$ 32,694	$ 49,059	$ 40	$ (8,178)	$ 77,914
Balance at December 31, 2008	$ 4,299	$ 32,883	$ 52,126	$ (7,757)	$ (8,492)	$ 73,059
Comprehensive income:						
Net income			2,101			2,101
Unrealized loss on securities, net of reclassification adjustments and taxes				(1,202)		(1,202)
Unrealized gain on hedging activities, net of reclassification adjustments and taxes				186		186
Total Comprehensive income						1,085
Cash dividends declared, $.27 per share			(1,033)			(1,033)
Acquisition of 3,000 shares of treasury stock					(51)	(51)
Treasury shares issued to dividend reinvestment plan, 12,049 shares		(34)			217	183
Stock option compensation		5				5

Balance at March 31, 2009	$ 4,299	$ 32,854	$ 53,194	$ (8,773)	$ (8,326)	$ 73,248

The accompanying notes are an integral part of these statements.

Table of Contents

Consolidated Statements of Cash Flows
(unaudited)

(Amounts in thousands)	For the Three Months Ended March 31 **2009**	2008
Cash flows from operating activities		
Net income	**$ 2,101**	$ 2,532
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	**361**	319
Net accretion of loans and investment securities	**(35)**	(85)
Stock option compensation expense	**5**	28
Amortization and net change in mortgage servicing rights valuation	**111**	245
Amortization of intangibles	**117**	90
Provision for loan losses	**593**	215
Net realized gains on sales of securities	**(12)**	(329)
Impairment writedown on equity securities	**209**	222
Loans originated for sale		(2,113)
Proceeds from sale of loans		2,632
Gain on sales of loans		(43)
Net loss on sale or disposal of other real estate/other repossessed assets	**(5)**	
Increase in cash surrender value of life insurance	**(164)**	(166)
Proceeds from surrender of life insurance policy	**(275)**	-
Loss on equity method investments		166
Decrease (increase) in interest receivable and other assets	**453**	(650)
Increase in interest payable and other liabilities	**959**	372
Other, net	**(110)**	(18)
Net cash provided by operating activities	**4,308**	3,417
Cash flows from investing activities		
Proceeds from sales of investment securities available for sale	**2,964**	3,254
Proceeds from maturities of investment securities available for sale	**5,120**	14,774
Net increase in restricted stock		(733)
Purchase of investment securities available for sale	**(2,687)**	(10,402)
Net increase in loans	**(20,754)**	(17,628)
Proceeds from sale of other real estate owned		175
Capital expenditures	**(609)**	(394)
Net cash used in investing activities	**(15,966)**	(10,954)
Cash flows from financing activities		
Net increase (decrease) in demand deposits, NOW accounts and savings accounts	**3,481**	(9,591)
Net increase (decrease) in certificates of deposit	**23,583**	(3,674)
Net (decrease) increase in short term borrowings	**(14,434)**	8,590

Long-term debt payments		**(1,183)**		(2,648)
Long-term debt advances		**260**		15,057
Dividends paid		**(1,033)**		(997)
Common stock issued to dividend reinvestment plan		**182**		174
Purchase of treasury shares		**(51)**		(419)
Net cash provided by financing activities		**10,805**		6,492
Decrease in cash and cash equivalents		**(853)**		(1,045)
Cash and cash equivalents as of January 1		**16,713**		25,491
Cash and cash equivalents as of March 31	**$**	**15,860**	$	24,446
Supplemental Disclosures of Cash Flow Information Cash paid during the year for:				
Interest on deposits and other borrowed funds	**$**	**3,323**	$	4,120
Income taxes	**$**	**203**	$	622

The accompanying notes are an integral part of these statements.

Table of Contents

FRANKLIN FINANCIAL SERVICES CORPORATION and SUBSIDIARIES
UNAUDITED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 Basis of Presentation

The consolidated financial statements include the accounts of Franklin Financial Services Corporation (the Corporation), and its wholly-owned subsidiaries, Farmers and Merchants Trust Company of Chambersburg (the Bank), Franklin Financial Properties Corp., and Franklin Future Fund Inc. Farmers and Merchants Trust Company of Chambersburg is a commercial bank that has one wholly-owned subsidiary, Franklin Realty Services Corporation. Franklin Realty Services Corporation is an inactive real-estate brokerage company. Franklin Financial Properties Corp. holds real estate assets that are leased by the Bank. Franklin Future Fund Inc. is a non-bank investment company. The activities of nonbank entities are not significant to the consolidated totals. All significant intercompany transactions and account balances have been eliminated.

In the opinion of management, all adjustments (which include only normal recurring adjustments) necessary to present fairly the consolidated financial position, results of operations, and cash flows as of March 31, 2009, and for all other periods presented have been made.

Certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. It is suggested that these consolidated financial statements be read in conjunction with the audited consolidated financial statements and notes thereto included in the Corporation s 2008 Annual Report on Form 10-K. The consolidated results of operations for the period ended March 31, 2009 are not necessarily indicative of the operating results for the full year.

The consolidated balance sheet at December 31, 2008 has been derived from the audited consolidated financial statements at that date, but does not include all of the information and footnotes required by generally accepted accounting principles for complete consolidated financial statements.

For purposes of reporting cash flows, cash and cash equivalents include Cash and due from banks, interest-bearing deposits in other banks and Federal funds sold. Generally, Federal funds are purchased and sold for one-day periods.

Earnings per share is computed based on the weighted average number of shares outstanding during each period end. A reconciliation of the weighted average shares outstanding used to calculate basic earnings per share and diluted earnings per share follows:

	For the Three Months Ended March 31	
(Amounts in thousands)	2009	2008
Weighted average shares outstanding (basic)	3,827	3,838
Impact of common stock equivalents		2
Weighted average shares outstanding (diluted)	3,827	3,840

Table of Contents

Note 2 Recent Accounting Pronouncements

FAS 157-4 Determining Fair Value When the Volume and Level of Activity for the Asset or Liability have Significantly Decreased and Identifying Transactions That Are Not Orderly

In April 2009, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) No. FAS 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly (FSP FAS 157-4). FASB Statement 157, *Fair Value Measurements*, defines fair value as the price that would be received to sell the asset or transfer the liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. FSP FAS 157-4 provides additional guidance on determining when the volume and level of activity for the asset or liability has significantly decreased. The FSP also includes guidance on identifying circumstances when a transaction may not be considered orderly.

FSP FAS 157-4 provides a list of factors that a reporting entity should evaluate to determine whether there has been a significant decrease in the volume and level of activity for the asset or liability in relation to normal market activity for the asset or liability. When the reporting entity concludes there has been a significant decrease in the volume and level of activity for the asset or liability, further analysis of the information from that market is needed and significant adjustments to the related prices may be necessary to estimate fair value in accordance with Statement 157.

This FSP clarifies that when there has been a significant decrease in the volume and level of activity for the asset or liability, some transactions may not be orderly. In those situations, the entity must evaluate the weight of the evidence to determine whether the transaction is orderly. The FSP provides a list of circumstances that may indicate that a transaction is not orderly. A transaction price that is not associated with an orderly transaction is given little, if any, weight when estimating fair value.

This FSP is effective for interim and annual reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. An entity early adopting FSP FAS 157-4 must also early adopt FSP FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*. The Corporation is currently reviewing the effect this new pronouncement will have on its consolidated financial statements and the Corporation did not adopt the pronouncement early.

FAS 115-2 and FAS 124-2 Recognition and Presentation of Other-Than-Temporary Impairments

In April 2009, the FASB issued FSP No. FAS 115-2 and FAS 124-2, Recognition and Presentation of Other-Than-Temporary Impairments (FSP FAS 115-2 and FAS 124-2). FSP FAS 115-2 and FAS 124-2 clarifies the interaction of the factors that should be considered when determining whether a debt security is other-than-temporarily impaired. For debt securities, management must assess whether (a) it has the intent to sell the security and (b) it is more likely than not that it will be required to sell the security prior to its anticipated recovery. These steps are done before assessing whether the entity will recover the cost basis of the investment. Previously, this assessment required management to assert it has both the intent and the ability to hold a security for a period of time sufficient to allow for an anticipated recovery in fair value to avoid recognizing an other-than-temporary impairment. This change does not affect the need to forecast recovery of the value of the security through either cash flows or market price.

Table of Contents

In instances when a determination is made that an other-than-temporary impairment exists but the investor does not intend to sell the debt security and it is not more likely than no