

TRI COUNTY FINANCIAL CORP /MD/

Form 10-Q

August 14, 2006

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**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, 2006**

**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 018279**

**Tri-County Financial Corporation**

(Exact name of registrant as specified in its charter)

Maryland  
(State of other jurisdiction of  
incorporation or organization)

52-1652138  
(I.R.S. Employer  
Identification No.)

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

20601  
(Zip Code)

(301) 843 0854

(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 is a large accelerated filer, an accelerated filer or a non-accelerated filer. (See definition of accelerated filer and large accelerated filer in rule 12b2 of the exchange act.)

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b2 of the Exchange Act). Yes  No

As of July 29, 2006, the registrant had 1,766,840 shares of common stock outstanding.

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**TRI-COUNTY FINANCIAL CORPORATION  
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**PART I FINANCIAL INFORMATION**  
**ITEM I. FINANCIAL STATEMENTS**  
**TRI-COUNTY FINANCIAL CORPORATION**  
**CONSOLIDATED BALANCE SHEETS JUNE 30, 2006 AND DECEMBER 31, 2005**  
**(UNAUDITED)**

	June 30, 2006	December 31, 2005
<b>ASSETS</b>		
Cash and due from banks	\$ 2,869,183	\$ 7,262,547
Federal funds sold	675,129	640,818
Interest-bearing deposits with banks	12,454,378	14,671,875
Securities available for sale	9,538,720	7,178,894
Securities held to maturity at amortized cost	106,205,210	116,486,685
Federal Home Loan Bank and Federal Reserve Bank stock at cost	7,158,800	7,190,300
Loans receivable net of allowance for loan losses of \$3,549,270 and \$3,383,334 respectively	404,506,928	369,592,253
Premises and equipment, net	6,546,664	6,460,545
Foreclosed real estate, net	460,884	475,561
Accrued interest receivable	2,549,593	2,406,542
Investment in bank owned life insurance	8,593,983	6,434,175
Other assets	3,020,764	2,487,280
<b>TOTAL ASSETS</b>	<b>\$ 564,580,236</b>	<b>\$ 541,287,475</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
<b>LIABILITIES</b>		
Noninterest-bearing deposits	\$ 41,352,192	\$ 44,325,083
Interest-bearing deposits	346,735,839	319,048,657
Total deposits	388,088,031	363,373,740
Short-term borrowings	32,244,357	20,074,975
Long-term debt	93,065,552	107,823,759
Guaranteed preferred beneficial interest in junior subordinated debentures	12,000,000	12,000,000
Accrued expenses and other liabilities	3,868,623	3,436,845
Total liabilities	529,266,563	506,709,319

## STOCKHOLDERS EQUITY:

Common stock par value \$.01; authorized - 15,000,000 shares; issued 1,761,499 and 1,760,991 shares, respectively	17,615	17,610
Additional paid in capital	9,182,554	9,057,805
Retained earnings	26,369,872	25,580,634
Accumulated other comprehensive (loss) income	(159,339)	49,362
Unearned ESOP shares	(97,029)	(127,255)
Total stockholders equity	35,313,673	34,578,156
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	\$ 564,580,236	\$ 541,287,475

See notes to consolidated financial statements

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TRI-COUNTY FINANCIAL CORPORATION  
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME (UNAUDITED)  
THREE AND SIX MONTHS ENDED JUNE 30, 2006 AND 2005

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2006	2005	2006	2005
<b>INTEREST INCOME:</b>				
Interest and fees on loans	\$ 7,175,349	\$ 5,504,666	\$ 13,838,876	\$ 10,316,319
Taxable interest and dividends on investment securities	1,589,901	1,763,829	3,181,203	3,503,352
Interest on deposits with banks	62,660	15,544	107,790	29,236
Total interest income	8,827,910	7,284,039	17,127,869	13,848,907
<b>INTEREST EXPENSE:</b>				
Interest on deposits	2,766,038	1,488,801	5,228,780	2,500,420
Interest on short-term borrowings	322,673	838,994	551,168	1,639,297
Interest on long-term debt	1,385,212	1,041,661	2,739,791	2,038,819
Total interest expenses	4,473,923	3,369,456	8,519,739	6,178,536
NET INTEREST INCOME	4,353,987	3,914,583	8,608,130	7,670,371
PROVISION FOR LOAN LOSSES	86,087	126,097	172,572	189,124
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	4,267,900	3,788,486	8,435,558	7,481,247

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TRI-COUNTY FINANCIAL CORPORATION  
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME (UNAUDITED)  
THREE AND SIX MONTHS ENDED JUNE 30, 2006 AND 2005

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	2006	2005	2006	2005
<b>NONINTEREST INCOME:</b>				
Loan appraisal, credit, and miscellaneous charges	\$ 135,172	\$ 61,973	\$ 233,789	\$ 124,880
Net gain on the sale of foreclosed property		3,756		39,756
Income from bank owned life insurance	89,036	62,201	159,808	123,330
Loss on sale of investment securities				(14,581)
Service charges	281,404	305,876	589,733	561,750
Total noninterest income	505,612	433,806	983,330	835,135
<b>NONINTEREST EXPENSE:</b>				
Salary and employee benefits	1,753,526	1,358,491	3,414,897	2,822,453
Occupancy	324,981	293,585	604,288	525,458
Advertising	100,983	118,158	246,191	205,570
Data processing	210,339	162,538	430,573	323,362
Legal and professional fees	309,153	129,723	548,167	249,168
Depreciation of furniture, fixtures, and equipment	128,931	109,250	241,427	196,350
Telephone communications	19,222	24,208	41,943	53,402
ATM expenses	58,855	80,087	116,177	149,881
Office supplies	33,239	37,587	68,950	67,951
Office equipment	11,458	19,974	24,251	29,676
Other	246,926	256,314	591,304	515,358
Total noninterest expenses	3,197,613	2,589,915	6,328,168	5,138,629
<b>INCOME BEFORE INCOME TAXES</b>	<b>1,575,899</b>	<b>1,632,377</b>	<b>3,090,720</b>	<b>3,177,753</b>
Income tax expense	516,964	553,288	1,058,648	1,074,303
<b>NET INCOME</b>	<b>1,058,935</b>	<b>1,079,089</b>	<b>2,032,072</b>	<b>2,103,450</b>
<b>OTHER COMPREHENSIVE INCOME NET OF TAX</b>				
Net unrealized holding (losses) gains arising during period	(46,914)	216,596	(208,701)	(83,070)
<b>COMPREHENSIVE INCOME</b>	<b>\$ 1,012,021</b>	<b>\$ 1,295,685</b>	<b>\$ 1,823,371</b>	<b>\$ 2,020,380</b>
<b>EARNINGS PER COMMON SHARE</b>				

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Basic	\$	0.60	\$	0.62	\$	1.15	\$	1.21
Diluted		0.56		0.59		1.08		1.14

Share and per share data have been adjusted to reflect the three for two common stock split effected on December 12, 2005 as if it had occurred on January 1, 2005.

See notes to consolidated financial statements



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**TRI-COUNTY FINANCIAL CORPORATION**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**  
**SIX MONTHS ENDED JUNE 30, 2006 AND 2005**

	<b>Six Months Ended</b>	
	<b>June 30,</b>	
	<b>2006</b>	<b>2005</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 2,032,072	\$ 2,103,450
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	172,572	189,124
Loss on sales of investment securities		14,581
Depreciation and amortization	455,017	373,650
Net amortization of premium/discount on investment securities	13,095	180,582
Increase in cash surrender value of bank owned life insurance	(159,808)	(123,330)
Deferred income tax provision (benefit)	166,844	(100,498)
Increase in accrued interest receivable	(143,051)	(398,750)
Decrease in deferred loan fees	(92,284)	(160,602)
Increase in accounts payable, accrued expenses, other liabilities	431,778	373,807
Increase in other assets	(592,814)	(111,572)
Net cash provided by operating activities	2,283,421	2,340,442
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchase of investment securities available for sale	(3,056,127)	(7,316)
Proceeds from sale, redemption or principal payments of investment securities available for sale	369,077	3,171,871
Purchase of investment securities held to maturity	(4,300,000)	(25,249,248)
Proceeds from maturities or principal payments of investment securities held to maturity	14,579,389	37,290,218
Net sale of FHLB and Federal Reserve Bank stock	31,500	33,200
Loans originated or acquired	(93,286,715)	(131,435,265)
Principal collected on loans	58,291,752	81,490,185
Purchase of bank owned life insurance	(2,000,000)	
Purchase of premises and equipment	(541,136)	(1,203,473)
Proceeds from sale of foreclosed real estate	14,677	39,756
Net cash used in investing activities	(29,897,583)	(35,870,072)

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**TRI-COUNTY FINANCIAL CORPORATION**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**  
**SIX MONTHS ENDED JUNE 30, 2006 AND 2005**

	<b>Six Months Ended</b>	
	<b>June 30,</b>	
	<b>2006</b>	<b>2005</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Net increase in deposits	\$ 24,714,291	\$ 51,639,659
Proceeds from long-term borrowings	260,000	20,000,000
Payments of long-term borrowings	(15,018,207)	(5,090,513)
Trust preferred debentures		5,000,000
Net increase (decrease) in short term borrowings	12,169,382	(35,419,900)
Exercise of stock options	81,505	166,815
Net change in unearned ESOP shares	73,554	60,395
Dividends paid	(972,966)	(930,669)
Redemption of common stock	(269,947)	(232,185)
Net cash provided by financing activities	21,037,612	35,193,602
(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(6,576,550)	1,663,972
CASH AND CASH EQUIVALENTS JANUARY 1	22,575,240	17,715,779
CASH AND CASH EQUIVALENTS JUNE 30	\$ 15,998,690	\$ 19,379,751
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:</b>		
Cash paid during the six months for:		
Interest	\$ 8,516,751	\$ 6,105,531
Income taxes	\$ 1,251,000	\$ 1,002,500
See notes to consolidated financial statements		

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)****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) 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, 2005 have been derived from audited financial statements. There have been no significant changes to the Company's accounting policies as disclosed in the 2005 Annual Report. The results of operations for the six months ended June 30, 2006 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 2006 presentation.

It is suggested that these consolidated financial statements be read in conjunction with the consolidated financial statements and notes included in the Company's Annual Report for the year ended December 31, 2005.

**2. NATURE OF BUSINESS**

The Company, through its bank subsidiary, provides domestic financial services primarily in southern Maryland. The primary financial services include real estate, commercial and consumer lending, as well as traditional demand deposits and savings products.

**3. INCOME TAXES**

The Company uses the liability method of accounting for income taxes as required by SFAS No. 109, Accounting for Income Taxes. Under the liability method, deferred tax assets and liabilities are determined based on differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities (i.e., temporary differences) and are measured at the enacted rates that will be in effect when these differences reverse.

**4. EARNINGS PER SHARE**

Earnings per common share are computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per common share is computed by dividing net income by the weighted average number of common shares outstanding during the period, including any potential dilutive common shares outstanding, such as options and warrants. As of June 30, 2006, there were no shares excluded from the diluted earnings per share computation. Basic and diluted earnings per share, have been computed based on weighted average common and common equivalent shares outstanding as follows:

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Basic	1,761,069	1,734,383	1,760,525	1,731,356

Diluted	1,890,232	1,847,276	1,876,258	1,845,375
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Share and per share data have been adjusted to reflect the three for two common stock split effected on December 12, 2005 as if it had occurred on January 1, 2005.

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The Company has stock option and incentive plans to attract and retain key personnel in order to promote the success of the business. These plans are described in note 12 to the financial statements included in our Annual Report to Stockholders for the year ended December 31, 2005. Prior to 2006, the Company applied the intrinsic value method as outlined in Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees ( APB No. 25 ) and related interpretations in accounting for stock options granted. Under the intrinsic value method, no compensation expense was recognized if the exercise price of the Company's employee stock options equaled the market price of the underlying stock on the date of the grant. Accordingly, no compensation cost was recognized in the accompanying consolidated statements of earnings prior to 2006 on stock options granted to employees or directors, since all options granted under the Company's incentive programs had an exercise price equal to the market value of the underlying common stock on the date of grant.

Effective January 1, 2006, the Company adopted SFAS No. 123(R), Share Based Payment ( SFAS No. 123(R) ). This statement replaced SFAS No. 123, Accounting for Stock based Compensation and superseded APB No. 25. SFAS No. 123(R) requires that all stock based compensation be recognized as an expense in the financial statements and that such cost be measured at the fair value of the award. This statement was adopted using the modified prospective method of application, which requires the Company to recognize compensation expense on a prospective basis. Therefore, prior period financial statements have not been restated. Under this method, in addition to reflecting compensation expense for new share-based awards, expense is also recognized to reflect the remaining service period of outstanding awards that had been included in pro forma disclosures in prior periods. As of December 31, 2005, all outstanding options were fully vested, so no expense will be recognized for options outstanding as of that date; however, the Company has accrued for outstanding options relating to the current year. SFAS No. 123(R) also requires that excess tax benefits related to stock option exercises be reflected as financing cash flows instead of operating cash flows.

The Company and the Bank currently maintain incentive plans which provide for payments to be made in either cash or stock options. The Company has accrued the full amounts due under these plans, but currently it is not possible to identify the portion that will be paid out in the form of stock options.

The following table illustrates the effect on the net earnings per common share if the fair value method had been applied to all outstanding awards for the three and six months ended June 30, 2005:

	Three Months Ended June 30, 2005	Six Months Ended June 30, 2005
Net income as reported	\$ 1,079,089	\$ 2,103,450
Less pro forma stock-based compensation:		
Expense determined under fair value method, net tax effects	(193,614)	(193,614)
	\$ 885,475	\$ 1,909,836
Earnings per common share		
Basic as reported	\$ 0.62	\$ 1.21
Basic pro forma	\$ 0.51	\$ 1.10
Diluted as reported	\$ 0.59	\$ 1.14
Diluted pro forma	\$ 0.48	\$ 1.03



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A summary of the Company's stock option plans as of June 30, 2006 and changes during the six month period then ended is presented below:

	Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value (1)	Weighted Average Contractual Life Remaining In Years
Outstanding at December 31, 2005	296,502	\$ 20.38		
Granted				
Exercised	(6,279)	12.98		
Expired				
Forfeited	(5,156)	19.27		