

FIDELITY D & D BANCORP INC
Form 10-K
March 17, 2015
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2014

COMMISSION FILE NUMBER 333-90273

FIDELITY D & D BANCORP, INC.

COMMONWEALTH OF PENNSYLVANIA I.R.S. EMPLOYER IDENTIFICATION NO: 23-3017653

BLAKELY AND DRINKER STREETS

DUNMORE, PENNSYLVANIA 18512

TELEPHONE NUMBER (570) 342-8281

SECURITIES REGISTERED UNDER SECTION 12(b) OF THE ACT:

None

SECURITIES REGISTERED UNDER SECTION 12(g) OF THE ACT:

Common Stock, without par value

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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

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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 (§ 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 No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by references in Part III of this Form 10-K or any amendment to this Form 10-K.

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 definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check One)

Large accelerated filer	Non-accelerated filer (Do not check if a smaller reporting company)	Accelerated filer	Smaller reporting company
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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No

The aggregate market value of the voting common stock held by non-affiliates of the registrant was \$52.4 million as of June 30, 2014, based on the closing price of \$27.85. The number of shares of common stock outstanding as of February 28, 2015, was 2,439,905.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's definitive Proxy Statement to be used in connection with the 2015 Annual Meeting of Shareholders are incorporated herein by reference in partial response to Part III.

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FIDELITY D & D BANCORP, INC.

PART I

Forward-Looking Statements

Certain of the matters discussed in this Annual Report on Form 10-K may constitute forward-looking statements for purposes of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended, and as such may involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of the Company to be materially different from future results, performance or achievements expressed or implied by such forward-looking statements. The words “expect,” “anticipate,” “intend,” “plan,” “believe,” “estimate,” and similar expressions are intended to identify such forward-looking statements.

The Company’s actual results may differ materially from the results anticipated in these forward-looking statements due to a variety of factors, including, without limitation:

- § the effects of economic conditions on current customers, specifically the effect of the economy on loan customers’ ability to repay loans;
- § the costs and effects of litigation and of unexpected or adverse outcomes in such litigation;
- § the impact of new laws and regulations, including the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 and the regulations promulgated there under;
- § impacts of the new capital and liquidity requirements of the Basel III standards and other regulatory pronouncements, regulations and rules;
- § governmental monetary and fiscal policies, as well as legislative and regulatory changes;
- § effects of short- and long-term federal budget and tax negotiations and their effect on economic and business conditions;
- § the effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Financial Accounting Standards Board and other accounting standard setters;
- § the risks of changes in interest rates on the level and composition of deposits, loan demand, and the values of loan collateral, securities and interest rate protection agreements, as well as interest rate risks;
- § the effects of competition from other commercial banks, thrifts, mortgage banking firms, consumer finance companies, credit unions, securities brokerage firms, insurance companies, money market and other mutual funds and other financial institutions operating in our market area and elsewhere, including institutions operating locally, regionally, nationally and internationally, together with such competitors offering banking products and services by mail, telephone, computer and the internet;
- § technological changes;
- § acquisitions and integration of acquired businesses;
- § the failure of assumptions underlying the establishment of reserves for loan losses and estimations of values of collateral and various financial assets and liabilities;
- § volatilities in the securities markets;
- § acts of war or terrorism; and
- § disruption of credit and equity markets.

The Company cautions readers not to place undue reliance on forward-looking statements, which reflect analyses only as of the date of this document. The Company has no obligation to update any forward-looking statements to reflect events or circumstances after the date of this document.

Readers should review the risk factors described in this document and other documents that we file or furnish, from time- to-time, with the Securities and Exchange Commission, including quarterly reports filed on Form 10-Q and any current reports filed or furnished on Form 8-K.

ITEM 1: BUSINESS

Fidelity D & D Bancorp, Inc. (the Company) was incorporated in the Commonwealth of Pennsylvania, on August 10, 1999, and is a bank holding company, whose wholly-owned state chartered commercial bank is The Fidelity Deposit and Discount Bank (the Bank) (collectively, the Company). The Company is headquartered at Blakely and Drinker Streets in Dunmore, Pennsylvania.

The Bank has offered a full range of traditional banking services since it commenced operations in 1903. The Bank has a personal and corporate trust department and also provides alternative financial and insurance products with asset management services. A full list of services provided by the Bank is detailed in the section entitled “Products and Services” contained within the 2014 Annual Report to Shareholders, incorporated by reference. The service area is comprised of the Borough of Dunmore and the surrounding communities within Lackawanna and Luzerne counties in Northeastern Pennsylvania. The Company had 159 full-time equivalent employees on December 31, 2014, which includes exempt officers, exempt, non-exempt and part-time employees.

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The banking business is highly competitive, and the success and profitability of the Company depends principally on its ability to compete in its market area. Competition includes, among other sources: local community banks; savings banks; regional banks; national banks; credit unions; savings & loans; insurance companies; money market funds; mutual funds; small loan companies and other financial services companies. The Company has been able to compete effectively with other financial institutions by emphasizing customer service enhanced by local decision making. These efforts enable the Company to establish long-term customer relationships and build customer loyalty by providing products and services designed to address their specific needs.

The banking industry is affected by general economic conditions including the effects of inflation, recession, unemployment, real estate values, trends in national and global economies and other factors beyond the Company's control. The Company's success is dependent, to a significant degree, on economic conditions in Northeastern Pennsylvania, especially within Lackawanna and Luzerne counties which the Company defines as its primary market area. An economic recession or a delayed economic recovery over a prolonged period of time in the Company's market could cause an increase in the level of the Company's non-performing assets and loan losses, and thereby cause operating losses, impairment of liquidity and erosion of capital. There are no concentrations of loans that, if lost, would have a material adverse effect on the continued business of the Company. There is no material concentration within a single industry or a group of related industries that is vulnerable to the risk of a near-term severe impact.

The Company's profitability is significantly affected by general economic and competitive conditions, changes in market interest rates, government policies and actions of regulatory authorities. The Company's loan portfolio is comprised principally of residential real estate, commercial and commercial real estate loans. The properties underlying the Company's mortgages are concentrated in Northeastern Pennsylvania. Credit risk, which represents the possibility of the Company not recovering amounts due from its borrowers, is significantly related to local economic conditions in the areas where the properties are located as well as the Company's underwriting standards. Economic conditions affect the market value of the underlying collateral as well as the levels of adequate cash flow and revenue generation from income-producing commercial properties.

During 2014, the national economy strengthened with the unemployment rate returning to the pre-2009 levels and the number of jobs increasing from the end of 2013. Similarly, the unemployment rate in the Company's local statistical market, Scranton-Wilkes-Barre, at 5.6%, approximated the national rate, as the local market unemployment rate declined 27%, from 7.7% at the end of 2013. Compared to year-end 2013, however, the number of ready-and-able workers searching for jobs declined and though there was job growth in our region in 2014, the shrinking labor force had a more significant influence on the rate of unemployment than did the increase in jobs. Also, in the Wilkes-Barre-Scranton real estate market, the median home values declined by 1.1% from year-end 2013 indicating a sustaining period of softness in the residential real estate market. A low and shrinking work force, akin to high unemployment, and declining property values that secure the related loans could adversely impact the ability or desire of borrowers to repay their loans, exposing the Company to the potential for credit loss. The Company's credit function strives to mitigate the negative impact of economic conditions by maintaining strict underwriting principles for commercial and consumer lending and ensuring that home mortgage underwriting adheres to the standards of secondary market makers. In addition, the Company strives to accelerate the property foreclosure process thereby lessening the negative financial impact of foreclosed property ownership. Refer to Item 1A, "Risk Factors" for material risks and uncertainties that management believes affect the Company.

Federal and state banking laws contain numerous provisions that affect various aspects of the business and operations of the Company and the Bank. The Company is subject to, among others, the regulations of the Securities and Exchange Commission (the SEC) and the Federal Reserve Board (the FRB) and the Bank is subject to, among others, the regulations of the Pennsylvania Department of Banking, the Federal Deposit Insurance Corporation (the FDIC)

and the rules promulgated by the Consumer Financial Protection Bureau (the CFPB) but continues to be examined and supervised by federal banking regulators for consumer compliance purposes. Refer to Part II, Item 7 “Supervision and Regulation” for descriptions of and references to applicable statutes and regulations which are not intended to be complete descriptions of these provisions or their effects on the Company or the Bank. They are summaries only and are qualified in their entirety by reference to such statutes and regulations. Applicable regulations relate to, among other things:

- operations
- securities
- risk management
- consumer compliance
- mergers
- consolidation
- reserves
- dividends
- branches
- capital adequacy

The Bank is examined by the Pennsylvania Department of Banking and the FDIC. The last examination was conducted by the Pennsylvania Department of Banking as of September 30, 2014.

The Company’s website address is <http://www.bankatfidelity.com>. The Company makes available through this website the annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K and amendments to those reports as soon as reasonably practical after filing with the SEC. You may read and copy any materials filed with the SEC at

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the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains an internet site that contains reports, proxy and information statements and other information about the Company at <http://www.sec.gov>.

The Company's accounting policies and procedures are designed to comply with accounting principles generally accepted in the United States of America (GAAP). Refer to "Critical Accounting Policies," which are incorporated by reference in Part II, Item 7.

ITEM 1A: RISK FACTORS

An investment in the Company's common stock is subject to risks inherent to the Company's business. The material risks and uncertainties that management believes affect the Company are described below. Before making an investment decision, you should carefully consider the risks and uncertainties described below together with all of the other information included or incorporated by reference in this report. The risks and uncertainties described below are not the only ones facing the Company. Additional risks and uncertainties that management is not aware of or focused on or that management currently deems immaterial may also impair the Company's business operations. This report is qualified in its entirety by these risk factors.

If any of the following risks actually occur, the Company's financial condition and results of operations could be materially and adversely affected. If this were to happen, the value of the Company's common stock could decline significantly, and you could lose all or part of your investment.

Risks Related to the Company's Business

The Company's business is subject to interest rate risk and variations in interest rates may negatively affect its financial performance.

Changes in the interest rate environment may reduce profits. The Company's earnings and cash flows are largely dependent upon its net interest income. Net interest income is the difference between the interest earned on loans, securities and other interest-earning assets, and interest paid on deposits, borrowings and other interest-bearing liabilities. As prevailing interest rates change, net interest spreads are affected by the difference between the maturities and re-pricing characteristics of interest-earning assets and interest-bearing liabilities. In addition, loan volume and yields are affected by market interest rates on loans, and rising interest rates generally are associated with a lower volume of loan originations. An increase in the general level of interest rates may also adversely affect the ability of certain borrowers to pay the interest on and principal of their obligations. Accordingly, changes in levels of market interest rates could materially adversely affect the Company's net interest spread, asset quality, loan origination volume and overall profitability.

The Company is subject to lending risk.

There are inherent risks associated with the Company's lending activities. These risks include, among other things, the impact of changes in interest rates and changes in the economic conditions in the markets where the Company operates as well as those across the Commonwealth of Pennsylvania and the United States. Increases in interest rates and/or weakening economic conditions could adversely impact the ability of borrowers to repay outstanding loans or the value of the collateral securing these loans. The Company is also subject to various laws and regulations that affect its lending activities. Failure to comply with applicable laws and regulations could subject the Company to regulatory

enforcement action that could result in the assessment of significant civil money penalties against the Company.

Commercial, commercial real estate and real estate construction loans are generally viewed as having more risk of default than residential real estate loans or consumer loans. These types of loans are also typically larger than residential real estate loans and consumer loans. Because these loans generally have larger balances than residential real estate loans and consumer loans, the deterioration of one or a few of these loans could cause a significant increase in non-performing loans. An increase in non-performing loans could result in a net loss of earnings from these loans, an increase in the provision for possible loan losses and an increase in loan charge-offs, all of which could have a material adverse effect on the Company's financial condition and results of operations.

The Company's allowance for possible loan losses may be insufficient.

The Company maintains an allowance for possible loan losses, which is a reserve established through a provision for possible loan losses charged to expense, that represents management's best estimate of probable losses that have been incurred within the existing portfolio of loans. The allowance, in the judgment of management, is necessary to reserve for estimated loan losses and risks inherent in the loan portfolio. The level of the allowance reflects management's continuing evaluation of industry concentrations; specific credit risks; loan loss experience; current loan portfolio quality; present economic, political and regulatory conditions and unidentified losses inherent in the current loan portfolio. The determination of the appropriate level of the allowance for possible loan losses inherently involves a high degree of subjectivity and requires the Company to make significant estimates of current credit risks and future trends, all of which may undergo material changes. Changes in economic conditions affecting borrowers, new information regarding existing loans, identification of additional problem loans and other factors, both within and outside of the Company's control, may require an increase in the allowance for possible loan losses. In addition, bank regulatory agencies periodically review the Company's allowance for loan losses and

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may require an increase in the provision for possible loan losses or the recognition of further loan charge-offs, based on judgments different than those of management. In addition, if charge-offs in future periods exceed the allowance for possible loan losses, the Company will need additional provisions to increase the allowance for possible loan losses. Any increases in the allowance for loan losses will result in a decrease in net income and capital and may have a material adverse effect on the Company's financial condition and results of operations.

If we conclude that the decline in value of any of our investment securities is other-than-temporary, we will be required to write down the credit-related portion of the impairment of that security through a charge to earnings.

We review our investment securities portfolio at each quarter-end reporting period to determine whether the fair value is below the current carrying value. When the fair value of any of our investment securities has declined below its carrying value, we are required to assess whether the decline is other-than-temporary. If we conclude that the decline is other-than-temporary, we will be required to write down the credit-related portion of the impairment of that security through a charge to earnings.

The Basel III capital requirements may require us to maintain higher levels of capital, which could reduce our profitability.

Basel III targets higher levels of base capital, certain capital buffers and a migration toward common equity as the key source of regulatory capital. Although the new capital requirements are phased in over the next decade and may change substantially before final implementation, Basel III signals a growing effort by domestic and international bank regulatory agencies to require financial institutions, including depository institutions, to maintain higher levels of capital. The direction of the Basel III implementation activities or other regulatory viewpoints could require additional capital to support our business risk profile prior to final implementation of the Basel III standards. If the Company and the Bank are required to maintain higher levels of capital, the Company and the Bank may have fewer opportunities to invest capital into interest-earning assets, which could limit the profitable business operations available to the Company and the Bank and adversely impact our financial condition and results of operations.

The Company may need or be compelled to raise additional capital in the future, but that capital may not be available when it is needed and on terms favorable to current shareholders.

Federal banking regulators require the Company and Bank to maintain adequate levels of capital to support their operations. These capital levels are determined and dictated by law, regulation and banking regulatory agencies. In addition, capital levels are also determined by the Company's management and board of directors based on capital levels that they believe are necessary to support the Company's business operations. The Company is evaluating its present and future capital requirements and needs, is developing a comprehensive capital plan and is analyzing capital raising alternatives, methods and options. Even if the Company succeeds in meeting the current regulatory capital requirements, the Company may need to raise additional capital in the near future to support possible loan losses during future periods or to meet future regulatory capital requirements.

Further, the Company's regulators may require it to increase its capital levels. If the Company raises capital through the issuance of additional shares of its common stock or other securities, it would likely dilute the ownership interests of current investors and would likely dilute the per-share book value and earnings per share of its common stock. Furthermore, it may have an adverse impact on the Company's stock price. New investors may also have rights, preferences and privileges senior to the Company's current shareholders, which may adversely impact its current shareholders. The Company's ability to raise additional capital will depend on conditions in the capital markets at that time, which are outside its control, and on its financial performance. Accordingly, the Company

cannot assure you of its ability to raise additional capital on terms and time frames acceptable to it or to raise additional capital at all. If the Company cannot raise additional capital in sufficient amounts when needed, its ability to comply with regulatory capital requirements could be materially impaired. Additionally, the inability to raise capital in sufficient amounts may adversely affect the Company's operations, financial condition and results of operations.

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The Company is subject to environmental liability risk associated with lending activities.

A significant portion of the Company's loan portfolio is secured by real property. During the ordinary course of business, the Company may foreclose on and take title to properties securing certain loans. In doing so, there is a risk that hazardous or toxic substances could be found on these properties. If hazardous or toxic substances are found, the Company may be liable for remediation costs, as well as for personal injury and property damage. Environmental laws may require the Company to incur substantial expense and may materially reduce the affected property's value or limit the Company's ability to use or sell the affected property. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws may increase the Company's exposure to environmental liability. Although the Company has policies and procedures to perform an environmental review before initiating any foreclosure action on real property, these reviews may not be sufficient to detect all potential environmental hazards. The remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect on the Company's financial condition and results of operations.

The Company's profitability depends significantly on economic conditions in the Commonwealth of Pennsylvania and the local region in which it conducts business.

The Company's success depends primarily on the general economic conditions of the Commonwealth of Pennsylvania and the specific local markets in which the Company operates. Unlike larger national or other regional banks that are more geographically diversified, the Company provides banking and financial services to customers primarily in Lackawanna and Luzerne Counties in Northeastern Pennsylvania. The local economic conditions in these areas have a significant impact on the demand for the Company's products and services as well as the ability of the Company's customers to repay loans, the value of the collateral securing loans and the stability of the Company's deposit funding sources. A significant decline in general economic conditions caused by inflation, recession, acts of terrorism, an outbreak of hostilities or other international or domestic occurrences, unemployment, changes in securities markets or other factors could impact these local economic conditions and, in turn, have a material adverse effect on the Company's financial condition and results of operations.

There is no assurance that the Company will be able to successfully compete with others for business.

The Company competes for loans, deposits and investment dollars with numerous regional and national banks and other community banking institutions, as well as other kinds of financial institutions and enterprises, such as securities firms, insurance companies, savings associations, credit unions, mortgage brokers and private lenders. Many competitors have substantially greater resources than the Company does, and operate under less stringent regulatory environments. The differences in resources and regulations may make it more difficult for the Company to compete profitably, reduce the rates that it can earn on loans and on its investments, increase the rates it must offer on deposits and other funds, and adversely affect its overall financial condition and earnings.

The Company is subject to extensive government regulation and supervision.

The Company, primarily through the Bank, is subject to extensive federal and state regulation and supervision. Banking regulations are primarily intended to protect depositors' funds, federal deposit insurance funds and the banking system as a whole, not shareholders. These regulations affect the Company's lending practices, capital structure, investment practices, dividend policy and growth, among other things. Federal or commonwealth regulatory agencies continually review banking laws, regulations and policies for possible changes. Changes to statutes, regulations or regulatory policies, including changes in interpretation or implementation of statutes, regulations or policies, could affect the Company in substantial and unpredictable ways. Such changes could subject the Company to

additional costs, limit the types of financial services and products the Company may offer and/or increase the ability of non-banks to offer competing financial services and products, among other things. Failure to comply with laws, regulations or policies could result in sanctions by regulatory agencies, civil money penalties and/or reputation damage, which could have a material adverse effect on the Company's business, financial condition and results of operations. While the Company has policies and procedures designed to prevent any such violations, there can be no assurance that such violations will not occur.

The Company's controls and procedures may fail or be circumvented.

Management regularly reviews and updates the Company's internal controls, disclosure controls and procedures, and corporate governance policies and procedures. Any system of controls, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Any failure or circumvention of the Company's controls and procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect on the Company's business, results of operations and financial condition.

New lines of business or new products and services may subject the Company to additional risks.

From time-to-time, the Company may implement new lines of business or offer new products and services within existing lines of business. There are substantial risks and uncertainties associated with these efforts, particularly in instances where the markets are not fully developed. In developing and marketing new lines of business and/or new products and services the Company may invest significant time and resources. Initial timetables for the introduction and development of new lines of business and/or new products or services may not be achieved and price and profitability targets may not prove feasible.

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External factors, such as compliance with regulations, competitive alternatives, and shifting market preferences, may also impact the successful implementation of a new line of business or a new product or service. Furthermore, any new line of business and/or new product or service could have a significant impact on the effectiveness of the Company's system of internal controls. Failure to successfully manage these risks in the development and implementation of new lines of business or new products or services could have a material adverse effect on the Company's business, results of operations and financial condition.

The Company's future acquisitions could dilute your ownership and may cause it to become more susceptible to adverse economic events.

The Company may use its common stock to acquire other companies or make investments in banks and other complementary businesses in the future. The Company may issue additional shares of common stock to pay for future acquisitions, which would dilute your ownership interest in the Company. Future business acquisitions could be material to the Company, and the degree of success achieved in acquiring and integrating these businesses into the Company could have a material effect on the value of the Company's common stock. In addition, any acquisition could require it to use substantial cash or other liquid assets or to incur debt. In those events, it could become more susceptible to economic downturns and competitive pressures.

The Company may not be able to attract and retain skilled people.

The Company's success depends, in large part, on its ability to attract and retain key people. Competition for the best people in most activities engaged in by the Company can be intense and the Company may not be able to hire people or to retain them. The unexpected loss of services of one or more of the Company's key personnel could have a material adverse impact on the Company's business because of their skills, knowledge of the Company's market, years of industry experience and the difficulty of promptly finding qualified replacement personnel.

The Company's information systems may experience an interruption or breach in security.

The Company relies heavily on communications and information systems to conduct its business. Any failure, interruption or breach in security of these systems could result in failures or disruptions in the Company's customer relationship management, general ledger, deposit, loan and other systems. The Company has policies and procedures designed to prevent or limit the effect of the failure, interruption or security breach of its information systems, however there can be no assurance that any such failures, interruptions or security breaches will not occur. The occurrence of any failures, interruptions or security breaches of the Company's information systems could damage the Company's reputation, result in a loss of customer business, subject the Company to additional regulatory scrutiny, or expose the Company to civil litigation and possible financial liability, any of which could have a material adverse effect on the Company's financial condition and results of operations.

The Company continually encounters technological change.

The financial services industry is continually undergoing rapid technological change with frequent introductions of new technology-driven products and services. The effective use of technology increases efficiency and enables financial institutions to better serve customers and to reduce costs. The Company's future success depends, in part, upon its ability to address the needs of its customers by using technology to provide products and services that will satisfy customer demands, as well as to create additional efficiencies in the Company's operations. Many of the Company's competitors have substantially greater resources to invest in technological improvements. The Company may not be able to effectively implement new technology-driven products and services or be successful in marketing

these products and services to its customers. Failure to successfully keep pace with technological change affecting the financial services industry could have a material adverse impact on the Company's business and, in turn, the Company's financial condition and results of operations.

The operations of our business, including our interaction with customers, are increasingly done via electronic means, and this has increased our risks related to cyber security.

We are exposed to the risk of cyber-attacks in the normal course of business. In general, cyber incidents can result from deliberate attacks or unintentional events. We have observed an increased level of attention in the industry focused on cyber-attacks that include, but are not limited to, gaining unauthorized access to digital systems for purposes of misappropriating assets or sensitive information, corrupting data, or causing operational disruption. To combat against these attacks, policies and procedures are in place to prevent or limit the effect of the possible security breach of our information systems and we have insurance against some cyber-risks and attacks. While we have not incurred any material losses related to cyber-attacks, nor are we aware of any specific or threatened cyber-incidents as of the date of this report, we may incur substantial costs and suffer other negative consequences if we fall victim to successful cyber-attacks. Such negative consequences could include remediation costs that may include liability for stolen assets or information and repairing system damage that may have been caused; deploying additional personnel and protection technologies, training employees, and engaging third party experts and consultants; lost revenues resulting from unauthorized use of proprietary information or the failure to retain or attract customers following an attack; litigation; and reputational damage adversely affecting customer or investor confidence.

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The Company is subject to claims and litigation pertaining to fiduciary responsibility.

From time-to-time, customers make claims and take legal action pertaining to the Company's performance of its fiduciary responsibilities. Whether customer claims and legal action related to the Company's performance of its fiduciary responsibilities are founded or unfounded, if such claims and legal actions are not resolved in a manner favorable to the Company, they may result in significant financial liability and/or adversely affect the market perception of the Company and its products and services as well as impact customer demand for those products and services. Any financial liability or reputation damage could have a material adverse effect on the Company's business, which, in turn, could have a material adverse effect on the Company's financial condition and results of operations.

Pennsylvania Business Corporation Law and various anti-takeover provisions under our articles and bylaws could impede the takeover of the Company.

Various Pennsylvania laws affecting business corporations may have the effect of discouraging offers to acquire the Company, even if the acquisition would be advantageous to shareholders. In addition, we have various anti-takeover measures in place under our articles of incorporation and bylaws, including a supermajority vote requirement for mergers, a staggered board of directors, and the absence of cumulative voting. Any one or more of these measures may impede the takeover of the Company without the approval of our board of directors and may prevent our shareholders from taking part in a transaction in which they could realize a premium over the current market price of our common stock.

The Company is a holding company and relies on dividends from its banking subsidiary for substantially all of its revenue and its ability to make dividends, distributions, and other payments.

As a bank holding company, the Company's ability to pay dividends depends primarily on its receipt of dividends from its subsidiary bank. Dividend payments from the bank are subject to legal and regulatory limitations, generally based on net profits and retained earnings, imposed by bank regulatory agencies. The ability of the bank to pay dividends is also subject to profitability, financial condition, regulatory capital requirements, capital expenditures and other cash flow requirements. There is no assurance that the bank will be able to pay dividends in the future or that the Company will generate cash flow to pay dividends in the future. The Company's failure to pay dividends on its common stock may have a material adverse effect on the market price of its common stock.

The Company's banking subsidiary may be required to pay higher FDIC insurance premiums or special assessments which may adversely affect its earnings.

Poor economic conditions and the resulting bank failures have increased the costs of the FDIC and depleted its deposit insurance fund. Additional bank failures may prompt the FDIC to increase its premiums or to issue special assessments. The Company generally is unable to control the amount of premiums or special assessments that its subsidiary is required to pay for FDIC insurance. Any future changes in the calculation or assessment of FDIC insurance premiums may have a material adverse effect on our results of operations, financial condition, and our ability to continue to pay dividends on our common stock at the current rate or at all.

Severe weather, natural disasters, acts of war or terrorism and other external events could significantly impact the Company's business.

Severe weather, natural disasters, acts of war or terrorism and other adverse external events could have a significant impact on the Company's ability to conduct business. Such events could affect the stability of the Company's deposit base, impair the ability of borrowers to repay outstanding loans, impair the value of collateral securing loans, cause significant property damage, result in loss of revenue and/or cause the Company to incur additional expenses. Severe weather or natural disasters, acts of war or terrorism or other adverse external events may occur in the future. Although management has established disaster recovery policies and procedures, the occurrence of any such event could have a material adverse effect on the Company's business, which, in turn, could have a material adverse effect on the Company's financial condition and results of operations.

Risks Associated with the Company's Common Stock

The Company's stock price can be volatile.

Stock price volatility may make it more difficult for you to resell your common stock when you want and at prices you find attractive. The Company's stock price can fluctuate significantly in response to a variety of factors including, among other things:

Actual or anticipated variations in quarterly results of operations.

Recommendations by securities analysts.

Operating and stock price performance of other companies that investors deem comparable to the Company.

News reports relating to trends, concerns and other issues in the financial services industry.

Perceptions in the marketplace regarding the Company and/or its competitors.

New technology used, or services offered, by competitors.

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Significant acquisitions or business combinations, strategic partnerships, joint ventures or capital commitments by or involving the Company or its competitors.

Failure to integrate acquisitions or realize anticipated benefits from acquisitions.

Changes in government regulations.

Geopolitical conditions such as acts or threats of terrorism or military conflicts.

General market fluctuations, industry factors and general economic and political conditions and events, such as economic slowdowns or recessions, interest rate changes or credit loss trends, could also cause the Company's stock price to decrease regardless of operating results.

The trading volume in the Company's common stock is less than that of other larger financial services companies.

The Company's common stock is listed for trading on the over-the-counter bulletin board and the trading volume in its common stock is less than that of other larger financial services companies. A public trading market having the desired characteristics of depth, liquidity and orderliness depends on the presence in the marketplace of willing buyers and sellers of the Company's common stock at any given time. This presence depends on the individual decisions of investors and general economic and market conditions over which the Company has no control. Given the lower trading volume of the Company's common stock, significant sales of the Company's common stock, or the expectation of these sales, could cause the Company's stock price to fall.

Risks Associated with the Company's Industry

Future governmental regulation and legislation could limit the Company's future growth.

The Company is a registered bank holding company, and its subsidiary bank is a depository institution whose deposits are insured by the FDIC. As a result, the Company is subject to various regulations and examinations by various regulatory authorities. In general, statutes establish the corporate governance and eligible business activities for the Company, certain acquisition and merger restrictions, limitations on inter-company transactions such as loans and dividends, capital adequacy requirements, requirements for anti-money laundering programs and other compliance matters, among other regulations. The Company is extensively regulated under federal and state banking laws and regulations that are intended primarily for the protection of depositors, federal deposit insurance funds and the banking system as a whole. Compliance with these statutes and regulations is important to the Company's ability to engage in new activities and consummate additional acquisitions.

In addition, the Company is subject to changes in federal and state tax laws as well as changes in banking and credit regulations, accounting principles and governmental economic and monetary policies. The Company cannot predict whether any of these changes may adversely and materially affect it. Federal and state banking regulators also possess broad powers to take supervisory actions as they deem appropriate. These supervisory actions may result in higher capital requirements, higher insurance premiums and limitations on the Company's activities that could have a material adverse effect on its business and profitability. While these statutes are generally designed to minimize potential loss to depositors and the FDIC insurance funds, they do not eliminate risk, and compliance with such statutes increases the Company's expense, requires management's attention and can be a disadvantage from a competitive standpoint with respect to non-regulated competitors.

The earnings of financial services companies are significantly affected by general business and economic conditions.

The Company's operations and profitability are impacted by general business and economic conditions in the United States and abroad. These conditions include short-term and long-term interest rates, inflation, money supply, political issues, legislative and regulatory changes, fluctuations in both debt and equity capital markets, broad trends in industry and finance, and the strength of the U.S. economy and the local economies in which the Company operates, all of which are beyond the Company's control. Deterioration in economic conditions could result in an increase in loan delinquencies and non-performing assets, decreases in loan collateral values and a decrease in demand for the Company's products and services, among other things, any of which could have a material adverse impact on the Company's financial condition and results of operations.

Financial services companies depend on the accuracy and completeness of information about customers and counterparties.

In deciding whether to extend credit or enter into other transactions, the Company may rely on information furnished by or on behalf of customers and counterparties, including financial statements, credit reports and other financial information. The Company may also rely on representations of those customers, counterparties or other third parties, such as independent auditors, as to the accuracy and completeness of that information. Reliance on inaccurate or misleading financial statements, credit reports or other financial information could have a material adverse impact on the Company's business and, in turn, the Company's financial condition and results of operations.

Consumers may decide not to use banks to complete their financial transactions.

Technology and other changes are allowing parties to complete financial transactions that historically have involved banks through alternative methods. For example, consumers can now maintain funds that would have historically been held as bank deposits in brokerage accounts or mutual funds. Consumers can also complete transactions such as paying bills and/or transferring funds directly without the assistance of banks. The process of eliminating banks as intermediaries, known as

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“disintermediation,” could result in the loss of fee income, as well as the loss of customer deposits and the related income generated from those deposits. The loss of these revenue streams and the lower cost deposits as a source of funds could have a material adverse effect on the Company’s financial condition and results of operations.

Future Downgrades of the United States Government may adversely affect the Company.

In August 2011, Standard & Poor’s downgraded the United States’ credit rating from AAA to AA+, and there are indications that Moody’s or Fitch Ratings also may downgrade the United States’ credit ratings in the future. Standard & Poor’s also downgraded the credit rating of the Federal Home Loan Bank System, a government-sponsored enterprise in which the Company invests and from which the Company receives a line of credit, from AAA to AA+. Furthermore, the credit rating of other entities, such as state and local governments, may be downgraded as a consequence of the downgrading of the United States’ credit rating. The impact that these credit rating downgrades may have on the national and local economy and on the Company’s financial condition and results of operation is uncertain and may adversely affect the Company and its business.

The regulatory environment for the financial services is being significantly impacted by financial regulatory reform initiatives in the United States and elsewhere, including Dodd-Frank and regulations promulgated to implement it.

Dodd-Frank, which was signed into law on July 21, 2010, comprehensively reforms the regulation of financial institutions, products and services. Dodd-Frank requires various federal regulatory agencies to implement numerous rules and regulations. Because the federal agencies are granted broad discretion in drafting these rules and regulations, many of the details and the impact of Dodd-Frank may not be known for many months or years.

While much of how the Dodd-Frank and other financial industry reforms will change our current business operations depends on the specific regulatory reforms and interpretations, many of which have yet to be released or finalized, it is clear that the reforms, both under Dodd-Frank and otherwise, will have a significant effect on our entire industry. Although Dodd-Frank and other reforms will affect a number of the areas in which we do business, it is not clear at this time the full extent of the adjustments that will be required and the extent to which we will be able to adjust our businesses in response to the requirements. Although it is difficult to predict the magnitude and extent of these effects at this stage, we believe compliance with Dodd-Frank and implementing its regulations and initiatives will negatively impact revenue and increase the cost of doing business, both in terms of transition expenses and on an ongoing basis, and it may also limit our ability to pursue certain business opportunities.

ITEM 1B: UNRESOLVED STAFF COMMENTS

None

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ITEM 2: PROPERTIES

As of December 31, 2014, the Company operated 11 full-service banking offices, of which six were owned and five were leased. None of the lessors of the properties leased by the Company are affiliated with the Company and all of the properties are located in the Commonwealth of Pennsylvania. The Company is headquartered at its owner-occupied main branch located on the corner of Blakely and Drinker Streets in Dunmore, PA.

The following table provides information with respect to the principal properties from which the Bank conducts business:

Location	Owned / leased*	Type of use	Full service	Drive-thru	ATM
Drinker & Blakely Streets, Dunmore, PA	Owned	Main Branch (1) (2)	x	x	x
111 Green Ridge St., Scranton, PA	Leased	Green Ridge Branch (2)	x	x	x
1311 Morgan Hwy., Clarks Summit, PA	Leased	Abington Branch (3)	x	x	x
1232 Keystone Industrial Park Rd., Dunmore, PA	Owned	Keystone Industrial Park Branch	x	x	x
338 North Washington Ave., Scranton, PA	Owned	Financial Center Branch (4)	x		x
4010 Birney Ave., Moosic, PA	Owned	Moosic Branch	x	x	x
801 Wyoming Ave., West Pittston, PA	Leased	West Pittston Branch (5)	x		x
1598 Main St., Peckville, PA	Leased	Peckville Branch	x	x	x
247 Wyoming Ave.,	Owned	Kingston Branch	x	x	x

Kingston, PA

511 Scranton-Carbondale Hwy., Eynon, PA	Leased	Eynon Branch	x	x	x
400 S. Main St., Scranton, PA	Owned	West Scranton Branch(2)	x	x	x

*All of the owned properties are free of encumbrances. At the Green Ridge St., Scranton branch office, the Company leases the land from an unrelated third party, however the building is the Company's own capital improvement.

- (1) Executive and administrative, commercial lending, trust and asset management services are located at the Main Branch.
- (2) This office has two automated teller machines (ATMs).
- (3) In addition, there is a banking facility located in the Clarks Summit State Hospital. The office is leased from the hospital under a lease-for-service-provided agreement with service limited to employees and patients of the hospital. This office was closed during the first quarter of 2015.
- (4) Executive, mortgage and consumer lending, finance, operations and a full-service call center are located in this building. A portion of the building is leased to a non-related entity.
- (5) The West Pittston branch will relocate to a new facility, currently under construction, in Pittston, PA. The West Pittston lease expires in 2015. The new branch is scheduled to open in April 2015 and its new long-term lease will commence upon occupancy of the new building. Similar to the Green Ridge St., Scranton branch office, the new Pittston branch will lease the land from an unrelated third party and the building is the Company's own capital improvement.

As of December 31, 2014, the Bank maintained two free standing 24-hour ATMs located at the following locations:

- The Shoppes at Montage, 1035 Shoppes Blvd., Moosic, PA;
- Gino Merili Veteran's Center, 401 Penn Ave., Scranton, PA.

During the first quarter of 2015, the Bank removed the 401 Penn Ave. ATM and added an ATM at the following location:

- Mountain Plaza Shopping Mall, 307 Moosic St., Scranton, PA.

Foreclosed assets held-for-sale include other real estate owned (ORE). The Company had twelve ORE properties as of December 31, 2014, which stemmed from eleven unrelated borrowers. Of the twelve properties, seven were listed for sale, while the remaining five properties are in litigation, awaiting closing and disposition plans or undergoing eviction proceedings. Upon possession, foreclosed properties are recorded on the Company's balance sheet at the lower of cost or fair value.

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ITEM 3: LEGAL PROCEEDINGS

The nature of the Company's business generates some litigation involving matters arising in the ordinary course of business. However, in the opinion of the Company after consulting with legal counsel, no legal proceedings are pending, which, if determined adversely to the Company or the Bank, would have a material effect on the Company's undivided profits or financial condition or results of operations. No legal proceedings are pending other than ordinary routine litigation incidental to the business of the Company and the Bank. In addition, to management's knowledge, no governmental authorities have initiated or contemplated any material legal actions against the Company or the Bank.

ITEM 4: MINE SAFETY DISCLOSURES

Not Applicable

PART II

ITEM 5: MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

The common stock of the Company is traded on the over-the-counter bulletin board under the symbol "FDBC." Shareholders requesting information about the Company's common stock may contact:

Salvatore R. DeFrancesco, Jr., Treasurer

Fidelity D & D Bancorp, Inc.

Blakely and Drinker Streets

Dunmore, PA 18512

(570) 342-8281

The following table lists the quarterly cash dividends paid per share and the range of high and low bid prices for the Company's common stock based on information obtained from on-line published sources. Such over-the-counter prices do not include retail mark-ups, markdowns or commissions:

	2014			2013		
	Prices High	Low	Dividends paid	Prices High	Low	Dividends paid
1st Quarter	\$ 28.16	\$ 25.81	\$ 0.25	\$ 27.50	\$ 20.11	\$ 0.25
2nd Quarter	\$ 28.50	\$ 26.00	\$ 0.25	\$ 27.00	\$ 22.50	\$ 0.25
3rd Quarter	\$ 32.00	\$ 27.65	\$ 0.25	\$ 27.00	\$ 24.05	\$ 0.25
4th Quarter	\$ 36.00	\$ 30.15	\$ 0.35	\$ 30.00	\$ 25.00	\$ 0.35

Dividends are determined and declared by the Board of Directors of the Company. The Company expects to continue to pay cash dividends in the future; however, future dividends are dependent upon earnings, financial condition, capital strength and other factors of the Company. For a further discussion of regulatory capital requirements see Note 15, "Regulatory Matters," contained within the notes to the consolidated financial statements, incorporated by reference in Part II, Item 8.

The Company offers a dividend reinvestment plan (DRP) for its shareholders. The DRP provides shareholders with a convenient and economical method of investing cash dividends payable on their common stock and the opportunity to make voluntary optional cash payments to purchase additional shares of the Company's common stock. Participants pay no brokerage commissions or service charges when they acquire additional shares of common stock through the DRP. The administrator may purchase shares directly from the Company, in the open market, in negotiated transactions with third parties or using a combination of these methods.

The Company had approximately 1,419 shareholders at December 31, 2014 and 1,407 shareholders as of February 28, 2015. The number of shareholders is the actual number of individual shareholders of record. Each security depository is considered a single shareholder for purposes of determining the approximate number of shareholders.

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Securities authorized for issuance under equity compensation plans

The following table summarizes the Company's equity compensation plans as of December 31, 2014 that have been approved and not approved by Fidelity D&D Bancorp, Inc. shareholders:

	(a)	(b)	(c)
Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights.	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders:			
2000 Independent Director Stock Option Plan	15,000	\$ 28.90	-
2000 Stock Incentive Plan	4,000	\$ 27.90	-
2002 Employee Stock Purchase Plan	4,358	\$ 23.40	74,236
2012 Omnibus Stock Incentive Plan	5,870	\$ 23.29	492,746
2012 Director Stock Incentive Plan	6,000	\$ 23.13	490,000
Equity compensation plans not approved by security holders - none	-	-	-
Total	35,228	\$ 26.19	1,056,982

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Performance graph

The following graph and table compare the cumulative total shareholder return on the Company's common stock against the cumulative total return of the NASDAQ Composite and the SNL index of greater than \$500 million in-asset banks traded on the OTC-BB and Pink Sheet (the SNL index) for the period of five fiscal years commencing January 1, 2010, and ending December 31, 2014. As of December 31, 2014, the SNL index consisted of 146 banks. A listing of the banks that comprise the index can be found on the Company's website at www.bankatfidelity.com and then clicking on, Investor Relations, Fidelity D & D Bancorp Stock, Stock Information, List of all companies in The SNL U.S. Bank Pink > \$500M link at bottom of page. The graph illustrates the cumulative investment return to shareholders, based on the assumption that a \$100 investment was made on December 31, 2009, in each of: the Company's common stock, the NASDAQ Composite and the SNL index. All cumulative total returns are computed assuming the reinvestment of dividends into the applicable securities. The shareholder return shown on the graph and table below is not necessarily indicative of future performance:

Index	Period Ending					
	12/31/09	12/31/10	12/31/11	12/31/12	12/31/13	12/31/14
Fidelity D & D Bancorp, Inc.	100.00	139.20	150.05	155.44	209.86	271.54
NASDAQ Composite	100.00	118.15	117.22	138.02	193.47	222.16
SNL Bank Pink > \$500M	100.00	105.64	103.86	114.53	139.20	163.18

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ITEM 6: SELECTED FINANCIAL DATA

Set forth below are our selected consolidated financial and other data. This financial data is derived in part from, and should be read in conjunction with the consolidated financial statements and notes thereto included in Part II, Item 8 of this report:

(dollars in thousands except per share data)

Balance sheet data:	2014	2013	2012	2011	2010
Total assets	\$ 676,485	\$ 623,825	\$ 601,525	\$ 606,742	\$ 561,673
Total investment securities	97,896	97,423	100,730	108,543	83,431
Net loans and leases	506,327	469,216	424,584	398,186	407,903
Loans held-for-sale	1,161	917	10,545	4,537	213
Total deposits	586,944	529,698	514,660	515,802	482,448
Short-term borrowings	3,969	8,642	8,056	9,507	8,548
Long-term debt	10,000	16,000	16,000	21,000	21,000
Total shareholders' equity	72,219	66,060	58,946	53,624	46,774
Operating data for the year ended:					
Total interest income	\$ 24,844	\$ 23,853	\$ 23,994	\$ 25,603	\$ 27,580
Total interest expense	2,917	2,968	3,354	4,761	6,827
Net interest income	21,927	20,885	20,640	20,842	20,753
Provision for loan losses	1,060	2,550	3,250	1,800	2,085
Net interest income after provision for loan losses	20,867	18,335	17,390	19,042	18,668
Other-than-temporary impairment	-	-	(136)	(246)	(11,836)
Other income	7,354	10,541	7,788	5,946	5,480
Other operating expense	19,703	19,119	18,581	18,052	18,073
Income (loss) before income taxes	8,518	9,757	6,461	6,690	(5,761)
Provision (credit) for income taxes	2,166	2,635	1,559	1,645	(2,557)
Net income (loss)	\$ 6,352	\$ 7,122	\$ 4,902	\$ 5,045	\$ (3,204)
Per share data:					
Net income (loss) per share, basic	\$ 2.63	\$ 3.03	\$ 2.14	\$ 2.28	\$ (1.50)
Net income (loss) per share, diluted	\$ 2.62	\$ 3.02	\$ 2.14	\$ 2.28	\$ (1.50)
Dividends declared	\$ 2,667	\$ 2,602	\$ 2,283	\$ 2,210	\$ 2,137
Dividends per share	\$ 1.10	\$ 1.10	\$ 1.00	\$ 1.00	\$ 1.00
Book value per share	\$ 29.75	\$ 27.62	\$ 25.37	\$ 23.78	\$ 21.48
Weighted-average shares outstanding	2,412,962	2,353,056	2,286,233	2,213,631	2,141,323
Shares outstanding	2,427,767	2,391,617	2,323,248	2,254,542	2,178,028

Ratios:

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Return on average assets	0.96%	1.15%	0.81%	0.85%	-0.55%
Return on average equity	9.12%	11.70%	8.62%	10.01%	-6.69%
Net interest margin	3.75%	3.80%	3.80%	3.89%	3.89%
Efficiency ratio	64.88%	64.99%	63.40%	65.47%	65.38%
Expense ratio	1.89%	1.87%	1.78%	2.04%	2.07%
Allowance for loan losses to loans	1.78%	1.86%	2.02%	1.97%	1.90%
Dividend payout ratio	41.99%	36.54%	46.56%	43.80%	N/M*
Equity to assets	10.68%	10.59%	9.80%	8.84%	8.33%
Equity to deposits	12.30%	12.47%	11.45%	10.40%	9.70%

* The result of this calculation is not meaningful.

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ITEM 7: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

Critical accounting policies

The presentation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect many of the reported amounts and disclosures. Actual results could differ from these estimates.

A material estimate that is particularly susceptible to significant change relates to the determination of the allowance for loan losses. Management believes that the allowance for loan losses at December 31, 2014 is adequate and reasonable. Given the subjective nature of identifying and valuing loan losses, it is likely that well-informed individuals could make different assumptions and could, therefore, calculate a materially different allowance value. While management uses available information to recognize losses on loans, changes in economic conditions may necessitate revisions in the future. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses. Such agencies may require the Company to recognize adjustments to the allowance based on their judgment of information available to them at the time of their examination.

Another material estimate is the calculation of fair values of the Company's investment securities. Fair values of investment securities are determined by pricing provided by a third-party vendor, who is a provider of financial market data, analytics and related services to financial institutions. Based on experience, management is aware that estimated fair values of investment securities tend to vary among valuation services. Accordingly, when selling investment securities, price quotes may be obtained from more than one source. As described in Notes 1 and 4 of the consolidated financial statements, incorporated by reference in Part II, Item 8, the majority of the Company's investment securities are classified as available-for-sale (AFS). AFS securities are carried at fair value on the consolidated balance sheets, with unrealized gains and losses, net of income tax, reported separately within shareholders' equity as a component of accumulated other comprehensive income (loss) (OCI).

The fair value of residential mortgage loans, classified as held-for-sale (HFS), is obtained from the Federal National Mortgage Association (FNMA) or the Federal Home Loan Bank (FHLB). Generally, the market to which the Company sells residential mortgages it originates for sale is restricted and price quotes from other sources are not typically obtained. On occasion, the Company may transfer loans from the loan portfolio to loans HFS. Under these circumstances, pricing may be obtained from other entities and the loans are transferred at the lower of cost or market value and simultaneously sold. For a further discussion on the accounting treatment of HFS loans, see the section entitled "Loans held-for-sale," contained within this management's discussion and analysis.

All significant accounting policies are contained in Note 1, "Nature of Operations and Summary of Significant Accounting Policies", within the notes to consolidated financial statements and incorporated by reference in Part II, Item 8.

The following discussion and analysis presents the significant changes in the financial condition and in the results of operations of the Company as of December 31, 2014 and 2013 and for each of the years then ended. This discussion should be read in conjunction with the consolidated financial statements and notes thereto included in Part II, Item 8 of this report.

Comparison of Financial Condition as of December 31, 2014

and 2013 and Results of Operations for each of the Years then Ended

Executive Summary

Nationally, the unemployment rate declined from 6.7% at December 31, 2013 to 5.6% at December 31, 2014, remaining at the lowest level since 2008. The unemployment rate in the Scranton-Wilkes-Barre Metropolitan Statistical Area (local) started to align with the national rate at the end of 2014 after lagging behind for years. According to the U.S. Bureau of Labor Statistics, the local unemployment rate at December 31, 2014 was 5.6%, a decline of 2.1 percentage points from 7.7% at December 31, 2013. However, during the same period, the local labor force declined by more than 1%. Although there were more jobs at the end of 2014 compared to the same 2013 period, the sizeable decline in the workforce had a greater impact in driving the unemployment rate downward. The median home values in the region declined 1.1% from a year ago, and according to Zillow, an online database advertising firm providing access to its real estate search engines to various media outlets, predicts values will rise negligibly within the next year. We believe market conditions are slowly improving in our region. In light of these statistics, we will continue to monitor the economic climate in our region and scrutinize growth prospects with credit quality as a principal consideration.

During 2014, our assets grew by more than 8% from deposit growth and retained net earnings, both of which were used to fund growth in the loan portfolio, pay down high costing long-term debt and fund facility construction projects. In 2015, we expect to continue to grow all facets of loans, however concentrated mostly within the commercial and consumer portfolios with funding provided by deposit growth. We expect to grow the investment portfolio weighted heavier in mortgage-backed securities - an interest rate risk strategy in the event rates begin to rise. The cash flow from these securities will provide liquidity to reinvest in higher yielding assets. Funding will be provided from cash on hand, deposits and operations.

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We continued to improve asset quality, reducing non-performing assets by nearly 11% including a 9% reduction in non-performing loans. Non-performing assets represented 1.18% of total assets as of December 31, 2014, down from 1.44% at the prior year end. For 2015, we expect to continue to improve asset quality including a decline in non-accrual loans and when necessary expeditiously control the ownership and subsequent disposition of foreclosed assets thereby minimizing the high cost and losses associated with property ownership.

We generated \$6.4 million in net income in 2014, down from \$7.1 million in 2013. However, our 2013 earnings benefited from a \$1.9 million after tax gain from the sale of our impaired pooled trust preferred securities portfolio. In 2014 our larger and stronger balance sheet with improved asset quality contributed to the success of our earnings performance. In 2015, we expect net earnings to increase over 2014; from growth in interest-earning assets, improved asset quality thereby requiring less credit related costs and sound overhead expense management. We expect growth in net interest income with a minor slip in the interest rate margin. From a financial condition and performance perspective, our mission for 2015 will be to continue to strengthen our capital position from strategic growth oriented objectives, implement creative marketing and revenue enhancing strategies, grow and cultivate more of our business services and continue to improve credit risk at tolerable levels thereby improving overall asset quality.

Finally, we will be relocating one of our branch offices in 2015. In the second quarter, we will move our West Pittston office to Pittston. The new branch office will provide a modern, state-of-the-art facility for our loyal customer base located in the northeastern region of Luzerne County.

For the near-term, we expect to continue to operate in a low, but slowly-rising interest rate environment, with a slightly accelerated pace of rate increases occurring in the second half of 2015. A rising rate environment positions the Company to improve its net interest income performance, but will continue to pressure the interest-rate yield and margin. Though we expect interest rates to rise, we anticipate net interest margin to decline slightly in 2015. The Federal Open Market Committee (FOMC) has not adjusted the short-term federal funds rate upward and expectations are for short-term rates to remain low but to begin to rise during the second half of the year, potentially pressuring deposit rate pricing. The shape of the interest rate yield curve sloped positive in 2014 and is expected to continue into 2015 with a more positive slope expected to occur in 2015 caused by higher forecasted long-term rates. Although, the rapid increase in short-term interest rates scenario will then lead to flattening of the yield curve and cannot be ruled out. Growth in all loan sectors at prudent loan pricing coupled with low funding costs, should help maintain an acceptable interest rate margin during 2015 and beyond.

Financial Condition

Consolidated assets increased \$52.7 million, or 8%, to \$676.5 million as of December 31, 2014 from \$623.8 million at December 31, 2013. The increase in assets occurred predominantly in the loan portfolios funded by growth in deposits of \$57.2 million, \$3.7 million in earnings, net of dividends declared, and \$0.8 million infused from the Company's dividend reinvestment and employee stock purchase plans. Deposit growth was also used to fund the pay down of \$6.0 million in long-term debt, fund construction projects and reduce short-term borrowings with the balance held in cash for future use.

The following table is a comparison of condensed balance sheet data as of December 31:

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(dollars in thousands)

Assets:	2014	%	2013	%	2012	%
Cash and cash equivalents	\$ 25,851	3.8 %	\$ 13,218	2.1 %	\$ 21,846	3.6 %
Investment securities	97,896	14.5	97,423	15.6	100,730	16.7
Federal Home Loan Bank stock	1,306	0.2	2,640	0.4	2,624	0.4
Loans and leases, net	507,488	75.0	470,133	75.4	435,129	72.3
Bank premises and equipment	14,846	2.2	13,602	2.2	14,127	2.3
Life insurance cash surrender value	10,741	1.6	10,402	1.7	10,065	1.7
Other assets	18,357	2.7	16,407	2.6	17,004	3.0
Total assets	\$ 676,485	100.0 %	\$ 623,825	100.0 %	\$ 601,525	100.0 %
Liabilities:						
Total deposits	\$ 586,944	86.7 %	\$ 529,698	84.9 %	\$ 514,660	85.6 %
Short-term borrowings	3,969	0.6	8,642	1.4	8,056	1.3
Long-term debt	10,000	1.5	16,000	2.6	16,000	2.7
Other liabilities	3,353	0.5	3,425	0.5	3,863	0.6
Total liabilities	604,266	89.3	557,765	89.4	542,579	