

FRANKLIN FINANCIAL SERVICES CORP /PA/  
Form 10-Q  
November 07, 2007

# UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 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 September 30, 2007

OR

OR



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

For the transition period from            to

Commission file number 0-12126

**FRANKLIN FINANCIAL SERVICES CORPORATION**

(Exact name of registrant as specified in its charter)

**PENNSYLVANIA**  
(State or other jurisdiction of  
incorporation or organization)

**25-1440803**  
(I.R.S. Employer  
Identification No.)

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

(Address of principal executive offices)

**717/264-6116**

(Registrant's telephone number, including area code)

(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.

**Large accelerated filer o**

**Accelerated filer x**

**Non-accelerated filer o**



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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

There were 3,844,241 outstanding shares of the Registrant's common stock as of October 31, 2007.

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## Part I - FINANCIAL INFORMATION

**Item 1. Financial Statements**

**Franklin Financial Services Corporation**  
**Consolidated Balance Sheets**  
**(Amounts in thousands, except per share data)**

	September 30 2007 (unaudited)	December 31 2006
<b>Assets</b>		
Cash and due from banks	\$ 16,084	\$ 21,855
Interest bearing deposits in other banks and fed funds sold	251	293
Total cash and cash equivalents	16,335	22,148
Investment securities available for sale	178,779	189,345
Restricted stock	2,921	3,142
Loans held for sale	3,561	2,561
Loans	563,884	528,534
Allowance for loan losses	(7,324)	(6,850)
Net Loans	556,560	521,684
Premises and equipment, net	13,780	13,101
Bank owned life insurance	18,048	17,561
Goodwill	8,520	9,113
Other intangible assets	2,800	3,071
Equity method investments	4,016	4,028
Other assets	15,539	13,579
Total Assets	\$ 820,859	\$ 799,333
<b>Liabilities</b>		
Deposits:		
Demand (non-interest bearing)	\$ 87,425	\$ 87,688
Savings and interest checking	368,478	337,985
Time	160,784	169,622
Total Deposits	616,687	595,295
Securities sold under agreements to repurchase	80,269	78,410
Short term borrowings	7,950	6,700
Long term debt	32,367	38,449
Other liabilities	9,009	8,865
Total Liabilities	746,282	727,719
<b>Shareholders equity</b>		
Common stock \$1 par value per share, 15,000 shares authorized with 4,299 shares issued and 3,844 and 3,838 shares outstanding at September 30, 2007 and December 31, 2006 , respectively	4,299	4,299
Capital stock without par value, 5,000 shares authorized with no shares issued or outstanding		

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Additional paid in capital	32,569	32,251
Retained earnings	46,370	42,649
Accumulated other comprehensive income (loss)	(807)	236
Treasury stock, 455 shares and 461 shares at cost at September 30, 2007 and December 31, 2006, respectively	(7,854)	(7,821)
Total shareholders' equity	74,577	71,614
Total Liabilities and Shareholders' Equity	\$ 820,859	\$ 799,333

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



**Franklin Financial Services Corporation**  
**Consolidated Statements of Income**

(Amounts in thousands, except per share data)

(unaudited)

	For the Three Months Ended September 30		For the Nine Months Ended September 30	
	2007	2006	2007	2006
<b>Interest Income</b>				
Loans, including fees	\$ 10,194	\$ 9,165	\$ 29,698	\$ 22,911
Interest and dividends on investments:				
Taxable interest	1,714	1,459	4,943	3,944
Tax exempt interest	545	509	1,684	1,487
Dividend income	73	85	240	230
Federal funds sold	50	309	307	504
Deposits and obligations of other banks	6	17	26	37
<b>Total interest income</b>	<b>12,582</b>	<b>11,544</b>	<b>36,898</b>	<b>29,113</b>
<b>Interest Expense</b>				
Deposits	4,637	4,234	13,901	9,950
Securities sold under agreements to repurchase	1,026	968	3,042	2,288
Short term borrowings	36		69	27
Long term debt	426	522	1,346	1,669
<b>Total interest expense</b>	<b>6,125</b>	<b>5,724</b>	<b>18,358</b>	<b>13,934</b>
<b>Net interest income</b>	<b>6,457</b>	<b>5,820</b>	<b>18,540</b>	<b>15,179</b>
Provision for loan losses	340		790	240
Net interest income after provision for loan losses	6,117	5,820	17,750	14,939
<b>Noninterest Income</b>				
Investment and trust services fees	1,390	753	3,253	2,367
Loan service charges and fees	223	153	535	490
Mortgage banking activities	71	26	399	244
Deposit service charges and fees	637	582	1,782	1,541
Other service charges and fees	398	277	987	761
Increase in cash surrender value of life insurance	164	166	487	397
Equity method investments	13	85	(12)	71
Other	(17)	62	74	75
Securities gains			284	95
<b>Total noninterest income</b>	<b>2,879</b>	<b>2,104</b>	<b>7,789</b>	<b>6,041</b>
<b>Noninterest Expense</b>				
Salaries and benefits	2,922	2,673	8,472	7,127
Net occupancy expense	433	371	1,253	977
Furniture and equipment expense	242	263	744	608
Advertising	293	272	1,040	816
Legal and professional fees	291	192	813	671
Data processing	334	355	1,035	964
Pennsylvania bank shares tax	170	167	511	415
Intangible Amortization	90	136	271	229
Other	834	817	2,784	2,207
<b>Total noninterest expense</b>	<b>5,609</b>	<b>5,246</b>	<b>16,923</b>	<b>14,014</b>
Income before Federal income taxes	3,387	2,678	8,616	6,966
Federal income tax expense	830	577	1,936	1,498

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<b>Net income</b>	\$	2,557	\$	2,101	\$	6,680	\$	5,468
<b>Per share data</b>								
Basic earnings per share	\$	0.66	\$	0.55	\$	1.74	\$	1.56
Diluted earnings per share	\$	0.66	\$	0.55	\$	1.73	\$	1.55
Cash dividends declared	\$	0.26	\$	0.25	\$	0.77	\$	0.74

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

**Franklin Financial Services Corporation**  
**Consolidated Statements of Changes in Shareholders' Equity**

**for the Nine Months Ended September 30, 2007 and 2006**

(unaudited)

(Dollars in thousands, except per share data)	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total
Balance at December 31, 2005	\$ 3,806	\$ 19,907	\$ 38,638	\$ 801	\$ (7,482)	\$ 55,670
Comprehensive income:						
Net income			5,468			5,468
Unrealized gain on securities, net of reclassification adjustments and taxes				281		281
Unrealized gain on hedging activities, net of reclassification adjustments and taxes				53		53
Total Comprehensive income						5,802
Acquisition of Fulton County Bancshares	493	12,069				12,562
Cash dividends declared, \$.74 per share			(2,590)			(2,590)
Acquisition of 24,192 shares of treasury stock					(621)	(621)
Common stock issued under stock option plans		76			325	401
Stock option compensation		127				127
Balance at September 30, 2006	\$ 4,299	\$ 32,179	\$ 41,516	\$ 1,135	\$ (7,778)	\$ 71,351
Balance at December 31, 2006	\$ 4,299	\$ 32,251	\$ 42,649	\$ 236	\$ (7,821)	\$ 71,614
Comprehensive income:						
Net income			6,680			6,680
Unrealized loss on securities, net of reclassification adjustments and taxes				(1,038)		(1,038)
Unrealized loss on hedging activities, net of reclassification adjustments taxes				(5)		(5)
Total Comprehensive income						5,637
Cash dividends declared, \$.77 per share			(2,959)			(2,959)
Common stock issued under stock option plans		25			69	94
Acquisition of 16,770 shares of treasury stock					(434)	(434)
Treasury shares issued to dividend reinvestment plan		188			332	520
Stock option compensation		105				105
Balance at September 30, 2007	\$ 4,299	\$ 32,569	\$ 46,370	\$ (807)	\$ (7,854)	\$ 74,577

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

## Franklin Financial Services Corporation

## Consolidated Statements of Cash Flows

(unaudited)

(Amounts in thousands)	For the Nine Months Ended September 30	
	2007	2006
<b>Cash flows from operating activities</b>		
Net income	\$ 6,680	\$ 5,468
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	958	738
Net (accretion) amortization of loans and investment securities	(795)	(18)
Stock option compensation expense	105	127
Amortization and net change in mortgage servicing rights valuation	50	185
Amortization of intangibles	271	229
Provision for loan losses	790	240
Securities gains, net	(284)	(95)
Loans originated for sale	(17,312)	(19,223)
Proceeds from sale of loans	16,493	16,580
Gain on sales of loans	(181)	(183)
Loss on sale or disposal of premises & equipment	17	0
Increase in cash surrender value of life insurance	(487)	(397)
Loss (gain) on equity method investments	12	(71)
Impairment writedown on equity securities	32	
Increase in interest receivable and other assets	(942)	(1,276)
Increase (decrease) in interest payable and other liabilities	257	(166)
Other, net	189	(19)
<b>Net cash provided by operating activities</b>	<b>5,853</b>	<b>2,119</b>
<b>Cash flows from investing activities</b>		
Proceeds from sales of investment securities available for sale	10,425	537
Proceeds from maturities of investment securities available for sale	76,378	35,492
Net decrease in restricted stock	221	501
Purchase of investment securities available for sale	(76,956)	(55,219)
Net increase in loans	(35,684)	(42,158)
Proceeds from sale of premises and equipment		240
Cash and cash equivalents acquired from Fulton Bancshares		3,725
Cash paid in acquisition of Fulton Bancshares		(11,286)
Settlement of receivables related to investments acquired in acquisition		33,591
Capital expenditures	(1,690)	(1,735)
<b>Net cash used in investing activities</b>	<b>(27,306)</b>	<b>(36,312)</b>
<b>Cash flows from financing activities</b>		
Net increase in demand deposits, NOW accounts and savings accounts	30,230	37,434
Net decrease in certificates of deposit	(8,838)	(3,526)
Net increase in short term borrowings	3,109	17,083
Long term debt payments	(6,082)	(9,395)
Dividends paid	(2,959)	(2,590)
Common stock issued to dividend reinvestment plan	520	
Common stock issued under stock option plans	94	401
Purchase of treasury shares	(434)	(621)
<b>Net cash provided by financing activities</b>	<b>15,640</b>	<b>38,786</b>
<b>(Decrease) increase in cash and cash equivalents</b>	<b>(5,813)</b>	<b>4,593</b>

<b>Cash and cash equivalents as of January 1</b>		<b>22,148</b>		24,738
<b>Cash and cash equivalents as of September 30</b>	<b>\$</b>	<b>16,335</b>	<b>\$</b>	29,331

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

FRANKLIN FINANCIAL SERVICES CORPORATION and SUBSIDIARIES

UNAUDITED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**Note 1 - Basis of Presentation**



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

In the opinion of management, all adjustments (which include only normal recurring adjustments) necessary to present fairly the financial position, results of operations, and cash flows at and as of September 30, 2007, and for all periods presented have been made.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. It is suggested that these consolidated financial statements be read in conjunction with the audited consolidated financial statements and notes thereto included in the Corporation's 2006 Annual Report on Form 10-K. The results of operations for the period ended September 30, 2007 are not necessarily indicative of the operating results for the full year.

The balance sheet at December 31, 2006 has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

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

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

(Amounts in thousands)	For the three months ended September 30		For the nine months ended September 30	
	2007	2006	2007	2006
Weighted average shares outstanding (basic)	3,847	3,840	3,844	3,516
Impact of common stock equivalents	6	7	8	7
Weighted average shares outstanding (diluted)	3,853	3,847	3,852	3,523



**Note 2 Comprehensive Income**

Comprehensive income consists of net income and other comprehensive income. Other comprehensive income includes unrealized gains and losses on available-for-sale securities and derivatives that are recognized as separate components of shareholders' equity.

The components of other comprehensive income (loss) and related tax effects are as follows:

(Amounts in thousands)	For the Three Months Ended September 30		For the Nine Months Ended September 30	
	2007	2006	2007	2006
<b>Net Income</b>	\$ 2,557	\$ 2,101	\$ 6,680	\$ 5,468
<b>Securities:</b>				
Unrealized gains (losses) arising during the period	502	1,273	(1,289)	522
Reclassification adjustment for (gains) included in net income			(284)	(95)
Net unrealized gains (losses)	502	1,273	(1,573)	427
Tax effect	(171)	(433)	535	(146)
Net of tax amount	331	840	(1,038)	281
<b>Derivatives:</b>				
Unrealized (losses) gains arising during the period	(32)	(36)	(25)	48
Reclassification adjustment for losses included in net income	8	4	18	33