SUSSEX BANCORP
Form 10-Q
May 10, 2017
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549

FORM 10-Q

(Mark One)
[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2017

[ ] 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 0-29030

SUSSEX BANCORP
(Exact name of registrant as specified in its charter)

New Jersey	22-3475473
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

100 Enterprise Drive, Suite 700, Rockaway, NJ 07866
(Address of principal executive offices) (Zip Code)

(844) 256-7328
(Registrant's telephone number, including area code)

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 x No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes x No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company x
(Do not check if a smaller reporting company)

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

As of May 4, 2017 there were 4,791,003 shares of common stock, no par value, outstanding.

SUSSEX BANCORP
FORM 10-Q

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FORWARD-LOOKING STATEMENTS

We may, from time to time, make written or oral “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995, including statements contained in our filings with the Securities and Exchange Commission (the “SEC”), our reports to shareholders and in other communications by us. This Report on Form 10-Q contains “forward-looking statements” which may be identified by the use of such words as “believe,” “expect,” “anticipate,” “should,” “planned,” “estimated” and “potential.” Examples of forward-looking statements include, but are not limited to, estimates with respect to our financial condition, results of operation and business that are subject to various factors which could cause actual results to differ materially from these estimates. These factors include, but are not limited to:

- changes in the interest rate environment that reduce margins;
- changes in the regulatory environment;
- the highly competitive industry and market area in which we operate;
- general economic conditions, either nationally or regionally, resulting in, among other things, a deterioration in credit quality;
- changes in business conditions and inflation;
- changes in credit market conditions;
- changes in the securities markets which affect investment management revenues;
- increases in Federal Deposit Insurance Corporation (“FDIC”) deposit insurance premiums and assessments could adversely affect our financial condition;
- changes in technology used in the banking business;
- the soundness of other financial services institutions which may adversely affect our credit risk;
- our controls and procedures may fail or be circumvented;
- new lines of business or new products and services which may subject us to additional risks;
- changes in key management personnel which may adversely impact our operations;
- the effect on our operations of recent legislative and regulatory initiatives that were or may be enacted in response to the ongoing financial crisis;
- severe weather, natural disasters, acts of war or terrorism and other external events which could significantly impact our business;
- the factors that could also cause actual results to differ materially from current expectations include failure to complete the proposed Merger (as defined herein), the imposition of adverse regulatory conditions in connection with regulatory approval of the proposed Merger, disruption to the parties' businesses as a result of the announcement and pendency of the Merger, the inability to realize expected cost savings or to implement integration plans and other adverse consequences associated with the Merger; and
- other factors detailed from time to time in our filings with the SEC.

Although we believe that the expectations reflected in such forward-looking statements are reasonable, actual results may differ materially from the results discussed in these forward-looking statements. You are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. We do not undertake any obligation to republish revised forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

PART I – FINANCIAL INFORMATION
Item 1 – Financial Statements
SUSSEX BANCORP
CONSOLIDATED BALANCE SHEETS
(Unaudited)

(Dollars in Thousands)	March 31, 2017	December 31, 2016
ASSETS		
Cash and due from banks	$3,051	$ 2,847
Interest-bearing deposits with other banks	4,637	11,791
Cash and cash equivalents	7,688	14,638
Interest bearing time deposits with other banks	100	100
Securities available for sale, at fair value	99,797	88,611
Securities held to maturity, at amortized cost (fair value of $8,788 and $11,739 at March 31, 2017 and December 31, 2016, respectively)	8,630	11,618
Federal Home Loan Bank Stock, at cost	4,269	5,106
Loans receivable, net of unearned income	718,800	695,257
Less: allowance for loan losses	6,797	6,696
Net loans receivable	712,003	688,561
Foreclosed real estate	2,464	2,367
Premises and equipment, net	8,505	8,728
Accrued interest receivable	2,006	2,058
Goodwill	2,820	2,820
Bank-owned life insurance	16,638	16,532
Other assets	7,362	7,589
Total Assets	$872,282	$ 848,728
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Deposits:		
Non-interest bearing	$130,130	$ 132,434
Interest bearing	566,446	528,487
Total deposits	696,576	660,921
Short-term borrowings	14,800	29,805
Long-term borrowings	66,000	66,000
Accrued interest payable and other liabilities	4,643	4,090
Subordinated debentures	27,841	27,840
Total Liabilities	809,860	788,656
Stockholders' Equity:		
Preferred stock, no par value, 1,000,000 shares authorized; none issued	—	—
Common stock, no par value, 10,000,000 shares authorized; 4,785,159 and 4,741,068 shares issued and outstanding	36,703	36,538
Deferred compensation obligation under Rabbi Trust	(1,272)	(1,383)

Retained earnings	25,111	23,291
Accumulated other comprehensive income	608	243
Stock held by Rabbi Trust	1,272	1,383
Total Stockholders' Equity	62,422	60,072
Total Liabilities and Stockholders' Equity	$872,282	$ 848,728

See Notes to Consolidated Financial Statements

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SUSSEX BANCORP
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
(Unaudited)

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(Dollars in thousands except per share data)	Three Months Ended March 31, 2017	2016
INTEREST INCOME		
Loans receivable, including fees	$7,598	$6,145
Securities:		
Taxable	341	376
Tax-exempt	313	201
Interest bearing deposits	16	4
Total Interest Income	8,268	6,726
INTEREST EXPENSE		
Deposits	717	575
Borrowings	481	437
Subordinated debentures	321	68
Total Interest Expense	1,519	1,080
Net Interest Income	6,749	5,646
PROVISION FOR LOAN LOSSES	407	211
Net Interest Income after Provision for Loan Losses	6,342	5,435
OTHER INCOME		
Service fees on deposit accounts	253	225
ATM and debit card fees	180	187
Bank-owned life insurance	106	76
Insurance commissions and fees	1,747	1,721
Investment brokerage fees	3	27
Net gain on sales of securities	107	167
Net (loss) on disposal of premises and equipment	—	(13)
Other	81	134
Total Other Income	2,477	2,524
OTHER EXPENSES		
Salaries and employee benefits	3,558	3,353
Occupancy, net	500	424
Data processing	557	549
Furniture and equipment	240	233
Advertising and promotion	106	105
Professional fees	277	174
Director fees	107	59
FDIC assessment	51	120
Insurance	66	73
Stationary and supplies	32	52
Loan collection costs	24	32
Net expenses and write-downs related to foreclosed real estate	45	75
Other	414	361
Total Other Expenses	5,977	5,610
Income before Income Taxes	2,842	2,349
EXPENSE FOR INCOME TAXES	831	775
Net Income	2,011	1,574
OTHER COMPREHENSIVE INCOME:		
Unrealized gains on available for sale securities arising during the period	676	985
Fair value adjustments on derivatives	40	(400)

Reclassification adjustment for net gain on securities transactions included in net income	(107)	(167)
Income tax related to items of other comprehensive (loss) income	(244)	(167)
Other comprehensive income, net of income taxes	365	251
Comprehensive income	$2,376	$1,825
EARNINGS PER SHARE		
Basic	$0.43	$0.34
Diluted	$0.43	$0.34

See Notes to Consolidated Financial Statements

SUSSEX BANCORP
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
Three Months Ended March 31, 2017 and 2016
(Unaudited)

(Dollars in Thousands)	Number of Shares Outstanding	Common Stock	Deferred Compensation Obligation Under Rabbi Trust	Retained Earnings	Accumulated Other Comprehensive Income	Stock Held by Rabbi Trust	Treasury Stock	Total Stockholders' Equity
Balance December 31, 2015	4,646,238	$35,927	—	$18,520	$ 86	—	$(592)	$ 53,941
Net income	—	—	—	1,574	—	—	—	1,574
Other comprehensive income	—	—	—	—	251	—	—	251
Treasury shares purchased	—	—	—	—	—	—	—	—
Restricted stock granted	30,822	—	—	—	—	—	—	—
Restricted stock forfeited	(1,084)	—	—	—	—	—	—	
Compensation expense related to stock option and restricted stock grants	—	101	—	—	—	—	—	101
Dividends declared on common stock ($0.04 per share)	—	—	—	(185)	—	—	—	(185)
Balance March 31, 2016	4,675,976	$36,028	$ —	$19,909	$ 337	$—	$(592)	$ 55,682
Balance December 31, 2016	4,741,068	$36,538	1,383	$23,291	$ 243	(1,383)	$—	$ 60,072
Net income	—	—	—	2,011	—		—	2,011
Other comprehensive income	—	—	—	—	365	—	—	365
Treasury shares purchased	—	—	—	—	—		—	—
Funding of Supplemental Director Retirement Plan	—	—	(111)	—	—	111	—	—
Options exercised	—	—	—	—	—		—	—
Restricted stock granted	47,326	—	—	—	—		—	—
Restricted stock forfeited	(3,235)	—	—	—	—	—	—	—
Compensation expense related to stock option and restricted stock grants	—	165	—	—	—		—	165
Dividends declared on common stock ($0.04 per share)	—	—	—	(191)	—		—	(191)
Balance March 31, 2017	4,785,159	$36,703	$ 1,272	$25,111	$ 608	$(1,272)	$—	$ 62,422

See Notes to Consolidated Financial Statements

SUSSEX BANCORP
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Three Months Ended March 31,	
(Dollars in thousands)	2017	2016
Cash Flows from Operating Activities		
Net income	$2,011	$1,574
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	407	211
Depreciation and amortization	272	258
Net amortization of securities premiums and discounts	410	412
Amortization of subordinated debt issuance costs	1	—
Net realized gain on sale of securities	(107)	(167)
Net realized loss on disposal of premises and equipment	—	13
Net realized gain on sale of foreclosed real estate	(2)	(3)
Write-downs of and provisions for foreclosed real estate	36	—
Deferred income tax (benefit) expense	(82)	(192)
Earnings on bank-owned life insurance	(106)	(76)
Compensation expense for stock options and stock awards	165	101
(Decrease) increase in assets:		
Accrued interest receivable	52	(493)
Other assets	105	(726)
Increase in accrued interest payable and other liabilities	553	904
Net Cash Provided by Operating Activities	3,715	1,816
Cash Flows from Investing Activities		
Securities available for sale:		
Purchases	(25,368)	(2,044)
Sales	12,303	8,088
Maturities, calls and principal repayments	2,152	1,789
Securities held to maturity:		
Purchases	—	(480)
Maturities, calls and principal repayments	2,981	491
Net increase in loans	(23,982)	(36,617)
Proceeds from the sale of foreclosed real estate	2	29
Purchases of bank premises and equipment	(49)	(518)
Net decrease in Federal Home Loan Bank stock	837	1,326
Net Cash Used in Investing Activities	(31,124)	(27,936)
Cash Flows from Financing Activities		
Net increase in deposits	35,655	57,444
Net decrease in short-term borrowed funds	(15,005)	(33,220)
Proceeds from long-term borrowings	—	5,000
Dividends paid	(191)	(185)
Net Cash Provided by Financing Activities	20,459	29,039
Net (Decrease) increase in Cash and Cash Equivalents	(6,950)	2,919
Cash and Cash Equivalents - Beginning	14,638	6,120
Cash and Cash Equivalents - Ending	$7,688	$9,039

Supplementary Cash Flows Information

Interest paid	$1,531	$975
Income taxes paid	$20	$795
Supplementary Schedule of Noncash Investing and Financing Activities		
Foreclosed real estate acquired in settlement of loans	$133	$—

See Notes to Consolidated Financial Statements

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NOTE 1 – SUMMARY OF SIGNIFICANT ACOUNTING POLICIES

Basis of Presentation

The accompanying unaudited consolidated financial statements include the accounts of Sussex Bancorp ("we," "us," "our" or the "company") and our wholly owned subsidiary Sussex Bank (the "Bank"). The Bank's wholly owned subsidiaries are SCB Investment Company, Inc., SCBNY Company, Inc., ClassicLake Enterprises, LLC, PPD Holding Company, LLC, and Tri-State Insurance Agency, Inc. ("Tri-State"), a full service insurance agency located in Sussex County, New Jersey with a satellite office located in Bergen County, New Jersey. Tri-State's operations are considered a separate segment for financial disclosure purposes. All inter-company transactions and balances have been eliminated in consolidation. The Bank operates eleven banking offices, eight located in Sussex County, New Jersey, one located in Bergen County, New Jersey, one located in Warren County, New Jersey, and one in Queens County, New York.

We are subject to the supervision and regulation of the Board of Governors of the Federal Reserve System (the "FRB"). The Bank's deposits are insured by the Deposit Insurance Fund ("DIF") of the FDIC up to applicable limits. The operations of the company and the Bank are subject to the supervision and regulation of the FRB, the FDIC and the New Jersey Department of Banking and Insurance (the "Department") and the operations of Tri-State are subject to supervision and regulation by the Department.

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information. Accordingly, they do not include all of the information and footnotes required by the accounting principles generally accepted in the United States of America ("U.S. GAAP") for full year financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included and are of a normal, recurring nature. Operating results for the three month period ended March 31, 2017 are not necessarily indicative of the results that may be expected for the year ending December 31, 2017. These unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto that are included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2016.

New Accounting Standards

In May 2014, the FASB issued an Accounting Standard Update ("ASU") 2014-09 to amend its guidance on "Revenue from Contracts with Customers (Topic 606). The objective of the ASU is to align the recognition of revenue with the transfer of promised goods or services provided to customers in an amount that reflects the consideration which the entity expects to be entitled in exchange for those goods or services. This ASU will replace most existing revenue recognition guidance under GAAP when it becomes effective. In August 2015, the FASB issued an amendment (ASU 2015-14) which defers the effective date of this new guidance by one year. More detailed implementation guidance on Topic 606 was issued in March 2016 (ASU 2016-08), April 2016 (ASU 2016-10) May 2016 (ASU 2016-12) and December 2016 (ASU 2016-20), and the effective date and transition requirements for these ASUs are the same as the effective date and transition requirements of ASU 2014-09. The amendments in ASU 2014-09 are effective for public business entities for annual periods beginning after December 15, 2017. The Company currently believes the impact of adopting the standard, as modified and augmented by subsequently issued pronouncements, will not be material to either past or future periods as it relates to the Company's core banking revenue streams, but is still evaluating the potential impact the new standard will have on noninterest income components.

In January 2016, FASB issued ASU 2016-01, Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. ASU 2016-01, among other things; (i) requires equity investments, with certain exceptions, to be measured at fair value with changes in fair value recognized in net income, (ii) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment; (iii) eliminates the requirement for public business entities to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; (iv) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; (v) requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments; (vi) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements; and (vii) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale. For public entities, the guidance is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. The Company is currently evaluating the impact of the pending adoption of the new standard on its consolidated financial statements.

In February 2016, FASB issued ASU 2016-02, Leases (Topic 842). Under the new guidance, lessees will be required to recognize the following for all leases (with the exception of short-term leases) at the commencement date: (i) a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (ii) a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged. Public business entities should apply the amendments in ASU 2016-02 for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application is permitted for all public business entities upon issuance. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The Company currently expects that upon adoption of ASU 2016-02, right-of-use assets and lease liabilities will be recognized in the consolidated balance sheet in amounts that will be material; however, there will be no material impact on operations.

In March 2016, FASB issued ASU 2016-09, Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. FASB issued ASU 2016-09 as part of its initiative to reduce complexity in accounting standards. The areas for simplification in this ASU 2016-09 involve several aspects of the accounting for employee share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. Some of the areas for simplification apply only to nonpublic entities. For public business entities, the amendments in this update are effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Early adoption is permitted for any entity in any interim or annual period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. An entity that elects early adoption must adopt all of the amendments in the same period. The Company`s adoption of the ASU did not have a significant impact on the Company`s consolidated financial statements. The effective tax rate decreased 3.8% to 29.2% from 33.0% for the quarters ended March 31, 2017 and 2016, respectively. The Company expects the annualized tax rate to be minimally impacted by the adoption of the ASU.

In June, 2016, the FASB issued Accounting Standards Update 2016-13, Financial Instruments – Credit Losses (Topic 326) (the "ASU"), which introduces new guidance for the accounting for credit losses on instruments within its scope. The new guidance introduces an approach based on expected losses to estimate credit losses on certain types of financial instruments. It also modifies the impairment model for available-for-sale (AFS) debt securities and provides for a simplified accounting model for purchased financial assets with credit deterioration since their origination. The ASU will be effective for public business entities that are SEC filers in fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. All other entities will have one additional year. Early application of the guidance will be permitted for all entities for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company is currently evaluating the impact of the pending adoption of the new standard on its consolidated financial statements. The Company has taken steps to prepare for implementation when it becomes effective, such as changes to its current model and evaluating the potential use of outside professionals for an updated model.

In August 2016, FASB issued ASU No. 2016-15, Classification of Certain Cash Receipts and Cash Payments (a consensus of the FASB Emerging Issues Task Force), which addresses eight classification issues related to the statement of cash flows; (i) debt prepayment or debt extinguishment costs, (ii) settlement of zero-coupon bonds, (iii) contingent consideration payments made after a business combination, (iv) proceeds from the settlement of insurance claims, (v) proceeds from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies, (vi) distributions received from equity method investees, (vii) beneficial interests in securitization transactions, and (viii) separately identifiable cash flows and application of the predominance principle. ASU 2016-15 is effective for public business entities for annual and interim periods in fiscal years beginning after December 15, 2017. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the ASU in an interim period, adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. An entity that elects early adoption must adopt all of the amendments in the same period. Entities should apply this ASU using a retrospective transition method to each period presented. If it is impracticable for an entity to apply the ASU retrospectively for some of the issues, it may apply the amendments for those issues prospectively as of the earliest date practicable. The Company's adoption of the ASU will not have a significant impact on the Company's consolidated financial statements.

In January 2017, FASB issued ASU 2017-04, Simplifying the Test for Goodwill Impairment (Topic 350). The main objective of this ASU is to simplify the accounting for goodwill impairment by requiring impairment charges be based upon the first step in the current two-step impairment test under Accounting Standards Codification (ASC) 350. Currently, if the fair value of a reporting unit is lower than its carrying amount (Step 1), an entity calculates any impairment charge by comparing the implied fair value of goodwill with its carrying amount (Step 2). This ASU’s objective is to simplify how all entities assess goodwill for impairment by eliminating Step 2 from the goodwill impairment test. As amended, the goodwill impairment test will consist of one step comparing the fair value of a reporting unit with its carrying amount. An entity should recognize a goodwill impairment charge for the amount by which the carrying amount exceeds the reporting unit’s fair value. The standard will be applied prospectively and is effective for annual and interim impairment tests performed in periods beginning after December 15, 2019. Early adoption is permitted for annual and interim goodwill impairment testing dates after January 1, 2017. The Company is currently evaluating the impact of the pending adoption on its consolidated financial statements.

In March 2017, FASB issued ASU 2017-08, Premium Amortization on Purchased Callable Debt Securities (Subtopic 310-20). The update shortens the amortization period for premiums on purchased callable debt securities to the earliest call date. The amendment will apply only to callable debt securities with explicit, noncontingent call features that are callable at fixed prices and on preset dates, apply to all premiums on callable debt securities, regardless of how they were generated, and require companies to reset the effective yield using the payment terms of the debt security if the call option is not exercised on the earliest call date. The ASU does not require an accounting change for securities held at a discount. The discount continues to be amortized to maturity and does not apply when the investor has already incorporated prepaymen