

EMCLAIRE FINANCIAL CORP  
Form 10-Q  
August 10, 2015

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended **June 30, 2015**

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: **001-34527**

**EMCLAIRE FINANCIAL CORP**

(Exact name of registrant as specified in its charter)

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Pennsylvania 25-1606091  
(State or other jurisdiction of incorporation or organization) (IRS Employer Identification No.)

612 Main Street, Emlenton, Pennsylvania 16373  
(Address of principal executive offices) (Zip Code)

**(844) 767-2311**

(Registrant's telephone number)

N/A

(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 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 whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company as defined in Rule 12b-2 of the Exchange Act.

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

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

The number of shares outstanding of the Registrant's common stock was 2,134,858 at August 10, 2015.



**EMCLAIRE FINANCIAL CORP**

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**PART I - FINANCIAL INFORMATION****Item 1. Interim Financial Statements**

Emclaire Financial Corp

Consolidated Balance Sheets (Unaudited)

As of June 30, 2015 and December 31, 2014

(Dollar amounts in thousands, except share and per share data)

	June 30, 2015	December 31, 2014
Assets		
Cash and due from banks	\$2,684	\$ 2,386
Interest earning deposits with banks	9,225	9,470
Cash and cash equivalents	11,909	11,856
Securities available for sale	146,715	149,861
Loans receivable, net of allowance for loan losses of \$5,370 and \$5,224	396,643	379,648
Federal bank stocks, at cost	2,512	2,406
Bank-owned life insurance	10,890	10,728
Accrued interest receivable	1,548	1,543
Premises and equipment, net	15,048	15,144
Goodwill	3,664	3,664
Core deposit intangible, net	652	749
Prepaid expenses and other assets	9,565	6,310
<b>Total Assets</b>	<b>\$599,146</b>	<b>\$ 581,909</b>
Liabilities and Stockholders' Equity		
Liabilities:		
Deposits:		
Non-interest bearing	\$115,551	\$ 111,282
Interest bearing	396,861	390,537
Total deposits	512,412	501,819
Short-term borrowed funds	7,500	6,500
Long-term borrowed funds	15,000	15,000
Accrued interest payable	187	199

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Accrued expenses and other liabilities	7,146	10,401
Total Liabilities	542,245	533,919
Commitments and Contingent Liabilities	-	-
Stockholders' Equity:		
Preferred stock, \$1.00 par value, 3,000,000 shares authorized; Series B, non-cumulative preferred stock, \$5,000 liquidation value, 5,000 shares issued and outstanding	5,000	5,000
Common stock, \$1.25 par value, 12,000,000 shares authorized; 2,235,875 and 1,882,675 shares issued; 2,133,858 and 1,780,658 shares outstanding, respectively	2,795	2,353
Additional paid-in capital	27,573	19,740
Treasury stock, at cost; 102,017 shares	(2,114 )	(2,114 )
Retained earnings	26,811	26,009
Accumulated other comprehensive loss	(3,164 )	(2,998 )
Total Stockholders' Equity	56,901	47,990
Total Liabilities and Stockholders' Equity	\$599,146	\$ 581,909

See accompanying notes to consolidated financial statements.

## Emclaire Financial Corp

## Consolidated Statements of Net Income (Unaudited)

For the three and six months ended June 30, 2015 and 2014

(Dollar amounts in thousands, except share and per share data)

	For the three months ended		For the six months ended	
	June 30,	2014	June 30,	2014
	2015		2015	
Interest and dividend income:				
Loans receivable, including fees	\$ 4,470	\$ 4,089	\$ 8,670	\$ 8,119
Securities:				
Taxable	520	493	1,045	897
Exempt from federal income tax	214	253	435	518
Federal bank stocks	29	44	102	79
Interest earning deposits with banks	19	27	34	38
Total interest and dividend income	5,252	4,906	10,286	9,651
Interest expense:				
Deposits	535	607	1,082	1,169
Borrowed funds	177	149	359	329
Total interest expense	712	756	1,441	1,498
Net interest income	4,540	4,150	8,845	8,153
Provision for loan losses	203	183	371	345
Net interest income after provision for loan losses	4,337	3,967	8,474	7,808
Noninterest income:				
Fees and service charges	378	394	726	771
Commissions on financial services	5	13	10	22
Title premiums	6	15	17	24
Net gain on sales of available for sale securities	34	-	34	658
Earnings on bank-owned life insurance	97	93	194	192
Other	328	318	646	605
Total noninterest income	848	833	1,627	2,272
Noninterest expense:				
Compensation and employee benefits	2,050	1,832	4,118	3,774
Premises and equipment	655	604	1,324	1,204
Intangible asset amortization	49	57	98	113
Professional fees	178	183	380	346
Federal deposit insurance	98	88	195	176
Other	981	942	1,861	2,314
Total noninterest expense	4,011	3,706	7,976	7,927
Income before provision for income taxes	1,174	1,094	2,125	2,153
Provision for income taxes	247	216	417	433
Net income	927	878	1,708	1,720

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Preferred stock dividends	25	25	50	50
Net income available to common stockholders	\$ 902	\$ 853	\$ 1,658	\$ 1,670
Basic earnings per common share	\$ 0.48	\$ 0.48	\$ 0.91	\$ 0.94
Diluted earnings per common share	0.48	0.48	0.90	0.94
Average common shares outstanding	1,864,298	1,770,158	1,823,086	1,769,775

See accompanying notes to consolidated financial statements.

**Emclaire Financial Corp**

## Consolidated Statements of Comprehensive Income (Unaudited)

For the three and six months ended June 30, 2015 and 2014

(Dollar amounts in thousands)

	For the three months ended June 30,		For the six months ended June 30,	
	2015	2014	2015	2014
Net income	\$ 927	\$ 878	\$ 1,708	\$ 1,720
Other comprehensive income				
Unrealized gains on securities:				
Unrealized holding gain (loss) arising during the period	(1,256 )	1,525	(218 )	2,755
Reclassification adjustment for gains included in net income	(34 )	-	(34 )	(658 )
	(1,290 )	1,525	(252 )	2,097
Tax effect	439	(519 )	86	(713 )
Net of tax	(851 )	1,006	(166 )	1,384
Comprehensive income	\$ 76	\$ 1,884	\$ 1,542	\$ 3,104

See accompanying notes to consolidated financial statements.

**Emclaire Financial Corp**

## Condensed Consolidated Statements of Cash Flows (Unaudited)

For the six months ended June 30, 2015 and 2014

(Dollar amounts in thousands)

	For the six months ended June 30, 2015		2014
Cash flows from operating activities			
Net income	\$ 1,708		\$ 1,720
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	500		386
Provision for loan losses	371		345
Amortization of premiums, net	166		127
Amortization of intangible assets and mortgage servicing rights	98		113
Realized gains on sales of available for sale securities, net	(34 )		(658 )
Net gains on foreclosed real estate	(18 )		(14 )
Stock compensation expense	108		84
Increase in bank-owned life insurance, net	(162 )		(161 )
Increase in accrued interest receivable	(5 )		(64 )
(Increase) decrease in prepaid expenses and other assets	(2,997 )		169
	(12 )		(39 )

Decrease in accrued interest payable			
Increase (decrease) in accrued expenses and other liabilities	(237	)	117
Net cash (used in) provided by operating activities	(514	)	2,125
Cash flows from investing activities			
Loan originations and principal collections, net	864		(8,531
Purchase of residential mortgage loans	(14,647	)	-
Settlement of syndicated national credits	(7,039	)	-
Available for sale securities:			
Sales	1,791		21,559
Maturities, repayments and calls	12,701		5,227
Purchases (Purchase)	(11,555	)	(53,255
redemption of federal bank stocks	(106	)	1,186
Proceeds from the sale of foreclosed real estate	102		121
Write-down of foreclosed real estate	6		-
Additions to premises and equipment	(404	)	(2,190
Net cash used in investing activities	(18,287	)	(35,883
Cash flows from financing activities			
Net increase in deposits	10,593		82,397
Repayments on Federal Home Loan Bank advances	-		(5,000
Net change in short-term borrowings	1,000		(22,000
	4		26

Proceeds from exercise of stock options, including tax benefit				
Dividends paid	(905	)	(829	)
Proceeds from the issuance of common stock	8,162		-	
Net cash provided by financing activities	18,854		54,594	
Increase in cash and cash equivalents	53		20,836	
Cash and cash equivalents at beginning of period	11,856		16,658	
Cash and cash equivalents at end of period	\$	11,909	\$	37,494
Supplemental information:				
Interest paid	\$	1,453	\$	1,537
Income taxes paid		525		-
Supplemental noncash disclosure:				
Transfers from loans to foreclosed real estate		263		20

See accompanying notes to consolidated financial statements.

## Emclaire Financial Corp

## Consolidated Statements of Changes in Stockholders' Equity (Unaudited)

For the three and six months ended June 30, 2015 and 2014

(Dollar amounts in thousands, except per share data)

	For the three months ended June 30,		For the six months ended June 30,	
	2015	2014	2015	2014
Balance at beginning of period	\$ 49,061	\$ 45,945	\$ 47,990	\$ 45,072
Net income	927	878	1,708	1,720
Other comprehensive income	(851 )	1,006	(166 )	1,384
Stock compensation expense	55	42	108	84
Dividends declared on preferred stock	(25 )	(25 )	(50 )	(50 )
Dividends declared on common stock	(428 )	(389 )	(855 )	(779 )
Exercise of stock options, including tax benefit	-	-	4	26
Issuance of common stock (350,000 shares)	8,162	-	8,162	-
Balance at end of period	\$ 56,901	\$ 47,457	\$ 56,901	\$ 47,457
Cash dividend per common share	\$ 0.24	\$ 0.22	\$ 0.48	\$ 0.44

See accompanying notes to consolidated financial statements.

## **Emclair Financial Corp**

Notes to Consolidated Financial Statements (Unaudited)

### **1. Nature of Operations and Basis of Presentation**

Emclair Financial Corp (the Corporation) is a Pennsylvania corporation and the holding company of The Farmers National Bank of Emlenton (the Bank) and Emclair Settlement Services, LLC (the Title Company). The Corporation provides a variety of financial services to individuals and businesses through its offices in Western Pennsylvania. Its primary deposit products are checking, savings and term certificate accounts and its primary lending products are residential and commercial mortgages, commercial business loans and consumer loans.

The consolidated financial statements include the accounts of the Corporation and its wholly owned subsidiaries, the Bank and the Title Company. All significant intercompany transactions and balances have been eliminated in preparing the consolidated financial statements.

The accompanying unaudited consolidated financial statements for the interim periods include all adjustments, consisting of normal recurring accruals, which are necessary, in the opinion of management, to fairly reflect the Corporation's consolidated financial position and results of operations. Additionally, these consolidated financial statements for the interim periods have been prepared in accordance with instructions for the Securities and Exchange Commission's (SEC's) Form 10-Q and Article 10 of Regulation S-X and therefore do not include all information or footnotes necessary for a complete presentation of financial condition, results of operations and cash flows in conformity with accounting principles generally accepted in the United States of America (GAAP). For further information, refer to the audited consolidated financial statements and footnotes thereto for the year ended December 31, 2014, as contained in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2014 filed with the SEC.

The balance sheet at December 31, 2014 has been derived from the audited financial statements at that date but does not include all the information and footnotes required by GAAP for complete financial statements.

The preparation of financial statements, in conformity with GAAP, requires management to make estimates and assumptions that affect the reported amounts in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. The results of operations for interim quarterly or year-to-date periods are not necessarily indicative of the results that may be expected for the entire year or any other period. Certain amounts previously reported may have been reclassified to conform to the current year's financial statement presentation.

**2.**

**Issuance of Common Stock**

On June 10, 2015, the Corporation sold 350,000 shares of common stock, par value \$1.25 per share, in a private offering to accredited individual and institutional investors at \$23.50 per share. The Corporation realized \$8.2 million in proceeds from the offering, net of \$63,000 of direct costs relating to the offering.

### **3. Participation in the Small Business Lending Fund (SBLF) of the U.S. Treasury Department (U.S. Treasury)**

On August 18, 2011, the Corporation entered into a Securities Purchase Agreement (the Agreement) with the U.S. Treasury Department, pursuant to which the Corporation issued and sold to the U.S. Treasury 10,000 shares of Senior Non-Cumulative Perpetual Preferred Stock, Series B (Series B Preferred Stock), having a liquidation preference of \$1,000 per share, for aggregate proceeds of \$10.0 million, pursuant to the U.S. Treasury's SBLF program. On September 17, 2013, with the approval of the Corporation's primary federal banking regulator, the Corporation redeemed 5,000 shares, or 50%, of its Series B Preferred Stock held by the U.S. Treasury at an aggregate redemption price of \$5.0 million, plus accrued but unpaid dividends. Following this redemption, the Treasury holds 5,000 shares of the Series B Preferred Stock, representing a remaining liquidation value of \$5.0 million.

The Series B Preferred Stock is entitled to receive non-cumulative dividends payable quarterly on each January 1, April 1, July 1 and October 1, beginning October 1, 2011. The dividend rate, which is calculated on the aggregate liquidation amount, was initially set at 5% per annum based upon the current level of Qualified Small Business Lending (QSBL) by the Bank at that time. The dividend rate in the subsequent periods for the first two and one-half years through the quarter ending December 31, 2013 was based upon the percentage change in qualified lending between each dividend period and the baseline QSBL level established at the time the Agreement was entered into. Such dividend rate varied from 1% to 5% per annum. For the two year period beginning January 1, 2014, the dividend rate is fixed at a rate of 2% per annum. If the Series B Preferred Stock remains outstanding for more than four-and-one-half years, beginning January 1, 2016, the dividend rate will be fixed at 9%. The dividend rate was 2.0% for the three and six month periods ended June 30, 2015 and 2014. Such dividends are not cumulative, but the Corporation may only declare and pay dividends on its common stock (or any other equity securities junior to the Series B Preferred Stock) if it has declared and paid dividends for the current dividend period on the Series B Preferred Stock, and will be subject to other restrictions on its ability to repurchase or redeem other securities.

Holders of the Series B Preferred Stock have the right to vote as a separate class on certain matters relating to the rights of holders of Series B Preferred Stock and on certain corporate transactions. Except with respect to such matters, the Series B Preferred Stock does not have voting rights.

The Corporation may redeem the shares of Series B Preferred Stock, in whole or in part, at any time at a redemption price equal to the sum of the liquidation amount and the per-share amount of any unpaid dividends for the then-current period, subject to any required prior approval by the Corporation's primary federal banking regulator. If redeemed in part, payments are required to be at least 25% of the original issuance.

### **4. Earnings per Common Share**

Basic earnings per common share (EPS) excludes dilution and is computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted EPS

includes the dilutive effect of additional potential common shares for assumed issuance of restricted stock and shares issued under stock options.

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**4. Earnings per Common Share (continued)**

The factors used in the Corporation's earnings per common share computation follow:

(Dollar amounts in thousands, except for per share amounts)	For the three months ended		For the six months ended	
	June 30, 2015	2014	June 30, 2015	2014
Earnings per common share - basic				
Net income	\$927	\$878	\$1,708	\$1,720
Less: Preferred stock dividends	25	25	50	50
Net income available to common stockholders	\$902	\$853	\$1,658	\$1,670
Average common shares outstanding	1,864,298	1,770,158	1,823,086	1,769,775
Basic earnings per common share	\$0.48	\$0.48	\$0.91	\$0.94
Earnings per common share - diluted				
Net income available to common stockholders	\$902	\$853	\$1,658	\$1,670
Average common shares outstanding	1,864,298	1,770,158	1,823,086	1,769,775
Add: Dilutive effects of assumed issuance of restricted stock and exercise of stock options	11,962	14,691	11,301	13,893
Average shares and dilutive potential common shares	1,876,260	1,784,849	1,834,387	1,783,668
Diluted earnings per common share	\$0.48	\$0.48	\$0.90	\$0.94
Stock options not considered in computing earnings per share because they were antidilutive	67,000	67,000	67,000	67,000

**5. Securities**

The following table summarizes the Corporation's securities as of June 30, 2015 and December 31, 2014:

(Dollar amounts in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale:				
June 30, 2015:				
U.S. Treasury and federal agency	\$ 1,492	\$ -	\$ (24)	) \$1,468
U.S. government sponsored entities and agencies	36,458	41	(69)	) 36,430
U.S. agency mortgage-backed securities: residential	34,001	447	-	) 34,448
U.S. agency collateralized mortgage obligations: residential	34,955	19	(877)	) 34,097
State and political subdivisions	33,395	477	(261)	) 33,611
Corporate debt securities	4,010	1	(9)	) 4,002
Equity securities	2,356	360	(57)	) 2,659

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	\$ 146,667	\$ 1,345	\$ (1,297	) \$146,715
December 31, 2014:				
U.S. Treasury and federal agency	\$ 1,491	\$ -	\$ (35	) \$1,456
U.S. government sponsored entities and agencies	35,452	10	(238	) 35,224
U.S. agency mortgage-backed securities: residential	38,026	745	-	38,771
U.S. agency collateralized mortgage obligations: residential	37,564	16	(963	) 36,617
State and political subdivisions	32,665	550	(191	) 33,024
Corporate debt securities	2,006	-	(8	) 1,998
Equity securities	2,356	415	-	2,771
	\$ 149,560	\$ 1,736	\$ (1,435	) \$149,861

**5. Securities (continued)**

The following table summarizes scheduled maturities of the Corporation's debt securities as of June 30, 2015. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties. Mortgage-backed securities and collateralized mortgage obligations are not due at a single maturity and are shown separately.

(Dollar amounts in thousands)	Available for sale Amortized Fair	
	Cost	Value
Due in one year or less	\$-	\$-
Due after one year through five years	50,470	50,585
Due after five through ten years	22,894	22,975
Due after ten years	1,990	1,951
Mortgage-backed securities: residential	34,001	34,448
Collateralized mortgage obligations: residential	34,955	34,097
	\$144,310	\$144,056

Information pertaining to securities with gross unrealized losses at June 30, 2015 and December 31, 2014, aggregated by investment category and length of time that individual securities have been in a continuous loss position are included in the table below:

(Dollar amounts in thousands)	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Description of Securities						
June 30, 2015:						
U.S. Treasury and federal agency	\$ -	\$ -	\$ 1,468	\$ (24 )	\$ 1,468	\$ (24 )
U.S. government sponsored entities and agencies	13,826	(23 )	9,951	(46 )	23,777	(69 )
U.S. agency collateralized mortgage obligations: residential	4,821	(35 )	27,459	(842 )	32,280	(877 )
State and political subdivisions	11,277	(146 )	3,726	(115 )	15,003	(261 )
Corporate debt securities	3,002	(8 )	500	(1 )	3,502	(9 )
Equity securities	893	(57 )	-	-	893	(57 )
	\$ 33,819	\$ (269 )	\$ 43,104	\$ (1,028 )	\$ 76,923	\$ (1,297 )
December 31, 2014:						
U.S. Treasury and federal agency	\$ -	\$ -	\$ 1,456	\$ (35 )	\$ 1,456	\$ (35 )
U.S. government sponsored entities and agencies	11,412	(51 )	16,805	(187 )	28,217	(238 )
U.S. agency collateralized mortgage obligations: residential	2,715	(14 )	30,594	(949 )	33,309	(963 )

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State and political subdivisions	5,154	(22 )	10,221	(169 )	15,375	(191 )
Corporate debt securities	1,998	(8 )	-	-	1,998	(8 )
	\$ 21,279	\$ (95 )	\$ 59,076	\$ (1,340 )	\$ 80,355	\$ (1,435 )

Gains on sales of available for sale securities for the three and six months ended June 30 were as follows:

(Dollar amounts in thousands)	For the three months ended June 30,		For the six months ended June 30,	
	2015	2014	2015	2014
Proceeds	\$ 1,791	\$ -	\$ 1,791	\$ 21,559
Gains	34	-	34	658
Tax provision related to gains	12	-	12	224

**5. Securities (continued)**

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic, market or other conditions warrant such evaluation. Consideration is given to: (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, (3) whether the market decline was affected by macroeconomic conditions and (4) whether the Corporation has the intent to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis. If the Corporation intends to sell an impaired security, or if it is more likely than not the Corporation will be required to sell the security before its anticipated recovery, the Corporation records an other-than-temporary loss in an amount equal to the entire difference between fair value and amortized cost. Otherwise, only the credit portion of the estimated loss on debt securities is recognized in earnings, with the other portion of the loss recognized in other comprehensive income. For equity securities determined to be other-than-temporarily impaired, the entire amount of impairment is recognized through earnings.

There was one equity security in an unrealized loss position for less than 12 months as of June 30, 2015. Equity securities owned by the Corporation consist of common stock of various financial service providers. The investment security is in an unrealized loss position as a result of recent market volatility. The Corporation does not invest in these securities with the intent to sell them for a profit in the near term. For investments in equity securities, in addition to the general factors mentioned above for determining whether the decline in market value is other-than-temporary, the analysis of whether an equity security is other-than-temporarily impaired includes a review of the profitability, capital adequacy and other relevant information available to determine the financial position and near term prospects of each issuer. The results of analyzing the aforementioned metrics and financial fundamentals suggest recovery of amortized cost as the sector improves. Based on that evaluation, and given that the Corporation's current intention is not to sell any impaired security and it is more likely than not it will not be required to sell this security before the recovery of its amortized cost basis, the Corporation does not consider the equity security with an unrealized loss as of June 30, 2015 to be other-than-temporarily impaired.

There were 105 debt securities in an unrealized loss position as of June 30, 2015, of which 49 were in an unrealized loss position for more than 12 months. Of these 49 securities, 2 were U.S. Treasury securities, 7 were U.S. government sponsored entity and agency securities, 22 were government-backed collateralized mortgage obligations, 17 were state and political subdivision securities and 1 was a corporate debt security. The unrealized losses associated with these securities were not due to the deterioration in the credit quality of the issuer that would likely result in the non-collection of contractual principal and interest, but rather have been caused by a rise in interest rates from the time the securities were purchased. Based on that evaluation and other general considerations, and given that the Corporation's current intention is not to sell any impaired securities and it is more likely than not it will not be required to sell these securities before the recovery of its amortized cost basis, the Corporation does not consider the debt securities with unrealized losses as of June 30, 2015 to be other-than-temporarily impaired.

**6. Loans Receivable and Related Allowance for Loan Losses**

The Corporation's loans receivable as of the respective dates are summarized as follows:

(Dollar amounts in thousands)	June 30, 2015	December 31, 2014
Mortgage loans on real estate:		
Residential first mortgages	\$ 122,587	\$ 107,173
Home equity loans and lines of credit	89,679	89,106
Commercial real estate	112,087	110,810
	324,353	307,089
Other loans:		
Commercial business	70,663	70,185
Consumer	6,997	7,598
	77,660	77,783
Total loans, gross	402,013	384,872
Less allowance for loan losses	5,370	5,224
Total loans, net	\$396,643	\$ 379,648

During the second quarter of 2015, the Corporation purchased four syndicated national credits (SNCs) each having a principal amount of \$1.0 million. The SNCs were purchased for a total of \$4.0 million plus a net premium of \$21,000 which is being amortized over the lives of the loans. During the third quarter of 2014, the Corporation purchased four SNCs each having a principal amount of \$1.0 million. The SNCs were purchased for a total of \$4.0 million plus a net premium of \$15,000 and other costs totaling \$11,000 which are being amortized over the lives of the loans. The SNCs are recorded as commercial business loans and are collateralized by all business assets of the individual borrowers. Until sufficient historical performance data can be collected and analyzed, these credits are assigned allowance for loan losses equal to a multiple of the Corporation's normal allowance allocation for Bank originated commercial business loans. During the six months ended June 30, 2015, the Corporation received \$1.5 million in principal payments on these SNC's, including one full payoff of \$1.0 million. As of June 30, 2015, these SNC's had a remaining outstanding balance of \$6.5 million.

**6. Loans Receivable and Related Allowance for Loan Losses (continued)**

The following table presents impaired loans by class, segregated by those for which a specific allowance was required and those for which a specific allowance was not necessary as of June 30, 2015:

(Dollar amounts in thousands)

	Impaired Loans with Specific Allowance			For the three months		Cash Basis Interest Recognized in Period
	As of June 30, 2015			ended June 30, 2015		
	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized in Period	
Residential first mortgages	\$ 169	\$ 169	\$ 27	\$ 170	\$ 2	\$ 2
Home equity and lines of credit	-	-	-	-	-	-
Commercial real estate	3,538	2,597	216	2,603	49	41
Commercial business	1,159	1,159	342	1,859	118	106
Consumer	-	-	-	-	-	-
Total	\$ 4,866	\$ 3,925	\$ 585	\$ 4,632	\$ 169	\$ 149

	For the six months			Cash Basis Interest Recognized in Period
	ended June 30, 2015			
	Average Recorded Investment	Interest Income Recognized in Period		
Residential first mortgages	\$ 170	\$ 4	\$ 4	
Home equity and lines of credit	-	-	-	
Commercial real estate	2,627	49	41	
Commercial business	2,113	118	106	
Consumer	-	-	-	
Total	\$ 4,910	\$ 171	\$ 151	

	Impaired Loans with No Specific Allowance			For the three months		Cash Basis Interest Recognized in Period
	As of June 30, 2015			ended June 30, 2015		
	Unpaid Principal Balance	Recorded Investment		Average Recorded Investment	Interest Income Recognized in Period	
Residential first mortgages	\$ -	\$ -	\$ 55	\$ 7	\$ 7	
Home equity and lines of credit	-	-	-	-	-	
Commercial real estate	805	406	608	1	1	

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Commercial business	73	73	62	-	-
Consumer	-	-	-	-	-
Total	\$ 878	\$ 479	\$ 725	\$ 8	\$ 8

For the six months  
ended June 30, 2015

	Average Interest Income		Cash Basis
	Recorded	Recognized	Interest
	Investment	in Period	Recognized
	in Period		in Period
Residential first mortgages	\$ 75	\$ 7	\$ 7
Home equity and lines of credit	-	-	-
Commercial real estate	690	6	6
Commercial business	58	2	2
Consumer	-	-	-
Total	\$ 823	\$ 15	\$ 15

**6. Loans Receivable and Related Allowance for Loan Losses (continued)**

The following table presents impaired loans by class, segregated by those for which a specific allowance was required and those for which a specific allowance was not necessary as of December 31, 2014:

(Dollar amounts in thousands)

	Impaired Loans with Specific Allowance					
	As of December 31, 2014			For the year ended December 31, 2014		Cash Basis Interest Recognized in Period
	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Recognized in Period	
Residential first mortgages	\$ 171	\$ 171	\$ 27	\$ 136	\$ 12	\$ 12
Home equity and lines of credit	-	-	-	-	-	-
Commercial real estate	3,615	2,674	268	2,673	16	-
Commercial business	2,622	2,622	495	1,524	66	-
Consumer	-	-	-	-	-	-
<b>Total</b>	<b>\$6,408</b>	<b>\$ 5,467</b>	<b>\$ 790</b>	<b>\$4,333</b>	<b>\$ 94</b>	<b>\$ 12</b>

  

	Impaired Loans with No Specific Allowance					
	As of December 31, 2014			For the year ended December 31, 2014		Cash Basis Interest Recognized in Period
	Unpaid Principal Balance	Recorded Investment	Average Recorded Investment	Interest Recognized in Period	Interest Recognized in Period	
Residential first mortgages	\$ 114	\$ 114	\$ 74	\$ 2	\$ -	\$ -
Home equity and lines of credit	-	-	-	-	-	-
Commercial real estate	1,254	855	839	15	4	4
Commercial business	51	51	250	1	1	1
Consumer	-	-	1,078	533	533	533
<b>Total</b>	<b>\$1,419</b>	<b>\$ 1,020</b>	<b>\$2,241</b>	<b>\$ 551</b>	<b>\$ 538</b>	<b>\$ 538</b>

**6. Loans Receivable and Related Allowance for Loan Losses (continued)**

The following table presents impaired loans by class, segregated by those for which a specific allowance was required and those for which a specific allowance was not necessary as of June 30, 2014:

(Dollar amounts in thousands)

	Impaired Loans with Specific Allowance			For the three months		Cash Basis Interest Recognized in Period
	As of June 30, 2014			ended June 30, 2014		
	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized in Period	
Residential first mortgages	\$ 172	\$ 172	\$ 28	\$ 127	\$ 8	\$ 2
Home equity and lines of credit	-	-	-	-	-	-
Commercial real estate	3,649	2,708	227	2,715	10	10
Commercial business	2,210	2,210	540	1,314	51	4
Consumer	-	-	-	-	-	-
Total	\$6,031	\$ 5,090	\$ 795	\$4,156	\$ 69	\$ 16

	For the six months			Cash Basis Interest Recognized in Period
	ended June 30, 2014			
	Average Recorded Investment	Interest Income Recognized in Period		
Residential first mortgages	\$ 112	\$ 9		\$ 3
Home equity and lines of credit	-	-		-
Commercial real estate	2,650	17		12
Commercial business	876	56		4
Consumer	-	-		-
Total	\$3,638	\$ 82		\$ 19

	Impaired Loans with No Specific Allowance			For the three months		Cash Basis Interest Recognized in Period
	As of June 30, 2014			ended June 30, 2014		
	Unpaid Principal Balance	Recorded Investment		Average Recorded Investment	Interest Income Recognized in Period	
Residential first mortgages	\$ 118	\$ 118		\$ 59	\$ 2	\$ -
Home equity and lines of credit	-	-		-	-	-
Commercial real estate	1,488	1,089		896	12	1

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Commercial business	430	428	407	1	1
Consumer	1,348	1,348	1,348	-	-
Total	\$ 3,384	\$ 2,983	\$ 2,710	\$ 15	\$ 2

For the six months  
ended June 30, 2014

	Average Recorded Investment	Interest Income Recognized in Period	Cash Basis Interest Recognized in Period
Residential first mortgages	\$ 46	\$ 2	\$ -
Home equity and lines of credit	-	-	-
Commercial real estate	823	14	3
Commercial business	383	1	1
Consumer	1,348	-	-
Total	\$ 2,600	\$ 17	\$ 4

Unpaid principal balance includes any loans that have been partially charged off but not forgiven. Accrued interest is not included in the recorded investment in loans based on the amounts not being material.

## 6. Loans Receivable and Related Allowance for Loan Losses (continued)

**Troubled debt restructurings (TDR).** The Corporation has certain loans that have been modified in order to maximize collection of loan balances. If, for economic or legal reasons related to the customer's financial difficulties, management grants a concession compared to the original terms and conditions of the loan that it would not have otherwise considered, the modified loan is classified as a TDR. Concessions related to TDRs generally do not include forgiveness of principal balances. The Corporation generally does not extend additional credit to borrowers with loans classified as TDRs.

At June 30, 2015 and December 31, 2014, the Corporation had \$2.7 million and \$5.6 million, respectively, of loans classified as TDRs, which are included in impaired loans above. At June 30, 2015 and December 31, 2014, the Corporation had \$170,000 and \$513,000 of the allowance for loan losses allocated to these specific loans.

During the three and six month periods ended June 30, 2015, the Corporation did not modify any loans as TDRs. During the three and six month periods ended June 30, 2014, the Corporation modified eleven additional loans to be identified as TDRs. One commercial relationship consisting of eight loans totaling \$2.4 million was modified as the Bank granted repayment concessions due to financial difficulties experienced by the borrower. Concessions on these eight loans included reduced monthly payments through the notes' maturities. An additional commercial real estate relationship consisting of two loans totaling \$2.1 million was modified as the Bank granted a payment concession on one loan and interest rate concessions on both loans due to cash flow considerations caused by vacancy rates. In addition, the Corporation modified a residential mortgage loan with pre- and post-modification recorded investments of \$76,000 and \$93,000, respectively, due to a bankruptcy court order. The modifications included capitalization of \$5,000 of accrued and unpaid interest and \$13,000 of legal expenses, a reduction in the interest rate from 6.25% to 5.00% and a 15 year extension of the original term. Because these loans were previously impaired with specific reserves allocated to them, there was no impact to the provision for loan losses for the three and six month periods ended June 30, 2014 as a result of the modifications.

A loan is considered to be in payment default once it is 30 days contractually past due under the modified terms. During the three and six month periods ended June 30, 2015, there was a default on one \$90,000 residential mortgage loan within 12 months following modification classified as a TDR at June 30, 2015. At June 30, 2015, this loan was 60-89 days past due. During the three and six month periods ended June 30, 2014, there were defaults on three loans classified as TDRs which totaled \$426,000 at June 30, 2014. Of these loans, two were not past due and one was 30-59 days delinquent at June 30, 2014.

**Credit Quality Indicators.** Management categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information and current economic trends, among other factors.

Commercial real estate and commercial business loans not identified as impaired are evaluated as risk rated pools of loans utilizing a risk rating practice that is supported by a quarterly special asset review. In this review process, strengths and weaknesses are identified, evaluated and documented for each criticized and classified loan and borrower, strategic action plans are developed, risk ratings are confirmed and the loan's performance status is reviewed.

Management has determined certain portions of the loan portfolio to be homogeneous in nature and assigns like reserve factors for the following loan pool types: residential real estate, home equity loans and lines of credit, and consumer installment and personal lines of credit.

## 6. Loans Receivable and Related Allowance for Loan Losses (continued)

The reserve allocation for risk rated loan pools is developed by applying the following factors:

Historic: Management utilizes a computer model to develop the historical net charge-off experience which is used to formulate the assumptions employed in the migration analysis applied to estimate future losses in the portfolio. Outstanding balance and charge-off information are input into the model and historical loss migration rate assumptions are developed to apply to pass, special mention, substandard and doubtful risk rated loans. A twelve-quarter rolling weighted-average is utilized to estimate probable incurred losses in the portfolios.

Qualitative: Qualitative adjustment factors for pass, special mention, substandard and doubtful ratings are developed and applied to risk rated loans to allow for: quality of lending policies and procedures; national and local economic and business conditions; changes in the nature and volume of the portfolio; experiences, ability and depth of lending management; changes in trends, volume and severity of past due, nonaccrual and classified loans and loss and recovery trends; quality of loan review systems; concentrations of credit and other external factors.

Management uses the following definitions for risk ratings:

Pass: Loans classified as pass typically exhibit good payment performance and have underlying borrowers with acceptable financial trends where repayment capacity is evident. These borrowers typically would have a sufficient cash flow that would allow them to weather an economic downturn and the value of any underlying collateral could withstand a moderate degree of depreciation due to economic conditions.

Special Mention: Loans classified as special mention are characterized by potential weaknesses that could jeopardize repayment as contractually agreed. These loans may exhibit adverse trends such as increasing leverage, shrinking profit margins and/or deteriorating cash flows. These borrowers would inherently be more vulnerable to the application of economic pressures.

Substandard: Loans classified as substandard exhibit weaknesses that are well-defined to the point that repayment is jeopardized. Typically, the Corporation is no longer adequately protected by both the apparent net worth and repayment capacity of the borrower.

Doubtful: Loans classified as doubtful have advanced to the point that collection or liquidation in full, on the basis of currently ascertainable facts, conditions and value, is highly questionable or improbable.

The following table presents the classes of the loan portfolio summarized by the aggregate pass and the criticized categories of special mention, substandard and doubtful within the Corporation's internal risk rating system as of June 30, 2015 and December 31, 2014:

(Dollar amounts in thousands)

	Not Rated	Pass	Special Mention	Substandard	Doubtful	Total
June 30, 2015:						
Residential first mortgages	\$ 121,574	\$-	\$-	\$ 1,013	\$ -	\$ 122,587
Home equity and lines of credit	89,091	-	-	588	-	89,679
Commercial real estate	-	105,968	97	6,022	-	112,087
Commercial business	-	68,528	317	1,818	-	70,663
Consumer	6,997	-	-	-	-	6,997
Total	\$ 217,662	\$ 174,496	\$ 414	\$ 9,441	\$ -	\$ 402,013
December 31, 2014:						
Residential first mortgages	\$ 106,448	\$-	\$-	\$ 725	\$ -	\$ 107,173
Home equity and lines of credit	88,699	-	-	407	-	89,106
Commercial real estate	-	103,908	515	6,387	-	110,810
Commercial business	-	65,627	1,292	&nbs	-	