

SI Financial Group, Inc.  
Form 10-Q  
May 07, 2015

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-Q  
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT  
OF 1934

For the Quarterly Period Ended March 31, 2015

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: 0-54241

SI FINANCIAL GROUP, INC.  
(Exact name of registrant as specified in its charter)

Maryland 80-0643149  
(State or other jurisdiction of incorporation or (I.R.S. Employer Identification No.)  
organization)

803 Main Street, Willimantic, Connecticut 06226  
(Address of principal executive offices) (Zip Code)

(860) 423-4581  
(Registrant's telephone number, including area code)

Not Applicable  
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

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 (Section 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 x No o

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 definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer o Accelerated Filer x  
Non-Accelerated Filer o Smaller Reporting Company o

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

As of May 1, 2015, there were 12,495,375 shares of the registrant's common stock outstanding.

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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements.

## SI FINANCIAL GROUP, INC.

## CONSOLIDATED BALANCE SHEETS

(In Thousands, Except Share Amounts / Unaudited)

	March 31, 2015	December 31, 2014
<b>ASSETS:</b>		
Cash and due from banks:		
Noninterest-bearing	\$17,413	\$18,965
Interest-bearing	35,264	20,286
Total cash and cash equivalents	52,677	39,251
Available for sale securities, at fair value	176,496	173,040
Loans held for sale	562	747
Loans receivable (net of allowance for loan losses of \$8,083 at March 31, 2015 and \$7,797 at December 31, 2014)	1,043,160	1,044,864
Federal Home Loan Bank stock, at cost	10,333	10,333
Bank-owned life insurance	21,468	21,306
Premises and equipment, net	21,915	21,711
Goodwill and other intangibles	18,547	18,697
Accrued interest receivable	3,835	3,853
Deferred tax asset, net	7,521	8,048
Other real estate owned, net	1,324	1,271
Other assets	7,589	7,412
Total assets	\$1,365,427	\$1,350,533
<b>LIABILITIES AND SHAREHOLDERS' EQUITY:</b>		
Liabilities:		
Deposits:		
Noninterest-bearing	\$137,639	\$146,062
Interest-bearing	892,008	864,651
Total deposits	1,029,647	1,010,713
Mortgagors' and investors' escrow accounts	2,039	3,600
Federal Home Loan Bank advances	144,006	148,277
Junior subordinated debt owed to unconsolidated trust	8,248	8,248
Accrued expenses and other liabilities	22,459	21,956
Total liabilities	1,206,399	1,192,794
Shareholders' Equity:		
Preferred stock (\$.01 par value; 1,000,000 shares authorized; none issued)	—	—
Common stock (\$.01 par value; 35,000,000 shares authorized; 12,776,315 shares and 12,776,426 shares issued and outstanding at March 31, 2015 and December 31, 2014, respectively)	128	128
Additional paid-in-capital	125,375	125,459
Unallocated common shares held by ESOP	(4,008	) (4,128
Unearned restricted shares	(1,214	) (1,312
Retained earnings	37,925	37,497

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Accumulated other comprehensive income	822	95
Total shareholders' equity	159,028	157,739
Total liabilities and shareholders' equity	\$1,365,427	\$1,350,533

See accompanying notes to unaudited interim consolidated financial statements.

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SI FINANCIAL GROUP, INC.  
CONSOLIDATED STATEMENTS OF INCOME  
(In Thousands, Except Per Share Amounts / Unaudited)

	Three Months Ended March 31,	
	2015	2014
Interest and dividend income:		
Loans, including fees	\$ 10,614	\$ 11,087
Securities:		
Taxable interest	733	880
Tax-exempt interest	59	42
Dividends	45	49
Other	19	13
Total interest and dividend income	11,470	12,071
Interest expense:		
Deposits	1,368	1,319
Federal Home Loan Bank advances	596	682
Subordinated debt and other borrowings	83	83
Total interest expense	2,047	2,084
Net interest income	9,423	9,987
Provision for loan losses	335	430
Net interest income after provision for loan losses	9,088	9,557
Noninterest income:		
Service fees	1,648	1,718
Wealth management fees	298	323
Increase in cash surrender value of bank-owned life insurance	162	142
Net gain on sales of securities	—	35
Mortgage banking	147	160
Net gain (loss) on fair value of derivatives	(5	) 17
Other	87	377
Total noninterest income	2,337	2,772
Noninterest expenses:		
Salaries and employee benefits	4,944	5,200
Occupancy and equipment	2,053	2,107
Computer and electronic banking services	1,297	1,352
Outside professional services	466	449
Marketing and advertising	246	226
Supplies	148	168
FDIC deposit insurance and regulatory assessments	245	349
Core deposit intangible amortization	150	164
Other real estate operations	82	169
Other	430	770
Total noninterest expenses	10,061	10,954

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Income before income tax provision	1,364	1,375
Income tax provision	443	469
Net income	\$921	\$906
Earnings per share:		
Basic	\$0.07	\$0.07
Diluted	\$0.07	\$0.07

See accompanying notes to unaudited interim consolidated financial statements.

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SI FINANCIAL GROUP, INC.  
 CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
 (In Thousands / Unaudited)

	Three Months Ended March 31,	
	2015	2014
Net income	\$921	\$906
Other comprehensive income, net of tax:		
Available for sale securities:		
Net unrealized holding gains	702	340
Reclassification adjustment for gains recognized in net income <sup>(1)</sup>	—	(23 )
Net unrealized holding gains on available for sale securities	702	317
Net unrealized gain on interest-rate swap derivative	25	23
Other comprehensive income	727	340
Comprehensive income	\$1,648	\$1,246

<sup>(1)</sup> Amounts are included in net gain on sales of securities in noninterest income on the consolidated statements of income. Income tax expense associated with the reclassification adjustment for the three months ended March 31, 2015 and 2014 was \$0 and \$12,000, respectively.

See accompanying notes to unaudited interim consolidated financial statements.

SI FINANCIAL GROUP, INC.  
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY  
FOR THE THREE MONTHS ENDED MARCH 31, 2015  
(In Thousands, Except Share Data / Unaudited)

	Common Stock		Additional Paid-in Capital	Unallocated		Retained Earnings	Accumulated Other Comprehensive Income	Total Shareholders' Equity
	Shares	Dollars		Common Shares Held by ESOP	Unearned Restricted Shares			
Balance at December 31, 2014	12,776,426	\$ 128	\$ 125,459	\$(4,128 )	\$(1,312 )	\$ 37,497	\$ 95	\$ 157,739
Comprehensive income	—	—	—	—	—	921	727	1,648
Cash dividends declared (\$0.04 per share)	—	—	—	—	—	(493 )	—	(493 )
Equity incentive plans compensation	—	—	85	—	98	—	—	183
Allocation of 12,159 ESOP shares	—	—	19	120	—	—	—	139
Tax benefit from share-based compensation	—	—	5	—	—	—	—	5
Stock options exercised	193,438	2	2,154	—	—	—	—	2,156
Common shares repurchased	(193,549 )	(2 )	(2,347 )	—	—	—	—	(2,349 )
Balance at March 31, 2015	12,776,315	\$ 128	\$ 125,375	\$(4,008 )	\$(1,214 )	\$ 37,925	\$ 822	\$ 159,028

See accompanying notes to unaudited interim consolidated financial statements.

SI FINANCIAL GROUP, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(In Thousands / Unaudited)

	Three Months Ended March 31,	
	2015	2014
Cash flows from operating activities:		
Net income	\$921	\$906
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	335	430
Employee stock ownership plan expense	139	142
Equity incentive plan expense	183	189
Excess tax benefit from share-based compensation	(5	) (3
Amortization of investment premiums and discounts, net	308	282
Amortization of loan premiums and discounts, net	375	322
Depreciation and amortization of premises and equipment	699	629
Amortization of core deposit intangible	150	164
Amortization of deferred debt issue costs	9	46
Net gain on sales of securities	—	(35
Net loss (gain) on fair value of derivatives	5	(17
Deferred income tax provision (benefit)	151	(6
Loans originated for sale	(3,390	) (4,307
Proceeds from sale of loans held for sale	3,599	5,410
Net gain on sales of loans held for sale	(87	) (94
Net loss (gain) on sales or write-downs of other real estate owned	(1	) 35
Increase in cash surrender value of bank-owned life insurance	(162	) (142
Change in operating assets and liabilities:		
Accrued interest receivable	18	101
Other assets	(114	) 1,899
Accrued expenses and other liabilities	541	3,762
Net cash provided by operating activities	3,674	9,713
Cash flows from investing activities:		
Purchases of available for sale securities	(10,306	) (12,297
Proceeds from sales of available for sale securities	—	81
Proceeds from maturities of and principal repayments on available for sale securities	7,607	12,684
Loan principal collections, net of originations	12,222	5,064
Purchases of loans	(11,280	) (443
Proceeds from sales of other real estate owned	—	357
Purchases of premises and equipment	(903	) (173
Net cash provided by (used in) investing activities	(2,660	) 5,273

SI FINANCIAL GROUP, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS (Concluded)  
(In Thousands / Unaudited)

	Three Months Ended March 31,	
	2015	2014
Cash flows from financing activities:		
Net increase in deposits	18,934	19,534
Net decrease in mortgagors' and investors' escrow accounts	(1,561	) (1,597
Proceeds from Federal Home Loan Bank advances	6,000	10,000
Repayments of Federal Home Loan Bank advances	(10,280	) (16,396
Excess tax benefit from share-based compensation	5	3
Cash dividends on common stock	(493	) (368
Stock options exercised	20	297
Common shares repurchased	(213	) (53
Net cash provided by financing activities	12,412	11,420
Net change in cash and cash equivalents	13,426	26,406
Cash and cash equivalents at beginning of period	39,251	27,321
Cash and cash equivalents at end of period	\$52,677	\$53,727
Supplemental cash flow information:		
Interest paid	\$2,031	\$2,075
Income taxes received, net	—	(1,816
Transfer of loans to other real estate owned	52	—
Stock options exercised by net-share settlement	2,136	19

See accompanying notes to unaudited interim consolidated financial statements.

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SI FINANCIAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2015 AND 2014 AND DECEMBER 31, 2014

NOTE 1. NATURE OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Business

SI Financial Group, Inc. (the “Company”) is the holding company for Savings Institute Bank and Trust Company (the “Bank”). Established in 1842, the Bank is a community-oriented financial institution headquartered in Willimantic, Connecticut. The Bank provides a variety of financial services to individuals, businesses and municipalities through its 26 offices in eastern Connecticut and Rhode Island. Its primary products include savings, checking and certificate of deposit accounts, residential and commercial mortgage loans, commercial business loans and consumer loans. In addition, wealth management services, which include trust, financial planning, life insurance and investment services, are offered to individuals and businesses through the Bank’s offices. The Company does not conduct any material business other than owning all of the stock of the Bank and making payments on the subordinated debentures held by the Company.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company, its wholly-owned subsidiary, the Bank, and the Bank’s wholly-owned subsidiaries, SI Mortgage Company and SI Realty Company, Inc. All significant intercompany accounts and transactions have been eliminated.

Basis of Financial Statement Presentation

The interim consolidated financial statements and related notes have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information, with the instructions to Form 10-Q and Rule 10.01 of Regulation S-X of the Securities and Exchange Commission and general practices within the banking industry. Accordingly, certain information and footnote disclosures required by GAAP for complete financial statements have been omitted. Information in the accompanying interim consolidated financial statements and notes to the financial statements of the Company as of March 31, 2015 and for the three months ended March 31, 2015 and 2014 is unaudited. These unaudited interim consolidated financial statements and related notes should be read in conjunction with the audited financial statements of the Company and the accompanying notes for the year ended December 31, 2014 contained in the Company’s Form 10-K.

In the opinion of management, the accompanying unaudited interim consolidated financial statements reflect all of the adjustments, consisting only of normal and recurring adjustments, necessary for a fair presentation of the financial condition, results of operations and cash flows as of and for the periods covered herein. The results of operations for the three months ended March 31, 2015 are not necessarily indicative of the operating results for the year ending December 31, 2015 or for any other period.

In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosures of contingent assets and liabilities, as of the date of the balance sheets and reported amounts of revenues and expenses for the periods presented. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, other-than-temporary impairment (“OTTI”) of securities, deferred income taxes and the impairment of long-lived assets.

Reclassifications

Amounts in the Company's prior year consolidated financial statements are reclassified to conform to the current year presentation. Such reclassifications have no effect on net income.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2015 AND 2014 AND DECEMBER 31, 2014

Loans Receivable

Loans receivable are stated at current unpaid principal balances, net of the allowance for loan losses and deferred loan origination fees and costs. Management has the ability and intent to hold its loans receivable for the foreseeable future or until maturity or pay-off.

A loan is impaired when, based on current information and events, it is probable the Company will be unable to collect all contractual principal and interest payments due in accordance with the terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Impairment is measured on a loan by loan basis for residential and commercial mortgage loans and commercial business loans by either the present value of expected future cash flows discounted at the loan's effective interest rate or, as a practical expedient, at the loan's observable market price or the fair value of the collateral if the loan is collateral dependent. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not typically identify individual consumer loans for impairment disclosures, unless such loans are subject to a troubled debt restructuring ("TDR") agreement.

The Company periodically may agree to modify the contractual terms of loans. When a loan is modified and concessions have been made to the original contractual terms, such as reductions of interest rates or deferral of interest or principal payments due to the borrower's financial condition, the modification is considered a TDR.

Management considers all nonaccrual loans, with the exception of certain consumer loans, to be impaired. Also, all TDRs are initially classified as impaired. In most cases, loan payments less than 90 days past due are considered minor collection delays and the related loans are generally not considered impaired.

Allowance for Loan Losses

The allowance for loan losses, a material estimate which could change significantly in the near-term, is established through a provision for loan losses charged to earnings to account for losses that are inherent in the loan portfolio and estimated to occur, and is maintained at a level that management considers adequate to absorb losses in the loan portfolio. Loan losses are charged against the allowance for loan losses when management believes the uncollectibility of the principal loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance for loan losses when received. In the determination of the allowance for loan losses, management may obtain independent appraisals for significant properties, if necessary.

Management's judgment in determining the adequacy of the allowance is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. The allowance for loan losses is evaluated on a monthly basis by management and is based on the evaluation of the known and inherent risk characteristics and size and composition of the loan portfolio, the assessment of current economic and real estate market conditions, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral, historical loan loss experience, the level and trends of nonperforming loans, delinquencies, classified assets and loan charge-offs and evaluations of loans and other relevant factors.

The allowance for loan losses consists of the following key elements:

Specific allowance for identified impaired loans. For loans identified as impaired, an allowance is established when the present value of expected cash flows (or observable market price of the loan or fair value of the collateral if the loan is collateral dependent) of the impaired loan is lower than the carrying value of that loan.

General valuation allowance. The general component represents a valuation allowance on the remainder of the loan portfolio, after excluding impaired loans. For this portion of the allowance, loans are segregated by category and assigned an allowance percentage based on historical loan loss experience

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SI FINANCIAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2015 AND 2014 AND DECEMBER 31, 2014

adjusted for qualitative factors stratified by the following loan segments: residential one- to four-family, multi-family and commercial real estate, construction, commercial business and consumer. Management uses a rolling average of historical losses based on the time frame appropriate to capture relevant loss data for each loan segment. This historical loss factor is adjusted for the following qualitative factors: changes in lending policies and procedures, including changes in underwriting standards and collection, charge-off and recovery practices; changes in international, national, regional and local economic and business conditions and developments that affect the collectibility of the portfolio, including the condition of various market segments; changes in the nature and volume of the loan portfolio and in the terms of the loans; changes in the experience, ability, and depth of lending management and other relevant staff; changes in the volume and severity of past due loans, the volume of nonaccrual loans and the volume and severity of adversely classified or graded loans; changes in the quality of the loan review system; changes in the underlying collateral for collateral-dependent loans; the existence and effect of any concentrations of credit and changes in the level of such concentrations; the effect of other external factors such as competition and legal and regulatory capital requirements on the level of estimated credit losses in the portfolio.

The qualitative factors are determined based on the following various risk characteristics for each loan segment. Risk characteristics relevant to each portfolio segment are as follows:

**Residential – One- to Four-Family –** The Bank primarily originates conventional loans with loan-to-value ratios less than 95% and generally originates loans with loan-to-value ratios in excess of 80% only when secured by first liens on owner-occupied one- to four-family residences. Loans with loan-to-value ratios in excess of 80% generally require private mortgage insurance or additional collateral. All loans in this segment are collateralized by owner-occupied residential real estate and repayment is dependent on the credit quality of the individual borrower. The overall health of the economy, including unemployment rates and housing prices, will have an effect on the credit quality of this segment.

**Multi-family and Commercial –** Loans in this segment are originated for the purpose of acquiring, developing, improving or refinancing multi-family and commercial real estate where the property is the primary collateral securing the loan, and the income generated from the property is the primary repayment source. The underlying cash flows generated by the properties can be adversely impacted by the economy as evidenced by increased vacancy rates. Payments on loans secured by income-producing properties often depend on the successful operation and management of the properties. Management continually monitors the cash flows of these loans.

**Construction –** This segment includes loans to individuals, and to a lesser extent builders, to finance the construction of residential dwellings. The Bank also originates construction loans for commercial development projects. Upon the completion of construction, the loan generally converts to a permanent mortgage loan. Credit risk is affected by cost overruns, correct estimates of the sale price of the property, time to sell at an adequate price and market conditions.

**Commercial Business –** Loans in this segment are made to businesses and are generally secured by assets of the business. Repayment is expected from the cash flows of the business. A weakened economy and reduced viability of the industry in which the customer operates will have a negative impact on the credit quality in this segment. The Bank also provides loans to investors in the time share industry, which are secured by consumer receivables, and provides loans for capital improvements to condominium associations, which are secured by the assigned rights to levy special assessments to condominium owners.

Consumer – Loans in this segment primarily include home equity lines of credit (representing both first and second liens), indirect automobile loans and, to a lesser extent, loans secured by marketable securities,

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SI FINANCIAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2015 AND 2014 AND DECEMBER 31, 2014

passbook or certificate accounts, motorcycles, automobiles and recreational vehicles, as well as unsecured loans. Consumer loan collections depend on the borrower's continuing financial stability, and therefore, are more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy.

In computing the allowance for loan losses, we do not assign a general valuation allowance to the Small Business Administration ("SBA") and United States Department of Agriculture ("USDA") loans that we purchase as such loans are fully guaranteed. These loans are included in commercial business loans. See Note 4 for details.

The majority of the Company's loans are collateralized by real estate located in eastern Connecticut and Rhode Island. To a lesser extent, certain commercial real estate loans are secured by collateral located outside of our primary market area. Accordingly, the collateral value of a substantial portion of the Company's loan portfolio and real estate acquired through foreclosure is susceptible to changes in local market conditions.

Although management believes it uses the best information available to establish the allowance for loan losses, future adjustments to the allowance for loan losses may be necessary and the Company's results of operations could be adversely affected if circumstances differ substantially from the assumptions used in making the determinations. Furthermore, while management believes it has established the allowance for loan losses in conformity with GAAP, our regulators, in reviewing the loan portfolio, may request us to increase our allowance for loan losses based on judgments different from ours. In addition, because future events affecting borrowers and collateral cannot be predicted with certainty, the existing allowance for loan losses may not be adequate or increases may be necessary should the quality of any loans deteriorate as a result of the factors discussed above. Any material increase in the allowance for loan losses would adversely affect the Company's financial condition and results of operations.

**Interest and Fees on Loans**

Interest on loans is accrued and included in net interest income based on contractual rates applied to principal amounts outstanding. Accrual of interest is discontinued when loan payments are 90 days or more past due, based on contractual terms, or when, in the judgment of management, collectibility of the loan or loan interest becomes uncertain. Subsequent recognition of income occurs only to the extent payment is received subject to management's assessment of the collectibility of the remaining interest and principal. A nonaccrual loan is restored to accrual status when it is no longer delinquent and collectibility of interest and principal is no longer in doubt and the borrower has made regular payments in accordance with the terms of the loan over a period of at least six months. Interest collected on nonaccrual loans is recognized only to the extent cash payments are received, and may be recorded as a reduction to principal if the collectibility of the principal balance of the loan is unlikely.

Loan origination fees, direct loan origination costs and loan purchase premiums are deferred, and the net amount is recognized as an adjustment of the related loan's yield utilizing the interest method over the contractual life of the loan. In addition, discounts related to fair value adjustments for loans receivable acquired in a business combination or asset purchase are accreted into earnings over the contractual term as an adjustment of the loan's yield. The Company periodically evaluates the cash flows expected to be collected for loans acquired with deteriorated credit quality. Changes in the expected cash flows compared to the expected cash flows as of the date of acquisition may impact the accretable yield or result in a charge to the provision for loan losses to the extent of a shortfall.

**Common Share Repurchases**

The Company is chartered in the state of Maryland. Maryland law does not provide for treasury shares, rather shares repurchased by the Company constitute authorized but unissued shares. GAAP states that accounting for treasury stock shall conform to state law. Therefore, the cost of shares repurchased by the Company has been allocated to common stock, additional paid-in capital and retained earnings balances.

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SI FINANCIAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2015 AND 2014 AND DECEMBER 31, 2014

Recent Accounting Pronouncements

Receivables - Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure. In January 2014, the Financial Accounting Standards Board ("FASB") issued amended guidance that clarifies when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan receivable should be derecognized and the real estate property recognized. The amended guidance clarifies that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. In addition, the amended guidance requires interim and annual disclosures of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The amended guidance may be applied prospectively or through a modified retrospective approach and is effective for fiscal years, and interim periods within those years, beginning after December 15, 2014, with early adoption permitted. The adoption of the amended guidance did not have a material impact on the Company's consolidated financial statements.

Receivables - Troubled Debt Restructurings by Creditors (Subtopic 310-40): Classification of Certain Government-Guaranteed Mortgage Loans upon Foreclosure - In August 2014, the FASB issued amended guidance that addresses the diversity in practice regarding the classification and measurement of foreclosed loans which were part of a government-sponsored loan guarantee program (e.g. HUD, FHA, VA). The amended guidance outlines certain criteria that, if met, the loan (residential or commercial) should be derecognized and a separate other receivable should be recorded upon foreclosure at the amount of the loan balance (principal and interest) expected to be recovered from the guarantor. This amended guidance will be effective for annual reporting periods beginning after December 15, 2014, including interim periods within that reporting period. Early adoption is permitted, provided the entity has adopted Receivables - Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure. The amended guidance should be adopted either prospectively or on a modified retrospective basis. The adoption of the amended guidance did not have a material impact on the Company's consolidated financial statements.

Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs - In April 2015, the FASB issued guidance, as part of its initiative to reduce complexity in accounting standards, simplifying the presentation of debt issuance costs. The amended guidance requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The amended guidance should be applied on a retrospective basis and is effective for fiscal years, and interim periods within those years, beginning after December 15, 2015, with early adoption permitted. The adoption of the amended guidance is not expected to have a material impact on the Company's consolidated financial statements.

NOTE 2. EARNINGS PER SHARE

Basic earnings per share is calculated by dividing the net income available to common shareholders by the weighted average number of common shares outstanding during the period. Unvested restricted shares are considered outstanding in the computation of basic earnings per share since the shares participate in dividends and the rights to the dividends are non-forfeitable. Diluted earnings per share is computed in a manner similar to basic earnings per share except that the weighted average number of common shares outstanding is increased to include the incremental common shares (as computed using the treasury stock method) that would have been outstanding if all potentially dilutive common stock equivalents were issued during the period. The Company's

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common stock equivalents relate solely to stock options. Repurchased common shares and unallocated common shares held by the Bank's ESOP are not deemed outstanding for earnings per share calculations.

Anti-dilutive shares are common stock equivalents with weighted average exercise prices in excess of the weighted average market value for the periods presented, and are not considered in diluted earnings per share calculations. The Company had anti-dilutive common shares outstanding of 372,936 and 394,497 for the three months ended March 31, 2015 and 2014, respectively.

The computation of earnings per share is as follows:

	Three Months Ended March 31,	
	2015	2014
	(Dollars in Thousands, Except Per Share Amounts)	
Net income	\$921	\$906
Weighted average common shares outstanding:		
Basic	12,315,733	12,295,225
Effect of dilutive stock options	38,641	48,252
Diluted	12,354,374	12,343,477
Earnings per share:		
Basic	\$0.07	\$0.07
Diluted	\$0.07	\$0.07

## NOTE 3. SECURITIES

Available for sale securities:

The amortized cost, gross unrealized gains and losses and fair values of available for sale securities at March 31, 2015 and December 31, 2014 are as follows:

	March 31, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In Thousands)			
Debt securities:				
U.S. Government and agency obligations	\$71,996	\$607	\$(185)	) \$72,418
Government-sponsored enterprises	27,372	318	(14)	) 27,676
Mortgage-backed securities: <sup>(1)</sup>				
Agency - residential	63,770	1,031	(707)	) 64,094
Non-agency - residential	248	3	(4)	) 247
Corporate debt securities	1,000	—	—	) 1,000
Collateralized debt obligation	1,156	—	(18)	) 1,138

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Obligations of state and political subdivisions	3,032	180	—	3,212
Tax-exempt securities	6,556	155	—	6,711
Total available for sale securities	\$175,130	\$2,294	\$(928)	) \$176,496

<sup>(1)</sup> Agency securities refer to debt obligations issued or guaranteed by government corporations or government-sponsored enterprises (“GSEs”). Non-agency securities, or private-label securities, are the sole obligation of their issuer and are not guaranteed by any of the GSEs or the U.S. Government.

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	December 31, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In Thousands)			
Debt securities:				
U.S. Government and agency obligations	\$66,232	\$385	\$(226)	) \$66,391
Government-sponsored enterprises	27,435	120	(67)	) 27,488
Mortgage-backed securities: <sup>(1)</sup>				
Agency - residential	67,008	907	(1,065)	) 66,850
Non-agency - residential	254	3	(4)	) 253
Corporate debt securities	1,000	—	—	1,000
Collateralized debt obligation	1,188	—	(7)	) 1,181
Obligations of state and political subdivisions	3,039	167	(6)	) 3,200
Tax-exempt securities	6,583	97	(3)	) 6,677
Total available for sale securities	\$172,739	\$1,679	\$(1,378)	) \$173,040