

EMCLAIRE FINANCIAL CORP  
Form 10-Q  
August 14, 2017

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, 2017

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)

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, smaller reporting company, or an emerging growth company. See definitions of "large accelerated filer," "accelerated

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filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

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

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 2,205,944 at August 14, 2017.

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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, 2017 and December 31, 2016

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

	June 30, 2017	December 31, 2016
Assets		
Cash and due from banks	\$2,455	\$ 2,758
Interest earning deposits with banks	32,260	14,810
Cash and cash equivalents	34,715	17,568
Securities available for sale	99,828	101,560
Loans held for sale	—	68
Loans receivable, net of allowance for loan losses of \$5,767 and \$5,545	545,766	515,435
Federal bank stocks, at cost	4,862	4,861
Bank-owned life insurance	11,555	11,390
Accrued interest receivable	1,827	1,815
Premises and equipment, net	17,908	18,282
Goodwill	10,288	10,288
Core deposit intangible, net	441	560
Prepaid expenses and other assets	9,675	10,308
<b>Total Assets</b>	<b>\$736,865</b>	<b>\$ 692,135</b>
Liabilities and Stockholders' Equity		
Liabilities:		
Deposits:		
Non-interest bearing	\$129,230	\$ 123,717
Interest bearing	499,944	461,223
Total deposits	629,174	584,940
Short-term borrowed funds	2,500	9,500
Long-term borrowed funds	39,000	34,500
Accrued interest payable	359	239
Accrued expenses and other liabilities	9,185	8,883
<b>Total Liabilities</b>	<b>680,218</b>	<b>638,062</b>
<b>Commitments and Contingent Liabilities</b>	<b>—</b>	<b>—</b>
Stockholders' Equity:		
Common stock, \$1.25 par value, 12,000,000 shares authorized; 2,302,961 and 2,254,375 shares issued; 2,200,944 and 2,152,358 shares outstanding, respectively	2,879	2,818

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Additional paid-in capital	29,211	27,900
Treasury stock, at cost; 102,017 shares	(2,114 )	(2,114 )
Retained earnings	30,790	29,960
Accumulated other comprehensive loss	(4,119 )	(4,491 )
Total Stockholders' Equity	56,647	54,073
Total Liabilities and Stockholders' Equity	\$736,865	\$ 692,135

See accompanying notes to consolidated financial statements.

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Emclaire Financial Corp  
Consolidated Statements of Net Income (Unaudited)  
For the three and six months ended June 30, 2017 and 2016  
(Dollar amounts in thousands, except share and per share data)

	For the three months ended June 30,		For the six months ended June 30,	
	2017	2016	2017	2016
Interest and dividend income:				
Loans receivable, including fees	\$5,801	\$ 5,185	\$11,367	\$ 9,887
Securities:				
Taxable	392	441	787	874
Exempt from federal income tax	140	156	283	316
Federal bank stocks	61	52	115	87
Interest earning deposits with banks	38	43	53	62
Total interest and dividend income	6,432	5,877	12,605	11,226
Interest expense:				
Deposits	749	721	1,452	1,309
Borrowed funds	318	296	632	540
Total interest expense	1,067	1,017	2,084	1,849
Net interest income	5,365	4,860	10,521	9,377
Provision for loan losses	201	121	363	302
Net interest income after provision for loan losses	5,164	4,739	10,158	9,075
Noninterest income:				
Fees and service charges	435	386	842	731
Net gain on sales of available for sale securities	350	81	350	83
Net gain on sales of loans	124	—	130	—
Other-than-temporary impairment loss	(508 )	—	(508 )	—
Earnings on bank-owned life insurance	101	100	202	198
Other	366	375	707	710
Total noninterest income	868	942	1,723	1,722
Noninterest expense:				
Compensation and employee benefits	2,347	2,177	4,670	4,225
Premises and equipment	726	692	1,484	1,378
Intangible asset amortization	59	56	119	105
Professional fees	216	190	417	373
Federal deposit insurance	102	89	210	182
Acquisition costs	106	92	107	401
Other	1,121	1,168	2,291	1,818
Total noninterest expense	4,677	4,464	9,298	8,482
Income before provision for income taxes	1,355	1,217	2,583	2,315

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Provision for income taxes	314	287	586	583
Net income	\$1,041	\$ 930	\$1,997	\$ 1,732
Basic earnings per common share	\$0.48	\$ 0.43	\$0.93	\$ 0.81
Diluted earnings per common share	0.48	0.43	0.92	\$ 0.80
Average common shares outstanding - basic	2,164,747	2,146,160	2,158,587	2,145,484
Average common shares outstanding - diluted	2,182,762	2,156,378	2,175,523	2,154,708

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, 2017 and 2016  
(Dollar amounts in thousands)

	For the three months ended June 30,		For the six months ended June 30,	
	2017	2016	2017	2016
Net income	\$1,041	\$930	\$1,997	\$1,732
Other comprehensive income				
Unrealized gains on securities:				
Unrealized holding gain arising during the period	15	699	406	2,030
Reclassification adjustment for gains included in net income	(350 )	(81 )	(350 )	(83 )
Reclassification adjustment for other than temporary impairment losses included in net income	508	—	508	—
Tax effect	173	618	564	1,947
	(59 )	(210 )	(192 )	(662 )
Net of tax	114	408	372	1,285
Comprehensive income	\$1,155	\$1,338	\$2,369	\$3,017

See accompanying notes to consolidated financial statements.



Emclaire Financial Corp  
Condensed Consolidated Statements of Cash Flows (Unaudited)  
For the six months ended June 30, 2017 and 2016  
(Dollar amounts in thousands)

	For the six months ended June 30,	
	2017	2016
Cash flows from operating activities		
Net income	\$1,997	\$1,732
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	578	550
Provision for loan losses	363	302
Amortization of premiums, net	174	176
Amortization of intangible assets and mortgage servicing rights	143	115
Impairment loss on security recognized in earnings	508	—
Realized gains on sales of available for sale securities, net	(350 )	(83 )
Net gains on sales of loans	(130 )	—
Net gains on foreclosed real estate	—	(10 )
Loans originated for sale	(3,265 )	—
Proceeds from the sale of loans originated for sale	3,371	—
Stock compensation expense	110	111
Increase in bank-owned life insurance, net	(165 )	(165 )
Increase in accrued interest receivable	(12 )	(102 )
Decrease in prepaid expenses and other assets	332	75
Increase in accrued interest payable	120	46
Increase (decrease) in accrued expenses and other liabilities	302	(702 )
Net cash provided by operating activities	4,076	2,045
Cash flows from investing activities		
Loan originations and principal collections, net	(32,600 )	3,604
Purchase of residential mortgage loans	—	(6,911 )
Proceeds from sales of loans held for sale previously classified as portfolio loans	1,817	—
Available for sale securities:		
Sales	18,195	6,118
Maturities, repayments and calls	5,850	11,060
Purchases	(21,939 )	(8,258 )
Net cash paid for acquisition	—	(3,309 )
Redemption (purchase) of federal bank stocks	(1 )	1,454
Proceeds from the sale of foreclosed real estate	124	171
Purchases of premises and equipment	(204 )	(392 )
Net cash provided by (used in) investing activities	(28,758 )	3,537
Cash flows from financing activities		
Net increase in deposits	44,234	34,299
Repayments on long-term debt	(500 )	(5,000 )
Proceeds from other long-term debt	5,000	5,000
Net change in short-term borrowings	(7,000 )	(11,750 )

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Proceeds from exercise of stock options	1,263	—
Dividends paid	(1,168 )	(1,116 )
Net cash provided by financing activities	41,829	21,433
Increase in cash and cash equivalents	17,147	27,015
Cash and cash equivalents at beginning of period	17,568	11,546
Cash and cash equivalents at end of period	\$34,715	\$38,561
Supplemental information:		
Interest paid	\$1,964	\$942
Income taxes paid	575	—
Supplemental noncash disclosure:		
Transfers from loans to foreclosed real estate	39	147
Transfers from portfolio loans to loans held for sale	1,725	—

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, 2017 and 2016

(Dollar amounts in thousands, except per share data)

	For the three months ended June 30,		For the six months ended June 30,	
	2017	2016	2017	2016
Balance at beginning of period	\$54,761	\$54,007	\$54,073	\$52,839
Net income	1,041	930	1,997	1,732
Other comprehensive income	114	408	372	1,285
Stock compensation expense	55	64	110	111
Dividends declared on common stock	(587 )	(558 )	(1,168 )	(1,116 )
Exercise of stock options (48,586 shares)	1,263	—	1,263	—
Balance at end of period	\$56,647	\$54,851	\$56,647	\$54,851
Cash dividend per common share	\$0.27	\$0.26	\$0.54	\$0.52

See accompanying notes to consolidated financial statements.

Emclaire Financial Corp  
Notes to Consolidated Financial Statements (Unaudited)

1. Nature of Operations and Basis of Presentation

Emclaire Financial Corp (the Corporation) is a Pennsylvania corporation and the holding company of The Farmers National Bank of Emlenton (the Bank) and Emclaire 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, 2016, as contained in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2016 filed with the SEC.

The balance sheet at December 31, 2016 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. Mergers and Acquisitions

On May 4, 2017, the Corporation and Northern Hancock Bank & Trust Co. (Northern Hancock) announced that they have entered into an Agreement and Plan of Merger providing for the acquisition of Northern Hancock by the Corporation. Northern Hancock is a West Virginia bank headquartered in Newall, West Virginia and operates two offices located in Hancock County, West Virginia.

Under the terms of the merger agreement, Northern Hancock will merge into the Bank and shareholders of Northern Hancock will receive 0.9793 of a share of the Corporation's common stock and \$3.35 in cash for each share of common stock of Northern Hancock upon completion of the merger or approximately \$1.7 million of stock and \$200,000 in cash in the aggregate. The merger is expected to be completed in the third quarter of 2017, subject to the satisfaction of customary closing conditions, including regulatory approval and the approval of the shareholders of Northern Hancock.



## 3. 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.

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 June 30, 2017		For the six months ended June 30, 2016	
Earnings per common share - basic				
Net income	\$ 1,041	\$ 930	\$ 1,997	\$ 1,732
Average common shares outstanding	2,164,747	2,146,160	2,158,587	2,145,484
Basic earnings per common share	\$0.48	\$ 0.43	\$0.93	\$ 0.81
Earnings per common share - diluted				
Net income	\$ 1,041	\$ 930	\$ 1,997	\$ 1,732
Average common shares outstanding	2,164,747	2,146,160	2,158,587	2,145,484
Add: Dilutive effects of assumed issuance of restricted stock and exercise of stock options	18,014	10,218	16,936	9,224
Average shares and dilutive potential common shares	2,182,761	2,156,378	2,175,523	2,154,708
Diluted earnings per common share	\$0.48	\$ 0.43	\$0.92	\$ 0.80
Stock options not considered in computing earnings per share because they were antidilutive	—	67,000	—	67,000

## 4. Securities

The following table summarizes the Corporation's securities as of June 30, 2017 and December 31, 2016:

(Dollar amounts in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale:				
June 30, 2017:				
U.S. Treasury and federal agency	\$4,545	\$ —	\$ (27 )	\$4,518
U.S. government sponsored entities and agencies	12,151	3	(111 )	12,043
U.S. agency mortgage-backed securities: residential	22,303	33	(94 )	22,242
U.S. agency collateralized mortgage obligations: residential	24,538	28	(564 )	24,002
State and political subdivisions	25,662	150	(31 )	25,781
Corporate debt securities	9,512	28	(20 )	9,520
Equity securities	1,580	160	(18 )	1,722
	\$ 100,291	\$ 402	\$ (865 )	\$99,828
December 31, 2016:				
U.S. Treasury and federal agency	4,550	—	(50 )	4,500
U.S. government sponsored entities and agencies	9,186	—	(188 )	8,998
U.S. agency mortgage-backed securities: residential	25,790	32	(196 )	25,626
U.S. agency collateralized mortgage obligations: residential	25,367	23	(684 )	24,706
State and political subdivisions	27,853	17	(262 )	27,608
Corporate debt securities	8,012	5	(85 )	7,932
Equity securities	1,829	373	(12 )	2,190
	\$ 102,587	\$ 450	\$ (1,477 )	\$ 101,560

The following table summarizes scheduled maturities of the Corporation's debt securities as of June 30, 2017. 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 Cost	Fair Value
Due in one year or less	\$3,158	\$3,155
Due after one year through five years	27,945	27,873
Due after five through ten years	19,756	19,835
Due after ten years	1,011	999
Mortgage-backed securities: residential	22,303	22,242
Collateralized mortgage obligations: residential	24,538	24,002
	\$98,711	\$98,106

## 4. Securities (continued)

Information pertaining to securities with gross unrealized losses at June 30, 2017 and December 31, 2016, 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
June 30, 2017:						
U.S. Treasury and federal agency	\$4,518	\$ (27 )	\$—	\$ —	\$4,518	\$ (27 )
U.S. government sponsored entities and agencies	9,054	(111 )	—	—	9,054	(111 )
U.S. agency mortgage-backed securities: residential	11,446	(94 )	—	—	11,446	(94 )
U.S. agency collateralized mortgage obligations: residential	9,481	(184 )	12,694	(380 )	22,175	(564 )
State and political subdivisions	3,863	(28 )	347	(3 )	4,210	(31 )
Corporate debt securities	4,995	(20 )	—	—	4,995	(20 )
Equity securities	—	—	231	(18 )	231	(18 )
	\$43,357	\$ (464 )	\$13,272	\$ (401 )	\$56,629	\$ (865 )
December 31, 2016:						
U.S. Treasury and federal agency	\$4,500	\$ (50 )	\$—	\$ —	\$4,500	\$ (50 )
U.S. government sponsored entities and agencies	8,998	(188 )	—	—	8,998	(188 )
U.S. agency mortgage-backed securities: residential	23,279	(196 )	—	—	23,279	(196 )
U.S. agency collateralized mortgage obligations: residential	13,568	(438 )	9,317	(246 )	22,885	(684 )
State and political subdivisions	21,924	(262 )	—	—	21,924	(262 )
Corporate debt securities	3,927	(85 )	—	—	3,927	(85 )
Equity securities	—	—	237	(12 )	237	(12 )
	\$76,196	\$ (1,219 )	\$9,554	\$ (258 )	\$85,750	\$ (1,477 )

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,	
	2017	2016	2017	2016
Proceeds	\$18,195	\$2,439	\$18,195	\$6,118
Gains	350	81	350	83
Tax provision related to gains	119	28	119	28

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.

4. Securities (continued)

There was one equity security in an unrealized loss position for more than 12 months as of June 30, 2017. Equity securities owned by the Corporation consist of common stock of various financial service providers. This investment security is in an unrealized loss position as a result of the illiquid nature of the stock. 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 in the near future. 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, 2017 to be other-than-temporarily impaired.

During the three months ended June 30, 2017, management determined that an other-than-temporary impairment existed on a corporate debt security due to deterioration in the credit quality of the issuer that would likely result in the non-collection of contractual principal and interest. This security was written down to its fair market value and the resulting impairment loss of \$508,000 was recognized in earnings during the quarter ended June 30, 2017.

After recognizing the aforementioned impairment, there were 69 debt securities in an unrealized loss position as of June 30, 2017, of which 14 were in an unrealized loss position for more than 12 months. Of these 69 securities, 25 were government-backed collateralized mortgage obligations, 12 were state and political subdivision securities, 10 were corporate securities, 9 were mortgage-backed securities, 8 were U.S. government sponsored entity and agency securities and 5 were U.S. Treasury securities. 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 these debt securities with unrealized losses as of June 30, 2017 to be other-than-temporarily impaired.

## 5. 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, 2017	December 31, 2016
Mortgage loans on real estate:		
Residential first mortgages	\$214,905	\$ 198,167
Home equity loans and lines of credit	90,736	91,359
Commercial real estate	179,891	166,994
	485,532	456,520
Other loans:		
Commercial business	58,797	57,788
Consumer	7,204	6,672
	66,001	64,460
Total loans, gross	551,533	520,980
Less allowance for loan losses	5,767	5,545
Total loans, net	\$545,766	\$ 515,435

During the quarter ended June 30, 2017, the Corporation sold \$1.1 million of residential mortgage loans that were previously classified as held for investment.

Included in total loans above are net deferred costs of \$1.4 million and \$1.3 million at June 30, 2017 and December 31, 2016, respectively.

An allowance for loan losses (ALL) is maintained to absorb probable incurred losses from the loan portfolio. The ALL is based on management's continuing evaluation of the risk characteristics and credit quality of the loan portfolio, assessment of current economic conditions, diversification and size of the portfolio, adequacy of collateral, past and anticipated loss experience and the amount of nonperforming loans.

Management reviews the loan portfolio on a quarterly basis using a defined, consistently applied process in order to make appropriate and timely adjustments to the ALL. When information confirms all or part of specific loans to be uncollectible, these amounts are promptly charged off against the ALL.

The allowance for loan losses is based on estimates and actual losses may vary from current estimates. Management believes that the granularity of the homogeneous pools and the related historical loss ratios and other qualitative factors, as well as the consistency in the application of assumptions, result in an ALL that is representative of the risk found in the components of the portfolio at any given date.

At June 30, 2017, there was no allowance for loan losses allocated to loans acquired in the April 2016 merger with United American Savings Bank.

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

The following table details activity in the ALL and the recorded investment by portfolio segment based on impairment method:

(Dollar amounts in thousands)	Residential Mortgages	Home Equity & Lines of Credit	Commercial Real Estate	Commercial Business	Consumer	Total
Three months ended June 30, 2017:						
Allowance for loan losses:						
Beginning Balance	\$ 1,956	\$ 648	\$ 2,449	\$ 583	\$ 52	\$ 5,688
Charge-offs	(10 )	(10 )	(90 )	(10 )	(8 )	(128 )
Recoveries	—	1	2	—	3	6
Provision	48	—	99	48	6	201
Ending Balance	\$ 1,994	\$ 639	\$ 2,460	\$ 621	\$ 53	\$ 5,767
Six months ended June 30, 2017:						
Allowance for loan losses:						
Beginning Balance	\$ 1,846	\$ 633	\$ 2,314	\$ 700	\$ 52	\$ 5,545
Charge-offs	(36 )	(11 )	(90 )	(10 )	(27 )	(174 )
Recoveries	—	20	4	—	9	33
Provision	184	(3 )	232	(69 )	19	363
Ending Balance	\$ 1,994	\$ 639	\$ 2,460	\$ 621	\$ 53	\$ 5,767
At June 30, 2017:						
Ending ALL balance attributable to loans:						
Individually evaluated for impairment	\$ 8	\$ —	\$ —	\$ —	\$ —	\$ 8
Acquired loans collectively evaluated for impairment	—	—	—	—	—	—
Originated loans collectively evaluated for impairment	1,986	639	2,460	621	53	5,759
Total	\$ 1,994	\$ 639	\$ 2,460	\$ 621	\$ 53	\$ 5,767
Total loans:						
Individually evaluated for impairment	\$ 442	\$ —	\$ 975	\$ 600	\$ —	\$ 2,017
Acquired loans collectively evaluated for impairment	21,849	4,324	24,486	1,038	—	51,697
Originated loans collectively evaluated for impairment	192,614	86,412	154,430	57,159	7,204	497,819
Total	\$ 214,905	\$ 90,736	\$ 179,891	\$ 58,797	\$ 7,204	\$ 551,533
At December 31, 2016:						
Ending ALL balance attributable to loans:						

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Individually evaluated for impairment	\$ 19	\$—	\$ 95	\$ 6	\$—	\$ 120
Acquired loans collectively evaluated for impairment	—	—	—	—	—	—
Originated loans collectively evaluated for impairment	1,827	633	2,219	694	52	5,425
Total	\$ 1,846	\$ 633	\$ 2,314	\$ 700	\$ 52	\$ 5,545
Total loans:						
Individually evaluated for impairment	\$ 135	\$—	\$ 1,014	\$ 684	\$—	\$ 1,833
Acquired loans collectively evaluated for impairment	25,024	5,225	27,492	1,182	13	58,936
Originated loans collectively evaluated for impairment	173,008	86,134	138,488	55,922	6,659	460,211
Total	\$ 198,167	\$ 91,359	\$ 166,994	\$ 57,788	\$ 6,672	\$ 520,980
Three months ended June 30, 2016:						
Allowance for loan losses:						
Beginning Balance	\$ 1,577	\$ 636	\$ 1,926	\$ 1,162	\$ 51	\$ 5,352
Charge-offs	(8	) (33	) —	—	(6	) (47
Recoveries	—	1	3	—	1	5
Provision	127	41	189	(242	) 6	121
Ending Balance	\$ 1,696	\$ 645	\$ 2,118	\$ 920	\$ 52	\$ 5,431
Six months ended June 30, 2016:						
Allowance for loan losses:						
Beginning Balance	\$ 1,429	\$ 586	\$ 2,185	\$ 960	\$ 45	\$ 5,205
Charge-offs	(40	) (33	) —	—	(15	) (88
Recoveries	—	1	7	—	4	12
Provision	307	91	(74	) (40	) 18	302
Ending Balance	\$ 1,696	\$ 645	\$ 2,118	\$ 920	\$ 52	\$ 5,431

## 5. 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, 2017:

(Dollar amounts in thousands)

	Impaired Loans with Specific Allowance					
	As of June 30, 2017			For the three months ended June 30, 2017		
	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized in Period	Cash Basis Interest Recognized in Period
Residential first mortgages	\$76	\$ 76	\$ 8	\$76	\$ 1	\$ 1
Home equity and lines of credit	—	—	—	—	—	—
Commercial real estate	—	—	—	—	—	—
Commercial business	—	—	—	—	—	—
Consumer	—	—	—	—	—	—
<b>Total</b>	<b>\$76</b>	<b>\$ 76</b>	<b>\$ 8</b>	<b>\$76</b>	<b>\$ 1</b>	<b>\$ 1</b>

	For the six months ended June 30, 2017					
				Average Recorded Investment	Interest Income Recognized in Period	Cash Basis Interest Recognized in Period
Residential first mortgages				\$96	\$ 2	\$ 2
Home equity and lines of credit				—	—	—
Commercial real estate				186	—	—
Commercial business				196	—	—
Consumer				—	—	—
<b>Total</b>				<b>\$478</b>	<b>\$ 2</b>	<b>\$ 2</b>

	Impaired Loans with No Specific Allowance					
	As of June 30, 2017			For the three months ended June 30, 2017		
	Unpaid Principal Balance	Recorded Investment	Average Recorded Investment	Interest Income Recognized in Period	Cash Basis Interest Recognized in Period	
Residential first mortgages	\$478	\$ 366	\$369	\$ 3	\$ 3	
Home equity and lines of credit	—	—	—	—	—	
Commercial real estate	1,149	975	983	—	—	
Commercial business	600	600	620	—	—	
Consumer	—	—	—	—	—	
<b>Total</b>	<b>\$2,227</b>	<b>\$ 1,941</b>	<b>\$1,972</b>	<b>\$ 3</b>	<b>\$ 3</b>	

For the six months ended June 30,  
2017

	Average Recorded Investment	Interest Recognized in Period	Cash Basis Interest Recognized in Period
Residential first mortgages	\$246	\$ 4	\$ 4
Home equity and lines of credit	—	—	—
Commercial real estate	807	1	1
Commercial business	446	1	1
Consumer	—	—	—
Total	\$1,499	\$ 6	\$ 6

## 5. 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, 2016:

(Dollar amounts in thousands)

	Impaired Loans with Specific Allowance					
	As of December 31, 2016			For the year ended December 31, 2016		
	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized in Period	Cash Basis Interest Recognized in Period
Residential first mortgages	\$168	\$ 135	\$ 19	\$119	\$ 6	\$ 6
Home equity and lines of credit	—	—	—	—	—	—
Commercial real estate	557	557	95	130	23	—
Commercial business	588	588	6	428	—	—
Consumer	—	—	—	—	—	—
<b>Total</b>	<b>\$1,313</b>	<b>\$ 1,280</b>	<b>\$ 120</b>	<b>\$677</b>	<b>\$ 29</b>	<b>\$ 6</b>
	Impaired Loans with No Specific Allowance					
	As of December 31, 2016			For the year ended December 31, 2016		
	Unpaid Principal Balance	Recorded Investment	Average Recorded Investment	Interest Income Recognized in Period	Cash Basis Interest Recognized in Period	
Residential first mortgages	—	—	23	—	—	
Home equity and lines of credit	—	—	—	—	—	
Commercial real estate	631	457	735	3	3	
Commercial business	96	96	322	2	2	
Consumer	—	—	—	—	—	
<b>Total</b>	<b>727</b>	<b>553</b>	<b>1,080</b>	<b>5</b>	<b>5</b>	



## 5. 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, 2016:

(Dollar amounts in thousands)

	Impaired Loans with Specific Allowance			For the three months ended June 30, 2016		
	As of June 30, 2016			Average Recorded Investment	Interest Income Recognized in Period	Cash Basis Interest Recognized in Period
	Unpaid Principal Balance	Recorded Investment	Related Allowance			
Residential first mortgages	\$78	\$ 78	\$ 19	\$78	\$ 1	\$ 1
Home equity and lines of credit	—	—	—	—	—	—
Commercial real estate	—	—	—	—	—	—
Commercial business	—	—	—	315	—	—
Consumer	—	—	—	—	—	—
<b>Total</b>	<b>\$78</b>	<b>\$ 78</b>	<b>\$ 19</b>	<b>\$393</b>	<b>\$ 1</b>	<b>\$ 1</b>
				For the six months ended June 30, 2016		
				Average Recorded Investment	Interest Income Recognized in Period	Cash Basis Interest Recognized in Period
Residential first mortgages				\$109	\$ 2	\$ 2
Home equity and lines of credit				—	—	—
Commercial real estate				31	—	—
Commercial business				517	—	—
Consumer				—	—	—
<b>Total</b>				<b>\$657</b>	<b>\$ 2</b>	<b>\$ 2</b>
	Impaired Loans with No Specific Allowance			For the three months ended June 30, 2016		
	As of June 30, 2016			Average Recorded Investment	Interest Income Recognized in Period	Cash Basis Interest Recognized in Period
	Unpaid Principal Balance	Recorded Investment	Related Allowance			
Residential first mortgages	\$91	\$ 58	\$58	\$	—	\$ —
Home equity and lines of credit	—	—	—	—	—	—
Commercial real estate	1,222	823	840	—	—	—
Commercial business	690	690	382	1	1	1
Consumer	—	—	—	—	—	—
<b>Total</b>	<b>\$2,003</b>	<b>\$ 1,571</b>	<b>\$1,280</b>	<b>\$</b>	<b>1</b>	<b>\$ 1</b>

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For the six months ended June 30,  
2016

	Average Recorded Investment	Interest Recognized in Period	Cash Basis Interest Recognized in Period
Residential first mortgages	\$38	\$ 2	\$ 2
Home equity and lines of credit	—	—	—
Commercial real estate	809	1	1
Commercial business	280	1	1
Consumer	—	—	—
Total	\$1,127	\$ 4	\$ 4

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

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 presented above or in the tables that follow based on the amounts not being material.

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, 2017 and December 31, 2016, the Corporation had \$537,000 and \$239,000, respectively, of loans classified as TDRs, which are included in impaired loans above. The Corporation had allocated \$8,000 and \$19,000 of specific allowance for these loans at June 30, 2017 and December 31, 2016, respectively.

The Corporation did not modify any loans as TDRs during the three month period ended June 30, 2017. During the six month period ended June 30, 2017, the Corporation modified one residential mortgage loan with a recorded investment of \$323,000 due to a bankruptcy order. At June 30, 2017, the Corporation did not have any allowance for loan losses allocated to this specific loan. The modification did not have a material impact on the Corporation's income statement during the periods. During the three and six month period ended June 30, 2016, the Corporation modified one home equity loan with a recorded investment of \$10,000 due to a bankruptcy order. At June 30, 2016, the Corporation did not have any specific allowance for loan losses allocated to this specific loan.

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, 2017 and 2016, the Corporation did not have any loans which were modified as TDRs for which there was a payment default within twelve months following the modification.

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.

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 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.

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

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, 2017 and December 31, 2016:

(Dollar amounts in thousands)

	Not Rated	Pass	Special Mention	Substandard	Doubtful	Total
June 30, 2017:						
Residential first mortgages	\$213,966	\$—	\$—	\$ 939	\$	—\$214,905
Home equity and lines of credit	90,231	—	—	505	—	90,736
Commercial real estate	—	173,291	1,199	5,401	—	179,891
Commercial business	—	57,130	537	1,130	—	58,797
Consumer	7,204	—	—	—	—	7,204
<b>Total</b>	<b>\$311,401</b>	<b>\$230,421</b>	<b>\$ 1,736</b>	<b>\$ 7,975</b>	<b>\$</b>	<b>—\$551,533</b>
December 31, 2016:						
Residential first mortgages	\$197,041	\$—	\$—	\$ 1,126	\$	—\$198,167
Home equity and lines of credit	91,017	—	—	342	—	91,359
Commercial real estate	—	161,312	1,077	4,605	—	166,994
Commercial business	—	52,125	4,926	737	—	57,788
Consumer	6,659	—	—	13	—	6,672
<b>Total</b>	<b>\$294,717</b>	<b>\$213,437</b>	<b>\$ 6,003</b>	<b>\$ 6,823</b>	<b>\$</b>	<b>—\$520,980</b>



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

Management further monitors the performance and credit quality of the loan portfolio by analyzing the age of the portfolio as determined by the length of time a recorded payment is past due. The following table presents the classes of the loan portfolio summarized by the aging categories of performing loans and nonperforming loans as of June 30, 2017 and December 31, 2016:

(Dollar amounts in thousands)

	Performing			Nonperforming		Total
	Accruing Loans Not Past Due	Accruing 30-59 Days Past Due	Accruing 60-89 Days Past Due	Accruing 90+ Days Past Due	Nonaccrual	
June 30, 2017:						
Residential first mortgages	\$211,336	\$ 1,814	\$ 816	\$ 180	\$ 759	\$214,905
Home equity and lines of credit	89,865	353	13	54	451	90,736
Commercial real estate	178,089	790	11	—	1,001	179,891
Commercial business	57,837	323	37	—	600	58,797
Consumer	7,167	28	9	—	—	7,204
<b>Total loans</b>	<b>\$544,294</b>	<b>\$ 3,308</b>	<b>\$ 886</b>	<b>\$ 234</b>	<b>\$ 2,811</b>	<b>\$551,533</b>
December 31, 2016:						
Residential first mortgages	\$194,830	\$ 1,916	\$ 295	\$ —	\$ 1,126	\$198,167
Home equity and lines of credit	90,557	460	—	2	340	91,359
Commercial real estate	165,318	561	—	42	1,073	166,994
Commercial business	56,972	56	34	—	726	57,788
Consumer	6,602	28	29	—	13	6,672
<b>Total loans</b>	<b>\$514,279</b>	<b>\$ 3,021</b>	<b>\$ 358</b>	<b>\$ 44</b>	<b>\$ 3,278</b>	<b>\$520,980</b>

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

The following table presents the Corporation's nonaccrual loans by aging category as of June 30, 2017 and December 31, 2016:

(Dollar amounts in thousands)

	Not Past Due	30-59 Days Past Due	60-89 Days Past Due	90 Days + Past Due	Total
June 30, 2017:					
Residential first mortgages	\$71	\$388	\$—	\$300	\$759
Home equity and lines of credit	—	—	17	434	451
Commercial real estate	369	—	—	632	1,001
Commercial business	600	—	—	—	600
Consumer	—	—	—	—	—
Total loans	\$1,040	\$388	\$17	\$1,366	\$2,811
December 31, 2016:					
Residential first mortgages	72	77	—	977	1,126
Home equity and lines of credit	—	—	—	340	340
Commercial real estate	397	—	557	119	1,073
Commercial business	631	—	—	95	726
Consumer	—	—	—	13	13
Total loans	\$1,100	\$77	\$557	\$1,544	\$3,278

## 6. Goodwill and Intangible Assets

The following table summarizes the Corporation's acquired goodwill and intangible assets as of June 30, 2017 and December 31, 2016:

	June 30, 2017		December 31, 2016	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Goodwill	\$10,288	\$ —	\$10,288	\$ —
Core deposit intangibles	4,259	3,818	4,259	3,699
Total	\$14,547	\$ 3,818	\$14,547	\$ 3,699

Goodwill resulted from four acquisitions. During 2016, the Corporation recorded \$6.6 million of goodwill related to the acquisition of United American Savings Bank. Goodwill represents the excess of the total purchase price paid for the acquisitions over the fair value of the identifiable assets acquired, net of the fair value of the liabilities assumed. Goodwill is not amortized but is evaluated for impairment on an annual basis or whenever events or changes in circumstances indicate the carrying value may not be recoverable. Impairment exists when a reporting unit's carrying value of goodwill exceeds its fair value. The Corporation has selected November 30 as the date to perform the annual



impairment test. No goodwill impairment charges were recorded during 2016 or in the first six months of 2017.

The core deposit intangible asset, resulting from two acquisitions, is amortized using the double declining balance method over a weighted average estimated life of the related deposits and is not estimated to have a significant residual value. During the three and six month periods ending June 30, 2017, the Corporation recorded intangible amortization expense totaling \$59,000 and \$119,000, respectively, compared to \$56,000 and \$105,000, respectively for the same periods in 2016.

## 7. Stock Compensation Plan

In April 2014, the Corporation adopted the 2014 Stock Incentive Plan (the 2014 Plan), which is shareholder approved and permits the grant of restricted stock awards and options to its directors, officers and employees for up to 176,866 shares of common stock. As of June 30, 2017, 65,783 shares of restricted stock and 88,433 stock options remain available for issuance under the plan.

In addition, the Corporation's 2007 Stock Incentive Plan and Trust (the 2007 Plan), which is shareholder approved, permitted the grant of restricted stock awards and options to its directors, officers and employees for up to 177,496 shares of common stock. As of June 30, 2017, no additional shares of stock may be issued as the plan expired on June 20, 2017.

Incentive stock options, non-incentive or compensatory stock options and share awards may be granted under the Plans. The exercise price of each option shall at least equal the market price of a share of common stock on the date of grant and have a contractual term of ten years. Options shall vest and become exercisable at the rate, to the extent and subject to such limitations as may be specified by the Corporation. Compensation cost related to share-based payment transactions must be recognized in the financial statements with measurement based upon the fair value of the equity instruments issued.

A summary of option activity under the Plans as of June 30, 2017, and changes during the period then ended is presented below:

	Options	Weighted-Average Exercise Price	Aggregate Intrinsic Value (in thousands)	Weighted-Average Remaining Term (in years)
Outstanding as of January 1, 2017	62,000	\$ 25.71	\$ 219	0.6
Granted	—	—	—	—
Exercised	(48,586)	25.99	80	—
Forfeited	—	—	—	—
Expired	(8,414 )	26.00	—	—
Outstanding as of June 30, 2017	5,000	\$ 22.50	\$ 27	1.4
Exercisable as of June 30, 2017	5,000	\$ 22.50	\$ 27	1.4

A summary of the status of the Corporation's nonvested restricted stock awards as of June 30, 2017, and changes during the period then ended is presented below:

	Shares	Weighted-Average Grant-date Fair Value
Nonvested at January 1, 2017	26,900	\$ 25.09
Granted	—	—
Vested	—	—
Forfeited	—	—
Nonvested as of June 30, 2017	26,900	\$ 25.09

For the three and six month periods ended June 30, 2017, the Corporation recognized stock compensation expense of \$55,000 and \$110,000, respectively, compared to \$64,000 and \$111,000, respectively, for the same periods in 2016. As of June 30, 2017, there was \$370,000 of total unrecognized compensation cost related to nonvested share-based compensation arrangements granted under the Plans. That cost is expected to be recognized over a weighted-average period of 1.6 years. It is the Corporation's policy to issue shares on the vesting date for restricted stock awards. Unvested restricted stock awards do not receive dividends declared by the Corporation.

## 8. Fair Value

Management uses its best judgment in estimating the fair value of the Corporation's financial instruments; however, there are inherent weaknesses in any estimation technique. Therefore, for substantially all financial instruments, the fair value estimates herein are not necessarily indicative of the amounts the Corporation could have realized in a sale transaction or exit price on the date indicated. The estimated fair value amounts have been measured as of their respective dates and have not been re-evaluated or updated for purposes of these financial statements subsequent to those respective dates. As such, the estimated fair values of these financial instruments subsequent to the respective reporting dates may be different than the amounts reported.

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair value.

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the Corporation has the ability to access at the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect the Corporation's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

An asset or liability's level is based on the lowest level of input that is significant to the fair value measurement.

The Corporation used the following methods and significant assumptions to estimate the fair value of each type of financial instrument:

Cash and cash equivalents – The carrying value of cash, due from banks and interest bearing deposits approximates fair value and are classified as Level 1.

Securities available for sale – The fair value of all investment securities are based upon the assumptions market participants would use in pricing the security. If available, investment securities are determined by quoted market prices (Level 1). Level 1 includes U.S. Treasury, federal agency securities and certain equity securities. For investment securities where quoted market prices are not available, fair values are calculated based on market prices on similar securities (Level 2). Level 2 includes U.S. Government sponsored entities and agencies, mortgage-backed securities, collateralized mortgage obligations, state and political subdivision securities and corporate debt securities. For investment securities where quoted prices or market prices of similar securities are not available, fair values are calculated by using unobservable inputs (Level 3) and may include certain equity securities held by the Corporation. The Level 3 equity security valuations were supported by an analysis prepared by the Corporation which relies on inputs such as the security issuer's publicly attainable financial information, multiples derived from prices in observed transactions involving comparable businesses and other market, financial and nonfinancial factors.

Loans – The fair value of loans receivable was estimated based on the discounted value of the future cash flows using the current rates being offered for loans with similar terms to borrowers of similar credit quality resulting in a Level 3 classification.



## 8. Fair Value (continued)

Impaired loans – At the time a loan is considered impaired, it is valued at the lower of cost or fair value. Impaired loans carried at fair value generally receive a specific allowance for loan losses. For collateral dependent loans, fair value is commonly based on real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business, resulting in a Level 3 classification. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly. As of June 30, 2017, the Corporation did not have any impaired loans carried at fair value measured using the fair value of collateral, compared to loan balances of \$1.2 million, net of a valuation allowance of \$120,000, at December 31, 2016. There was no additional provision for loan losses recorded for impaired loans during the three and six month periods ended June 30, 2017 and 2016.

Other real estate owned (OREO) – Assets acquired through or instead of foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. Fair value is commonly based on recent real estate appraisals. Management's ongoing review of appraisal information may result in additional discounts or adjustments to the valuation based upon more recent market sales activity or more current appraisal information derived from properties of similar type and/or locale. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. As of June 30, 2017 and December 31, 2016, the Corporation had no OREO measured at fair value. There was no expense recorded during the three and six month periods ended June 30, 2017 and 2016 associated with the write-down of OREO.

Appraisals for both collateral-dependent impaired loans and OREO are performed by certified general appraisers (for commercial properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been reviewed by the Corporation. Once received, management reviews the assumptions and approaches utilized in the appraisal as well as the overall resulting fair value in comparison with independent data sources such as recent market data or industry-wide statistics. On an annual basis, the Corporation compares the actual selling price of OREO that has been sold to the most recent appraisal to determine what additional adjustment should be made to the appraisal value to arrive at fair value. The most recent analysis performed indicated that a discount of 10% should be applied.

Federal bank stock – It is not practical to determine the fair value of federal bank stocks due to restrictions placed on its transferability.

Deposits – The fair value of deposits with no stated maturity, such as non-interest bearing demand deposits, checking with interest, savings and money market accounts, is equal to the amount payable on demand resulting in either a Level 1 or Level 2 classification. The fair values of time deposits are based on the discounted value of contractual cash flows. The discount rate is estimated using the rates currently offered for deposits of similar maturities resulting in a Level 2 classification.

Borrowings – The fair value of borrowings with the FHLB is estimated using discounted cash flows based on current incremental borrowing rates for similar types of borrowing arrangements resulting in a Level 2 classification.

Accrued interest receivable and payable – The carrying value of accrued interest receivable and payable approximates fair value. The fair value classification is consistent with the related financial instrument.

## 8. Fair Value (continued)

For assets measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy are as follows:

Description	Total	(Level 1)	(Level 2)	(Level 3)
		Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs
June 30, 2017:				
U.S. Treasury and federal agency	\$4,518	\$ 4,518	\$ —	\$ —
U.S. government sponsored entities and agencies	12,043	—	12,043	—
U.S. agency mortgage-backed securities: residential	22,242	—	22,242	—
U.S. agency collateralized mortgage obligations: residential	24,002	—	24,002	—
State and political subdivision	25,781	—	25,781	—
Corporate debt securities	9,520	—	9,520	—
Equity securities	1,722	1,587	—	135
	\$99,828	\$ 6,105	\$ 93,588	\$ 135
December 31, 2016:				
U.S. Treasury and federal agency	4,500	4,500	—	—
U.S. government sponsored entities and agencies	8,998	—	8,998	—
U.S. agency mortgage-backed securities: residential	25,626	—	25,626	—
U.S. agency collateralized mortgage obligations: residential	24,706	—	24,706	—
State and political subdivisions	27,608	—	27,608	—
Corporate debt securities	7,932	—	7,932	—
Equity securities	2,190	2,054	—	136
	\$101,560	\$ 6,554	\$ 94,870	\$ 136

The Corporation's policy is to transfer assets or liabilities from one level to another when the methodology to obtain the fair value changes such that there are more or fewer unobservable inputs as of the end of the reporting period. During the three and six month periods ended June 30, 2017 and 2016, the Corporation had no transfers between levels. The following table presents changes in Level 3 assets measured on a recurring basis for the three and six month periods ended June 30, 2017 and 2016:

(Dollar amounts in thousands)	Three months ended June 30,		Six months ended June 30,	
	2017	2016	2017	2016
Balance at the beginning of the period	\$136	\$74	\$136	\$74
Total gains or losses (realized/unrealized):				
Included in earnings	—	—	—	—
Included in other comprehensive income	(1 )	1	(1 )	1



Acquired	—	60	—	60
Transfers in and/or out of Level 3	—	—	—	—
Balance at the end of the period	\$135	\$135	\$135	\$135

## 8. Fair Value (continued)

The Corporation had no assets measured at fair value on a non-recurring basis at June 30, 2017. For assets measured at fair value on a non-recurring basis at December 31, 2016, the fair value measurements by level within the fair value hierarchy are as follows:

Description	Total	(Level 1)	(Level 2)	(Level 3)
		Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs
December 31, 2016:				
Impaired residential mortgage loan	\$58	\$	—\$	—\$ 58
Impaired commercial real estate loan	463			463
Impaired commercial business loan	582	—	—	582
	\$1,103	\$	—\$	—\$ 1,103

The following table presents quantitative information about Level 3 fair value measurements for assets measured at fair value on a non-recurring basis:

(Dollar amounts in thousands)	Valuation Technique(s)	Unobservable Input(s)	Weighted Average
December 31, 2016:			
Impaired residential mortgage loan	\$58 Sales comparison approach	Adjustment for differences between comparable sales	10 %
Impaired commercial real estate loan	463 Sales comparison approach	Adjustment for differences between comparable sales	37 %
Impaired commercial business loan	582 Liquidation value of business assets	Adjustment for differences between comparable business assets	64 %

Excluded from the tables above at December 31, 2016 was an impaired residential mortgage loan totaling \$58,000 classified as a TDR which was measured using a discounted cash flow methodology.

## 8. Fair Value (continued)

The following table sets forth the carrying amount and estimated fair values of the Corporation's financial instruments included in the consolidated balance sheet as of June 30, 2017 and December 31, 2016:

(Dollar amounts in thousands)

Description	Carrying Amount	Fair Value Measurements using:			
		Total	Level 1	Level 2	Level 3
June 30, 2017:					
Financial Assets:					
Cash and cash equivalents	\$34,715	\$34,715	\$34,715	\$—	\$—
Securities available for sale	99,828	99,828	6,105	93,588	135
Loans held for sale	—	—	—	—	—
Loans, net	545,766	547,265	—	—	547,265
Federal bank stock	4,862	—	N/A	N/A	N/A
Accrued interest receivable	1,827	1,827	53	335	1,439
	\$686,998	\$683,635	\$40,873	\$93,923	\$548,839
Financial Liabilities:					
Deposits	629,174	631,082	461,889	169,193	—
Borrowed funds	41,500	41,377	—	41,377	—
Accrued interest payable	359	359	8	351	—
	\$671,033	\$672,818	\$461,897	\$210,921	\$—

Description	Carrying Amount	Fair Value Measurements using:			
		Total	Level 1	Level 2	Level 3
December 31, 2016:					
Financial Assets:					
Cash and cash equivalents	\$17,568	\$17,568	\$17,568	\$—	\$—
Securities available for sale	101,560	101,560	6,554	94,870	136
Loans held for sale	68	68	—	68	—
Loans, net	515,435	519,573	—	—	519,573
Federal bank stock	4,861	—	N/A	N/A	N/A
Accrued interest receivable	1,815	1,815	37	365	1,413
	\$641,307	\$640,584	\$24,159	\$95,303	\$521,122
Financial Liabilities:					
Deposits	584,940	582,458	423,693	158,765	—
Borrowed funds	44,000	44,027	—	44,027	—
Accrued interest payable	239	239	7	232	—
	\$629,179	\$626,724	\$423,700	\$203,024	\$—

## 9. Regulatory Matters

Banks and bank holding companies are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations, involve quantitative measures of assets, liabilities, and certain off-balance sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can initiate regulatory action.



## 9. Regulatory Matters (continued)

In 2015, the Board of Governors of the Federal Reserve System amended its Small Bank Holding Company Policy Statement by increasing the policy's consolidated assets threshold from \$500 million to \$1 billion. The primary benefit of being deemed a "small bank holding company" is the exemption from the requirement to maintain consolidated regulatory capital ratios; instead, regulatory capital ratios only apply at the subsidiary bank level.

The final rules implementing Basel Committee on Banking Supervision's capital guidelines for U.S. banks (BASEL III rules) became effective for the Bank on January 1, 2015 with full compliance with all of the requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019. Under the BASEL III rules, the Bank must hold a capital conservation buffer above the adequately capitalized risk-based capital ratios. The capital conservation buffer is being phased in from 0.0% for 2015 to 2.50% by 2019. The capital conservation buffer for 2017 is 1.25% and was 0.625% for 2016. The net unrealized gain or loss on available for sale securities is not included in computing regulatory capital. Management believes as of June 30, 2017, the Bank meets all capital adequacy requirements to which they are subject.

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required. At June 30, 2017, the most recent regulatory notifications categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the institution's category.

The following table sets forth certain information concerning the Bank's regulatory capital as of the dates presented. The capital adequacy ratios disclosed below are exclusive of the capital conservation buffer.

(Dollar amounts in thousands)	June 30, 2017		December 31, 2016	
	Amount	Ratio	Amount	Ratio
Total capital to risk-weighted assets:				
Actual	\$60,628	12.47%	\$58,605	12.69%
For capital adequacy purposes	38,880	8.00 %	36,945	8.00 %
To be well capitalized	48,600	10.00%	46,181	10.00%
Tier 1 capital to risk-weighted assets:				
Actual	\$54,855	11.29%	\$53,050	11.49%
For capital adequacy purposes	29,160	6.00 %	27,709	6.00 %
To be well capitalized	38,880	8.00 %	36,945	8.00 %
Common Equity Tier 1 capital to risk-weighted assets:				
Actual	\$54,855	11.29%	\$53,050	11.49%
For capital adequacy purposes	21,870	4.50 %	20,781	4.50 %
To be well capitalized	31,590	6.50 %	30,018	6.50 %
Tier 1 capital to average assets:				
Actual	\$54,855	7.78 %	\$53,050	7.84 %
For capital adequacy purposes	28,215	4.00 %	27,081	4.00 %
To be well capitalized	35,269	5.00 %	33,852	5.00 %



10. Accumulated Other Comprehensive Income (Loss)

The following tables summarize the changes within each classification of accumulated other comprehensive income (loss), net of tax, for the three months ended June 30, 2017 and 2016 and summarizes the significant amounts reclassified out of each component of accumulated other comprehensive income:

(Dollar amounts in thousands)	Unrealized Gains and Losses on Available-for-Sale Securities	Defined Benefit Pension Items	Totals
Accumulated Other Comprehensive Income (Loss) at April 1, 2017	\$ (421 )	\$(3,812)	\$(4,233)
Other comprehensive income before reclassification	10	—	10
Amounts reclassified from accumulated other comprehensive income (loss)	104	—	104
Net current period other comprehensive income	114	—	114
Accumulated Other Comprehensive Income (Loss) at June 30, 2017	\$ (307 )	\$(3,812)	\$(4,119)

(Dollar amounts in thousands)

Details about Accumulated Other Comprehensive Loss Components	Amount Reclassified from Accumulated Other Income For the three months ended June 30, 2017	Affected Line Item in the Comprehensive Statement Where Net Income is Presented
Unrealized gains and losses on available-for-sale securities	\$ 350	Net gain on sale of available-for-sale securities
Unrealized gains and losses on available-for-sale securities	(508 )	Other than temporary impairment losses
	54	Provision for income taxes
Total reclassifications for the period	\$ (104 )	Net of tax

(Dollar amounts in thousands)	Unrealized Gains and Losses on Available-for-Sale Securities	Defined Benefit Pension Items	Totals
Accumulated Other Comprehensive Income (Loss) at April 1, 2016	\$ 630	\$(3,514)	\$(2,884)
Other comprehensive income before reclassification	461	—	461
Amounts reclassified from accumulated other comprehensive income (loss)	(53 )	—	(53 )
Net current period other comprehensive income	408	—	408

Accumulated Other Comprehensive Income (Loss) at June 30, 2016	\$ 1,038	\$(3,514)	\$(2,476)
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## 10. Accumulated Other Comprehensive Income (Loss) (continued)

(Dollar amounts in thousands)

Details about Accumulated Other Comprehensive Loss Components	Amount Reclassified from Accumulated Other Income For the three months ended June 30, 2016	Affected Line Item in the Comprehensive Statement Where Net Income is Presented
Unrealized gains and losses on available-for-sale securities	\$ 81	Net gain on sale of available-for-sale securities
	(28 )	Provision for income taxes
Total reclassifications for the period	\$ 53	Net of tax

The following tables summarize the changes within each classification of accumulated other comprehensive income (loss), net of tax, for the six months ended June 30, 2017 and 2016 and summarizes the significant amounts reclassified out of each component of accumulated other comprehensive income:

(Dollar amounts in thousands)	Unrealized Gains and Losses on Available-for-Sale Securities	Defined Benefit Pension Items	Totals
Accumulated Other Comprehensive Income (Loss) at January 1, 2017	\$ (679 )	\$(3,812)	\$(4,491)
Other comprehensive income before reclassification	268	—	268
Amounts reclassified from accumulated other comprehensive income (loss)	104	—	104
Net current period other comprehensive income	372	—	372
Accumulated Other Comprehensive Income (Loss) at June 30, 2017	\$ (307 )	\$(3,812)	\$(4,119)

(Dollar amounts in thousands)

Details about Accumulated Other Comprehensive Loss Components	Amount Reclassified from Accumulated Other Income For the six months ended June 30, 2017	Affected Line Item in the Comprehensive Statement Where Net Income is Presented
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Unrealized gains and losses on available-for-sale securities	\$ 350	Net gain on sale of available-for-sale securities
Unrealized gains and losses on available-for-sale securities	(508	) Other than temporary impairment losses
	54	Provision for income taxes
Total reclassifications for the period	\$ (104	) Net of tax

10. Accumulated Other Comprehensive Income (Loss) (continued)

(Dollar amounts in thousands)	Unrealized Gains and Losses on Available-for-Sale Securities	Defined Benefit Pension Items	Totals
Accumulated Other Comprehensive Income (Loss) at January 1, 2016	\$ (247 )	\$(3,514)	\$(3,761)
Other comprehensive income before reclassification	1,340	—	1,340
Amounts reclassified from accumulated other comprehensive income (loss)	(55 )	—	(55 )
Net current period other comprehensive income	1,285	—	1,285
Accumulated Other Comprehensive Income (Loss) at June 30, 2016	\$ 1,038	\$(3,514)	\$(2,476)