

ARROW FINANCIAL CORP  
Form 10-Q  
August 06, 2014

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q

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

For the Quarterly Period Ended June 30, 2014

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

Commission File Number: 0-12507

ARROW FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

New York  
(State or other jurisdiction of  
incorporation or organization)  
250 GLEN STREET, GLENS FALLS, NEW YORK 12801  
(Address of principal executive offices) (Zip Code)  
Registrant's telephone number, including area code: (518) 745-1000

22-2448962  
(I.R.S. Employer  
Identification No.)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).  Yes  No

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

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

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

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Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding as of July 31, 2014
Common Stock, par value \$1.00 per share	12,351,522

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FORM 10-Q  
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## PART I - Financial Information

ARROW FINANCIAL CORPORATION AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS

(In Thousands, Except Share and Per Share Amounts)

(Unaudited)

	June 30, 2014	December 31, 2013	June 30, 2013
<b>ASSETS</b>			
Cash and Due From Banks	\$35,351	\$37,275	\$32,706
Interest-Bearing Deposits at Banks	16,459	12,705	11,894
Investment Securities:			
Available-for-Sale	366,848	457,606	501,574
Held-to-Maturity (Approximate Fair Value of \$304,259 at June 30, 2014; \$302,305 at December 31, 2013; and \$252,691 at June 30, 2013)	297,437	299,261	248,914
Federal Home Loan Bank and Federal Reserve Bank Stock	4,583	6,281	6,136
Loans	1,344,124	1,266,472	1,204,734
Allowance for Loan Losses	(15,036)	(14,434)	(14,678)
Net Loans	1,329,088	1,252,038	1,190,056
Premises and Equipment, Net	28,465	29,154	29,301
Goodwill	22,003	22,003	22,003
Other Intangible Assets, Net	3,865	4,140	4,384
Other Assets	48,952	43,235	36,201
Total Assets	\$2,153,051	\$2,163,698	\$2,083,169
<b>LIABILITIES</b>			
Noninterest-Bearing Deposits	\$286,735	\$278,958	\$261,910
NOW Accounts	820,589	817,366	754,371
Savings Deposits	523,626	498,779	494,586
Time Deposits of \$100,000 or More	70,600	78,928	87,369
Other Time Deposits	159,116	168,299	181,669
Total Deposits	1,860,666	1,842,330	1,779,905
Federal Funds Purchased and Securities Sold Under Agreements to Repurchase	16,896	11,777	14,738
Federal Home Loan Bank Overnight Advances	24,000	53,000	40,000
Federal Home Loan Bank Term Advances	10,000	20,000	30,000
Junior Subordinated Obligations Issued to Unconsolidated Subsidiary Trusts	20,000	20,000	20,000
Other Liabilities	23,873	24,437	20,919
Total Liabilities	1,955,435	1,971,544	1,905,562
<b>STOCKHOLDERS' EQUITY</b>			
Preferred Stock, \$5 Par Value; 1,000,000 Shares Authorized	—	—	—
Common Stock, \$1 Par Value; 20,000,000 Shares Authorized (16,744,486 Shares Issued at June 30, 2014, and December 31, 2013; and 16,416,163 Shares Issued at June 30, 2013)	16,744	16,744	16,416
Additional Paid-in Capital	230,131	229,290	219,772
Retained Earnings	32,132	27,457	30,625
	(1,550)	(1,800)	(1,900)

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Unallocated ESOP Shares (74,845 Shares at June 30, 2014; 87,641 Shares at December 31, 2013; and 95,172 Shares at June 30, 2013)			
Accumulated Other Comprehensive Loss	(3,489	) (4,373	) (11,739
Treasury Stock, at Cost (4,319,587 Shares at June 30, 2014; 4,296,723 Shares at December 31, 2013; and 4,277,680 Shares at June 30, 2013)	(76,352	) (75,164	) (75,567
Total Stockholders' Equity	197,616	192,154	177,607
Total Liabilities and Stockholders' Equity	\$2,153,051	\$2,163,698	\$2,083,169
See Notes to Unaudited Interim Consolidated Financial Statements.			

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## ARROW FINANCIAL CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF INCOME

(In Thousands, Except Per Share Amounts)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
<b>INTEREST AND DIVIDEND INCOME</b>				
Interest and Fees on Loans	\$ 13,202	\$ 12,650	\$ 25,976	\$ 25,433
Interest on Deposits at Banks	16	19	29	46
Interest and Dividends on Investment Securities:				
Fully Taxable	2,041	1,639	4,049	3,435
Exempt from Federal Taxes	1,436	1,501	2,907	2,891
Total Interest and Dividend Income	16,695	15,809	32,961	31,805
<b>INTEREST EXPENSE</b>				
NOW Accounts	495	786	959	1,564
Savings Deposits	226	277	445	545
Time Deposits of \$100,000 or More	201	305	431	624
Other Time Deposits	359	505	750	1,059
Federal Funds Purchased and Securities Sold Under Agreements to Repurchase	5	6	9	9
Federal Home Loan Bank Advances	127	199	272	372
Junior Subordinated Obligations Issued to Unconsolidated Subsidiary Trusts	142	145	283	289
Total Interest Expense	1,555	2,223	3,149	4,462
NET INTEREST INCOME	15,140	13,586	29,812	27,343
Provision for Loan Losses	505	100	963	200
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	14,635	13,486	28,849	27,143
<b>NONINTEREST INCOME</b>				
Income From Fiduciary Activities	1,906	1,758	3,779	3,332
Fees for Other Services to Customers	2,377	2,371	4,571	4,653
Insurance Commissions	2,293	2,176	4,737	4,204
Net (Loss) Gain on Securities Transactions	(27)	13	(27)	540
Net Gain on Sales of Loans	166	498	289	1,105
Other Operating Income	304	255	556	411
Total Noninterest Income	7,019	7,071	13,905	14,245
<b>NONINTEREST EXPENSE</b>				
Salaries and Employee Benefits	7,880	7,637	15,522	15,258
Occupancy Expenses, Net	2,316	2,119	4,657	4,395
FDIC Assessments	282	267	555	531
Other Operating Expense	3,259	3,251	6,469	6,501
Total Noninterest Expense	13,737	13,274	27,203	26,685
INCOME BEFORE PROVISION FOR INCOME TAXES	7,917	7,283	15,551	14,703
Provision for Income Taxes	2,393	2,076	4,707	4,315
NET INCOME	\$ 5,524	\$ 5,207	\$ 10,844	\$ 10,388
Average Shares Outstanding:				
Basic	12,348	12,261	12,351	12,267
Diluted	12,369	12,279	12,373	12,285

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Per Common Share:

Basic Earnings	\$0.45	\$0.42	\$0.88	\$0.85
Diluted Earnings	0.45	0.42	0.88	0.85

Share and Per Share Amounts have been restated for the September 2013 2% stock dividend.  
See Notes to Unaudited Interim Consolidated Financial Statements.

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ARROW FINANCIAL CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In Thousands)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Net Income	\$5,524	\$5,207	\$10,844	\$10,388
Other Comprehensive Income, Net of Tax:				
Net Unrealized Securities Holding Gains Arising During the Period	514	(3,643 )	755	(3,423 )
Reclassification Adjustment for Securities Losses (Gains) Included in Net Income	16	(8 )	16	(326 )
Amortization of Net Retirement Plan Actuarial Loss	69	236	139	472
Accretion of Net Retirement Plan Prior Service Credit	(13 )	—	(26 )	—
Other Comprehensive Income (Loss)	586	(3,415 )	884	(3,277 )
Comprehensive Income	\$6,110	\$1,792	\$11,728	\$7,111

See Notes to Unaudited Interim Consolidated Financial Statements.

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ARROW FINANCIAL CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY  
(In Thousands, Except Share and Per Share Amounts)  
(Unaudited)

	Common Stock	Additional Paid-In Capital	Retained Earnings	Unallo- cated ESOP Shares	Accumu- lated Other Com- prehensive Income (Loss)	Treasury Stock	Total
Balance at December 31, 2013	\$16,744	\$229,290	\$27,457	\$ (1,800 )	\$ (4,373 )	\$ (75,164 )	\$192,154
Net Income	—	—	10,844	—	—	—	10,844
Other Comprehensive (Loss) Income	—	—	—	—	884	—	884
Cash Dividends Paid, \$.50 per Share <sup>1</sup>	—	—	(6,169 )	—	—	—	(6,169 )
Stock Options Exercised, Net (21,565 Shares)	—	308	—	—	—	212	520
Shares Issued Under the Directors' Stock Plan (3,872 Shares)	—	63	—	—	—	38	101
Shares Issued Under the Employee Stock Purchase Plan (9,713 Shares)	—	146	—	—	—	95	241
Stock-Based Compensation Expense	—	180	—	—	—	—	180
Tax Benefit for Disposition of Stock Options	—	9	—	—	—	—	9
Purchase of Treasury Stock (61,609 Shares)	—	—	—	—	—	(1,568 )	(1,568 )
Acquisition of Subsidiaries (3,595 Shares)	—	56	—	—	—	35	91
Allocation of ESOP Stock (12,796 Shares)	—	79	—	250	—	—	329
Balance at June 30, 2014	\$16,744	\$230,131	\$32,132	\$ (1,550 )	\$ (3,489 )	\$ (76,352 )	\$197,616
Balance at December 31, 2012	\$16,416	\$218,650	\$26,251	\$ (2,150 )	\$ (8,462 )	\$ (74,880 )	\$175,825
Net Income	—	—	10,388	—	—	—	10,388
Other Comprehensive (Loss) Income	—	—	—	—	(3,277 )	—	(3,277 )
Cash Dividends Paid, \$.49 per Share <sup>1</sup>	—	—	(6,014 )	—	—	—	(6,014 )
Stock Options Exercised, Net (23,685 Shares)	—	262	—	—	—	233	495
Shares Issued Under the Directors' Stock Plan (4,255 Shares)	—	64	—	—	—	42	106
Shares Issued Under the Employee Stock	—	141	—	—	—	103	244

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Purchase Plan (10,402 Shares)							
Shares Issued for Dividend							
Reinvestment Plans (17,323 Shares)	—	260	—	—	—	170	430
Stock-Based Compensation Expense	—	189	—	—	—	—	189
Tax Benefit for Disposition of Stock Options	—	9	—	—	—	—	9
Purchase of Treasury Stock (54,231 Shares)	—	—	—	—	—	(1,329 )	(1,329 )
Acquisition of Subsidiaries (9,503 Shares)	—	139	—	—	—	94	233
Allocation of ESOP Stock (7,718 Shares)	—	58	—	250	—	—	308
Balance at June 30, 2013	\$16,416	\$219,772	\$30,625	\$(1,900 )	\$(11,739 )	\$(75,567 )	\$177,607

<sup>1</sup> Cash dividends paid per share have been adjusted for the September 2013 2% stock dividend.

See Notes to Unaudited Interim Consolidated Financial Statements.

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ARROW FINANCIAL CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Dollars in Thousands)  
(Unaudited)

	Six Months Ended June 30,	
	2014	2013
Cash Flows from Operating Activities:		
Net Income	\$10,844	\$10,388
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Provision for Loan Losses	963	200
Depreciation and Amortization	3,854	4,785
Allocation of ESOP Stock	329	308
Gains on the Sale of Securities Available-for-Sale	—	(527)
Gains on the Sale of Securities Held-to-Maturity	—	(18)
Losses on the Sale of Securities Held-to-Maturity	—	5
Losses on the Sale of Securities Available-for-Sale	27	—
Loans Originated and Held-for-Sale	(9,723)	(32,465)
Proceeds from the Sale of Loans Held-for-Sale	8,993	35,868
Net Gains on the Sale of Loans	(289)	(1,105)
Net Losses on the Sale of Premises and Equipment, Other Real Estate Owned and Repossessed Assets	46	106
Contributions to Retirement Benefit Plans	(465)	(221)
Deferred Income Tax Benefit	(180)	(93)
Shares Issued Under the Directors' Stock Plan	101	106
Stock-Based Compensation Expense	180	189
Net (Increase) Decrease in Other Assets	(714)	3,760
Net Increase (Decrease) in Other Liabilities	67	(2,690)
Net Cash Provided By Operating Activities	14,033	18,596
Cash Flows from Investing Activities:		
Proceeds from the Sale of Securities Available-for-Sale	40,725	16,273
Proceeds from the Maturities and Calls of Securities Available-for-Sale	107,292	60,679
Purchases of Securities Available-for-Sale	(57,515)	(107,772)
Proceeds from the Sale of Securities Held-to-Maturity	—	1,181
Proceeds from the Maturities and Calls of Securities Held-to-Maturity	37,435	17,905
Purchases of Securities Held-to-Maturity	(36,380)	(29,112)
Net Increase in Loans	(77,926)	(36,195)
Proceeds from the Sales of Premises and Equipment, Other Real Estate Owned and Repossessed Assets	918	440
Purchase of Premises and Equipment	(618)	(1,453)
Cash Paid for Subsidiaries, Net	(75)	(75)
Net Decrease (Increase) in Other Investments	1,698	(344)
Purchase of Bank Owned Life Insurance	(5,245)	—
Net Cash Provided By (Used In) Investing Activities	10,309	(78,473)
Cash Flows from Financing Activities:		
Net Increase in Deposits	18,336	48,750
Net (Decrease) Increase in Short-Term Borrowings	(23,881)	13,060
Repayments of Federal Home Loan Bank Term Advances	(10,000)	—
Purchase of Treasury Stock	(1,568)	(1,329)
Stock Options Exercised, Net	520	495
Shares Issued Under the Employee Stock Purchase Plan	241	244

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Tax Benefit from Exercise of Stock Options	9	9
Shares Issued for Dividend Reinvestment Plans	—	430
Cash Dividends Paid	(6,169 )	(6,014 )
Net Cash (Used In) Provided By Financing Activities	(22,512 )	55,645
Net Increase in Cash and Cash Equivalents	1,830	(4,232 )
Cash and Cash Equivalents at Beginning of Period	49,980	48,832
Cash and Cash Equivalents at End of Period	\$51,810	\$44,600
Supplemental Disclosures to Statements of Cash Flow Information:		
Interest on Deposits and Borrowings	\$3,222	\$4,552
Income Taxes	4,485	4,011
Non-cash Investing and Financing Activity:		
Transfer of Loans to Other Real Estate Owned and Repossessed Assets	932	684
Acquisition of Subsidiaries	91	233

See Notes to Unaudited Interim Consolidated Financial Statements.

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NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)

Note 1. ACCOUNTING POLICIES

In the opinion of the management of Arrow Financial Corporation (Arrow), the accompanying unaudited consolidated interim financial statements contain all of the adjustments necessary to present fairly the financial position as of June 30, 2014, December 31, 2013 and June 30, 2013; the results of operations for the three and six-month periods ended June 30, 2014 and 2013; the consolidated statements of comprehensive income for the three and six-month periods ended June 30, 2014 and 2013; the changes in stockholders' equity for the six-month periods ended June 30, 2014 and 2013; and the cash flows for the six-month periods ended June 30, 2014 and 2013. All such adjustments are of a normal recurring nature. Certain prior period amounts have been reclassified to conform to the current presentation. The preparation of financial statements requires the use of management estimates. The unaudited consolidated interim financial statements should be read in conjunction with the audited annual consolidated financial statements of Arrow for the year ended December 31, 2013, included in Arrow's 2013 Form 10-K.

New Accounting Standards Updates (ASU): During 2014, through the date of this report, the FASB issued twelve accounting standards updates, only two of which apply to Arrow.

ASU 2014-01 "Investments-Equity Method and Joint Ventures" allows an entity that invests in affordable housing projects that qualify for low-income housing tax credits to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. Under the proportional amortization method, an entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognizes the net investment performance in the income statement as a component of income tax expense. The standard is effective for annual years beginning after December 15, 2014, with earlier adoption allowed. We adopted the proportional amortization method in the first quarter of 2014. The adoption did not have a material impact on our financial condition or results of operations.

ASU 2014-04 "Receivables - Trouble Debt Restructurings by Creditors" provides additional guidance on when an in substance repossession or foreclosure occurs and is effective for annual periods beginning after December 15, 2014. We are evaluating the impact of adopting this standard, and we do not expect that it will have a material impact on our financial condition or results of operations.

Note 2. INVESTMENT SECURITIES (In Thousands)

The following table is the schedule of Available-For-Sale Securities at June 30, 2014, December 31, 2013 and June 30, 2013:

Available-For-Sale Securities

	U.S. Agency Obligations	State and Municipal Obligations	Mortgage- Backed Securities - Residential	Corporate and Other Debt Securities	Mutual Funds and Equity Securities	Total Available- For-Sale Securities
June 30, 2014						
Available-For-Sale Securities, at Amortized Cost	\$92,328	\$102,456	\$148,672	\$17,065	\$1,120	\$361,641
Available-For-Sale Securities, at Fair Value	92,186	102,862	153,770	16,829	1,201	366,848
Gross Unrealized Gains	4	413	5,143	15	81	5,656
Gross Unrealized Losses	146	7	45	251	—	449
Available-For-Sale Securities, Pledged as Collateral						228,990

Maturities of Debt Securities,  
at Amortized Cost:

Within One Year	—	42,106	9,470	—	51,576
From 1 - 5 Years	80,659	58,160	126,647	16,065	281,531
From 5 - 10 Years	11,669	1,550	12,555	—	25,774
Over 10 Years	—	640	—	1,000	1,640

Maturities of Debt Securities,  
at Fair Value:

Within One Year	—	42,194	9,576	—	51,770
From 1 - 5 Years	80,520	58,460	130,851	16,029	285,860
From 5 - 10 Years	11,666	1,568	13,343	—	26,577
Over 10 Years	—	640	—	800	1,440

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## Available-For-Sale Securities

	U.S. Agency Obligations	State and Municipal Obligations	Mortgage- Backed Securities - Residential	Corporate and Other Debt Securities	Mutual Funds and Equity Securities	Total Available- For-Sale Securities
Securities in a Continuous Loss Position, at Fair Value:						
Less than 12 Months	\$42,888	\$2,860	\$8,740	\$—	\$—	\$54,488
12 Months or Longer	33,031	4,223	1,935	8,537	—	47,726
Total	\$75,919	\$7,083	\$10,675	\$8,537	\$—	\$102,214
Number of Securities in a Continuous Loss Position	24	24	8	12	—	68
Unrealized Losses on Securities in a Continuous Loss Position:						
Less than 12 Months	\$30	\$—	\$34	\$—	\$—	\$64
12 Months or Longer	116	7	11	251	—	385
Total	\$146	\$7	\$45	\$251	\$—	\$449
December 31, 2013						
Available-For-Sale Securities, at Amortized Cost	\$136,868	\$127,224	\$171,321	\$17,142	\$1,120	\$453,675
Available-For-Sale Securities, at Fair Value	136,475	127,389	175,778	16,798	1,166	457,606
Gross Unrealized Gains	2	306	4,714	10	46	5,078
Gross Unrealized Losses	395	141	257	354	—	1,147
Available-For-Sale Securities, Pledged as Collateral						243,769
Securities in a Continuous Loss Position, at Fair Value:						
Less than 12 Months	\$60,664	\$29,967	\$15,190	\$7,375	\$—	\$113,196
12 Months or Longer	33,849	4,597	11,841	6,063	—	56,350
Total	\$94,513	\$34,564	\$27,031	\$13,438	\$—	\$169,546
Number of Securities in a Continuous Loss Position	26	107	13	19	—	165
Unrealized Losses on Securities in a Continuous Loss Position:						
Less than 12 Months	\$336	\$120	\$108	\$92	\$—	\$656
12 Months or Longer	59	21	149	262	—	491
Total	\$395	\$141	\$257	\$354	\$—	\$1,147