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Sound Financial Bancorp, Inc.
Form 10-Q
November 13, 2013

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 September 30, 2013

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 001-35633

Sound Financial Bancorp, Inc.
(Exact Name of Registrant as Specified in its Charter)

Maryland 45-5188530
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

2005 5th Avenue, Suite 200, Seattle, Washington 98121
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (206) 448-0884

None

(Former name, former address and former fiscal year, if changed since last report)

Indicate by checkmark 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 checkmark whether the registrant has submitted electronically and posted on its corporate website, 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 checkmark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting Company. See definition of "large accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Act.

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

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(Do not check if smaller
reporting company)

Indicate by checkmark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES [] NO [X]

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

As of November 12, 2013, there were 2,550,810 shares of the registrant's common stock outstanding.

SOUND FINANCIAL BANCORP, INC.
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SOUND FINANCIAL BANCORP, INC. AND SUBSIDIARY
Condensed Consolidated Balance Sheets
(In thousands, except share amounts)

	September 30, 2013	December 31, 2012
ASSETS	(unaudited)	
Cash and cash equivalents	\$13,961	\$12,727
Available-for-sale securities, at fair value	16,639	22,900
Loans held for sale	1,664	1,725
Loans	379,786	326,744
Allowance for loan losses	(4,115)	(4,248)
Total Loans, net	375,671	322,496
Accrued interest receivable	1,313	1,280
Bank-owned life insurance ("BOLI"), net	10,950	7,220
Other real estate owned ("OREO") and repossessed assets, net	981	2,503
Mortgage servicing rights, at fair value	2,843	2,306
Federal Home Loan Bank ("FHLB") stock, at cost	2,336	2,401
Premises and equipment, net	2,174	2,256
Other assets	3,196	3,230
Total assets	\$431,728	\$381,044
LIABILITIES		
Deposits		
Interest-bearing	\$306,767	\$276,849
Noninterest-bearing demand	34,575	35,234
Total deposits	341,342	312,083
Accrued expenses and other liabilities	3,520	3,309
Advance payments from borrowers for taxes and insurance	562	331
Borrowings	40,381	21,864
Total liabilities	385,805	337,587
COMMITMENTS AND CONTINGENCIES (NOTE 8)		
STOCKHOLDERS' EQUITY		
Preferred stock, \$0.01 par value, 1,000,000 shares authorized, none issued or outstanding	-	-
Common stock, \$0.01 par value, 40,000,000 shares authorized, 2,550,810 and 2,587,544 shares issued and outstanding as of September 30, 2013 and December 31, 2012, respectively	26	26
Additional paid-in capital	24,370	24,789
Unearned shares - Employee Stock Ownership Plan ("ESOP")	(1,598)	(1,598)
Retained earnings	23,410	20,736
Accumulated other comprehensive loss, net of tax	(285)	(496)
Total stockholders' equity	45,923	43,457
Total liabilities and stockholders' equity	\$431,728	\$381,044

See notes to condensed consolidated financial statements

SOUND FINANCIAL BANCORP, INC. AND SUBSIDIARY
Condensed Consolidated Statements of Income (unaudited)
(In thousands, except share and per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
INTEREST INCOME				
Loans, including fees	\$4,926	\$4,437	\$14,268	\$13,459
Interest and dividends on investments, cash and cash equivalents	59	105	239	244
Total interest income	4,985	4,542	14,507	13,703
INTEREST EXPENSE				
Deposits	528	540	1,527	1,617
Borrowings	50	56	164	167
Total interest expense	578	596	1,691	1,784
Net interest income	4,407	3,946	12,816	11,919
PROVISION FOR LOAN LOSSES	450	1,075	1,150	3,675
Net interest income after provision for loan losses	3,957	2,871	11,666	8,244
NONINTEREST INCOME				
Service charges and fee income	564	574	1,714	1,638
Earnings on cash surrender value of bank-owned life insurance	78	60	230	179
Mortgage servicing income	76	148	387	346
Fair value adjustment on mortgage servicing rights	271	(211)	656	97
Other-than-temporary impairment losses on securities	-	(32)	(30)	(156)
Net gain on sale of loans	37	668	794	1,226
Total noninterest income	1,026	1,207	3,751	3,330
NONINTEREST EXPENSE				
Salaries and benefits	1,858	1,537	5,224	4,242
Operations	825	697	2,809	2,007
Regulatory assessments	57	108	239	329
Occupancy	353	314	961	918
Data processing	348	264	954	769
Net loss on OREO and repossessed assets	125	265	963	757
Total noninterest expense	3,566	3,185	11,150	9,022
Income before provision for income taxes	1,417	893	4,267	2,552
Provision for income taxes	423	281	1,333	800
Net income	\$994	\$612	\$2,934	\$1,752
Earnings per common share:				
Basic	\$0.39	\$0.24	\$1.14	\$0.68
Diluted	\$0.38	\$0.23	\$1.11	\$0.67
Weighted average number of common shares outstanding:				
Basic	2,576,995	2,587,669	2,583,588	2,585,694
Diluted	2,634,087	2,627,820	2,635,564	2,616,070

See notes to condensed consolidated financial statements

SOUND FINANCIAL BANCORP, INC. AND SUBSIDIARY
Condensed Consolidated Statements of Comprehensive Income (unaudited)
(In thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Net income	\$994	\$612	\$2,934	\$1,752
Available for sale securities:				
Unrealized gains arising during the period, net of taxes of \$33, \$22, \$98 and \$43, respectively	65	42	191	83
Reclassification adjustments for other-than-temporary impairment, net of taxes of \$0, \$11, \$10 and \$53, respectively	-	21	20	103
Other comprehensive income, net of tax	\$65	\$63	\$211	\$186
Comprehensive income	\$1,059	\$675	\$3,145	\$1,938

See notes to condensed consolidated financial statements

SOUND FINANCIAL BANCORP, INC. AND SUBSIDIARY
Condensed Consolidated Statements of Stockholders' Equity
For the Nine Months Ended September 30, 2013 and 2012 (unaudited)
(In thousands, except number of shares)

	Shares	Common Stock	Additional Paid-in Capital	Unearned ESOP Shares	Retained Earnings	Accumulated Other Comprehensive Loss, net of tax	Total Stockholders' Equity
Balances at December 31, 2011	2,949,045	\$30	\$11,939	\$(693)	\$18,096	\$ (659)	\$ 28,713
Net income					1,752		1,752
Other comprehensive income, net of tax						186	186
Restricted stock awards	11,000						
Cancel Sound Community Bank MHC shares	(1,621,435)	(16)					(16)
Exchange of common stock at 0.87423 shares per common share	(168,357)	(2)					(2)
Fractional share distribution	(209)						
Proceeds from stock offering, net of offering costs	1,417,500	14	12,658				12,672
Purchase of common stock by ESOP				(1,134)			(1,134)
Share-based compensation			125				125
Balances at September 30, 2012	2,587,544	\$26	\$24,722	\$(1,827)	\$19,848	\$ (473)	\$ 42,296

	Shares	Common Stock	Additional Paid-in Capital	Unearned ESOP Shares	Retained Earnings	Accumulated Other Comprehensive Loss, net of tax	Total Stockholders' Equity
Balances at December 31,	2,587,544	\$26	\$24,789	\$(1,598)	\$20,736	\$ (496)	\$ 43,457

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2012								
Net income				2,934				2,934
Other comprehensive income, net of tax					211			211
Share-based compensation		126						126
Restricted stock forfeited and retired	(734)						
Cash dividends on common stock (\$0.05 per share)				(260)			(260
Common stock repurchased	(36,000)		(545)				(545
Balances at September 30, 2013	2,550,810	\$26	\$24,370	\$(1,598)	\$23,410	\$ (285) \$ 45,923

See notes to condensed consolidated financial statements

SOUND FINANCIAL BANCORP, INC. AND SUBSIDIARY
Condensed Consolidated Statements of Cash Flows (unaudited)
(In thousands)

	Nine Months Ended September 30,	
	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$2,934	\$1,752
Adjustments to reconcile net income to net cash from operating activities		
Accretion of net premium on investments	402	69
Other-than-temporary impairment losses on securities	30	156
Provision for loan losses	1,150	3,675
Depreciation and amortization	340	284
Compensation expense related to stock options and restricted stock	126	125
Fair value adjustment on mortgage servicing rights	(656)	(97)
Additions to mortgage servicing rights	(655)	(544)
Amortization of mortgage servicing rights	774	774
Increase in cash surrender value of BOLI	(230)	(179)
Gain on sale of loans	(794)	(1,226)
Proceeds from sale of loans	110,658	63,865
Originations of loans held for sale	(109,803)	(65,373)
Loss on sale and write-downs of OREO and repossessed assets	855	314
Change in operating assets and liabilities		
Accrued interest receivable	(33)	(15)
Other assets	(76)	(1,398)
Accrued interest payable	(7)	(6)
Other liabilities	218	366
Net cash from operating activities	5,233	4,984
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from principal payments, maturities and sales of available for sale securities	8,060	1,219
FHLB stock redeemed	65	-
Purchase of available for sale securities	(1,910)	(19,056)
Net increase in loans	(56,100)	(15,074)
Improvements to OREO and other repossessed assets	(33)	(392)
Proceeds from sale of OREO and other repossessed assets	2,475	2,726
Purchases of premises and equipment, net	(258)	(136)
Purchases of BOLI	(3,500)	-
Net cash used by investing activities	(51,201)	(30,713)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase in deposits	29,259	13,046
Proceeds from borrowings	205,500	-
Repayment of borrowings	(186,983)	(482)
Dividends paid on common stock	(260)	-
Net change in advances from borrowers for taxes and insurance	231	251
Common stock purchase by ESOP	-	(1,134)
Repurchase of common stock	(545)	-
Proceeds from stock offering, net of offering costs	-	12,672
Net cash from financing activities	47,202	24,353
Net increase (decrease) in cash and cash equivalents	1,234	(1,376)

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Cash and cash equivalents, beginning of period	12,727	17,031
Cash and cash equivalents, end of period	\$13,961	\$15,655

SUPPLEMENTAL CASH FLOW INFORMATION:

Cash paid for income taxes	\$1,340	\$750
Interest paid on deposits and borrowings	\$1,698	\$1,790
Noncash net transfer from loans to OREO and repossessed assets	\$1,775	\$2,375

See notes to condensed consolidated financial statements

SOUND FINANCIAL BANCORP, INC. AND SUBSIDIARY
Notes to Condensed Consolidated Financial Statements (unaudited)

Note 1 – Basis of Presentation

The accompanying financial information is unaudited and has been prepared from the consolidated financial statements of Sound Financial Bancorp, Inc., and its wholly owned subsidiary, Sound Community Bank (the “Bank”, collectively, “we,” “us,” “our,” or the “Company”). These unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (“GAAP”) for interim financial information and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X as promulgated by the Securities and Exchange Commission (“SEC”). In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of the financial position and results of operations for the periods presented have been included. Certain information and disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to the rules and regulations of the SEC. These unaudited financial statements should be read in conjunction with the Company’s Annual Report on Form 10-K for the year ended December 31, 2012, as filed with the SEC on March 31, 2013 (“2012 Form 10-K”). The results for the interim periods are not necessarily indicative of results for a full year. For further information, refer to the consolidated financial statements and footnotes for the year ended December 31, 2012, included in the 2012 Form 10-K.

Certain amounts in the prior quarters’ consolidated financial statements have been reclassified to conform to the current presentation. These classifications do not have an impact on previously reported net income, retained earnings, stockholders’ equity or earnings per share.

On August 22, 2012, the Company completed its conversion from the mutual holding company structure and related public stock offering, so that it is now a stock holding company that is wholly owned by public shareholders. Please see Note 2 – Conversion and Stock Issuance for more information.

Note 2 – Conversion and Stock Issuance

The Company, a Maryland corporation, was organized by Sound Community MHC, Sound Financial, Inc. and Sound Community Bank to facilitate the “second-step” conversion of Sound Community Bank from the mutual holding company structure to the stock holding company structure (the “Conversion”). Upon consummation of the Conversion, which occurred on August 22, 2012, the Company became the holding company for Sound Community Bank and now owns all of the issued and outstanding shares of Sound Community Bank’s common stock.

In connection with the Conversion, the Company sold a total of 1,417,500 shares of common stock in offering to certain depositors of Sound Community Bank and others, including 113,400 shares to the Sound Community Bank employee stock ownership plan (“ESOP”). All shares were sold at a purchase price of \$10.00 per share. Proceeds from the offering, net of \$1.5 million in expenses, totaled \$12.7 million. The Company used \$1.1 million of the proceeds to fund the ESOP and made a \$7.5 million capital contribution to the Bank. In addition, concurrent with the offering, shares of Sound Financial, Inc. common stock owned by public stockholders were exchanged for 0.87423 shares of the Company’s common stock, with cash being paid in lieu of issuing any fractional shares. At September 30, 2013, the Company had 2,550,810 shares outstanding.

All share and per share information in this report for periods prior to the Conversion has been revised to reflect the 0.87423 Conversion exchange ratio.

SOUND FINANCIAL BANCORP, INC. AND SUBSIDIARY
Notes to Condensed Consolidated Financial Statements (unaudited)

Note 3 – Accounting Pronouncements Recently Issued or Adopted

In January 2013, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Updated (“ASU”) No. 2013-01, Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities. This update clarifies that ASU No. 2011-11 applies only to derivatives, including bifurcated embedded derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions that are either offset or subject to an enforceable master netting arrangement or similar agreement. Entities with other types of financial assets and financial liabilities subject to a master netting arrangement or similar agreement are no longer subject to the disclosure requirements in ASU No. 2011-11. The amendments were effective for annual and interim reporting periods beginning on or after January 1, 2013. The adoption of ASU No. 2013-01 did not have a material impact on the Company's consolidated financial statements.

In February 2013, the FASB issued ASU No. 2013-02, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. This update requires an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component and to present either on the face of the statement where net income is presented, or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income, but only if the amount reclassified is required to be reclassified to net income in its entirety in the same reporting period. The amendments were effective for annual and interim reporting periods beginning on or after December 15, 2012. The adoption of this update did not have a material impact on the Company's consolidated financial statements.

In July 2013, the FASB issued ASU No. 2013-10, Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes. This update permits the use of the Fed Funds Effective Swap Rate (OIS) to be used as a U.S. benchmark interest rate for hedge account purposes. The amendment was effective prospectively for qualifying new or redesignated hedging relationships entered into on or after July 17, 2013. The adoption of this update did not have a material impact on the Company's consolidated financial statements.

In July 2013, the FASB issued ASU No. 2013-11, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. This update requires an entity to present an unrecognized tax benefit, or a portion of an unrecognized tax benefit, as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except to the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. No new recurring disclosures are required. The amendments are effective for annual and interim reporting periods beginning on or after December 15, 2013 and are to be applied prospectively to all unrecognized tax benefits that exist at the effective date. Retrospective application is permitted. The adoption of this update is not expected to have a material impact on the Company's consolidated financial statements.

SOUND FINANCIAL BANCORP, INC. AND SUBSIDIARY
Notes to Condensed Consolidated Financial Statements (unaudited)

Note 4 – Investments

The amortized cost and fair value of our available-for-sale securities (“AFS”) and the corresponding amounts of gross unrealized gains and losses at the dates indicated were as follows (in thousands):

	Amortized Cost	Gains	Gross Unrealized Losses 1 Year Or Less		Losses Greater Than 1 Year	Estimated Fair Value	
September 30, 2013							
Municipal bonds	\$1,910	\$38	\$-	\$-		\$1,948	
Agency mortgage-backed securities	12,393	29	(220) -		12,202	
Non-agency mortgage-backed securities	2,767	83	-	(361)	2,489	
Total	\$17,070	\$150	\$(220)	\$(361)	\$16,639
December 31, 2012							
Agency mortgage-backed securities	\$20,378	\$27	\$(278)	\$-	\$20,127	
Non-agency mortgage-backed securities	3,273	19	-	(519)	2,773	
Total	\$23,651	\$46	\$(278)	\$(519)	\$22,900

The amortized cost and fair value of investments available-for-sale at September 30, 2013, by contractual maturity, are shown below (in thousands). Expected maturities of investments available-for-sale may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.