PEOPLES FINANCIAL SERVICES CORP.
Form 10-Q
May 09, 2018
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 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 March 31, 2018

or

Transition report pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934

for the transition period from

001-36388

(Commission File Number)

PEOPLES FINANCIAL SERVICES CORP.

(Exact name of registrant as specified in its charter)

Pennsylvania	23-2391852

(State of	(IRS Employer
incorporation)	ID Number)
150 North Washington Avenue, Scranton, PA (Address of principal executive offices)	18503 (Zip code)

(570) 346-7741

(Registrant's telephone number, including area code)

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 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, a smaller reporting company, or an emerging growth company as defined in Rule 12b-2 of the Exchange Act.

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of the registrant’s common stock, as of the latest practicable date: 7,396,505 at April 30, 2018.

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PEOPLES FINANCIAL SERVICES CORP.

FORM 10-Q

For the Quarter Ended March 31, 2018

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Peoples Financial Services Corp.

CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(Dollars in thousands, except share data)

	March 31, 2018	December 31, 2017
Assets:		
Cash and due from banks:		
Cash and due from banks	$ 26,699	$ 36,336
Interest-bearing deposits in other banks	76	1,152
Total cash and due from banks	26,775	37,488
Investment securities:		
Available-for-sale	271,378	272,548
Equity investments carried at fair value	189	
Held-to-maturity: Fair value March 31, 2018, $9,104; December 31, 2017, $9,547	9,028	9,274
Total investment securities	280,595	281,822
Loans, net	1,725,781	1,693,065
Less: allowance for loan losses	19,718	18,960
Net loans	1,706,063	1,674,105
Loans held for sale		106
Premises and equipment, net	37,511	37,557
Accrued interest receivable	6,482	6,936
Goodwill	63,370	63,370
Intangible assets, net	2,948	3,178
Other assets	66,644	64,469
Total assets	$ 2,190,388	$ 2,169,031
Liabilities:		
Deposits:		
Noninterest-bearing	$ 394,729	$ 380,729
Interest-bearing	1,325,289	1,338,289
Total deposits	1,720,018	1,719,018
Short-term borrowings	142,500	123,675
Long-term debt	49,265	49,734
Accrued interest payable	518	497
Other liabilities	11,463	11,131
Total liabilities	1,923,764	1,904,055
Stockholders' equity:		
Common stock, par value $2.00, authorized 25,000,000 shares, issued and outstanding 7,396,505 shares at March 31, 2018 and at December 31, 2017	14,793	14,793
Capital surplus	135,080	135,043
Retained earnings	124,841	121,353

Accumulated other comprehensive loss	(8,090)	(6,213)
Total stockholders' equity	266,624	264,976
Total liabilities and stockholders' equity	$ 2,190,388	$ 2,169,031

See notes to consolidated financial statements

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Peoples Financial Services Corp.

CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME (UNAUDITED)

(Dollars in thousands, except per share data)

For the Three Months Ended March 31,	2018	2017
Interest income:		
Interest and fees on loans:		
Taxable	$ 17,509	$ 15,541
Tax-exempt	870	726
Interest and dividends on investment securities:		
Taxable	858	697
Tax-exempt	701	794
Dividends	16	12
Interest on interest-bearing deposits in other banks	40	29
Interest on federal funds sold		
Total interest income	19,994	17,799
Interest expense:		
Interest on deposits	1,834	1,434
Interest on short-term borrowings	667	174
Interest on long-term debt	306	348
Total interest expense	2,807	1,956
Net interest income	17,187	15,843
Provision for loan losses	1,050	1,200
Net interest income after provision for loan losses	16,137	14,643
Noninterest income:		
Service charges, fees and commissions	2,088	1,572
Merchant services income	250	1,015
Commission and fees on fiduciary activities	497	508
Wealth management income	411	319
Mortgage banking income	147	179
Life insurance investment income	187	189
Net loss on investment securities	(8)	
Total noninterest income	3,572	3,782
Noninterest expense:		
Salaries and employee benefits expense	6,955	6,275
Net occupancy and equipment expense	2,814	2,394
Merchant services expense	2	730
Amortization of intangible assets	230	268
Professional fees and outside services	623	529
FDIC insurance and assessments	286	127
Donations	313	272

Other expenses	1,858	1,761
Total noninterest expense	13,081	12,356
Income before income taxes	6,628	6,069
Income tax expense	774	1,269
Net income	5,854	4,800
Other comprehensive loss:		
Unrealized loss on investment securities available-for-sale	(2,376)	273
Income tax (benefit) expense	(501)	96
Other comprehensive (loss) income, net of income taxes	(1,875)	177
Comprehensive income	$ 3,979	$ 4,977
Per share data:		
Net income:		
Basic	$ 0.79	$ 0.65
Diluted	$ 0.79	$ 0.65
Average common shares outstanding:		
Basic	7,396,505	7,394,143
Diluted	7,396,505	7,394,143
Dividends declared	$ 0.32	$ 0.31

See notes to consolidated financial statements

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Peoples Financial Services Corp.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (UNAUDITED)

(Dollars in thousands, except per share data)

	Common Stock	Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance, January 1, 2018	$ 14,793	$ 135,043	$ 121,353	$ (6,213)	$ 264,976
Stock based compensation		37			37
Net income			5,854		5,854
Other comprehensive income, net of income taxes				(1,875)	(1,875)
Dividends declared: $0.32 per share			(2,368)		(2,368)
Reclassification related to adoption of ASU 2016-01			2	(2)	
Balance, March 31, 2018	$ 14,793	$ 135,080	$ 124,841	$ (8,090)	$ 266,624
Balance, January 1, 2017	$ 14,788	$ 134,871	$ 111,114	$ (4,155)	$ 256,618
Stock based compensation		17			17
Net income			4,800		4,800
Other comprehensive income, net of income taxes				177	177
Dividends declared: $0.31 per share			(2,293)		(2,293)
Common stock grants awarded, net of unearned compensation of $81: 2,020 shares	4	(4)			
Balance, March 31, 2017	$ 14,792	$ 134,884	$ 113,621	$ (3,978)	$ 259,319

See notes to consolidated financial statements

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Peoples Financial Services Corp.

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(Dollars in thousands, except per share data)

For the Three Months Ended March 31,	2018	2017
Cash flows from operating activities:		
Net income	$ 5,854	$ 4,800
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation of premises and equipment	538	451
Amortization of deferred loan costs	234	211
Amortization of intangibles	230	268
Amortization of low income housing partnerships	116	117
Provision for loan losses	1,050	1,200
Net loss on investment securities	8	
Net gain on sale of other real estate owned	(11)	(1)
Loans originated for sale	(2,608)	(5,141)
Proceeds from sale of loans originated for sale	2,729	4,734
Net gain on sale of loans originated for sale	(15)	(37)
Net amortization of investment securities	623	759
Life insurance investment income	(187)	(189)
Stock based compensation	37	17
Net change in:		
Accrued interest receivable	454	624
Other assets	517	(580)
Accrued interest payable	21	(5)
Other liabilities	295	308
Net cash provided by operating activities	9,885	7,536
Cash flows from investing activities:		
Proceeds from repayments of investment securities:		
Available-for-sale	7,919	9,285
Held-to-maturity	242	331
Purchases of investment securities:		
Available-for-sale	(9,941)	(14,999)
Net (purchase) redemption of restricted equity securities	(1,669)	270
Net increase in lending activities	(33,730)	(27,349)
Purchases of premises and equipment	(492)	(2,158)
Proceeds from sale of other real estate owned	83	208
Net cash used in investing activities	(37,588)	(34,412)
Cash flows from financing activities:		
Net increase in deposits	1,000	26,787
Repayment of long-term debt	(469)	(519)
Net increase (decrease) in short-term borrowings	18,825	(5,225)
Cash dividends paid	(2,366)	(2,293)
Net cash provided by financing activities	16,990	18,750

Net decrease in cash and cash equivalents	(10,713)	(8,126)
Cash and cash equivalents at beginning of period	37,488	39,941
Cash and cash equivalents at end of period	$ 26,775	$ 31,815

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Peoples Financial Services Corp.

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(Dollars in thousands, except per share data)

For the Three Months Ended March 31,	2018	2017
Supplemental disclosures:		
Cash paid during the period for:		
Interest	$ 2,786	$ 1,961
Income taxes	1,800	
Noncash items:		
Transfers of loans to other real estate	$ 495	$ 50

See notes to consolidated financial statements

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Peoples Financial Services Corp.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

1. Summary of significant accounting policies:

Nature of operations:

Peoples Financial Services Corp., a bank holding company incorporated under the laws of Pennsylvania, provides a full range of financial services through its wholly-owned subsidiary, Peoples Security Bank and Trust Company (“Peoples Bank”). The Company services its retail and commercial customers through twenty-seven full-service community banking offices located within the Lackawanna, Lehigh, Luzerne, Monroe, Montgomery, Northampton, Susquehanna, Wayne and Wyoming Counties of Pennsylvania and Broome County of New York.

Basis of presentation:

The accompanying unaudited consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP’) for interim financial information and with the instructions to Form 10-Q and Article 10-01 of Regulation S-X. In the opinion of management, all normal recurring adjustments necessary for a fair presentation of the financial position and results of operations for the periods presented have been included. All significant intercompany balances and transactions have been eliminated in consolidation. Prior-period amounts are reclassified when necessary to conform to the current year’s presentation. These reclassifications did not have any effect on the operating results or financial position of the Company. The operating results and financial position of the Company for the three months ended and as of March 31, 2018, are not necessarily indicative of the results of operations and financial position that may be expected in the future.

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates that are particularly susceptible to material change in the near term relate to the determination of the allowance for loan losses, fair value of financial instruments, the valuation of real estate acquired in connection with foreclosures or in satisfaction of loans, the valuation of deferred tax assets, determination of other-than-temporary impairment losses on securities, impairment of goodwill and fair value of assets acquired and liabilities assumed in business combinations. Actual results could differ from those estimates. For additional information and disclosures required under GAAP, reference is made to the Company's Annual Report on Form 10-K for the period ended December 31, 2017.

Revenue from Contracts with Customers:

The Company records revenue from contracts with customers in accordance with Accounting Standards Codification Topic 606, "Revenue from Contracts with Customers" ("Topic 606"). Under Topic 606, the Company must identify the contract with a customer, identify the performance obligations in the contract, determine the transaction price, allocate the transaction price to the performance obligations in the contract, and recognize revenue when (or as) the Company satisfies a performance obligation. Significant revenue has not been recognized in the current reporting period that results from performance obligations satisfied in previous periods.

The Company's primary sources of revenue are derived from interest and dividends earned on loans, investment securities, and other financial instruments that are not within the scope of Topic 606. The Company has evaluated the nature of its contracts with customers and determined that further disaggregation of revenue from contracts with customers into more granular categories beyond what is presented in the Consolidated Statements of Income was not necessary. The Company generally fully satisfies its performance obligations on its contracts with customers as services are rendered and the transaction prices are typically fixed; charged either on a periodic basis or based on activity. The Company's accounting policies will not change materially since the principles of revenue recognition from the Accounting Standards Update are largely consistent with existing guidance and current practices applied by our business. The following is a discussion of revenues within the scope of the new guidance:

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(Dollars in thousands, except per share data)

Service charges, fees and commissions. Service charges, fees and commissions on deposit accounts include fees for banking services provided, overdrafts and non-sufficient funds. Revenue is generally recognized in accordance with published deposit account agreements for retail accounts or contractual agreements for commercial accounts. Our deposit services also include our ATM and debit card interchange revenue that is presented net of the associated costs. Interchange revenue is generated by our deposit customers' usage and volume of activity. Interchange rates are not controlled by the Company, which effectively acts as processor that collects and remits payments associated with customer debit card transactions.

Commission and fees on fiduciary activities. Commission and fees on fiduciary activities includes fees and commissions from investment management, administrative and advisory services primarily for individuals, and to a lesser extent, partnerships and corporations. Revenue is recognized on an accrual basis at the time the services are performed and when we have a right to invoice and are based on either the market value of the assets managed or the services provided.

Wealth management services. Wealth management services income includes fees and commissions charged when we arrange for another party to transfer brokerage services to a customer. The fees and commissions under this agent relationship are based upon stated fee schedules based upon the type of transaction, volume, and value of the services provided.

Other noninterest income. Other noninterest income includes, among other things, merchant services income. Merchant services revenue is derived from a third party vendor that processes credit card transactions on behalf of our merchant customers. Merchant services revenue is primarily comprised of residual fee income based on the referred merchant's processing volumes and/or margin.

Recent accounting standards:

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09, "Revenue from Contracts with Customers" ("ASU 2014-09"), which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU replaces most existing revenue recognition guidance in GAAP. The new standard was effective for the Company on January 1, 2018. Adoption of ASU 2014-09 did not have a material impact on the Company's consolidated financial statements and related disclosures as the Company's primary sources of revenues are derived from interest and dividends earned on loans, investment securities, and other financial instruments that are not within the scope of ASU 2014-09. The Company's revenue recognition pattern for revenue streams within the scope of ASU 2014-09, including but not limited to service charges on deposit accounts and gains/losses on the sale of other real estate owned, did not change significantly from current practice. The standard permits the use of either the full retrospective or modified retrospective transition method. The Company elected to use the modified retrospective transition method which requires application of ASU 2014-09 to uncompleted contracts at the date of adoption however, periods prior to the date of adoption will not be retrospectively revised as the impact of the ASU on uncompleted contracts at the date of adoption was not material.

In January 2016, the FASB issued Accounting Standards Update ("ASU") No. 2016-01, “Financial Instruments – Overall.” The guidance in this ASU among other things, (1) requires equity investments with certain exceptions, to be measured at fair value with changes in fair value recognized in net income, (2) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment, (3) eliminates the requirement for public businesses entities to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet, (4) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes, (5) requires an entity to present separately in other comprehensive income the portion of the change in fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments, (6) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements and (7) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities. ASU 2016-01 was effective for the Company on January 1, 2018 and resulted in a reclassification adjustment of $2 to accumulated other comprehensive income related to a gain on equity securities owned, as well as the use of an exit price rather than an entrance price to

Peoples Financial Services Corp.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

determine the fair value of loans not measured at fair value on a non-recurring basis in the consolidated balance sheets. See Note 7 – Fair Value Accounting for further information regarding the valuation of these loans.

In February 2016, the FASB issued ASU No. 2016-02, "Leases". From the lessee's perspective, the new standard establishes a right-of-use ("ROU") model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement for a lessess. From the lessor's perspective, the new standard requires a lessor to classify leases as either sales-type, finance or operating. A lease will be treated as a sale if it transfers all of the risks and rewards, as well as control of the underlying asset, to the lessee. If risks and rewards are conveyed without the transfer of control, the lease is treated as a financing. If the lessor doesn't convey risks and rewards or control, an operating lease results. The amendments in this ASU are effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2018. Early application of this ASU is permitted for all entities. Adoption of ASU 2016-02 is not expected to have a material impact on the Company's consolidated financial statements. The Company leases certain properties under operating leases that will result in the recognition of lease assets and lease liabilities on the Company's balance sheet under the ASU. At March 31, 2018, the Company had contractual future minimum lease commitments of approximately $3.1 million, before considering renewal options that are generally present.

In June 2016, the FASB issued ASU 2016-13, "Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments." This ASU will have a significant impact on the Company's calculation and accounting for its Allowance for Loan Losses as well as credit losses related to investment securities available-for-sale. A summary of significant provisions of this ASU is as follows:

The ASU requires that a financial asset (or a group of financial assets) measured at amortized cost basis be presented, net of a valuation allowance for credit losses, at an amount expected to be collected on the financial asset(s), and that the income statement include the measurement of credit losses for newly recognized financial assets as well as changes in expected losses on previously recognized financial assets. The provisions of this ASU require measurement of expected credit losses based on relevant information including past events, historical experience, current conditions, and reasonable and supportive forecasts that affect the collectability of the asset. The provisions of this ASU differ from current U.S. GAAP in that current U.S. GAAP generally delays recognition of the full amount of credit losses until the loss is probable of occurring.

The amendments in the Update retain many of the disclosure requirements related to credit quality in current U.S. GAAP, updated to reflect the change from an incurred loss methodology to an expected credit loss methodology. In addition, the Update requires that disclosure of credit quality indicators in relation to the amortized cost of financing receivables, a current requirement, be further disaggregated by year of origination.

This ASU requires that credit losses on available-for-sale debt securities be presented as an allowance rather than as a write-down, and limits the amount of the allowance for credit losses to the amount by which the fair value is below amortized cost. For purchased investment securities available-for-sale with a more-than-insignificant amount of credit deterioration since origination, the ASU requires an allowance be determined in a manner similar to other investment securities available-for-sale; however, the initial allowance would be added to the purchase price, with only subsequent changes in the allowance recorded in credit loss expense, and interest income recognized at the effective rate excluding the discount embedded in the purchase price related to estimated credit losses at acquisition.

This ASU will be effective for the Company for interim and annual periods beginning in the first quarter of 2020. Earlier adoption is permitted beginning in the first quarter of 2019. The Company will record the effect of implementing this ASU through a cumulative-effect adjustment through retained earnings as of the beginning of the reporting period in which Topic 326 is effective.

We are evaluating the impact of the ASU on our consolidated financial statements. In addition to our allowance for loan losses, we will also record an allowance for credit losses on debt securities instead of applying the impairment model currently utilized. The amount of the adjustments will be impacted by each portfolio's composition and credit quality at the adoption date as well as economic conditions and forecasts at that time.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

In August of 2016, the FASB issued ASU 2016-15, “Statement of Cash Flows (Topic 230) –Classification of Certain Cash Receipts and Cash Payments.” This Update is intended to reduce the diversity in practice around how certain transactions are classified within the statement of cash flows. ASU 2016-15 is effective for public companies for annual periods beginning after December 15, 2017, including interim periods within those fiscal years. Early adoption is permitted with retrospective application. The Corporation adopted ASU 2016-15 on January 1, 2018 and did not have a significant impact on its statement of cash flows.

In January 2017, the FASB issued ASU 2017-04, “Intangibles – Goodwill and Other (Topic 350)” to simplify the accounting for goodwill impairment. This guidance, among other things, removes step 2 of the goodwill impairment test thus eliminating the need to determine the fair value of individual assets and liabilities of the reporting unit. Upon adoption of this ASU, goodwill impairment will be the amount by which a reporting unit’s carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. This may result in more or less impairment being recognized than under current guidance. This Update will become effective for the Company’s annual and interim goodwill impairment tests beginning in the first quarter of 2020. Adoption of this update is not expected to have a material effect on the Company’s financial statements.

In March 2017, the FASB issued ASU No. 2017-07, “Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost.” Under the new guidance, employers will present the service cost component of the net periodic benefit cost in the same income statement line item (e.g., Salaries and Benefits) as other employee compensation costs arising from services rendered during the period. In addition, only the service cost component will be eligible for capitalization in assets. Employers will present the other components separately (e.g., Other Noninterest Expense) from the line item that includes the service cost. ASU No. 2017-07 is effective for interim and annual reporting periods beginning after December 15, 2017. Early adoption was permitted. Employers will apply the guidance on the presentation of the components of net periodic benefit cost in the income statement retrospectively. The guidance limiting the capitalization of net periodic benefit cost in assets to the service cost component will be applied prospectively. The Corporation adopted ASU 2017-07 on January 1, 2018, and did not have a significant impact on the Company’s financial statements.

2. Other comprehensive loss:

The components of other comprehensive loss and their related tax effects are reported in the Consolidated Statements of Income and Comprehensive Income. The accumulated other comprehensive loss included in the Consolidated Balance Sheets relates to net unrealized gains and losses on investment securities available-for-sale and benefit plan adjustments.

The components of accumulated other comprehensive loss included in stockholders' equity at March 31, 2018 and December 31, 2017 is as follows:

	March 31, 2018	December 31, 2017
Net unrealized loss on investment securities available-for-sale	$ (3,613)	$ (1,237)
Income tax	(759)	(260)
Net of income taxes	(2,854)	(977)
Benefit plan adjustments	(6,628)	(6,628)
Income tax	(1,392)	(1,392)
Net of income taxes	(5,236)	(5,236)
Accumulated other comprehensive loss	$ (8,090)	$ (6,213)

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Peoples Financial Services Corp.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

Other comprehensive income (loss) and related tax effects for the three months ended March 31, 2018 and 2017 is as follows:

Three Months Ended March 31,	2018	2017
Unrealized (loss) gain on investment securities available-for-sale	$ (2,376)	$ 273
Net gain on the sale of investment securities available-for-sale(1)		
Other comprehensive (loss) gain before taxes	(2,376)	273
Income tax	(501)	96
Other comprehensive (loss) gain before taxes	$ (1,875)	$ 177

(1)Represents amounts reclassified out of accumulated comprehensive loss and included in gains on sale of investment securities on the consolidated statements of income and comprehensive income.

3. Earnings per share:

Basic earnings per share represent income available to common stockholders divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per share reflect additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance.

There were no shares considered anti-dilutive for the three month periods ended March 31, 2018 and 2017.

	2018		2017	
For the Three Months Ended March 31	Basic	Diluted	Basic	Diluted
Net Income	$ 5,854	$ 5,854	$ 4,800	$ 4,800
Average common shares outstanding	7,396,505	7,396,505	7,394,143	7,394,143
Earnings per share	$ 0.79	$ 0.79	$ 0.65	$ 0.65

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Peoples Financial Services Corp.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

4. Investment securities:

The amortized cost and fair value of investment securities aggregated by investment category at March 31, 2018 and December 31, 2017 are summarized as follows:

March 31, 2018	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale:				
U.S. Treasury securities	$ 25,927	$ 7	$ 458	$ 25,476
U.S. Government-sponsored enterprises	95,268	6	2,777	92,497
State and municipals:				
Taxable	14,525	383		14,908
Tax-exempt	97,705	864	875	97,694
Residential Mortgage-backed securities:				
U.S. Government agencies	13,135	1	106	13,030
U.S. Government-sponsored enterprises	22,127	3	397	21,733
Commercial Mortgage-backed securities:				
U.S. Government-sponsored enterprises	6,303		263	6,040
Total	$ 274,990	$ 1,264	$ 4,876	$ 271,378
Held-to-maturity:				
Tax-exempt state and municipals	$ 6,858	$ 24	$ 57	$ 6,825
Residential Mortgage-backed securities:				
U.S. Government agencies	51			51
U.S. Government-sponsored enterprises	2,119	114	5	2,228
Total	$ 9,028	$ 138	$ 62	$ 9,104

December 31, 2017	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale:				
U.S. Treasury securities	$ 20,042		$ 228	$ 19,814

U.S. Government-sponsored enterprises	95,358	$ 30	1,740	93,648
State and municipals:				
Taxable	14,559	488		15,047
Tax-exempt	103,199	1,136	502	103,833
Residential Mortgage-backed securities:				
U.S. Government agencies	14,517	2	85	14,434
U.S. Government-sponsored enterprises	19,752	10	231	19,531
Commercial Mortgage-backed securities:				
U.S. Government-sponsored enterprises	6,315		120	6,195
Equity securities				
Common	43	3		46
Total	$ 273,785	$ 1,669	$ 2,906	$ 272,548
Held-to-maturity:				
Tax-exempt state and municipals	$ 6,859	$ 152	$ 13	$ 6,998
Residential Mortgage-backed securities:				
U.S. Government agencies	54			54
U.S. Government-sponsored enterprises	2,361	138	4	2,495
Total	$ 9,274	$ 290	$ 17	$ 9,547

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Peoples Financial Services Corp.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

Equity Securities

Our equity securities portfolio consists of stock of two other financial institutions. At March 31, 2018 and December 31, 2017, we had $189 thousand and $46 thousand, respectively, in equity securities recorded at fair value. Prior to January 1, 2018, equity securities were stated at fair value with unrealized gains and losses reported as a separate component of AOCI, net of tax. At December 31, 2017, net unrealized gains of $3 thousand had been recognized in AOCI. On January 1, 2018, these unrealized gains and losses were reclassified out of AOCI and into retained earnings with subsequent changes in fair value being recognized in net income. The following is a summary of unrealized and realized gains and losses recognized in net income on equity securities during the three months ended March 31, 2018 (in thousands):

March 31, 2018		Three months ended March 31, 2018
Net gains and (losses) recognized during the period on equity securities	$	(8)
Less: Net gains and (losses) recognized during the period on equity securities sold during the period		
Unrealized gains and (losses) recognized during the reporting period on equity securities still held at the reporting date	$	(8)

Restricted Investment In Stock

Restricted investment in stock includes Federal Home Loan Bank of Pittsburgh (FHLB) with a carrying cost of $10,189, Atlantic Community Bankers Bank (ACBB) stock with a carrying cost of $42 and VISA Class B stock with a carry cost of $0 at March 31, 2018. FHLB and ACBB stock was issued to the Bank as a requirement to facilitate the Bank’s participation in borrowing and other banking services. The Bank’s investment in FHLB stock may fluctuate, as it is based on the member banks’ use of FHLB’s services.

The Bank owns 44,982 shares of Visa Class B stock, which was necessary to participate in Visa services in support of the Bank’s credit card, debit card, and related payment programs (permissible activities under banking regulations) as a member institution. Following the resolution of Visa’s covered litigation, shares of Visa’s Class B stock will be converted to Visa Class A shares using a conversion factor (1.6483 as of March 31, 2018), which is periodically adjusted to reflect VISA's ongoing litigation costs. There is a very limited market for this stock, as only current owners of Class B shares are permitted to transact in Class B. Due to the lack of orderly trades and public information of such trades, Visa Class B's is difficult to value.

These restricted investments are carried at cost and evaluated for OTTI periodically. As of March 31, 2018, there was no OTTI associated with these shares.

The maturity distribution of the fair value, which is the net carrying amount, of the debt securities classified as available-for-sale at March 31, 2018, is summarized as follows:

March 31, 2018	Fair Value
Within one year	$ 17,927
After one but within five years	164,920
After five but within ten years	32,389
After ten years	15,339
	230,575
Mortgage-backed securities	40,803
Total	$ 271,378

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Peoples Financial Services Corp.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

The maturity distribution of the amortized cost and fair value, of debt securities classified as held-to-maturity at March 31, 2018, is summarized as follows:

March 31, 2018	Amortized Cost	Fair Value
Within one year		
After one but within five years		
After five but within ten years		
After ten years	$ 6,858	$ 6,825
	6,858	6,825
Mortgage-backed securities	2,170	2,279
Total	$ 9,028	$ 9,104

Securities with a carrying value of $156,522 and $163,936 at March 31, 2018 and December 31, 2017, respectively, were pledged to secure public deposits and certain other deposits as required or permitted by law.

Securities and short-term investment activities are conducted with a diverse group of government entities, corporations and state and local municipalities. The counterparty's creditworthiness and type of collateral is evaluated on a case-by-case basis. At March 31, 2018 and December 31, 2017, there were no significant concentrations of credit risk from any one issuer, with the exception of U.S. Government agencies and sponsored enterprises that exceeded 10.0 percent of stockholders' equity.

The fair value and gross unrealized losses of investment securities with unrealized losses for which an other-than-temporary impairment ("OTTI") has not been recognized at March 31, 2018 and December 31, 2017, aggregated by investment category and length of time that the individual securities have been in a continuous unrealized loss position, are summarized as follows:

	Less Than 12 Months		12 Months or More		Total	
March 31, 2018	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses

U.S. Treasury securities	$ 19,143	$ 366	$ 2,429	$ 92	$ 21,572	$ 458
U.S. Government-sponsored enterprises	39,607	950	50,763	1,827	90,370	2,777
State and municipals:						
Tax-exempt	61,928	844	4,109	88	66,037	932
Residential Mortgage-backed securities:						
U.S. Government agencies	9,190	54	3,592	52	12,782	106