

CHOICEONE FINANCIAL SERVICES INC
Form 10-Q
August 14, 2006

**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, 2006

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: **000-19202**

ChoiceOne Financial Services, Inc.
(Exact Name of Registrant as Specified in its Charter)

Michigan
(State or Other Jurisdiction of
Incorporation or Organization)

38-2659066
(I.R.S. Employer Identification No.)

**109 East Division
Sparta, Michigan**
(Address of Principal Executive Offices)

49345
(Zip Code)

(616) 887-7366

(Registrant's Telephone Number, including Area Code)

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 check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by checkmark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

As of July 31, 2006, the Registrant had outstanding 1,660,974 shares of common stock.

PART I. FINANCIAL INFORMATIONItem 1. Financial Statements.ChoiceOne Financial Services, Inc.
CONSOLIDATED BALANCE SHEETS

(Dollars in thousands)	June 30, 2006	December 31, 2005
	(Unaudited)	
Assets		
Cash and due from banks	\$ 3,930	\$ 4,990
Securities available for sale	49,663	44,212
Federal Home Loan Bank stock	2,623	2,623
Federal Reserve Bank stock	376	376
Loans held for sale	610	264
Loans	182,716	185,568
Allowance for loan losses	(1,861)	(1,963)
Loans, net	180,855	183,605
Premises and equipment, net	5,546	5,596
Other real estate owned, net	1,209	1,255
Loan servicing rights, net	424	445
Cash value of life insurance policies	2,278	2,237
Other assets	3,114	2,507
Total assets	\$ 250,628	\$ 248,110
Liabilities		
Deposits - noninterest-bearing	\$ 21,142	\$ 22,180
Deposits - interest-bearing	166,750	159,932
Total deposits	187,892	182,112
Securities sold under agreement to repurchase	6,317	7,139
Federal funds purchased	4,267	4,399
Advances from Federal Home Loan Bank	28,000	30,750
Other liabilities	2,068	1,993
Total liabilities	228,544	226,393
Shareholders' Equity		
Preferred stock; shares authorized: 100,000; shares outstanding: none	-	-
Common stock and paid in capital, no par value; shares authorized: 4,000,000; shares outstanding:		

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1,659,761 at June 30, 2006 and 1,649,940 at December 31, 2005	17,603	17,422
Retained earnings	5,112	4,594
Accumulated other comprehensive income (loss), net	(631)	(299)
<hr/>		
Total shareholders' equity	22,084	21,717
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Total liabilities and shareholders' equity	\$ 250,628	\$ 248,110
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See accompanying notes to consolidated financial statements.

ChoiceOne Financial Services, Inc.
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME (Unaudited)

(Dollars in thousands, except per share data)	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Interest income				
Loans, including fees	\$ 3,195	\$ 2,841	\$ 6,362	\$ 5,499
Securities:				
Taxable	345	245	644	499
Tax exempt	202	171	392	343
Other	2	1	4	2
Total interest income	3,744	3,258	7,402	6,343
Interest expense				
Deposits	1,534	965	2,861	1,822
Advances from Federal Home Loan Bank	269	241	558	448
Other	62	51	122	94
Total interest expense	1,865	1,257	3,541	2,364
Net interest income	1,879	2,001	3,861	3,979
Provision for loan losses	25	150	35	250
Net interest income after provision for loan losses	1,854	1,851	3,826	3,729
Noninterest income				
Customer service charges	311	268	609	501
Insurance and investment commissions	234	221	438	493
Gains on sales of loans	56	47	104	108
Gains (losses) on sales of securities	56	-	55	(1)
Loan servicing fees, net	21	18	42	40
Profit-sharing income	36	20	99	39
Other	19	48	50	71
Total noninterest income	733	622	1,397	1,251
Noninterest expense				
Compensation and benefits	996	980	2,008	1,954
Occupancy and equipment	277	274	555	559
Data processing	166	140	322	281
Professional fees	80	125	208	243
Supplies and postage	61	59	113	114
Advertising and promotional	34	47	67	74

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Other	244	113	506	324
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Total noninterest expense	1,858	1,738	3,779	3,549
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Income before income tax	729	735	1,444	1,431
Income tax expense	184	189	364	370
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Net income	\$ 545	\$ 546	\$ 1,080	\$ 1,061
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Comprehensive income	\$ 276	\$ 808	\$ 748	\$ 971
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Basic earnings per share	\$ 0.33	\$ 0.33	\$ 0.65	\$ 0.64
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Diluted earnings per share	\$ 0.33	\$ 0.33	\$ 0.65	\$ 0.64
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Dividends declared per share	\$ 0.17	\$ 0.17	\$ 0.34	\$ 0.33
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See accompanying notes to consolidated financial statements.

ChoiceOne Financial Services, Inc.
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (Unaudited)

(Dollars in thousands)	Number of Shares	Common Stock and Paid in Capital	Unallocated Shares held by ESOP	Retained Earnings	Accumulated Other Comprehensive Income (Loss), Net	Total
Balance, January 1, 2005	1,570,937	\$ 15,913	\$ (9)	\$ 5,053	\$ 112	\$ 21,069
Comprehensive income						
Net income				1,061		1,061
Net change in unrealized gain (loss)					(90)	(90)
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Total comprehensive income						971
Shares issued	7,165	143				143
Shares repurchased	(8,647)	(186)				(186)
Shares committed to be released under Employee Stock Ownership Plan		(9)	9			-
Change in ESOP repurchase obligation		13				13
Cash dividends declared (\$0.33 per share)				(545)		(545)
Stock dividend	78,439	1,516		(1,520)		(4)
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Balance, June 30, 2005	1,647,894	\$ 17,390	\$ -	\$ 4,049	\$ 22	\$ 21,461
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Balance, January 1, 2006	1,649,940	\$ 17,422	\$ -	\$ 4,594	\$ (299)	\$ 21,717
Comprehensive income						
Net income				1,080		1,080
Net change in unrealized gain (loss)					(332)	(332)
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Total comprehensive income						748
Shares issued	9,821	168				168
Change in ESOP repurchase obligation		1				1
Effect of stock options granted		12				12
Cash dividends declared (\$0.34 per share)				(562)		(562)
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Balance, June 30, 2006	1,659,761	\$ 17,603	\$ -	\$ 5,112	\$ (631)	\$ 22,084
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See accompanying notes to consolidated financial statements.

ChoiceOne Financial Services, Inc.
CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

(Dollars in thousands)	Six Months Ended June 30,	
	2006	2005
Cash flows from operating activities:		
Net income	\$ 1,080	\$ 1,061
Adjustments to reconcile net income to net cash from operating activities:		
Provision for loan losses	35	250
Depreciation	256	283
Amortization	225	292
Expense related to employee stock options granted	12	-
Stock dividends on Federal Home Loan Bank stock	-	(55)
(Gains) losses on sales of securities	(55)	1
Gains on sales of loans	(104)	(108)
Loans originated for sale	(7,284)	(5,239)
Proceeds from loan sales	7,013	5,097
Earning on bank-owned life insurance	(41)	(35)
Net changes in:		
Other assets	(396)	(56)
Other liabilities	247	(333)
Net cash from operating activities	988	1,158
Cash flows from investing activities:		
Securities available for sale:		
Sales	1,230	1,376
Maturities, prepayments and calls	2,143	2,283
Purchases	(9,416)	(798)
Loan originations and payments, net	2,519	(6,605)
Additions to premises and equipment, net of disposals	(206)	(797)
Purchase of bank-owned life insurance	-	(2,000)
Net cash used in investing activities	(3,730)	(6,541)
Cash flows from financing activities:		
Net change in deposits	5,780	2,589
Net change in securities sold under agreements to repurchase	(822)	(362)
Net change in federal funds purchased	(132)	564
Proceeds from Federal Home Loan Bank advances	30,000	23,000
Payments on Federal Home Loan Bank advances	(32,750)	(20,000)
Issuance of common stock	168	143
Repurchase of common stock	-	(186)
Cash dividends	(562)	(549)
Net cash from financing activities	1,682	5,199

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Net change in cash and cash equivalents	(1,060)	(184)
Beginning cash and cash equivalents	4,990	3,619
Ending cash and cash equivalents	\$ 3,930	\$ 3,435
Supplemental disclosures of cash flow information:		
Cash paid for interest	\$ 3,249	\$ 2,268
Cash paid for income taxes	\$ 535	\$ 240
Loans transferred to other real estate	\$ 196	\$ 467

See accompanying notes to consolidated financial statements.

ChoiceOne Financial Services, Inc.
NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The consolidated financial statements include ChoiceOne Financial Services, Inc. (the "Registrant") and its wholly-owned subsidiary, ChoiceOne Bank (the "Bank"), and the Bank's wholly-owned subsidiaries ChoiceOne Insurance Agencies, Inc. (the "Insurance Agency"), and ChoiceOne Mortgage Company of Michigan (the "Mortgage Company"). Intercompany transactions and balances have been eliminated in consolidation.

The consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information, prevailing practices within the banking industry and the instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

The accompanying consolidated financial statements reflect all adjustments ordinary in nature which are, in the opinion of management, necessary for a fair presentation of the Consolidated Balance Sheets as of June 30, 2006 and December 31, 2005, the Consolidated Statements of Income for the three- and six-month periods ended June 30, 2006 and June 30, 2005, the Consolidated Statements of Changes in Shareholders' Equity for the six-month periods ended June 30, 2006 and June 30, 2005, and the Consolidated Statements of Cash Flows for the six-month periods ended June 30, 2006 and June 30, 2005. Operating results for the six months ended June 30, 2006 are not necessarily indicative of the results that may be expected for the year ending December 31, 2006.

The accompanying consolidated financial statements should be read in conjunction with the consolidated financial statements and footnotes thereto included in the Registrant's Annual Report on Form 10-K for the year ended December 31, 2005.

Allowance for Loan Losses

The allowance for loan losses is maintained at a level believed adequate by management to absorb probable incurred losses inherent in the consolidated loan portfolio. Management's evaluation of the adequacy of the allowance is an estimate based on reviews of individual loans, assessments of the impact of current and anticipated economic conditions on the portfolio and historical loss experience of seasoned loan portfolios. See Note 2 to the interim consolidated financial statements for additional information.

Management believes the accounting estimate related to the allowance for loan losses is a "critical accounting estimate" because (1) the estimate is highly susceptible to change from period to period because of assumptions concerning the changes in the types and volumes of the portfolios and anticipated economic conditions and (2) the impact of recognizing an impairment or loan loss could have a material effect on ChoiceOne's assets reported on the balance sheet as well as its net income.

Stock Transactions

A total of 2,935 shares of common stock were issued to the Registrant's Board of Directors for a cash price of \$54,000 under the terms of the Directors' Stock Purchase Plan in the first half of 2006. A total of 5,000 shares of common stock were issued to shareholders for a cash price of \$86,000 under the Dividend Reinvestment Plan in the six months ended June 30, 2006. A total of 1,886 shares were issued to employees for a cash price of \$28,000 under the Employee Stock Purchase Plan for the six months ended June 30, 2006. The Registrant did not repurchase any shares

from shareholders in the first half of 2006.

Reclassifications

Certain amounts presented in prior periods have been reclassified to conform to the current presentation.

ChoiceOne Financial Services, Inc.
NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 2 - ALLOWANCE FOR LOAN LOSSES

An analysis of changes in the allowance for loan losses follows:

(Dollars in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Balance at beginning of period	\$ 1,931	\$ 1,783	\$ 1,963	\$ 1,739
Provision charged to expense	25	150	35	250
Recoveries credited to the allowance	40	25	91	58
Loans charged off	(135)	(145)	(228)	(234)
Balance at end of period	\$ 1,861	\$ 1,813	\$ 1,861	\$ 1,813

Information regarding impaired loans follows:

(Dollars in thousands)	June 30, 2006	December 31, 2005
Loans with no allowance allocated	\$ 434	\$ 306
Loans with allowance allocated	925	1,157
Amount of allowance for loan losses allocated	316	465

(Dollars in thousands)	Three Months Ended June 30,	
	2006	2005
Average balance during the period	\$ 1,347	\$ 906
Interest income recognized thereon	29	8
Cash basis interest income recognized	37	9

(Dollars in thousands)	Six Months Ended June 30,	
	2006	2005
Average balance during the period	\$ 1,386	\$ 826
Interest income recognized thereon	58	22
Cash basis interest income recognized	75	22

NOTE 3 - EARNINGS PER SHARE

Earnings per share are based on the weighted average number of shares outstanding during the period. A computation of basic earnings per share and diluted earnings per share follows:

(Dollars in thousands, except per share data)	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
<u>Basic Earnings Per Share</u>				
Net income available to common shareholders	\$ 545	\$ 546	\$ 1,080	\$ 1,061
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Weighted average common shares outstanding	1,656,773	1,646,133	1,653,882	1,646,778

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