

SI Financial Group, Inc.  
Form 10-Q  
August 07, 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

For the Transition Period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 0-54241

SI FINANCIAL GROUP, INC.  
(Exact name of registrant as specified in its charter)

\_\_\_\_\_  
Maryland 80-0643149  
(State or other jurisdiction of incorporation or (I.R.S. Employer Identification No.)  
organization)

803 Main Street, Willimantic, Connecticut 06226  
(Address of principal executive offices) (Zip Code)

(860) 423-4581  
(Registrant's telephone number, including area code)

Not Applicable  
(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 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 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

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

As of August 1, 2014, there were 12,806,248 shares of the registrant's common stock outstanding.

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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements.

## SI FINANCIAL GROUP, INC.

## CONSOLIDATED BALANCE SHEETS

(In Thousands, Except Share Amounts / Unaudited)

	June 30, 2014	December 31, 2013
<b>ASSETS:</b>		
Cash and due from banks:		
Noninterest-bearing	\$19,991	\$20,554
Interest-bearing	28,422	6,767
Total cash and cash equivalents	48,413	27,321
Available for sale securities, at fair value	172,489	170,220
Loans held for sale	560	1,764
Loans receivable (net of allowance for loan losses of \$7,445 at June 30, 2014 and \$6,916 at December 31, 2013)	1,038,182	1,047,410
Federal Home Loan Bank stock, at cost	11,949	13,109
Bank-owned life insurance	21,012	20,726
Premises and equipment, net	20,971	21,090
Goodwill and other intangibles	18,997	19,566
Accrued interest receivable	3,897	4,021
Deferred tax asset, net	9,527	9,705
Other real estate owned, net	1,664	2,429
Other assets	6,480	9,018
Total assets	\$1,354,141	\$1,346,379
<b>LIABILITIES AND SHAREHOLDERS' EQUITY:</b>		
Liabilities:		
Deposits:		
Noninterest-bearing	\$143,306	\$139,428
Interest-bearing	862,915	845,321
Total deposits	1,006,221	984,749
Mortgagors' and investors' escrow accounts	3,301	3,214
Federal Home Loan Bank advances	158,541	176,272
Junior subordinated debt owed to unconsolidated trust	8,248	8,248
Accrued expenses and other liabilities	22,273	21,054
Total liabilities	1,198,584	1,193,537
Shareholders' Equity:		
Preferred stock (\$.01 par value; 1,000,000 shares authorized; none issued)	—	—
Common stock (\$.01 par value; 35,000,000 shares authorized; 12,804,452 and 12,798,461 shares issued and outstanding at June 30, 2014 and December 31, 2013, respectively)	128	128
Additional paid-in-capital	125,511	125,277
Unallocated common shares held by ESOP	(4,368	) (4,608
Unearned restricted shares	(1,523	) (1,751
Retained earnings	35,725	34,644

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Accumulated other comprehensive income (loss)	84	(848	)
Total shareholders' equity	155,557	152,842	
Total liabilities and shareholders' equity	\$1,354,141	\$1,346,379	

See accompanying notes to unaudited interim consolidated financial statements.

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SI FINANCIAL GROUP, INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(In Thousands, Except Per Share Amounts / Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,		
	2014	2013	2014	2013	
Interest and dividend income:					
Loans, including fees	\$10,667	\$7,194	\$21,754	\$14,717	
Securities:					
Taxable interest	894	1,070	1,774	2,092	
Tax-exempt interest	59	20	101	20	
Dividends	48	7	97	7	
Other	15	11	28	21	
Total interest and dividend income	11,683	8,302	23,754	16,857	
Interest expense:					
Deposits	1,359	1,284	2,678	2,636	
Federal Home Loan Bank advances	637	716	1,319	1,491	
Subordinated debt and other borrowings	84	83	167	166	
Total interest expense	2,080	2,083	4,164	4,293	
Net interest income	9,603	6,219	19,590	12,564	
Provision for loan losses	415	55	845	190	
Net interest income after provision for loan losses	9,188	6,164	18,745	12,374	
Noninterest income:					
Total other-than-temporary impairment losses	—	(8	) —	(8	)
Portion of losses recognized in other comprehensive income/loss	—	—	—	—	
Net impairment losses	—	(8	) —	(8	)
Service fees	1,785	1,233	3,503	2,449	
Wealth management fees	310	287	633	544	
Increase in cash surrender value of bank-owned life insurance	144	68	286	136	
Net gain on sales of securities	29	—	64	3	
Mortgage banking	155	271	315	850	
Net gain (loss) on fair value of derivatives	(26	) 126	(9	) 173	
Other	65	95	442	365	
Total noninterest income	2,462	2,072	5,234	4,512	
Noninterest expenses:					
Salaries and employee benefits	5,031	4,121	10,231	8,529	
Occupancy and equipment	1,862	1,304	3,969	2,687	
Computer and electronic banking services	1,313	971	2,665	1,839	
Outside professional services	553	382	1,002	650	
Marketing and advertising	312	171	538	301	
Supplies	151	106	319	206	
FDIC deposit insurance and regulatory assessments	301	230	650	463	

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Merger expenses	—	209	—	893
Core deposit intangible amortization	149	—	313	—
Other real estate operations	62	192	231	319
Other	603	523	1,373	903
Total noninterest expenses	10,337	8,209	21,291	16,790
Income before income tax provision	1,313	27	2,688	96
Income tax provision	399	87	868	233
Net income (loss)	\$914	\$(60	) \$1,820	\$(137 )
Earnings (loss) per share:				
Basic	\$0.07	\$(0.01	) \$0.15	\$(0.01 )
Diluted	\$0.07	\$(0.01	) \$0.15	\$(0.01 )

See accompanying notes to unaudited interim consolidated financial statements.



SI FINANCIAL GROUP, INC.  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)  
(In Thousands / Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Net income (loss)	\$914	\$(60)	) \$1,820	\$(137)
Other comprehensive income (loss), net of tax:				
Available for sale securities:				
Net unrealized holding gains (losses)	588	(1,576)	) 928	(1,580)
Reclassification adjustment for gains recognized in net income (loss) <sup>(1)</sup>	(19)	) —	(42)	) (2)
Plus: credit portion of OTTI losses recognized in net loss <sup>(2)</sup>	—	5	—	5
Plus: noncredit portion of OTTI loss	—	(4)	) —	(39)
Net unrealized gains (losses) on available for sale securities	569	(1,575)	) 886	(1,616)
Net unrealized gain on interest-rate swap derivative	23	44	46	72
Other comprehensive income (loss)	592	(1,531)	) 932	(1,544)
Comprehensive income (loss)	\$1,506	\$(1,591)	) \$2,752	\$(1,681)

<sup>(1)</sup> Amounts are included in net gain on the sales of securities in noninterest income on the consolidated statements of operations. Income tax expense associated with the reclassification adjustment for the three and six months ended June 30, 2014 was \$10,000 and \$22,000, respectively, and \$0 and \$1,000 for the three and six months ended June 30, 2013, respectively.

<sup>(2)</sup> Amounts are included in net impairment losses recognized in noninterest income on the consolidated statements of operations. Income tax expense associated with the reclassification adjustment for both the three and six months ended June 30, 2013 totaled \$3,000.

See accompanying notes to unaudited interim consolidated financial statements.

SI FINANCIAL GROUP, INC.  
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY  
FOR THE SIX MONTHS ENDED JUNE 30, 2014  
(In Thousands, Except Share Data / Unaudited)

	Common Stock		Additional Paid-in Capital	Unallocated		Retained Earnings	Accumulated	
	Shares	Dollars		Common Shares Held by ESOP	Unearned Restricted Shares		Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance at December 31, 2013	12,798,461	\$ 128	\$ 125,277	\$(4,608 )	\$(1,751 )	\$ 34,644	\$ (848 )	\$ 152,842
Comprehensive income	—	—	—	—	—	1,820	932	2,752
Cash dividends declared (\$0.06 per share)	—	—	—	—	—	(739 )	—	(739 )
Equity incentive plan compensation	—	—	153	—	228	—	—	381
Allocation of 24,318 ESOP shares	—	—	42	240	—	—	—	282
Tax benefit from share-based compensation	—	—	3	—	—	—	—	3
Stock options exercised	50,010	—	542	—	—	—	—	542
Common shares repurchased	(44,019 )	—	(506 )	—	—	—	—	(506 )
Balance at June 30, 2014	12,804,452	\$ 128	\$ 125,511	\$(4,368 )	\$(1,523 )	\$ 35,725	\$ 84	\$ 155,557

See accompanying notes to unaudited interim consolidated financial statements.

SI FINANCIAL GROUP, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(In Thousands / Unaudited)

	Six Months Ended	
	June 30,	
	2014	2013
Cash flows from operating activities:		
Net income (loss)	\$1,820	\$(137 )
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Provision for loan losses	845	190
Employee stock ownership plan expense	282	280
Equity incentive plan expense	381	384
Excess tax benefit from share-based compensation	(3 )	(3 )
Amortization of investment premiums and discounts, net	512	603
Amortization of loan premiums and discounts, net	641	698
Depreciation and amortization of premises and equipment	1,277	854
Amortization of core deposit intangible	313	—
Amortization of deferred debt issue costs	66	107
Net gain on sales of securities	(64 )	(3 )
Net loss (gain) on fair value of derivatives	9	(173 )
Deferred income tax benefit	(46 )	(13 )
Loans originated for sale	(8,497 )	(25,816 )
Proceeds from sale of loans held for sale	9,761	30,804
Net gain on sales of loans held for sale	(185 )	(731 )
Net gain on sales of loans held for investment	—	(201 )
Net loss on sales or write-downs of other real estate owned	39	46
Increase in cash surrender value of bank-owned life insurance	(286 )	(136 )
Impairment charge on long-lived assets	175	81
Other-than-temporary impairment losses on securities	—	8
Change in operating assets and liabilities:		
Accrued interest receivable	124	(27 )
Other assets	2,488	847
Accrued expenses and other liabilities	1,283	(308 )
Net cash provided by operating activities	10,935	7,354
Cash flows from investing activities:		
Purchases of available for sale securities	(20,675 )	(40,863 )
Proceeds from sales of available for sale securities	1,109	1,000
Proceeds from maturities of and principal repayments on available for sale securities	18,191	22,417
Redemption of Federal Home Loan Bank stock	1,160	325
Loan principal collections, net of originations	33,484	28,909
Purchases of loans	(25,832 )	(18,448 )
Proceeds from sales of loans held for investment	—	3,189
Proceeds from sales of other real estate owned	816	897
Purchases of premises and equipment	(1,158 )	(1,096 )
Net cash provided by (used in) investing activities	7,095	(3,670 )



SI FINANCIAL GROUP, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS (Concluded)  
(In Thousands / Unaudited)

	Six Months Ended	
	June 30,	
	2014	2013
Cash flows from financing activities:		
Net increase in deposits	21,472	3,174
Net increase (decrease) in mortgagors' and investors' escrow accounts	87	(421)
Proceeds from Federal Home Loan Bank advances	10,000	10,000
Repayments of Federal Home Loan Bank advances	(27,797)	(15,000)
Excess tax benefit from share-based compensation	3	3
Cash dividends on common stock	(739)	(573)
Stock options exercised	542	—
Common shares repurchased	(506)	(7)
Net cash provided by (used in) financing activities	3,062	(2,824)
Net change in cash and cash equivalents	21,092	860
Cash and cash equivalents at beginning of period	27,321	37,689
Cash and cash equivalents at end of period	\$48,413	\$38,549
Supplemental cash flow information:		
Interest paid	\$4,201	\$4,309
Income taxes paid, net	850	1,112
Transfer of loans to other real estate owned	90	381

See accompanying notes to unaudited interim consolidated financial statements.

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SI FINANCIAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2014 AND 2013 AND DECEMBER 31, 2013

NOTE 1. NATURE OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Business

SI Financial Group, Inc. (the "Company") is the holding company for Savings Institute Bank and Trust Company (the "Bank"). Established in 1842, the Bank is a community-oriented financial institution headquartered in Willimantic, Connecticut. The Bank provides a variety of financial services to individuals, businesses and municipalities through its twenty-six offices in eastern Connecticut and Rhode Island. Its primary products include savings, checking and certificate of deposit accounts, residential and commercial mortgage loans, commercial business loans and consumer loans. In addition, wealth management services, which include trust, financial planning, life insurance and investment services, are offered to individuals and businesses through the Bank's offices. The Company does not conduct any material business other than owning all of the stock of the Bank and making payments on the subordinated debentures held by the Company.

On September 6, 2013, the Company acquired Newport Bancorp, Inc. ("Newport"), and its wholly-owned subsidiary, Newport Federal Savings Bank. The acquisition added six full-service banking offices in eastern Connecticut and Rhode Island.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company, its wholly-owned subsidiary, the Bank, and the Bank's wholly-owned subsidiaries, SI Mortgage Company and SI Realty Company, Inc. All significant intercompany accounts and transactions have been eliminated.

Basis of Financial Statement Presentation

The interim consolidated financial statements and related notes have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information, with the instructions to Form 10-Q and Rule 10.01 of Regulation S-X of the Securities and Exchange Commission ("SEC") and general practices within the banking industry. Accordingly, certain information and footnote disclosures required by GAAP for complete financial statements have been omitted. Information in the accompanying interim consolidated financial statements and notes to the financial statements of the Company as of June 30, 2014 and for the three and six months ended June 30, 2014 and 2013 is unaudited. These unaudited interim consolidated financial statements and related notes should be read in conjunction with the audited financial statements of the Company and the accompanying notes for the year ended December 31, 2013 contained in the Company's Form 10-K.

In the opinion of management, the accompanying unaudited interim consolidated financial statements reflect all of the adjustments, consisting only of normal and recurring adjustments, necessary for a fair presentation of the financial condition, results of operations and cash flows as of and for the periods covered herein. The results of operations for the three and six months ended June 30, 2014 are not necessarily indicative of the operating results for the year ending December 31, 2014 or for any other period.

In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosures of contingent assets and liabilities, as of the date of the balance sheets and reported amounts of revenues and expenses for the periods presented. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term

relate to the determination of the allowance for loan losses, other-than-temporary impairment (“OTTI”) of securities, deferred income taxes and the impairment of long-lived assets.

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SI FINANCIAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2014 AND 2013 AND DECEMBER 31, 2013

Reclassifications

Amounts in the Company's prior year consolidated financial statements are reclassified to conform to the current year presentation. Such reclassifications have no effect on net income.

Loans Receivable

Loans receivable are stated at current unpaid principal balances, net of the allowance for loan losses and deferred loan origination fees and costs. Management has the ability and intent to hold its loans receivable for the foreseeable future or until maturity or pay-off.

A loan is impaired when, based on current information and events, it is probable the Company will be unable to collect all contractual principal and interest payments due in accordance with the terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Impairment is measured on a loan by loan basis for residential and commercial mortgage loans and commercial business loans by either the present value of expected future cash flows discounted at the loan's effective interest rate or, as a practical expedient, at the loan's observable market price or the fair value of the collateral if the loan is collateral dependent. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not typically identify individual consumer loans for impairment disclosures, unless such loans are subject to a troubled debt restructuring ("TDR") agreement.

The Company periodically may agree to modify the contractual terms of loans. When a loan is modified and concessions have been made to the original contractual terms, such as reductions of interest rates or deferral of interest or principal payments due to the borrower's financial condition, the modification is considered a TDR.

Management considers all nonaccrual loans, with the exception of certain consumer loans, to be impaired. Also, all TDRs are initially classified as impaired. In most cases, loan payments less than 90 days past due are considered minor collection delays and the related loans are generally not considered impaired.

Allowance for Loan Losses

The allowance for loan losses, a material estimate which could change significantly in the near-term, is established through a provision for loan losses charged to earnings to account for losses that are inherent in the loan portfolio and estimated to occur, and is maintained at a level that management considers adequate to absorb losses in the loan portfolio. Loan losses are charged against the allowance for loan losses when management believes that the uncollectibility of the principal loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance for loan losses when received. In the determination of the allowance for loan losses, management may obtain independent appraisals for significant properties, if necessary.

Management's judgment in determining the adequacy of the allowance is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. The allowance for loan losses is evaluated on a monthly basis by management and is based on the evaluation of the known and inherent risk characteristics and size and composition of the loan portfolio, the assessment of current economic and real estate market conditions, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral, historical loan loss experience, the level and trends of nonperforming loans, delinquencies, classified assets and loan charge-offs and evaluations of loans and other relevant factors.



The allowance for loan losses consists of the following key elements:

• Specific allowance for identified impaired loans. For loans that are identified as impaired, an allowance is established when the present value of expected cash flows (or observable market price of the loan or fair

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SI FINANCIAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2014 AND 2013 AND DECEMBER 31, 2013

value of the collateral if the loan is collateral dependent) of the impaired loan is lower than the carrying value of that loan.

General valuation allowance. The general component represents a valuation allowance on the remainder of the loan portfolio, after excluding impaired loans. For this portion of the allowance, loans are segregated by category and assigned an allowance percentage based on historical loan loss experience adjusted for qualitative factors stratified by the following loan segments: residential one- to four-family, multi-family and commercial real estate, construction, commercial business and consumer. Management uses a rolling average of historical losses based on the time frame appropriate to capture relevant loss data for each loan segment. This historical loss factor is adjusted for the following qualitative factors: levels/trends in delinquencies, classified loans and nonaccrual loans; level of loan charge-offs; trends in volume, nature and terms of loans; existence and effect of/or changes in the level of credit concentrations; effects of changes in risk selection, underwriting standards and other changes in lending policies, procedures and practices; experience/ability and depth of lending management and staff, national and local economic trends and conditions and impact on value of underlying collateral for collateral dependent loans.

The qualitative factors are determined based on the following various risk characteristics for each loan segment. Risk characteristics relevant to each portfolio segment are as follows:

Residential – One- to Four-Family – The Bank primarily originates conventional loans with loan-to-value ratios less than 95% and generally originates loans with loan-to-value ratios in excess of 80% only when secured by first liens on owner-occupied one- to four-family residences. Loans with loan-to-value ratios in excess of 80% generally require private mortgage insurance or additional collateral. All loans in this segment are collateralized by owner-occupied residential real estate and repayment is dependent on the credit quality of the individual borrower. The overall health of the economy, including unemployment rates and housing prices, will have an effect on the credit quality of this segment.

Multi-family and Commercial – Loans in this segment are originated for the purpose of acquiring, developing, improving or refinancing multi-family and commercial real estate where the property is the primary collateral securing the loan, and the income generated from the property is the primary repayment source. The underlying cash flows generated by the properties are adversely impacted by a downturn in the economy as evidenced by increased vacancy rates, which in turn, will have an effect on the credit quality in this segment. Payments on loans secured by income-producing properties often depend on the successful operation and management of the properties. Management continually monitors the cash flows of these loans.

Construction – This segment includes loans to individuals, and to a lesser extent builders, to finance the construction of residential dwellings. The Bank also originates construction loans for commercial development projects. Upon the completion of construction, the loan generally converts to a permanent mortgage loan. Credit risk is affected by cost overruns, time to sell at an adequate price and market conditions.

Commercial Business – Loans in this segment are made to businesses and are generally secured by assets of the business. Repayment is expected from the cash flows of the business. A weakened economy and reduced viability of the industry in which the customer operates will have a negative impact on the credit quality in this segment. The Bank also provides loans to investors in the time share industry, which are secured by consumer receivables, and

provides loans for capital improvements to condominium associations, which are secured by the assigned rights to levy special assessments to condominium owners.

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SI FINANCIAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2014 AND 2013 AND DECEMBER 31, 2013

Consumer – Loans in this segment primarily include home equity lines of credit (representing both first and second liens), indirect automobile loans and, to a lesser extent, loans secured by marketable securities, passbook or certificate accounts, motorcycles, automobiles and recreational vehicles, as well as unsecured loans. Consumer loan collections depend on the borrower's continuing financial stability, and therefore, are more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy.

In computing the allowance for loan losses, we do not assign a general valuation allowance to the Small Business Administration ("SBA") and United States Department of Agriculture ("USDA") loans that we purchase as such loans are fully guaranteed. These loans are included in commercial business loans. See Note 4 for details.

The majority of the Company's loans are collateralized by real estate located in eastern Connecticut and Rhode Island. To a lesser extent, certain commercial real estate loans are secured by collateral located outside of our primary market area. Accordingly, the collateral value of a substantial portion of the Company's loan portfolio and real estate acquired through foreclosure is susceptible to changes in local market conditions.

Although management believes that it uses the best information available to establish the allowance for loan losses, future adjustments to the allowance for loan losses may be necessary and the Company's results of operations could be adversely affected if circumstances differ substantially from the assumptions used in making the determinations. Furthermore, while management believes it has established the allowance for loan losses in conformity with GAAP, our regulators, in reviewing the loan portfolio, may request us to increase our allowance for loan losses based on judgments different from ours. In addition, because future events affecting borrowers and collateral cannot be predicted with certainty, the existing allowance for loan losses may not be adequate or increases may be necessary should the quality of any loans deteriorate as a result of the factors discussed above. Any material increase in the allowance for loan losses would adversely affect the Company's financial condition and results of operations.

**Interest and Fees on Loans**

Interest on loans is accrued and included in net interest income based on contractual rates applied to principal amounts outstanding. Accrual of interest is discontinued when loan payments are 90 days or more past due, based on contractual terms, or when, in the judgment of management, collectibility of the loan or loan interest becomes uncertain. Subsequent recognition of income occurs only to the extent payment is received subject to management's assessment of the collectibility of the remaining interest and principal. A nonaccrual loan is restored to accrual status when it is no longer delinquent and collectibility of interest and principal is no longer in doubt and the borrower has made regular payments in accordance with the terms of the loan over a period of at least six months. Interest collected on nonaccrual loans is recognized only to the extent cash payments are received, and may be recorded as a reduction to principal if the collectibility of the principal balance of the loan is unlikely.

Loan origination fees and direct loan origination costs are deferred, and the net amount is recognized as an adjustment of the related loan's yield utilizing the interest method over the contractual life of the loan. In addition, discounts related to fair value adjustments for loans receivable acquired in a business combination or asset purchase are accreted into earnings over the contractual term as an adjustment of the loan's yield. The Company periodically evaluates the cash flows expected to be collected for loans acquired with deteriorated credit quality. Changes in the expected cash flows compared to the expected cash flows as of the date of acquisition may impact the accretable yield or result in a charge to the provision for loan losses to the extent of a shortfall.



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SI FINANCIAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2014 AND 2013 AND DECEMBER 31, 2013

Common Share Repurchases

The Company is chartered in the state of Maryland. Maryland law does not provide for treasury shares, rather shares repurchased by the Company constitute authorized but unissued shares. GAAP states that accounting for treasury stock shall conform to state law. Therefore, the cost of shares repurchased by the Company has been allocated to common stock and retained earnings balances.

Recent Accounting Pronouncements

Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure - In January 2014, the Financial Accounting Standards Board ("FASB") issued amended guidance that clarifies when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan receivable should be derecognized and the real estate property recognized. The amended guidance clarifies that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. In addition, the amended guidance requires interim and annual disclosures of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The amended guidance may be applied prospectively or through a modified retrospective approach and is effective for fiscal years, and interim periods within those years, beginning after December 15, 2014, with early adoption permitted. The adoption of the amended guidance is not expected to have a material impact on the Company's consolidated financial statements.

NOTE 2. EARNINGS (LOSS) PER SHARE

Basic earnings (loss) per share is calculated by dividing the net income (loss) available to common shareholders by the weighted average number of common shares outstanding during the period. Unvested restricted shares are considered outstanding in the computation of basic earnings (loss) per share since the shares participate in dividends and the rights to the dividends are non-forfeitable. Diluted earnings (loss) per share is computed in a manner similar to basic earnings (loss) per share except that the weighted average number of common shares outstanding is increased to include the incremental common shares (as computed using the treasury stock method) that would have been outstanding if all potentially dilutive common stock equivalents were issued during the period. The Company's common stock equivalents relate solely to stock options. Repurchased common shares and unallocated common shares held by the Bank's ESOP are not deemed outstanding for earnings (loss) per share calculations.

Anti-dilutive shares are common stock equivalents with weighted average exercise prices in excess of the weighted average market value for the periods presented, and are not considered in diluted earnings (loss) per share calculations. The Company had anti-dilutive common shares outstanding of 384,289 and 389,393 for the three and six months ended June 30, 2014, respectively, and 771,538 and 626,396 for the three and six months ended June 30, 2013, respectively.



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The computation of earnings (loss) per share is as follows:

	Three Months Ended		Six Months Ended	
	June 30, 2014	2013	June 30, 2014	2013
	(Dollars in Thousands, Except Per Share Data)			
Net income (loss)	\$914	\$(60	) \$1,820	\$(137
				)
Weighted average common shares outstanding:				
Basic	12,341,727	9,567,612	12,318,604	9,561,808
Effect of dilutive stock options	45,706	—	46,979	—
Diluted	12,387,433	9,567,612	12,365,583	9,561,808
Earnings (loss) per share:				
Basic	\$0.07	\$(0.01	) \$0.15	\$(0.01
Diluted	\$0.07	\$(0.01	) \$0.15	\$(0.01
				)

## NOTE 3. SECURITIES

Available for sale securities:

The amortized cost, gross unrealized gains and losses and approximate fair values of available for sale securities at June 30, 2014 and December 31, 2013 are as follows:

	June 30, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In Thousands)			
Debt securities:				
U.S. Government and agency obligations	\$60,137	\$441	\$(204	) \$60,374
Government-sponsored enterprises	24,561	145	(105	) 24,601
Mortgage-backed securities: <sup>(1)</sup>				
Agency - residential	73,695	1,074	(1,157	) 73,612
Non-agency - residential	396	16	(2	) 410
Corporate debt securities	1,460	21	—	1,481
Collateralized debt obligation	1,186	—	(2	) 1,184
Obligations of state and political subdivisions	4,048	179	(35	) 4,192
Tax-exempt securities	6,637	26	(28	) 6,635
Total available for sale securities	\$172,120	\$1,902	\$(1,533	) \$172,489

<sup>(1)</sup> Agency securities refer to debt obligations issued or guaranteed by government corporations or government-sponsored enterprises (“GSEs”). Non-agency securities, or private-label securities, are the sole obligation of their issuer and are not guaranteed by any of the GSEs or the U.S. Government.





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	December 31, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In Thousands)			
Debt securities:				
U.S. Government and agency obligations	\$54,228	\$485	\$(168)	) \$54,545
Government-sponsored enterprises	26,551	134	(393)	) 26,292
Mortgage-backed securities: <sup>(1)</sup>				
Agency - residential	77,037	889	(1,809)	) 76,117
Non-agency - residential	530	26	(2)	) 554
Corporate debt securities	3,708	90	—	3,798
Collateralized debt obligation	1,210	—	(19)	) 1,191
Obligations of state and political subdivisions	4,063	141	(81)	) 4,123
Tax-exempt securities	3,841	—	(266)	) 3,575
Foreign government securities	25	—	—	25
Total available for sale securities	\$171,193	\$1,765	\$(2,738)	) \$170,220

<sup>(1)</sup> Agency securities refer to debt obligations issued or guaranteed by government corporations or GSEs. Non-agency securities, or private-label securities, are the sole obligation of their issuer and are not guaranteed by any of the GSEs or the U.S. Government.

The amortized cost and fair value of debt securities by contractual maturities at June 30, 2014 are presented below. Maturities are based on the final contractual payment dates, and do not reflect the impact of potential prepayments or early redemptions. Because mortgage-backed securities ("MBS") are not due at a single maturity date, they are not included in the maturity categories in the following maturity summary.

	Amortized Cost (In Thousands)	Fair Value
Within 1 year	\$	