FENTURA FINANCIAL INC
Form 10-Q
November 14, 2008

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

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

For the quarterly period ended September 30, 2008

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE EXCHANGE ACT**

For the transition period from __________ to __________

Commission file number 000-23550

Fentura Financial, Inc.

(Exact name of registrant as specified in its charter)

Michigan	**38-2806518**
(State or other jurisdiction of incorporation or organization)	(IRS Employee Identification No.)

175 N Leroy, P.O. Box 725, Fenton, Michigan 48430

(Address of Principal Executive Offices)

(810) 629-2263

(Registrant s telephone number)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the 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. þ Yes o No

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

Large accelerated filer o	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company þ

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date: October 24, 2008

Class Common Stock Shares Outstanding 2,181,285

Fentura Financial Inc.
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PART I FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

Fentura Financial, Inc.

Consolidated Balance Sheets

(000 s omitted except share data)	September 30, 2008 (unaudited)	Dec 31, 2007
ASSETS		
Cash and due from banks	$ 13,979	$ 22,734
Federal funds sold	5,600	7,300
Total cash & cash equivalents	19,579	30,034
Securities-available for sale	54,921	71,792
Securities-held to maturity, (fair value of $8,070 at September 30, 2008 and $8,714 at December 31, 2007)	8,099	8,685
Total securities	63,020	80,477
Loans held for sale	1,461	1,655
Loans:		
Commercial	308,029	313,642
Real estate loans construction	54,730	59,805
Real estate loans mortgage	38,746	39,817
Consumer loans	57,298	58,139
Total loans	458,803	471,403
Less: Allowance for loan losses	(11,342)	(8,554)
Net loans	447,461	462,849
Bank Owned Life Insurance	7,201	7,042
Bank premises and equipment	19,006	20,101
Federal Home Loan Bank stock	2,032	2,032
Accrued interest receivable	2,509	2,813
Goodwill	7,955	7,955
Acquisition intangibles	335	485
Equity Investment	2,392	3,089
Other Real Estate Owned	6,917	2,003
Other assets	7,490	7,484
Total Assets	$587,358	$628,019
LIABILITIES		
Deposits:		
Non-interest bearing deposits	$ 73,867	$ 75,148
Interest bearing deposits	434,257	468,355

Total deposits	508,124	543,503
Short term borrowings	2,375	649
Federal Home Loan Bank Advances	15,007	11,030
Repurchase Agreements	0	5,000
Subordinated debentures	14,000	14,000
Accrued taxes, interest and other liabilities	1,651	4,341
Total liabilities	541,157	578,523
SHAREHOLDERS EQUITY		
Common stock no par value 2,180,571 shares issued (2,163,385 at Dec. 31, 2007)	42,738	42,478
Retained earnings	4,987	7,488
Accumulated other comprehensive income (loss)	(1,524)	(470)
Total shareholders equity	46,201	49,496
Total Liabilities and Shareholders Equity	$587,358	$628,019

See notes to consolidated financial statements.

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Fentura Financial, Inc.
Consolidated Statements of Income (Unaudited)

(000 s omitted except per share data)	Three Months Ended September 30 2008	2007	Nine Months Ended September 30 2008	2007
INTEREST INCOME				
Interest and fees on loans	$7,582	$ 8,796	$23,143	$26,360
Interest and dividends on securities:				
Taxable	523	786	1,716	2,504
Tax-exempt	161	169	429	564
Interest on federal funds sold	42	40	156	251
Total interest income	8,308	9,791	25,444	29,679
INTEREST EXPENSE				
Deposits	3,109	4,147	10,421	12,098
Borrowings	366	547	1,301	1,692
Total interest expense	3,475	4,694	11,722	13,790
NET INTEREST INCOME	4,833	5,097	13,722	15,889
Provision for loan losses	736	5,144	5,628	6,232
Net interest income after Provision for loan losses	4,097	(47)	8,094	9,657
NON-INTEREST INCOME				
Service charges on deposit accounts	802	860	2,291	2,547
Gain on sale of mortgage loans	42	65	260	268
Trust and investment services income	458	471	1,432	1,439
Other income and fees	43	574	619	1,609
Total non-interest income	1,345	1,970	4,602	5,863
NON-INTEREST EXPENSE				
Salaries and employee benefits	2,683	2,868	8,620	9,308
Occupancy	492	543	1,574	1,556
Furniture and equipment	478	532	1,508	1,591
Loan and collection	173	111	718	287
Advertising and promotional	114	125	363	396
Loss on security impairment	233	0	843	0
Other operating expenses	1,045	1,057	3,157	3,192
Total non-interest expense	5,218	5,236	16,783	16,330
INCOME (LOSS) BEFORE TAXES	224	(3,313)	(4,087)	(810)

Federal income taxes/(benefit)	(71)	(1,206)	(1,586)	(495)
NET INCOME (LOSS)	$ 295	$ (2,107)	$ (2,501)	$ (315)
Per share:				
Net income (loss) basic	$ 0.14	$ (0.98)	$ (1.15)	$ (0.15)
Net income (loss) diluted	$ 0.14	$ (0.98)	$ (1.15)	$ (0.15)
Cash Dividends declared	$ 0.00	$ 0.25	$ 0.00	$ 0.75

See notes to consolidated financial statements.

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Fentura Financial, Inc.
Consolidated Statements of Changes in Shareholders Equity (Unaudited)

(000 s omitted)	Nine Months Ended September 30, 2008	2007
COMMON STOCK		
Balance, beginning of period	$ 42,478	$ 42,158
Issuance of shares under		
Director stock purchase plan & Dividend reinvestment program (17,186 and 11,799 shares)	254	628
Stock repurchase (0 and 17,184 shares)	0	(520)
Stock options exercised (0 and 295 shares)	0	6
Stock compensation expense	6	32
Balance, end of period	42,738	42,304
RETAINED EARNINGS		
Balance, beginning of period	7,488	10,118
Net income (loss)	(2,501)	(315)
Cash dividends declared	0	(1,623)
Balance, end of period	4,987	8,180
ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)		
Balance, beginning of period	(470)	(958)
Change in unrealized gain (loss) on securities available for sale, net of tax	(1,054)	537
Balance, end of period	(1,524)	(421)
TOTAL SHAREHOLDERS EQUITY	$ 46,201	$ 50,063

See notes to consolidated financial statements.

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Fentura Financial, Inc.
Consolidated Statements of Cash Flows (Unaudited)

(000 s omitted)	Nine Months Ended September 30, 2008	2007
OPERATING ACTIVITIES:		
Net income (loss)	$ (2,501)	$ (315)
Adjustments to reconcile net income (loss) to cash Provided by Operating Activities:		
Stock compensation expense	6	32
Depreciation and amortization	663	1,396
Provision for loan losses	5,628	6,232
Loans originated for sale	(19,918)	(13,505)
Proceeds from the sale of loans	20,372	13,650
(Gain) Loss on sales of loans	(260)	(268)
Gain (Loss) on sale of fixed assets	(118)	0
Loss on security impairment	843	0
Loss on equity investment	697	0
Earnings from bank owned life insurance	(159)	(159)
Net (increase) decrease in interest receivable & other assets	2,317	(5,159)
Net increase (decrease) in interest payable & other liabilities	(2,152)	(1,881)
Total Adjustments	7,919	338
Net Cash Provided By (Used In) Operating Activities	5,418	23
Cash Flows From Investing Activities:		
Proceeds from maturities of securities AFS	7,441	1,649
Proceeds from maturities of securities HTM	1,332	12,744
Proceeds from calls of securities AFS	12,662	4,700
Proceeds from calls of securities HTM	0	140
Proceeds from sales of securities AFS	1,999	0
Purchases of securities AFS	(7,067)	(4,571)
Purchases of securities HTM	(750)	0
Net (increase) decrease in loans	2,843	(17,533)
Sales of Other Real Estate Owned	2,782	1,022
Acquisition of premises and equipment, net	89	(3,746)
Net Cash Provided By (Used in) Investing Activities	18,549	(5,595)
Cash Flows From Financing Activities:		
Net increase (decrease) in deposits	(35,379)	1,379
Net increase (decrease) in short term borrowings	1,726	3,750
Net increase (decrease) in repurchase agreements	(5,000)	(5,000)
Purchase of advances from FHLB	27,001	7,000
Repayments of advances from FHLB	(23,024)	(7,022)

Net proceeds from stock issuance and purchase	254	114
Cash dividends	0	(1,623)
Net Cash Provided By (Used In) Financing Activities	(34,422)	(1,402)
NET CHANGE IN CASH AND CASH EQUIVALENTS	$(10,455)	$ (6,974)
CASH AND CASH EQUIVALENTS BEGINNING	$ 30,034	$ 29,446
CASH AND CASH EQUIVALENTS ENDING	$ 19,579	$ 22,472
CASH PAID FOR:		
INTEREST	$ 11,388	$ 13,789
INCOME TAXES	$ 0	$ 450
NONCASH DISCLOSURES:		
Transfers from loans to other real estate	$ 6,917	$ 147

See notes to consolidated financial statements

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Fentura Financial, Inc.
Consolidated Statements of Comprehensive Income (Unaudited)

(000 s Omitted)	Three Months Ended September 30, 2008	Three Months Ended September 30, 2007	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007
Net Income (loss)	$ 295	$(2,107)	$(2,501)	$(315)
Other comprehensive income (loss), net of tax:				
Unrealized holding gains (losses) arising during period	(869)	618	(1,896)	537
Less: Impairment loss recognized during period	(233)	0	(843)	0
Other comprehensive income (loss)	(636)	618	(1,053)	537
Comprehensive income (loss)	$(341)	$(1,489)	$(3,554)	$ 222

Fentura Financial, Inc.
Notes to Consolidated Financial Statements (Unaudited)
Note 1 Basis of Presentation

The consolidated financial statements at December 31, 2007 and September 30, 2008 include Fentura Financial, Inc. (the Corporation) and its wholly owned subsidiaries, The State Bank in Fenton, Michigan; Davison State Bank in Davison, Michigan; and West Michigan Community Bank in Hudsonville, Michigan (the Banks), as well as Fentura Mortgage Company, West Michigan Mortgage Company, LLC, and the other subsidiaries of the Banks. Intercompany transactions and balances are eliminated in consolidation.

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and the instructions for Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the nine months ended September 30, 2008 are not necessarily indicative of the results that may be expected for the year ending December 31, 2008. For further information, refer to the consolidated financial statements and footnotes thereto included in the Corporation s annual report on Form 10-K for the year ended December 31, 2007.

Reclassifications: Some items in the prior year financial statements were reclassified to conform to the current presentation.

Securities: Securities are classified as held to maturity and carried at amortized cost when management has the positive intent and ability to hold them to maturity. Securities are classified as available for sale when they might be sold before maturity. Securities available for sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income.

Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized on the level-yield method without anticipating prepayments. Gains and losses on sales are based on the amortized cost of the security sold. Securities are written down to fair value when a decline in fair value is not temporary.

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Declines in the fair value of securities below their cost that are other than temporary are reflected as realized losses. In estimating other-than-temporary losses, management considers: the length of time and extent the fair value has been less than cost, the financial condition and near term prospects of the issuer, and the Corporation s ability and intent to hold the security for a period sufficient to allow for any anticipated recovery in fair value.

Allowance for Loan Losses: The allowance for loan losses is a valuation allowance for probable incurred credit losses, increased by the provision for loan losses and decreased by charge-offs less recoveries. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management s judgment, should be charged-off. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed.

A loan is impaired when full payment under the loan terms is not expected. Impairment is evaluated in total for smaller-balance loans of similar nature such as residential mortgage, consumer, and on an individual loan basis for other loans. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan s existing rate or at the fair value of collateral if repayment is expected solely from the collateral.

Stock Option Plans

The Nonemployee Director Stock Option Plan provides for granting options to nonemployee directors to purchase the Corporation s common stock. No options have been granted in 2008. The purchase price of the shares is the fair market value at the date of the grant, and there is a three-year vesting period before options may be exercised. Options to acquire no more than 8,131 shares of stock may be granted under the Plan in any calendar year and options to acquire not more than 73,967 shares in the aggregate may be outstanding at any one time.

The Employee Stock Option Plan grants options to eligible employees to purchase the Corporation s common stock at or above, the fair market value of the stock at the date of the grant. Awards granted under this plan are limited to an aggregate of 86,936 shares. The administrator of the plan is a committee of directors. The administrator has the power to determine the number of options to be granted, the exercise price of the options and other terms of the options, subject to consistency with the terms of the Plan.

The following table summarizes stock option activity:

	Number of Options	Weighted Average Price
Options outstanding at December 31, 2007	40,228	$ 29.74
Options forfeited 2008	(12,722)	$ 29.94
Options outstanding at September 30, 2008	27,506	$ 29.64

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Note 2 Adoption of New Accounting Standards

Fair Value Option and Fair Value Measurements

In September 2006, the FASB issued Statement No. 157, *Fair Value Measurements*. This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. This Statement establishes a fair value hierarchy about the assumptions used to measure fair value and clarifies assumptions about risk and the effect of a restriction on the sale or use of an asset. The standard was effective for fiscal years beginning after November 15, 2007. In February 2008, the FASB issued Staff Position (FSP) 157-2, *Effective Date of FASB Statement No. 157*. This FSP delays the effective date of FAS 157 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value on a recurring basis (at least annually) to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. The Corporation adopted the standard effective January 1, 2008 and applicable disclosures have been added to the Notes to Consolidated Financial Statements. On October 10, 2008 the FASB issued FSP 157-3, *Determining the Fair Value of a Financial Asset when the Market for that Asset is not Active*, which illustrates key considerations in determining the fair value of a financial asset when the market for that asset is not active. The FSP provides clarification for how to consider various inputs in determining fair value under current market conditions consistent with the principles of FAS 157.

In February 2007, the FASB issued Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. The standard provides companies with an option to report selected financial assets and liabilities at fair value and establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. The Corporation did not elect the fair value option for any financial assets or financial liabilities as of January 1, 2008, the effective date of the standard.

Note 3 Fair Value

Statement No. 157 establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity s own assumptions about the assumptions that market participants would use in pricing and asset or liability.

The fair values of securities available for sale are determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1 inputs) or matrix pricing, which is a mathematical technique widely used to in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities relationship to other benchmark quoted securities (Level 2 inputs).

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Assets and Liabilities Measured on a Recurring Basis

Assets and liabilities measured at fair value on a recurring basis are summarized below:

		Fair Value Measurements at September 30, 2008 Using		
(000 s omitted)	September 30, 2008	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Available for sale securities	$54,921	$ 10	$ 53,374	$ 1,537

Level 1 assets are comprised of investments in other financial institutions, which are publicly traded on the open market.

Level 2 assets are comprised of available for sale securities including, U.S. Treasuries, Government Agencies and Municipal Securities.

Level 3 assets are comprised of investments in other financial institutions including DeNovo banks.

The table below presents a reconciliation and income statement classification of gains and losses for all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the nine month period ended September 30, 2008:

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)		
(000 s omitted)	Asset	Liability	Total
Beginning balance, Jan. 1, 2008	$ 2,721	$ 0	$ 2,721
Total gains or losses (realized / unrealized)			
Included in earnings Loss on security impairment	(843)	0	(843)
Included in other comprehensive income	(341)	0	(341)
Transfers in and / or out of Level 3	0	0	0
Ending balance, September 30, 2008	$ 1,537	$ 0	$ 1,537

Assets and Liabilities Measured on a Non-Recurring Basis

Assets and liabilities measured at fair value on a non-recurring basis are summarized below:

		Fair Value Measurements at September 30, 2008 Using		
(000 s omitted)	September 30, 2008	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)

Assets:				
Impaired loans	$17,092	$ 0	$ 0	$ 17,092

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The following represent impairment charges recognized during the period:
Impaired loans, which are measured for impairment using the fair value of the collateral for collateral dependent loans, had a carrying amount of $40,493,000, with a valuation allowance of $5,163,000, resulting in an additional provision for loan losses of $995,000 for the period. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan s existing rate or at the fair value of collateral if repayment is expected solely from the collateral.

Note 4 Securities

During the quarter ended September 30, 2008, the Corporation recognized a $233,400 other-than-temporary impairment loss on one of its DeNovo bank investments. The institution experienced a net operating loss for 2007 and for the first nine months of 2008. The 2008 year to date other-than-temporary impairment recognition on this investment totals $843,200, the full investment amount. This investment was in an unrealized loss position at December 31, 2007 and since such time; its unrealized loss has continued to increase. The book value of this investment was $843,200 and its market value was 18.5% less at December 31, 2007. Throughout 2007 and into 2008, this institution, based in Michigan, has experienced credit quality deterioration. The De Novo Bank has since been closed by regulatory authorities.

Note 5 Allowance for Loan Losses

Activity in the allowance for loan losses for the nine month period ended September 30, 2008 and 2007 is as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Balance, beginning of period	$12,778	$7,174	$ 8,554	$ 6,692
Provision for loan losses	736	5,144	5,628	6,232
Loans charged off	(2,369)	(948)	(3,302)	(1,703)
Loan recoveries	197	55	462	204